Basel II Pillar 3 disclosure

FOR THE YEAR ENDED 30 JUNE 2010

FIRSTRAND
Bank Holdings

FirstRand Bank Holdings Limited
Basel II Pillar 3 disclosure/30 June 2010

FIRSTRAND BANK HOLDINGS LIMITED

1. INTRODUCTION

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 enable users of that information, amongst other things, to make an accurate assessment of the bank's financial condition, including its capital adequacy position, and 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 report is the Basel II Pillar 3 report of FirstRand Bank Holdings Limited ("FRBH" or "the Banking Group"), and is an extract of the annual report of FRBH. This report complies with the risk disclosure requirements of Basel II Pillar 3 and IFRS 7 Financial Instruments: Disclosure ("IFRS 7"). For fully consolidated entities in the Banking Group, no difference in the manner in which entities are consolidated for accounting and regulatory purposes exist. Toyota Financial Services, an associate of FirstRand Bank Limited, is equity accounted for accounting purposes and pro rata consolidated for regulatory purposes.

Risk in FRBH is managed on a group basis with FirstRand Bank Limited ("FRB") as its major subsidiary. Some differences between the practices, approaches, processes and policies of FRBH and FRB exist and these are highlighted by a reference to the appropriate entity, where necessary. The Pillar 3 disclosures in this report have been internally verified by the Banking Group's governance processes.

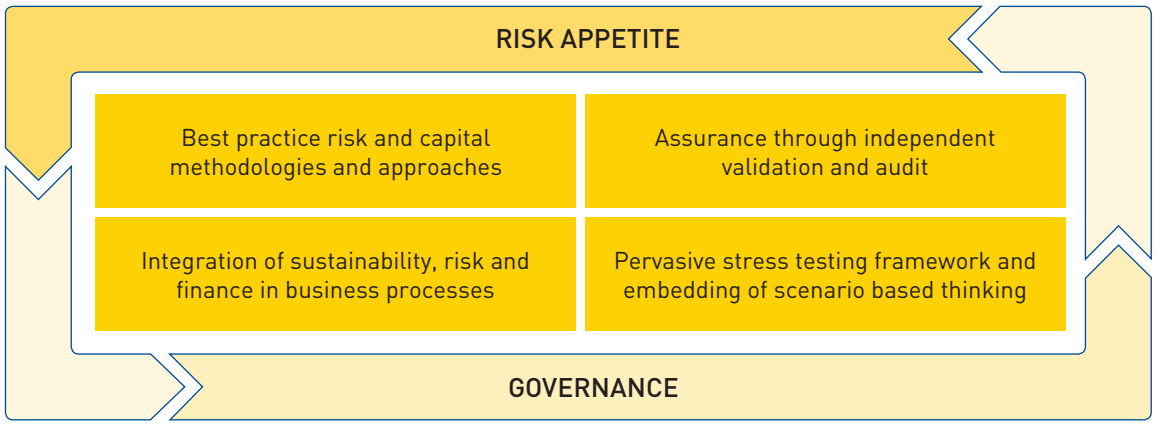
FRBH, one of FirstRand's (or "the Group") major subsidiaries, adheres to the same corporate governance principles, structures and policy framework as FirstRand.

FRBH's primary business objective, like that of the Group, is the generation of sustainable profits. The effective management of financial and non financial risk is fundamental to the successful and sustainable realisation of the Group's strategic objectives. Risk taking is an essential part of the Group's business and FirstRand thus explicitly recognises risk assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates. As an integrated financial services provider and through a portfolio of leading franchises, FirstRand wants to be appropriately represented in all significant earnings pools across all chosen market and risk taking activities. This entails building revenue streams that are diverse and creating long term value via sustainable earning pools with acceptable earnings volatility.

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.

The Banking Group follows a comprehensive approach to risk and capital management that comprises six core components, illustrated in the chart below.

Components of FirstRand's approach to risk and capital management



These core components are discussed further in the major sections of this report:

- FirstRand's **risk appetite** frames all organisational decision making and forms the basis for the refinement of risk identification, assessment and management capabilities (see page 9).
- A strong **governance** structure and policy framework foster the embedding of risk considerations in existing business processes and ensure that consistent standards exist across the Banking Group's operating units (see page 12).
- Best practice **risk and capital methodologies** have been developed in and for the relevant business areas (see page 13).
- 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 Banking Group is deploying 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 (see page 9).
- **Independent oversight, validation and audit functions** ensure a high standard across methodological, operational and process components of the Banking Group's risk and capital management process (see page 11).

2. DEFINITIONS

The Banking 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, reputational risk, macroeconomic risk and environmental, social and governance ("ESG") risks.	**Strategic risk** is the risk to current or prospective earnings arising from adverse 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. It is often termed volume and margin risk and relates to the Banking Group's ability to generate sufficient levels of revenue to offset its costs. This includes the risk of adverse changes in the macro and global economic conditions.	13
		Reputational risk is the risk of reputational damage due to compliance failures, pending litigations or bad press reports.	
		Macroeconomic risk is the risk to the business due to changes in macroeconomic conditions, global economic conditions or credit shocks.	
		ESG risks focus on the environmental, social and governance issues which impact the Banking Group's ability to successfully and sustainably implement business strategy.	
Financial risks	Capital management	The Banking 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 and a strong credit rating, ensure confidence in the solvency of the Banking Group during calm and turbulent periods in the economy and financial markets.	15
	Credit risk	Credit risk is the risk of loss due to the non performance of a counterparty in respect of any financial or performance 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, presettlement 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 bilateral contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows.	59
	Market risk	Market risk is the risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates.	61
	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.	64

Risk category	Risk components	Definition	Page reference
Financial risks	Foreign exchange and translation risk	**Foreign exchange risk** is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank has net open positions in foreign exchange, and as such 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.	67
	Funding and 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. This definition of liquidity risk is expanded in the Funding and liquidity risk section on page 68.	68
	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.	75
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, but excludes strategic, business and reputational risks.	80
	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.	83

3. HIGH LEVEL OVERVIEW OF THE RISK PROFILE

Income statement/earnings profile

In line with the Banking Group's objective to maintain a well-diversified earnings pool across a broad range of business activities, the current earnings profile is made up of revenue relating to credit lending activities (net interest income or "NII") and revenue as a result of transactional and client activities (non interest revenue or "NIR").

Both revenue components are dependent on macroeconomic conditions:

- The interest rate and general credit environment will impact NII in terms of endowment and impairment levels (which are impacted by consumer indebtedness/affordability levels, unemployment, etc.), as well as the level of advances growth
- Transactional income and fee and commission income (sources of annuity NIR are more stable although dependent on the level of economic activity.

For the year ended 30 June 2010, gross revenue comprised 38% NII and 62% NIR. The larger proportion of NIR is appropriate as it relates to transactional revenues that have low volatility and stable annuity profiles and this contributes significantly to capacity to absorb the impact of risks resulting from credit lending and other activities. NIR has been stable during the recent financial crisis and continues to grow at acceptable levels.

Balance sheet structure

FirstRand's earnings are substantially driven by its balance sheet, and through its integrated balance sheet management approach, the Banking Group ensures appropriate alignment between credit, capital and funding strategies within the appropriate risk framework.

The Banking Group's growth strategy can impact the composition of the balance sheet. The current profile is explained below.

Assets

Loans and advances

Advances resulting from lending activities constitute the largest portion (approximately two thirds) of assets on the Banking Group's balance sheet. More than 90% of these advances relate to the South African market with the performance of the Banking Group's advances thus largely dependent on macroeconomic conditions and the state of the South African economy. Approximately two thirds of advances result from retail lending activities. As a result, adverse conditions such as high interest rates and debt servicing cost, unemployment and asset price shocks could negatively impact the financial performance of the Banking Group.

Trading, investment and liquid assets

Investments, investment securities, derivatives, cash and other assets make up the remainder of the balance sheet. More than half of investment security assets relate to instruments the Banking Group holds in compliance with liquidity and prudential requirements. The remainder of derivatives, investment securities and cash holdings together with corresponding derivative liabilities represent an accounting based disaggregation of the Banking Group's portfolio of client deal structuring activities. The majority of these positions are offsetting from a risk profile perspective.

Liabilities

The Banking Group's liabilities are comprised of:

- deposits from its retail, commercial and corporate customers (the nature and term of which are a function of customers' preferences);
- institutional funding (over which the Banking Group can exert more influence, although it is limited by the structural constraints of the market in South Africa – more about this in the *Funding and liquidity risk* section below); and
- short trading positions and derivatives, which represent the accounting based disaggregation relating to deal structuring activities as described in the Assets section above.

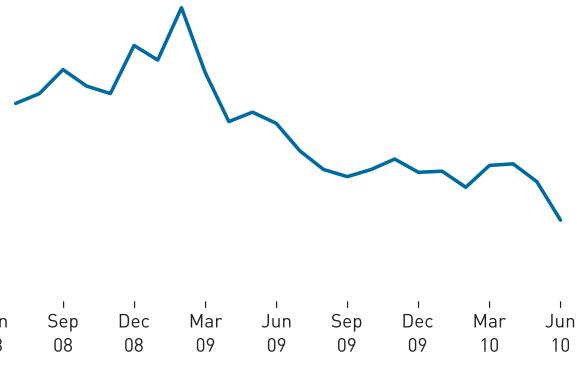
Financial risks

Credit risk

Credit strategy is managed as part of the broader balance sheet management process and is aligned with the Banking Group's view of trends in the wider economy. The Banking Group's current origination strategies are resulting in improving credit quality across all retail portfolios (as evidenced in the vintage analyses for the large retail portfolios on page 52). These portfolios were also positively impacted by interest rates continuing to trend downwards, positive income growth and increasing wages. However, job losses also continued, albeit at a slower rate.

Interest rate reductions, which started in 2008 and continued into 2010, resulted in a reduction in NPL inflows and consequently in the credit impairment charges of most retail portfolios (the chart below shows the decline in NPL inflows at FNB HomeLoans, the Banking Group's largest retail lending book). The level of NPLs remained high, however, due to the debt counselling process. As a result of the improvement in credit quality, the Banking Group's retail portfolios now fall within the Banking Group's desired credit appetite ranges.

FNB HomeLoans – trend analysis of new NPLs



Despite the reduction in debt servicing costs as a result of lower interest rates, the subsequent improvement in affordability and underlying asset recovery (e.g. house price growth), credit appetite has not increased considerably. Consumers remain leveraged and vulnerable to shifts in the external economic environment and concerns remain with regards to unemployment prospects and the timing and strength of the recovery.

Large corporate credit exposures arise mainly from

- term lending activities in RMB's Investment Banking division;
- short term exposures from overdraft and working capital facilities provided in FNB Corporate and Transactional Banking; and
- short term money market exposures in FICC.

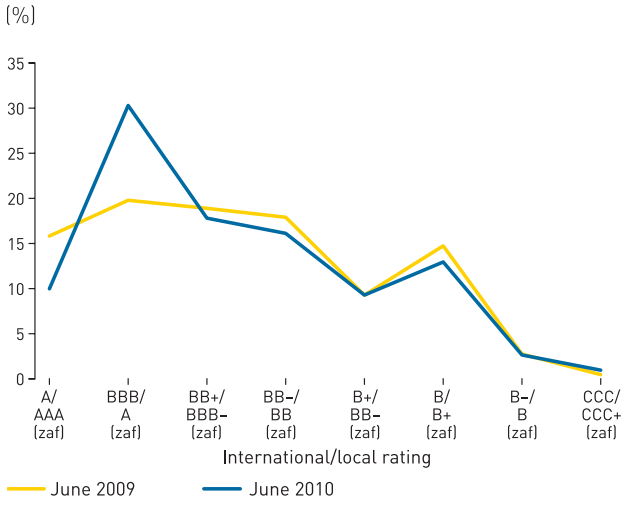
In addition, exposures resulting from financial market activities, such as cash placements by Group Treasury at other institutions, and credit exposure resulting from positive mark to market movements on derivatives and securities financing activities (e.g. reverse repos), are also managed as part of the wholesale credit process.

The performance of the Banking Group could be negatively impacted by a large wholesale exposure default. These exposures are, however, diversified and actively managed to mitigate this risk. In addition, risk management processes and prudential limits are in place to limit the loss in the event of default for each exposure. Prudential limits for wholesale credit exposures are set considering the following:

- Credit risk capacity and appetite: the Banking Group's own credit risk capacity and appetite for wholesale lending activities has been determined considering an acceptable level of earnings volatility resulting from credit related losses.
- Counterparty debt capacity: the client's debt capacity, ability and willingness to repay its debt is a key consideration. A counterparty's prudential limit will be capped at its own debt capacity.
- Risk sharing: the Banking Group's appetite to participate in the counterparts' debt capacity is informed by when, and to what extent, the Banking Group will share risk with other banks.

The Wholesale portfolio has remained resilient in the face of the market downturn in the year under review, as can be seen in the graph on wholesale credit quality below. The majority of negative credit migrations were experienced in specific sub-sectors, such as property development and transportation, while most of the exposures in other industries showed resilience against the downturn. The strategy of rebalancing the Wholesale portfolio to more investment grade lending has also already started paying off. Lending appears likely to remain tepid as corporates maintain high levels of cash and investment spending remains subdued.

Rating distribution – FRB Corporate book



In line with the Banking Group's objective to rebalance its portfolio, it is increasing its exposure to large corporate credit. The existing in-force book, which has been originated by the investment bank, has historically performed well, but, due to the natural run off profile of these exposures, capacity is available to write more high quality credit. To support this initiative, the Banking Group has created a corporate and investment banking unit, with an integrated client coverage team and has adjusted certain prudential limits in investment grade and defensive counters.

Market risk

The financial performance of the Banking Group and its ability to realise positions at a favourable return is dependent on market conditions and the environment in which it operates. The Banking Group's business in the market risk space is, in the main, affected by the level of underlying market activity and client flows, volatility of underlying markets, and the absence or presence of clearly trending markets.

FirstRand's market risk sits predominantly within the trading activities of RMB with the bulk resulting from activities in equity and fixed income markets in South Africa. As can be seen from the chart showing the daily regulatory trading book earnings vs 1 day 99% VaR (page 64), the level of risk decreased towards the end of the financial year, mainly reflecting market conditions characterised by decreasing market volatility and reduced opportunities.

Going forward it is expected that RMB's increased focus on corporate client acquisition will result in increased client flows for the trading units, and therefore increased capacity for taking risk.

Equity investment risk

Portfolio investments in equity instruments are undertaken in RMB. In addition, there are strategic equity investments undertaken in FNB, WesBank and the Corporate Centre. Unlisted investments in RMB are mainly taken through its Investment Banking division, whilst listed investments are primarily made through the Equities division.

All investments are subject to a due diligence process, which is reviewed and challenged at the Investment committee prior to the granting of final approval. In addition, normal semi annual reviews are carried out and crucial parts of these reviews, such as valuation estimates, are independently peer reviewed.

Listed investment positions were included in the Banking Group's equity investment risk ETL process during the current year, following improvements made in the assessment of underlying liquidity of trading positions, as well as improvements in the quantification of listed investment exposures. These positions were previously reported as part of the trading ETL process. The risk measure is based on a 90 day ETL calculated using RMB's Internal Market Risk Model and is supplemented by a measure of the specific (idiosyncratic) risk of the individual securities per the Banking Group's specific risk measurement methodology. The Listed equity investment ETL (on a total listed investment exposure of R1.376 billion) amounted to R575 million at 30 June 2010.

Equity investment risk also includes the three investments acquired by RMB in 2008 following the default of Dealstream (a clearing client). These investments were written down in the current year which resulted in a significant derisking of this portfolio. RMB continues to hold and manage these exposures as part of its legacy portfolio to realise value over the longer term.

The value in use of the Dealstream portfolio amounted to R320 million at 30 June 2010 (R1 019 million at 30 June 2009).

Funding and liquidity risk

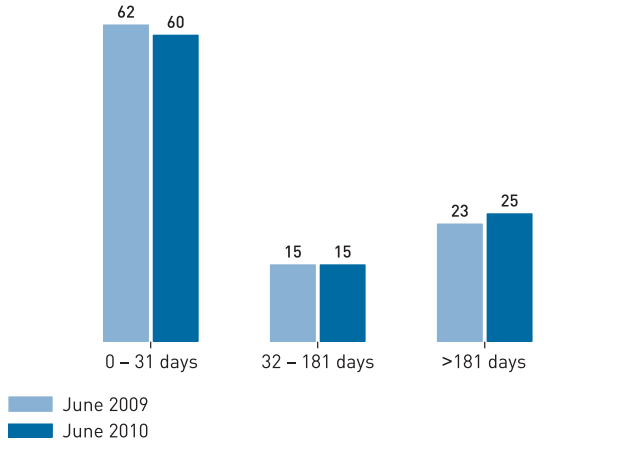
The South African market is characterised by a low discretionary savings rate. However, there is a higher degree of contractual savings, which are captured by institutions such as pension funds, provident funds and asset management providers. A portion of this translates into wholesale funding for banks, which is more expensive and has a shorter term than traditional retail deposits. All major banks in South Africa are thus reliant on a significant portion of short term, expensive institutional deposits to fund longer dated assets such as mortgages. In other words, liquidity risk in the South African banking system is structurally higher than in most other markets. This situation is to some extent mitigated by the following factors (which helped the country to weather the global financial crisis without any disruptions to the interbank market):

- The so-called "closed rand" system, whereby all rand transactions (whether physical or derivative) have to be cleared and settled in South Africa. FirstRand Bank is one of the major clearing/settlement agents. The payments and settlement system in South Africa is currently only open to registered banks in South Africa.
- The institutional funding base is fairly stable as it is, in effect, recycled retail savings.
- The country has a prudential exchange control framework in place.
- South Africa has a low dependence on foreign currency funding (i.e. low rollover risk).

Against this backdrop, FirstRand's objective is to fund its activities in a sustainable, efficient, diversified and flexible manner, underpinned by strong counterparty relationships. The Banking Group has a strong and stable deposit franchise, which spans the consumer, commercial and corporate segments. Institutional funding represents a third of the Banking Group's total funding. This reliance on funding from the institutional market remains a risk concentration that is actively managed through the holding of appropriate liquidity buffers and continued focus on lengthening the term profile of this funding. The Banking Group conducts scenario and stress simulations to ensure it has a prudent liquidity buffer over and above the minimum statutory requirement. The term structure of liabilities is driven by the funding profile requirements of the Banking Group, and any associated interest rate risk that arises is managed as part of the banking book's net interest rate profile (discussed in the next section).

Over the past year, the Banking Group continued to lengthen its funding profile (as shown in the chart below) and further increased liquidity buffers.

FirstRand Bank funding profile



Increased issuance by Government to fund the budget deficit and infrastructure investment places upward pressure on yields, however this has been tempered by the global shift in asset allocation to emerging markets. Liquidity premiums remain at levels higher than previous years but have significantly retraced from their peaks. Where the term is less than one year, premiums have moderated as banks favour longer term funding, and asset growth is expected to remain subdued.

Interest rate risk in the banking book

Interest rate risk in the banking book is made up of two components, namely the endowment effect and interest rate mismatch.

The endowment effect results from a large proportion of "endowment" liabilities (including sticky deposits and equity) that fund variable rate assets (e.g. Prime linked mortgages), therefore bank earnings are vulnerable to declining interest rates. The endowment effect currently accounts for 80% of the interest rate risk in the banking book. The negative endowment effect had a severe impact on NII in the year to June 2010, as rates were on average 3.9 percentage points lower than in the comparative period.

The endowment risk is managed as part of the holistic balance sheet management approach, in conjunction with other factors such as credit impairments and balance sheet growth and according to the Banking Group's house view. If required, the interest rate profile is adjusted through hedging strategies. From an interest rate mismatch perspective, the Banking Group also hedges its residual fixed rate position, which has been adjusted for optionality (e.g. prepayments).

Non financial risks

Operational risk

Operational risk relates to the risk of loss arising from shortcomings or failures in internal processes, people or systems, or from external events.

Banks have to be able to process large numbers of simple and complex transactions on a daily basis. The ability to process these transactions effectively could be impacted by failure of IT systems, internal or external fraud, large litigation, business disruption or process failure. Disruption in power supply, complex systems and interconnectivity with other financial institutions and exchanges increase the risk of operational failure.

Operational risk could also cause reputational damage, and therefore efforts to identify, manage and mitigate operational risk should be equally sensitive to reputational risk as well as the risk of financial loss.

The Banking Group manages operational risk using group wide control standards supported by commitment of senior management, independent oversight by ERM, active participation by deployed segment and divisional risk managers, and training of staff in a process of identifying, measuring, monitoring and reporting operational risk. In this process, the Banking Group uses a variety of best practice approaches and tools in the assessment and management of operational risk. ERM, a risk management function independent of the revenue producing units, is also responsible for developing and implementing the framework to manage operational risks, and provides regular reports of operational risk exposures to the Board.

Given the ever changing and complex nature of its business and its processes, the Banking Group employs a dynamic approach to managing operational risk and this approach results in almost continuous change or renewal. It is common practice, when implementing change of this nature, to proactively address less than optimal operational procedures with meaningful adjustments to risk management. The Board and management are not satisfied with the current level of operational losses, albeit in line with industry experience and has therefore embarked on a consistent and disciplined approach of linking business processes to the operational risk and control environment.

Risk arising from the changing regulatory environment

The Banking Group is subject to extensive regulation in the environments where it operates. Most notably this includes the Banks Act 94 of 1990 (as amended), the Regulations thereto and the Basel II framework. In terms of the Basel II framework, the Banking Group is subject to Tier 1 and Tier 2 minimum capital requirements.

The Banking Group continues to monitor developments, search for opportunities to engage with the regulators, and assess the impact of the regulatory changes on its business operations. Two of the most significant regulatory changes impacting the Banking Group are discussed below.

Basel Committee on Banking Supervision proposals on capital and liquidity

The recent global financial crisis is expected to result in increased political and regulatory pressure on banking systems worldwide. Some of these pressures are likely to materialise in South Africa, particularly given its G20 membership. For example, the South African Reserve Bank ("SARB") is expected to implement the Basel Committee on Banking Supervision ("BCBS") proposals on capital and liquidity.

The impact of the proposed new requirements is expected to be especially significant from a liquidity perspective. Given the structural funding challenges in South Africa, banks would not be able to comply with the net stable funding ratio and liquidity coverage ratio as set out in the original December 2009 proposals. The revisions to the proposals outlined in July 2010 have gone some way in addressing banks' concerns, and the most significant change affecting the South African banking sector relates to the implementation of new liquidity requirements. The Liquid Coverage Ratio (LCR) will be revised by September 2010 to specifically cater for jurisdictions such as South Africa, where there are not sufficient liquid assets to meet the standard. The implementation of the Net Stable Funding Ratio (NSFR) has been postponed to 2018. Combined with changed assumptions for run off rates on deposits, funding for residential mortgages, and the treatment of interbank funding, FirstRand views these amendments positively, as they reduce the potential for market disruptions inherent in the original proposals.

Government and industry have agreed to set up a task team to investigate the structural funding issues in the South African banking system. The task team will consider issues relating to the lack of retail savings, the disintermediation of banks which resulted from the growth in money market funds, and the different regulatory treatment of banks and money market funds.

FirstRand participated in the Basel quantitative impact study ("QIS") that the BCBS conducted to assess the impact of the new proposals on banks. Preliminary calculations carried out as part of this exercise show that there would be a reduction in both the Tier 1 and total capital adequacy ratios, however, FirstRand Bank and the Banking Group remain above the current regulatory minimum levels. Although the new regulatory minimum has not been finalised, FirstRand believes it will be adequately capitalised to meet the new requirements.

Exchange control reforms

Reforms to exchange control (which involve a shift to a system of prudential regulation) were recently announced, which are part of the National Treasury's ongoing exchange control modernisation policy. Whilst these reforms do not represent the abolition of exchange controls, they are extremely positive developments for South Africa as whole. They introduce greater flexibility and efficiency to foreign exchange transactions, and further strengthen international confidence in South Africa's financial system. This should facilitate, over time, increased foreign flows

into and out of the domestic economy. Customers will also benefit as the administrative procedures previously carried out by the SARB will now be managed by Authorised Dealers such as FirstRand Bank (and its divisions FNB and RMB), which means that foreign exchange transactions can now be serviced directly by existing branch networks to a much greater degree.

The introduction of the new exchange control prudential limit, which allows banks to invest up to 25% of adjusted liabilities in foreign currency assets, created new growth opportunities (the Banking Group's current utilisation is approximately 4%). Increased utilisation of the prudential limit will be subject to the Banking Group's internal limits and risk appetite.

Conclusion

As a large financial services provider in South Africa, it is imperative that FirstRand establishes a risk and earnings profile that protects it from undesirable volatility in its financial results, which may adversely affect its reputation.

The Banking Group operates in an environment which results in certain balance sheet concentrations, e.g. the reliance of the SA banking market on institutional funding, and large/lumpy wholesale credit exposures. In response to these concentrations, the Banking Group aims to safeguard its reputation, targets a credit rating of A-, and manages its balance sheet profile such that it is in line with its peer group.

Going forward the Banking Group will execute on its stated strategy, leveraging off an existing platform of diverse revenue streams and strong operating franchises. In the process, management aims to rebalance the current portfolio to achieve an appropriate mix between:

- retail and corporate assets;
- mass, consumer and wealth revenue streams within retail;
- client flows and secondary markets within corporate and investment banking;
- originating assets and liabilities; and
- South Africa and rest of Africa.

Whilst effective management of risks incurred directly or indirectly is considered a key determinant of successful execution, certain external risk factors can impact on these objectives. The Banking Group constantly monitors all of these risk factors and will adjust its strategy accordingly.

The macro environment going forward is likely to present challenges to topline growth for the Banking Group. Banking earnings are particularly sensitive to domestic GDP growth and the South African economy is driven largely by consumer activity. Domestic households remain highly indebted and advances growth is therefore expected to lag economic activity. Corporate balance sheets continue to be robust, but investment levels remain muted, new employment sluggish, and this could constrain growth in the medium term.

4. INTEGRATED RISK AND CAPITAL MANAGEMENT

Focus on sustainability and integration of risk and finance

A key lesson from the recent developments in the international financial markets is that failure to take a comprehensive and integrated view, not only across different risk types, but also across the traditionally separate functions of risk and finance, substantially increases the risk of financial underperformance or organisational failure.

The Banking Group considers the sustainability of its earnings within acceptable volatility as a core objective and key performance measure. The value of its franchises is ultimately driven by financial strength and the Banking Group is adopting a management approach that seeks to balance independent franchises with strong central oversight aimed at ensuring optimal outcomes.

This is necessary since the optimisation of each individual franchise's value does not necessarily ensure the maximisation of the Banking Group's value, given potential natural offsets as well as concentrations across the businesses and efficiency gains available from aggregating, mitigating and managing risks at a Banking Group level, where appropriate.

The franchises are ultimately responsible for maximising risk adjusted returns on a sustainable basis, within the limits of the risk appetite. Significant shifts in the macro environment are also critical to any strategic adjustments. FirstRand manages its business based on a single "house view" which inputs into the budgeting and forecasting process, informs credit origination strategies and capital stress testing, directs the interest rate positioning of the banking book, and is used for tail risk strategies.

There is a central unit tasked with formulating and communicating this macroeconomic view. It provides the business units with a forecast of key variables that impact the financial position and 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 is updated on a quarterly basis, or more frequently if required.

Capital Management and Group Treasury within Corporate Centre are responsible for the management of the Banking Group's capital and liquidity position. The capital position provides the final buffer against adverse business performance under extremely severe economic conditions. For the purpose of determining the strategy with respect to capital management actions and the setting of its dividend policy, scenario analyses are extensively employed as supplements to budgets based on consistent planning assumptions and stress scenarios.

The Banking Group, through a combined initiative of its finance, capital and risk functions, continues to integrate financial, capital and risk data and information on a common platform. This information, both actual and through the budget process, is used as a 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, proactive manner on the basis of a consistent, integrated view incorporating aspects of both finance and risk domains.

Internal capital adequacy assessment process

An important lesson learnt by FirstRand from the financial turmoil, is that the Internal Capital Adequacy Assessment Process ("ICAAP") is key to managing its business. ICAAP is not seen as merely meeting regulatory requirements and this process 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;
- embedding the 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 act as early warning signs and triggers so that contingency plans can be implemented; and
- the determination of the capital management strategy and how the organisation will manage its capital including during periods of stress.

Stress testing and scenario based analysis

The evaluation of business plans and strategic options at a Banking Group and business level, as well as the choice of tactical steps towards implementing these plans is a process that is 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 as well as on the basis of unforeseen events is an integral part of the strategy setting and planning and budgeting processes.

The core scenario reflects the Banking 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 Banking Group level with respect to potential deviations from budget and the potential implications for earnings volatility. In addition reverse stress test scenarios provide management and regulators with a structured view on potential developments that may threaten the stability of the institution.

The Banking 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 strongly related to the economic environment or the Banking 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 and the strategy.

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

Risk appetite

The level of risk the Banking 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 FRBH Risk, capital and compliance committee ("RCC committee") and its subcommittees, as described in the Risk governance structure section on page 12.

The risk appetite framework sets out specific principles, objectives and measures that link diverse considerations such as strategy setting, risk considerations, target capitalisation levels and acceptable levels of earnings volatility. As each franchise is ultimately tasked with the generation of sustainable returns, risk appetite acts 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 Banking Group is willing to accept from certain risks that are core to its business; and
- the level of capitalisation it seeks to maintain 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 and 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 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 Banking 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.

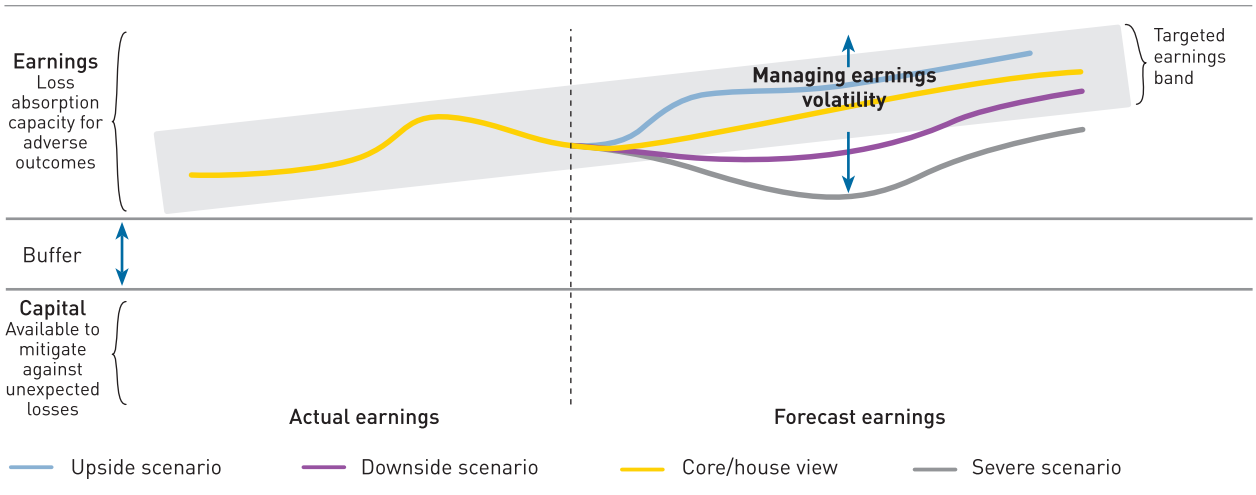
Earnings volatility thresholds were refined for the major risk types and a number of changes to business practices were made to ensure that activities remained within its risk appetite.

Risk appetite measures are included in all 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.

Within the Banking Group context, earnings are seen as the primary source of loss absorption under adverse conditions. The Banking Group's capacity to absorb earnings volatility and fluctuations is therefore supported by the generation of sustainable profits.

The earnings buffer and capital provide protection against unexpected events for stakeholders. The chart below illustrates the strategy to manage earnings volatility through the cycle.

Managing earnings volatility through the cycle



5. RISK MANAGEMENT FRAMEWORK AND GOVERNANCE STRUCTURE

Risk governance

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

In addition, effective risk management requires multiple points of control or safeguards that should be applied consistently at various levels throughout the organisation. There are three primary lines of control across the Banking Group's operations:

1. 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.

2. Risk control – Business heads are supported in this by deployed risk management functions that are involved in all business decisions and are represented at an executive level across all franchises. These are overseen by an independent, central risk control function, Enterprise Risk Management ("ERM").

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

The risk management structure described above is set out in the Business Performance and Risk Management Framework ("BPRMF"). As a policy of both the Board and the Executive committee, it delineates the roles and responsibilities of key stakeholders in business, support and control functions across the various franchises and the Banking Group. The BPRMF explicitly recognises the three lines of control, illustrated in the chart below.

Lines of risk control in the Banking Group

FIRST LINE OF RISK CONTROL

Head of business: Primary Risk Owner

Embeds risk management as a core discipline and gives consideration to potential risks in business decisions:

- ensures the entity acts in accordance with mandates approved by the Board or its delegated authority;
- identifies and quantifies key risks to business under normal and stress conditions;
- specifies and implements appropriate risk management processes;
- specifies and implements early warning measures, associated reporting, management and escalation processes;
- implements risk control and mitigation strategies;
- implements corrective actions as required;
- reports risk information to the executive committee and the governance committee structure as appropriate through to the boards; and
- ensures staff understanding of responsibilities in relation to risk management.

Corporate centre functions

Supports business owners, the Board and Executive committee in the implementation of the Banking Group strategy across the portfolio from an operational perspective and comprises:

- **The central unit** tasked with formulating and communicating the Banking Group's macro-economic view and associated risk scenarios, used for planning and stress testing purposes.
- **Group Treasury** is responsible for management of funding and liquidity, interest rate risk in the banking book, exchange control and strategic relations with respect to liquidity and funding.
- **Capital Management** is responsible for capital planning and advises the Board and the executive committee on potential capital actions, dividend strategy and other capital management related topics.

SECOND LINE OF RISK CONTROL

Enterprise Risk Management

Provides independent oversight and monitoring across the Banking Group on behalf of the Board and relevant committees:

- headed by Banking Group CRO who is a member of the executive committee;
- takes ownership of and maintains risk frameworks;
- agrees deployed and divisional risk plans;
- 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 vis-à-vis management of risk exposures to relevant committees;
- ensures appropriate risk skills throughout the Banking Group alongside an appropriate risk management culture for risk taking;
- performs risk measurement validation and maintains risk governance structures; and
- manages regulatory relationships with respect to risk matters.

Deployed segment and divisional risk managers

Support business unit management in identifying and quantifying significant risks:

- divisional risk heads have direct reporting line to Banking Group CRO and head of respective division;
- represented on divisional executive committees, primary focus on risk identification, measurement and control;
- approve 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; and
- ensure all risk management and loss containment activities are performed in a timely manner as agreed with ERM.

Regulatory Risk Management

Ensures that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws:

Regulatory Risk Management is an integral part of managing risks inherent in the business of banking and forms part of the second line of risk control.

The risks, responsibilities and processes of Regulatory Risk Management are discussed in the regulatory risk section.

THIRD LINE OF RISK CONTROL

Group Internal Audit

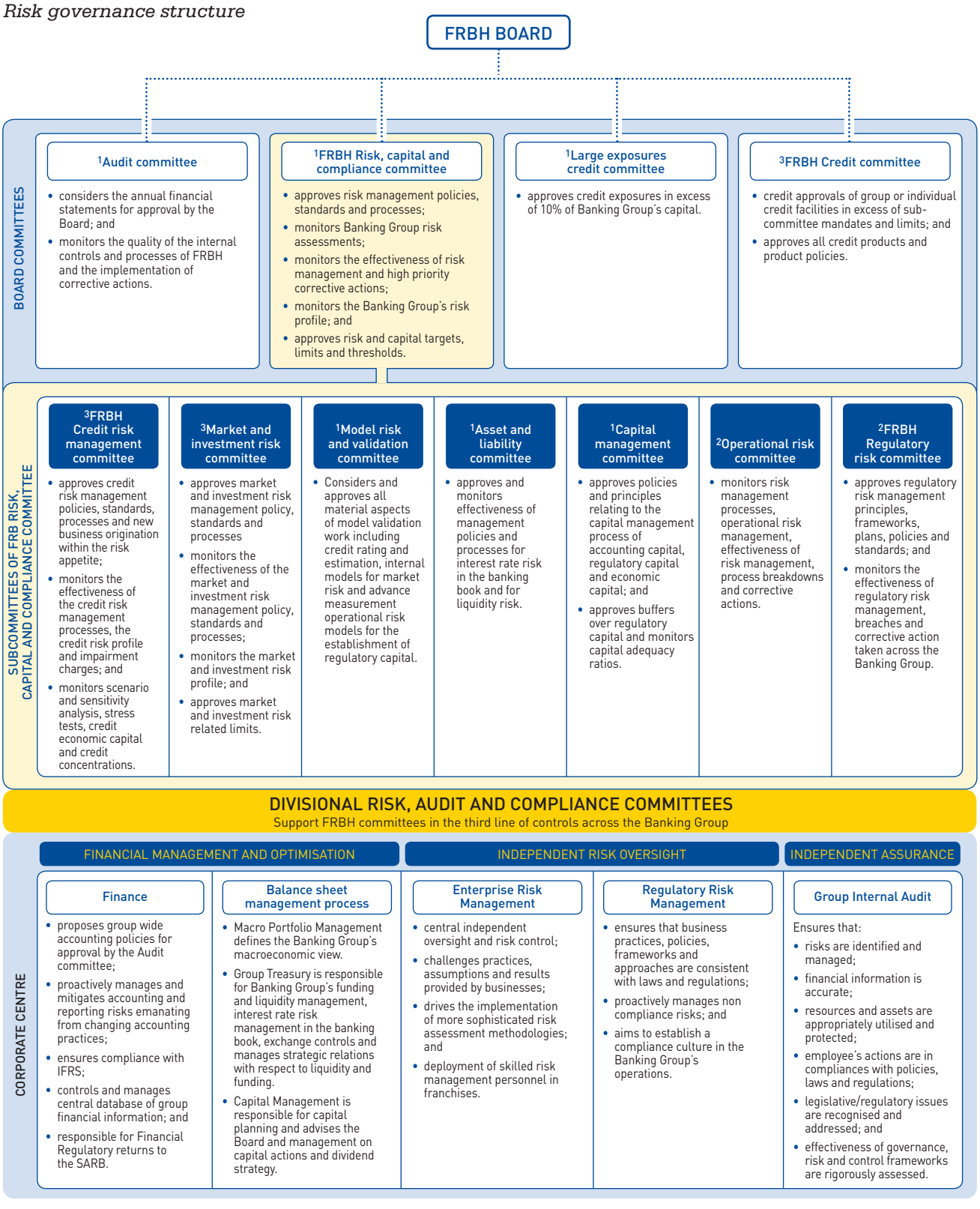
Provides independent assurance of the adequacy and effectiveness of risk management practices:

- headed by Chief Audit Executive and reports to the Board through the FRBH Audit committee chairman;
- reviews risk assessment results of the business entities;
- assesses compliance with the directives of the BPRMF;
- evaluates the development and implementation of policies and procedures for risk management in line with policies of the Board or relevant committees;
- reviews the integrity, accuracy and completeness of risk reports to the RCC committee and the Board;
- monitors results of internal and external audit processes;
- coordinates audit process with ERM, RRM and external auditors;
- attends various governance and management committees to remain informed and align risk based audit approach;
- conducts work in accordance with globally recognised internal audit standards; and
- internal audit practices and activities are annually assessed by external auditors.

The individual franchises: FNB, RMB and WesBank also take responsibility for managing risks in the unregulated entities within FirstRand Investment Holdings (Pty) Limited ("FRIHL"). These entities are subject to the same risk management policies and procedures of the respective franchises and are governed consistently across the Banking Group. Risks in these entities are, however, reported through the risk governance structure of the Group through the FirstRand Audit, risk and compliance committee.

In line with the Banking Group's corporate governance framework, the FRBH Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, managed and monitored across the banking operations. 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



1 *Chairperson is a non executive board member.*
2 *Chairperson is an independent non executive member.*
3 *Chairperson is executive management. The FRBH Credit and Credit risk management committees have non executive board representation.*

The primary board committee overseeing risk matters in the Banking Group is the FRBH RCC committee. It has delegated responsibility for a number of specialist topics to various subcommittees, as outlined in the chart above. The RCC committee submits its reports and findings to FirstRand's Audit, risk and compliance committee for review. Refer to Audit, risk and compliance committee section of the FirstRand annual report for a description of its role and responsibilities. The role of the RCC committee and its subcommittees is described further with reference to the applicable governance structures and processes for each particular risk type in the major risk sections. A number of the individual committees' members are non executives, further strengthening the Banking 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 Banking Group. The board committees are typically staffed by members of the respective committees of the individual franchises' boards so as to ensure a common understanding of the challenges businesses face and how these are addressed across the Banking Group.

Regular risk reporting and challenge of current practices

As part of the reporting, challenge, debate and control process, ERM also 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.

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

6. RISK PROFILE

The following detailed sections provide in depth descriptions of the approaches, methodologies, models and processes used in the identification and management of capital and 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.

7. STRATEGIC AND BUSINESS RISK

Key developments and focus

Strategic and business risks	Developments under the strategic risk realm include the phased implementation of Oracle HR across the Group to address human resource strategic and governance imperatives. Initial recipients of this were FNB, FirstRand Corporate Centre, RMB, Momentum and FNB Africa. Although the economic climate has improved, the pace of organic growth is slow and cost management remains a key area of focus. As a result, the pace of recruitment is subdued which will put pressure on transformation targets. This is being closely monitored at divisional executive level and by the Transformation committee.
Reputational risk	Banks continue to undergo local and international media scrutiny following the financial crisis. Ongoing emphasis is placed on reputational risk and stakeholder management.
Macroeconomic risk	The slowdown in economic recovery and concerns about sovereign risks globally could undermine stability gains as nations begin to reach the limits of public sector support for the financial system.
ESG risks	During the year FirstRand's operating franchises identified and rated the principal ESG risks affecting each franchise's ability to successfully and sustainably implement business strategy. Regular internal reporting against these risks is integrated into existing risk reporting structures on an ongoing basis.

Introduction and objectives

The risk of choosing of an inappropriate strategy or failing to execute the chosen strategy appropriately is inherent in all business endeavours. The Banking 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 businesses. The objective is to develop and maintain a portfolio that delivers sustainable earnings and thus minimises the chance of any adverse scenario occurring.

Organisational structure and governance

The development and execution of business level strategy is the responsibility of 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 executive management, as well as functions within Corporate Centre, review the external environment, industry trends, potential emerging risk factors, competitors' 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 level of potential business risk faced is assessed. Reports on the results of such 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 for. The risk to earnings on the other hand can be assessed, and this forms an explicit part of the Banking Group's risk appetite and ICAAP.

Business risk is assessed regularly as part of ICAAP. It is managed strategically at a Banking 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 is reviewed to determine whether it is likely that revenues would be insufficient to cover costs in a very 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.

Reputational risk

As a financial services provider, the Banking Group's business is one that is inherently built on trust and close relationships with its clients. Safeguarding its reputation is therefore of paramount importance to ensure continued prosperity and is thus seen as the responsibility of every staff member. Reputational risks can arise from ESG or as a consequence of financial or operational risk events.

The Banking Group's reputation is built on the way in which it conducts its 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 in its operations 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 Banking 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 and 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

During the year an ESG risk management process was adopted. The process involves the identification of the key ESG risks affecting each of the operating franchises. This process informs a view of the top ESG risks affecting the ability to successfully implement business strategy and influences the measures taken for managing, mitigating and avoiding these risks.

The management and reporting of, the most significant ESG risks are integrated into existing risk reporting structures and management frameworks. This process is supported by the inclusion of more extensive non financial reports into existing reporting processes. These provide objective quantitative and qualitative information in respect of ESG performance. Each business unit defines tolerances for its principle ESG risks and action plans for addressing these in line with particular circumstances and risk appetite.

The integrated management of ESG risks within the ERM structure provides the foundation for a focused approach for ensuring that the non financial and stakeholder performance is managed comprehensively and efficiently on a day-to-day basis.

The top five inherent ESG risks are:

- employment equity;
- employee satisfaction;
- customer satisfaction;
- governance effectiveness; and
- Equator Principles compliance.

The impact and likelihood of these risks are evaluated taking into account measures for management, mitigation and avoidance. This residual risk profile demonstrates that all risks with a major potential impact are unlikely to arise given the internal controls in place.

Tolerances and mitigating actions are defined at divisional and Banking Group level and progress in respect of these is tracked through existing risk reporting structures. During the year under review board oversight of these processes was provided by FirstRand's Audit, risk and compliance committee. This committee will be replaced by two committees dealing with audit and risk issues separately from 1 July 2010. The FirstRand Risk, capital and compliance committee will oversee the management of ESG risks and will regularly update the FirstRand Audit committee.

8. CAPITAL MANAGEMENT

Key developments and focus

Capital management continues to focus on maintaining strong solvency levels, with a particular focus on the quality of capital. This is reflected in the Tier 1 ratios for FRB and FRBH which remained above target levels throughout the year. Tier 1 continued to exceed economic capital requirements for a range of normal and severe scenarios as well as for stress events. Performance measurement is aligned with risk 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. During 2010 the Banking Group returned to positive NIACC generation which created value for shareholders. The impact of the new Basel proposals on Tier 1 and total capital adequacy ratios was assessed through the Basel QIS. The Banking Group will continue to operate above the current regulatory minimum capital requirement if the principles, as included in the broad agreement reached in July 2010, are implemented.

Introduction and objectives

The Banking Group targets a particular earnings profile that will allow it to generate sustainable returns within appropriate levels of volatility.

Sustainability also refers to the business' 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 its operations and the interests of its stakeholders are 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 of the Banking 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 – as well as expectations of investors, 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.

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 Banking 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 Banking Group includes both regulated and unregulated entities. FRBH is the regulated entity and includes all regulated bank subsidiaries and other entities.

Dividends

The total capital plan includes a dividend policy, which is set in order to ensure sustainable dividend cover based on sustainable normalised earnings, after taking 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.

Organisational structure and governance

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

Capital is freely transferable within the Banking Group, subject to the approval of exchange control authorities for entities outside the common monetary area.

The board approved capital plan is reviewed as part of the Banking Group's ICAAP, with the stress testing framework being an extension to the process. These processes are under continuous review and refinement and continue to inform the targeted buffer.

Capital adequacy and planning

The year under review

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

With increased focus on Tier 1 during the year, FRBH achieved a very strong Tier 1 ratio of 13.5%. Stronger internal capital generation through earnings, offset to an extent by an increase in credit and operational risk weighted assets, led to an overall increase in the Tier 1 and total capital adequacy ratios for FRBH.

Supply of capital – Tier 1

The Banking Group aims to back all economic risks with Tier 1 capital as it 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 higher levels of profitability during the year.

Supply of capital – Tier 2

The current pricing of subordinated bond instruments, the inability of these instruments to absorb losses, and the Banking Group's reduced risk appetite make the issuance of these instruments unattractive at present. Accordingly, no new Tier 2 instruments were issued during the year. It is the Banking Group's intention to redeem all instruments on call date. On 16 August 2010, SARB approval was received to call the FRB01 and FRB02 subordinated bonds on 31 August 2010. The table below provides more detail on the Banking Group's capital instruments.

Characteristics of capital instruments

Capital type	Instrument	Nominal (million)	Rate type	Coupon rate	Maturity rate
Other Tier 1	Non cumulative non redeemable preference share capital	3 000	Floating	68% of prime	Perpetual
Upper Tier 2	FRBC21	628	Fixed	12%	21 Dec 2018
	FRBC22	440	Floating	3 month JIBAR + 300bps	22 Dec 2018
Lower Tier 2 (Subordinated bonds)	FRB01*	700	Fixed	13%	31 Aug 2010
	FRB02*	300	Floating	3 month JIBAR + 71.5bps	31 Aug 2010
	FRB03	1 740	Fixed	9%	15 Sept 2014
	FRB05	2 110	Fixed	9%	21 Dec 2018
	FRB06	1 000	Floating	3 month JIBAR + 65bps	5 Nov 2012
	FRB07	300	Floating	3 month JIBAR + 65bps	6 Dec 2012
	FRB08	100	Floating	3 month JIBAR + 70bps	10 Jun 2016
	FRB09	100	Floating	3 month JIBAR + 70bps	10 Jun 2017
	FNBB001	108	Fixed	11%	1 Dec 2016
	FNB17	260	Fixed	9%	29 Mar 2012

* *Approval received from the SARB to call the FRB01 and FRB02 on 31 August 2010.*

Demand for capital

With the introduction of Basel II, capital requirements expressed as a percentage of risk weighted assets ("RWA") have become more risk sensitive and more cyclical than under the previous regime. This cyclicality is to a large extent driven by external factors that affect the risk measures across various portfolios and therefore, drive capital requirements.

The overall increase in RWA for both FRBH and FRB was driven predominantly by the following factors:

- credit risk – increased due to volume growth and recalibrations;
- operational risk – increased risk profile for FRB and gross income for other businesses under the Standardised Approach; and
- market risk – derisked financial positions at FRB.

Regulatory developments

The BCBS proposals published during 2009 and 2010 in response to the global financial crisis, which would impact bank's capital, focused on:

- strengthening the resilience of the banking sector;
- enhancing the current Basel II framework; and
- revising the market risk framework.

The BCBS conducted a QIS to assess the impact of these proposals on participating banks. The results of this study aim to produce a fully calibrated set of requirements for implementation in 2012. The BCBS announced during July 2010 that it had reached broad agreement on some of the capital and liquidity proposals released during 2009. The full details of the proposals as well as the outcome of the QIS are expected by the end of 2010. A further "Countercyclical capital buffer proposal" was issued in July 2010 with the consultation period closing in September 2010.

FRBH participated in the QIS process and preliminary calculations show a reduction on the Tier 1 and total capital adequacy ratios of the Banking Group, however, both FRB and FRBH remain above the current regulatory minimum. The current proposals form part of the ongoing capital planning of the Banking Group. Targeted capital ratios may be revisited as more information becomes available.

The SARB issued a draft set of regulations due to be implemented at the start of 2012 that currently cover the revised market risk and securitisation frameworks.

Regulatory capital

The targeted capital levels as well as the current ratios at 30 June 2010 are summarised in the table below.

Capital adequacy position

	FRBH		FRB*		
R million	Actual	Target	Actual	Target	Regulatory minimum
Capital adequacy ratio (%)	15.6	12 – 13.5	14.0	11.5 – 13.0	9.5#
Tier 1 ratio (%)	13.5	10.0	11.7	9.5	7.0

* *Reflects solo supervision, i.e. FRB excluding branches, subsidiaries and associates.*

\# *The regulatory minimum excludes the bank specific (Pillar 2b) add on and capital floor.*

The following table shows the composition of regulatory capital (financial resources) for FRBH at 30 June 2010, while the subsequent tables provide a breakdown of RWA and capital requirement.

Composition of qualifying capital and capital ratios of FRBH

	FRBH			
	2010		2009	
R million		**%**		%
Ordinary shareholders equity as per IFRS	**44 448**		41 045	
Less: non qualifying reserves	**(1 174)**		(2 747)	
Cash flow reserve	**466**		285	
Available-for-sale reserve	**(310)**		(393)	
Share based payment reserve	**(447)**		(502)	
Foreign currency translation reserve	**(674)**		(712)	
Other reserves	**(205)**		(567)	
Unappropriated profits	**(4)**		(858)	
Ordinary shareholders equity qualifying as capital	**43 274**		38 298	
Ordinary share capital and share premium	**6 064**		5 672	
Reserves	**37 210**		32 626	
Non controlling interest	**1 831**		1 517	
Non cumulative non redeemable preference shares	**3 100**		3 100	
Less: total impairments	**(2 089)**		(2 303)	
Excess of expected loss over eligible provisions (50%)	**(379)**		(325)	
First loss credit enhancements in respect of securitisation structures (50%)	**(207)**		(260)	
Goodwill and other impairments	**(1 503)**		(1 718)	
Total Tier 1 capital	**46 116**	**13.5**	40 612	12.3
Upper Tier 2 instruments	**1 068**		1 068	
Tier 2 subordinated debt instruments	**6 666**		6 642	
Other reserves	**196**		193	
Less: total impairments	**(586)**		(493)	
Excess of expected loss over eligible provisions (50%)	**(379)**		(325)	
First loss credit enhancements in respect of securitisation structures (50%)	**(207)**		(260)	
Other impairments	**–**		92	
Total Tier 2 capital	**7 344**	**2.1**	7 410	2.2
Total qualifying capital and reserves	**53 460**	**15.6**	48 022	14.6

RWA by risk type of FRBH

R million	FRBH			
	2010		2009	
	RWA	**Capital requirement#**	RWA	Capital requirement#
Credit risk	**246 875**	**23 453**	241 447	22 937
Operational risk	**51 058**	**4 851**	47 125	4 477
Market risk	**10 853**	**1 031**	13 246	1 258
Equity investment risk	**17 729**	**1 684**	13 649	1 297
Other risk	**15 093**	**1 434**	14 037	1 334
Total RWA	**341 608**	**32 453**	329 504	31 303

 # Capital requirement calculated at 9.5% of RWA.

RWA calculation approach for each risk type of the Banking Group

The following table provides a list of the Basel II approaches applied to each risk type for FRB and the other regulated entities of FRBH.

RWA calculation approach for each risk type

Risk type	FRB	Other regulated entities (FRBH)
Credit risk	Advanced Internal Ratings Based Approach ("AIRB")	Standardised Approach
Operational risk	Advanced Measurement Approach ("AMA")	Domestic operations: AMA
		Offshore operations: Standardised Approach
Market risk	Internal Model Approach	Standardised Approach

The following table provides the RWA numbers per Basel II approach for each risk type of FRBH.

RWA numbers per Basel II approach for each risk type

R million	RWA 2010
Credit risk	**246 875**
AIRB Approach	**210 328**
Corporate, banks and sovereigns	**86 446**
SME	**37 860**
Residential mortgages	**39 266**
Qualifying revolving retail	**9 639**
Other retail	**32 191**
Securitisation exposure	**4 926**
Standardised Approach	**36 547**
Equity investment risk	**17 729**
Standardised Approach	**894**
Simple risk weighted method	**16 835**
Operational risk	**51 058**
Standardised Approach	**6 845**
AMA	**44 213**
Market risk*	**10 853**
Internal Model Approach	**4 669**
Standardised Approach	**6 184**

* *Includes banking and trading book.*

The following table shows the composition of regulatory capital (financial resources) for FRB at 30 June 2010, while the subsequent tables provide a breakdown of RWA and capital requirement.

Composition of qualifying capital and capital ratios of FRB

	FRB*			
	2010		2009	
R million		**%**		%
Ordinary shareholders equity as per IFRS	**33 085**		29 681	
Less: non qualifying reserves	**(477)**		(1 178)	
Cash flow reserve	**466**		337	
Available-for-sale reserve	**(532)**		(279)	
Share based payment reserve	**(411)**		(532)	
Unappropriated profits	**–**		(704)	
Ordinary shareholders equity qualifying as capital	**32 608**		28 503	
Ordinary share capital and share premium	**10 969**		10 821	
Reserves	**21 639**		17 682	
Non cumulative non redeemable preference shares	**3 000**		3 000	
Less: total impairments	**(2 323)**		(1 782)	
Excess of expected loss over eligible provisions (50%)	**(379)**		(325)	
First loss credit enhancements in respect of securitisation structures (50%)	**(45)**		–	
Qualifying capital in branches	**(1 732)**		(1 297)	
Goodwill and other impairments	**(167)**		(160)	
Total Tier 1 capital	**33 285**	**11.7**	29 721	10.7
Upper Tier 2 instruments	**1 068**		1 068	
Tier 2 subordinated debt instruments	**5 914**		5 872	
Less: total impairments	**(424)**		(234)	
Excess of expected loss over eligible provisions (50%)	**(379)**		(325)	
First loss credit enhancements in respect of securitisation structures (50%)	**(45)**		–	
Other impairments	**–**		91	
Total Tier 2 capital	**6 558**	**2.3**	6 706	2.4
Total qualifying capital and reserves	**39 843**	**14.0**	36 427	13.1

* *Reflects solo supervision, i.e. FRB excluding branches, subsidiaries and associates.*

RWA by risk type of FRB

R million	FRB* 2010 RWA	FRB* 2010 Capital requirement#	FRB* 2009 RWA	FRB* 2009 Capital requirement#
Credit risk	**210 328**	**19 981**	205 472	19 520
Operational risk	**38 223**	**3 631**	35 000	3 325
Market risk	**4 669**	**444**	7 809	742
Equity investment risk	**16 835**	**1 599**	17 469	1 660
Other risk	**13 690**	**1 301**	12 071	1 147
Total RWA	**283 745**	**26 956**	277 821	26 394

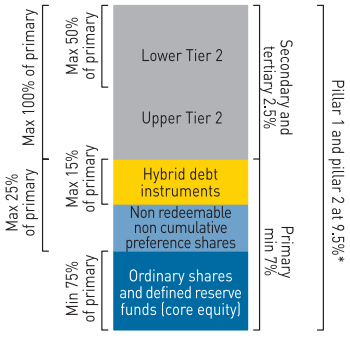
* *Reflects solo supervision, i.e. FRB excluding branches, subsidiaries and associates.*
\# *Capital requirement calculated at 9.5% of RWA.*

Capital adequacy position

The graph below depicts the current capital adequacy position for FRBH and FRB.

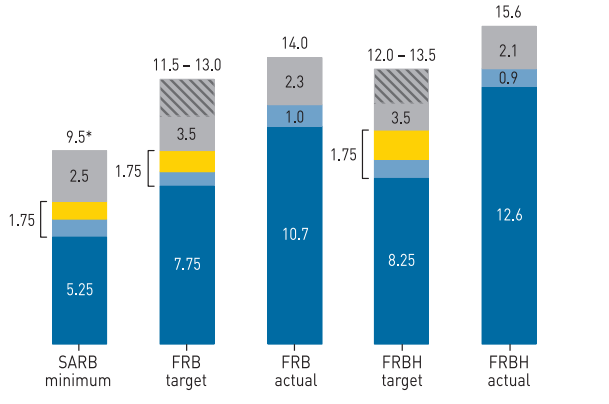
Capital adequacy position and composition of qualifying capital

Minimum capital adequacy



Capital adequacy

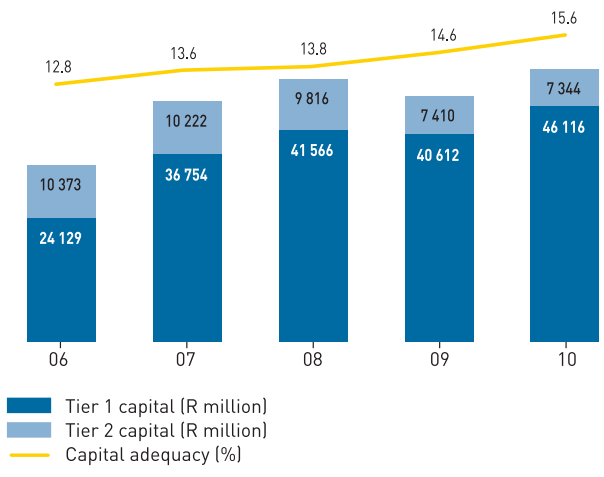
(%)



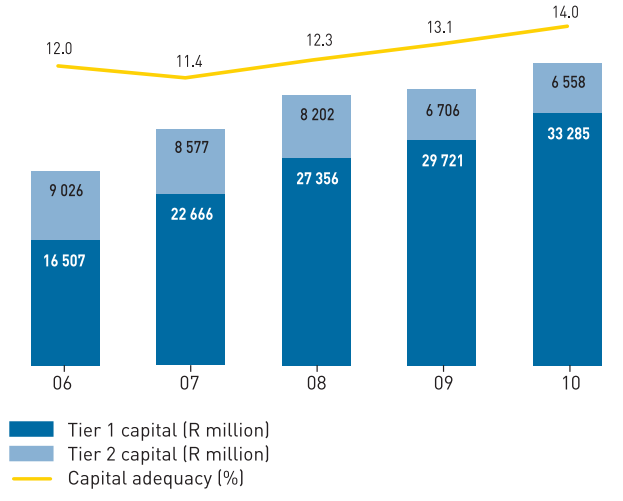
* *Excludes the Bank specific (Pillar 2b) add on and capital floor.*

The graph below provides a historical overview of the capital adequacy for FRBH and FRB.

FRBH regulatory capital position



FRB regulatory capital position



* *Information for comparative years – prior to the Basel II implementation on 1 January 2008 – is on a Basel I basis.*

The capital adequacy position of FRBH and its subsidiaries is set out below.

RWA and capital adequacy position for FRBH and its subsidiaries

	2010		2009	
R million	**Risk weighted assets**	**Total capital adequacy %**	Risk weighted assets	Total capital adequacy %
Basel II				
FirstRand Bank Holdings Limited*	**341 608**	**15.6**	329 504	14.6
FirstRand Bank Limited (South Africa)	**283 745**	**14.0**	277 821	13.1
FirstRand Bank UK (London Branch)	**5 210**	**12.8**	3 144	21.4
FirstRand India	**241**	**247.5**	126	157.2
FirstRand (Ireland) Plc	**5 042**	**31.0**	8 355	18.2
RMB Australia Holdings Limited	**4 887**	**21.5**	4 611	19.5
FNB (Namibia) Limited	**9 910**	**20.1**	–	–
Basel I**				
FNB (Botswana) Limited	**6 834**	**17.4**	6 031	19.1
FNB (Lesotho) Limited	**228**	**17.9**	214	19.1
FNB (Moçambique) S.A.	**699**	**12.9**	466	17.4
FNB (Namibia) Limited	**–**	**–**	8 789	20.3
FNB (Swaziland) Limited	**1 467**	**20.9**	1 026	24.7
FNB (Zambia) Limited	**173**	**64.5**	48	168.0

* *FRBH successfully implemented Basel II at the beginning of January 2008. The registered banks in FRBH must comply with the SARB regulations and those of their home regulators, with primary focus placed on Tier 1 capital and total capital adequacy ratios.*

** *Entities operating under Basel II are subject to a minimum capital requirement of 9.5% (excluding the Pillar 2b add on). FNB Africa subsidiaries (excluding FNB (Namibia) Limited) currently report under Basel I – these entities are subject to a 10% minimum capital requirement in terms of local rules, except FNB (Botswana) Limited, where the minimum capital requirement is 15%. These entities also report under Basel II and are included on this basis for the consolidated position of FRBH. FNB (Namibia) Limited implemented Basel II on 1 January 2010.*

Economic capital

In addition to the regulatory capital requirements disclosed in the previous section, economic capital requirements are also calculated on the basis of a number of internally developed models. Economic capital is defined as the level of capital that must be held commensurate with its risk profile under severe stress conditions. This will provide comfort to a range of stakeholders that the Banking 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 Banking Group remains well capitalised in the current environment, with levels of Tier 1 capital exceeding the level of economic capital required. The Banking 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 purposes.

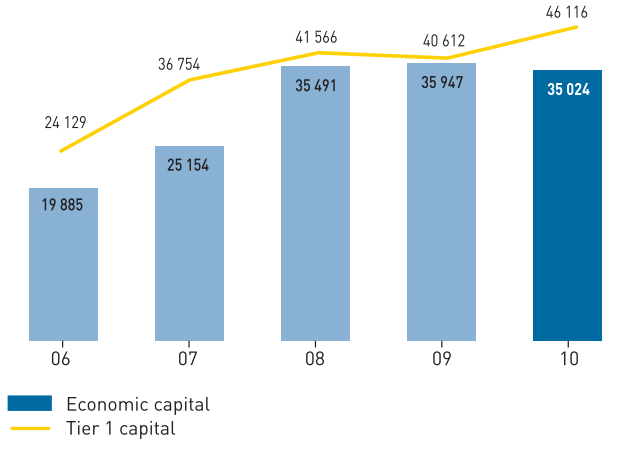
ICAAP assists in the attribution of capital in proportion to the risks inherent in the respective business units with reference to both normal economic circumstances and times of potential stress, which may lead to the realisation of risks not previously considered. This process is also supported by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

The allocation methodology for economic capital is broadly based on the approaches set out as part of the AIRB component of Basel II, with the exception of credit risk, which is considered at a product level. A number of assumptions are necessarily made in the attribution and allocation. These are reviewed periodically and any changes will have a direct impact on business unit level measures such as economic profit or NIACC. The economic capital framework incorporates aspects of the portfolio's composition in its calibration and reflects the effects of risk concentrations and diversification benefits.

The graph below provides an overview of the evolution of economic capital requirements and Tier 1 capital (available financial resources) for FRBH.

Economic capital

(R million)

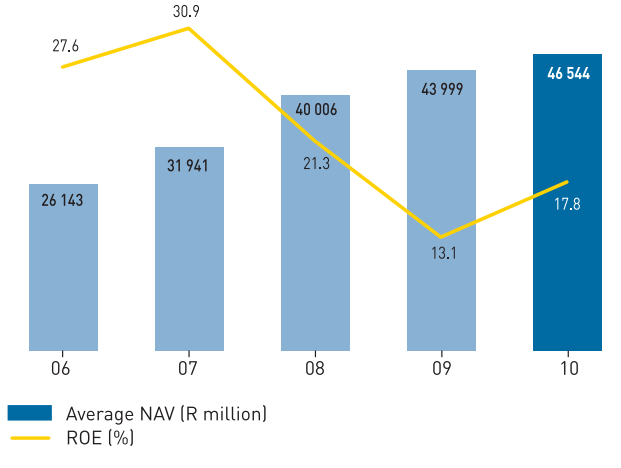


Normalised return on equity

The Banking Group achieved a normalised ROE of 18% compared to 13% for the prior year.

The Banking Group's total shareholders' equity and reserves (excluding non controlling interests) totalled R52 077 million as at 30 June 2010 (2009: R47 213 million). The average ordinary shareholders' equity and reserves for the period amounted to R46 544 million (2009: R43 999 million). Ordinary shareholders' equity comprises share capital and premium, distributable and non distributable reserves.

Normalised return on equity



Economic profit

The Banking Group's performance measures are aligned with risk considerations.

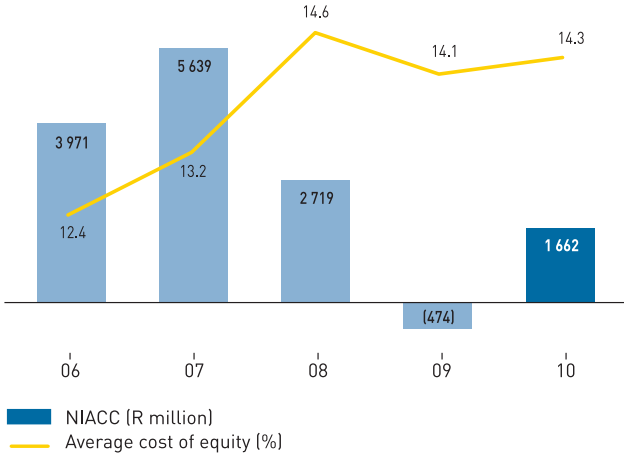
The use of economic profit or NIACC is embedded across the businesses and management culture. As a function of normalised earnings and capital utilised in the businesses, economic profit provides a clear indication of economic value added by a transaction or business unit. Positive internal capital generation through earnings at a marginally higher cost of equity produced economic value for shareholders during the year under review. The following table and chart provide an overview of the relevant calculation and creation of economic profit over time.

Economic profit

R million	2010	2009
Normalised earnings	**8 535**	6 056
Preference dividends	**(230)**	(309)
Normalised earnings attributable to ordinary shareholders	**8 305**	5 747
Charge for capital*	**(6 643)**	(6 221)
Net economic profit/(loss)**	**1 662**	(474)
Average ordinary shareholders' equity	**46 544**	43 999
Return on average ordinary shareholders' equity (%)	**17.8**	13.1
Average cost of equity (%)	**14.3**	14.1

* *Capital charge based on average cost of capital.*
** *Economic profit = normalised earnings – (average cost of equity x average ordinary shareholders equity and reserves).*

Evolution of economic profit and cost equity



9. CREDIT RISK

Key developments and focus

During the year under review there was significant focus on further refining the risk appetite framework. Bottom up and top down analyses produced risk appetite thresholds for all major business units, which will in the future be monitored at both the business units and the centre. The Banking Group's credit risk appetite and the corresponding origination strategies are continuously refined.

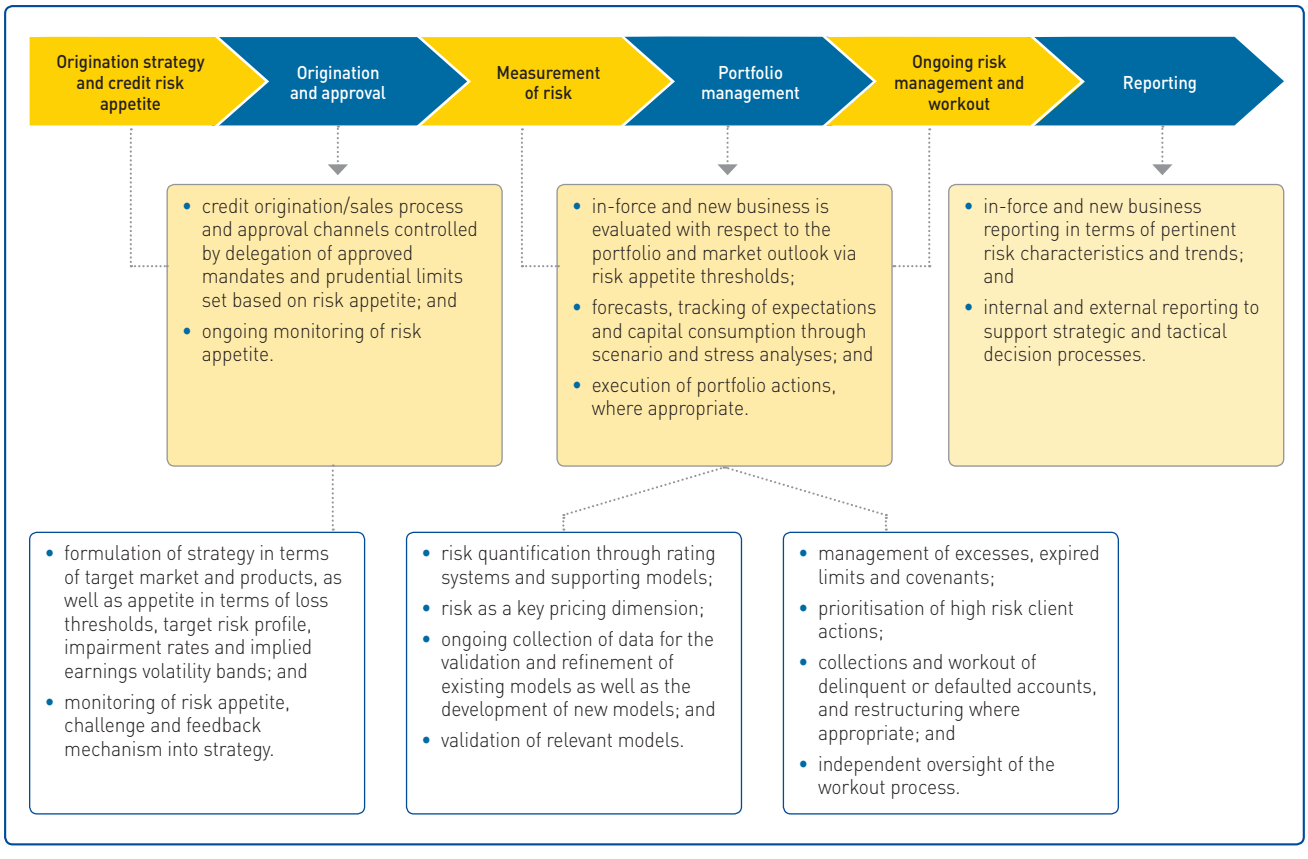
Introduction and objectives

Credit risk is one of the core risks assumed in pursuit of the Banking 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 Banking Group Credit Risk Management ("GCRM") function within ERM and relevant board committees, as well as the unit responsible for the house macro view ("BSM unit") and the Performance Measurement function within Corporate Centre, fulfil this role.

The scope of credit risk identification and management practices across the Banking Group therefore 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 regularly receives and reviews 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 various businesses. 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 integrates with the BPRMF (see page 10).

Two credit focused board committees, the FRBH Credit committee and the Large exposures credit committee as well as two subcommittees of the RCC committee, the FRBH Credit risk management committee and the Model risk and validation 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 Banking Group Credit Risk Management function ("GCRM")

The GCRM function in ERM provides independent oversight of the credit risk management practices in the deployed risk management functions in the businesses. It is the owner of the CRMF and related policies and monitors the implementation of credit risk related frameworks. In addition, its responsibilities include:

- monitoring of the credit components of the risk appetite framework;
- monitoring and reporting of the credit risk profile;
- 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;
- supervision of the credit impairment process; and
- 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 MPM 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; and
- maintaining the credit governance structure.

Performance Measurement function/BSM unit

The Performance Measurement function and BSM unit within Corporate Centre is responsible for management of the balance sheet with respect to credit risk and fulfils both an operational and a central coordination role. Its mandates include:

- the formulation of the macroeconomic and credit outlook used for planning and stress testing purposes;
- the quantification and allocation of credit economic capital including the credit risk assessment employed for ICAAP and the assessment of appropriate capital buffers;
- active participation in the formulation of credit and origination strategies, in particular with a view to the implementation and management of the Banking Group's credit risk appetite across the business units;
- credit risk related stress testing, scenario analysis and portfolio modelling;
- 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 Banking 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 areas such as the assessment of capital requirements, pricing, impairment calculations and stress testing of the portfolio. All of these models are built on a number of client and facility rating models in line with Basel II AIRB requirements and the FRB Model building framework. The Banking Group was granted regulatory approval under Basel II for the approaches as shown in the table below.

Basel approach	FRB	Remaining FRBH subsidiaries
AIRB	√	
Standardised approach		√

Even though only FRB has regulatory approval to use the AIRB Approach, the same or similar models in FRB are applied for the internal assessment of credit risk in the remaining FRBH 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 Banking Group level credit risk assessment where the measures are combined with estimates of correlations between individual counterparties and industries 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 classified it 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 Banking 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.

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.*

A FirstRand ("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. These mappings are reviewed and updated on a regular basis.

In line with international best practice, the Banking 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 typically an input to economic and regulatory capital calculations.
- Point in time ("PIT") PD measures reflect default expectations in the current economic environment and thus tends to be more volatile than TTC. PIT PD's are typically 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 Banking 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 typically expressed as a percentage of exposure outstanding at the time of default.

In most portfolios, LGD is strongly dependent on:

- the type, quality, and level of subordination;
- the value of collateral held compared to the size of the overall exposure; and
- the 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 an LGD 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 businesses alongside other risk measures.

Specialised lending

Where the Banking 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 obligation is the income generated by the assets (i.e. specialised lending); and
- the PD and LGD cannot be determined.

Specialised lending relates mainly to project and commodity finance. In terms of the slotting approach, the exposure is rated after assessing the risks and mitigants applied to reduce/eliminate the risk and mapped to one of four supervisory categories. Less than 1% of the book is subject to the slotting approach.

Rating process

A consistent rating process is employed across the various businesses, 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, PD's 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.

Rating process of credit portfolios

Portfolio and type of exposures	Description of rating system
Large corporate portfolios (Wholesale: FNB 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 the requirements of Basel II. **Rating process:** • The rating assignment to corporate credit counterparties is based on a detailed individual assessment of the counterparty's creditworthiness. • This assessment is performed through a qualitative analysis of the business and financial risks of the counterparty and is supplemented by internally developed statistical rating models. • The rating models were developed using internal and external data covering more than 10 years. The qualitative analysis is based on the methodology followed by international rating agencies. • The rating assessment is reviewed by the FRBH 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 the requirements of Basel II. **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 FRBH 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.

Portfolio and type of exposures	Description of rating system
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 the requirements of Basel II. **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 FRBH 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.
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.	The default definitions applied in the rating systems are aligned to the requirements of Basel II. **SME retail rating process:** • The 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 was 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 ("CCF") are estimated on the basis of the Banking Group's internal historical experience and benchmarked against international studies.
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. **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. **Other retail exposures (Retail portfolios in FNB Personal Loans, Smart Products and WesBank retail auto finance and personal loans)**	**Rating process and approach:** • These 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 PD's 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 the 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 for these product types. EAD estimates are based on actual historic EAD, segmented appropriately (e.g. straight vs. budget in the case of credit cards).

Model validation

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

The independent validation of the rating systems is carried out by GCRM in ERM. It is responsible for reviewing all rating systems and a comprehensive revalidation of all material rating systems on an annual basis. An actuarial auditing team in Group Internal Audit ("GIA") carries out additional reviews of the rating systems as well as sample revalidations. The results of these analyses are reported to the Model risk and validation committee. As part of this process, extensive documentation covering all steps of the model development lifecycle from inception through to validation is maintained. This includes:

- developmental evidence, detailing processes followed and data used to set parameters for the model. GCRM is the custodian of these documents, which are updated on at least an annual basis 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 a core component of the Banking Group's business, it aims to optimise the amount of credit risk it takes to achieve its return objectives. The mitigation of credit risk is an important component of this process, which begins with the structuring and approval of facilities for only those clients and within those parameters that fall within the risk appetite.

In addition, various instruments are used to reduce exposure in 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 typically supported by the property financed and the cash flows generated by it;
- 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 FICC business is mitigated through the use of netting agreements and financial collateral.

The Banking Group employs strict policies governing the valuation and management of collateral across all business areas. Collateral is managed internally so as 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 Banking Group level through the GCRM function of 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 a Banking 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 the respective 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 which are actively monitored and updated on at least a monthly basis;
- restructuring of facilities where appropriate;
- use of credit derivatives;
- an efficient workout; and
- the 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 Credit Cards; and
- revaluation of properties before approval of additional facilities.

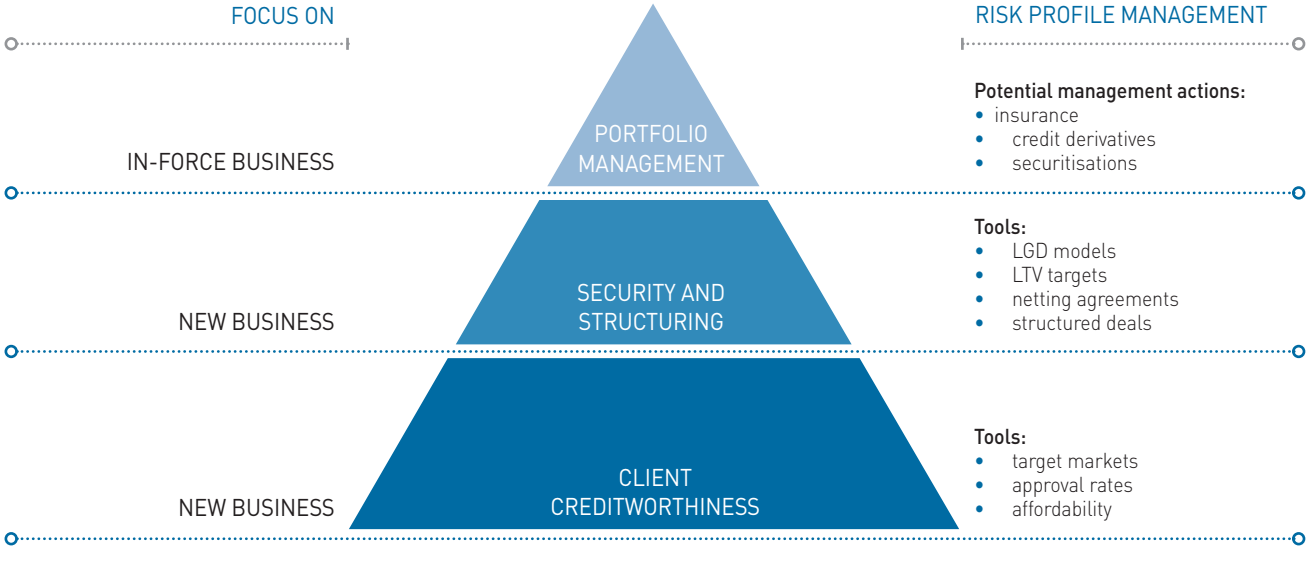
Commercial and other portfolios of clients that fall between the corporate and retail segments are treated in a hybrid manner, dependent on the number of exposures and the size of individual transactions.

Reports on the overall quality of the portfolio are monitored closely at a business unit as well as at a Banking Group level. As indicated previously, the Performance Measurement function within Corporate Centre is actively involved in the determination of credit strategy and required changes thereto, so as to ensure that the credit portfolio is managed within the constraints of the Banking Group's credit risk appetite.

Use of credit risk tools and measures

Credit risk measures are used in a large number of business processes, including pricing, the setting of impairments, in determining capitalisation levels and in determining business strategy, risk appetite and the choice of appropriate return targets. Credit risk tools and measures are used extensively in the determination of the 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 Banking 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 FRBH 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.	PIT PD, long run LGD and roll rates are used in the derivation of specific, portfolio and IBNR provisions.
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 Banking 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 strategy 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 measured consistently on the basis of capital consumption and economic value added in the form of economic profit.

Discussion of credit risk portfolio

Credit strategy is managed as part of the broader balance sheet management process and is aligned with the Banking Group's view of trends in the wider economy. The Banking Group's 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 and 53). These portfolios were also positively impacted by interest rates continuing to trend downwards, positive income growth and increasing wages. However, job losses also continued, albeit at a slower rate.

The commercial market remains fragile. Improvement is expected to follow the consumer spending growth recovery.

Retail credit portfolios

Interest rate reductions, which started in 2008 and continued into 2010, resulted in a reduction in NPL inflows (see chart on page 4) and consequently in the credit impairment charges of most retail portfolios. The level of NPLs remained high, however, due to the debt counselling process. As a result of the improvement in credit quality, the Banking Group's retail portfolios now fall within the desired credit appetite ranges.

Despite the reduction in debt servicing costs as a result of lower interest rates, the subsequent improvement in affordability and underlying asset recovery (e.g. house price growth), credit appetite has not increased considerably. Consumers remain leveraged and vulnerable to shifts in the external economic environment and concerns remain with regards to unemployment prospects and the timing and strength of the recovery.

Wholesale portfolios

During the year under review the corporate portfolios were resilient, however, lending appears likely to remain tepid as corporates maintain high levels of cash and investment spending remains subdued. Commercial market NPLs and impairments have increased since June 2009 due to the lagged impact of the economic cycle.

Credit assets

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

Credit assets by type and segment

R million	2010	2009
Cash and short term funds	**22 427**	21 678
Money at call and short notice	**2 009**	1 414
Balances with central banks and guaranteed by central banks	**11 513**	12 559
Balances with other banks	**8 905**	7 705
Gross advances	**441 723**	429 777
FNB	**199 113**	204 370
FNB Retail	**168 660**	166 094
FNB Corporate	**1 863**	11 414
FNB Commercial	**28 590**	26 862
WesBank	**92 756**	92 328
RMB	**128 252**	112 895
FNB Africa	**19 646**	17 519
Other	**1 956**	2 665
Derivatives	**39 752**	60 213
Debt investment securities (excluding non recourse investments)	**88 294**	79 127
Accounts receivable	**4 580**	4 046
Loans due by holding company and fellow subsidiaries	**1 628**	333
Loans to Insurance Group	**1 302**	1 868
Reinsurance assets	**524**	287
Credit risk not recognised on the statement of financial position	**84 000**	84 105
Guarantees	**24 011**	19 011
Acceptances	**299**	279
Letters of credit	**5 541**	5 576
Irrevocable commitments	**52 809**	57 786
Underwriting exposures	**–**	2
Credit derivatives	**1 340**	1 451
Total	**684 230**	681 434

Credit quality

Advances are considered past due where specific payment dates were 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 table provides an age analysis of exposures classified as past due as at 30 June 2010.

Age analysis of advances

R million	2010						
	Neither past nor impaired	Renego-tiated but current	Past due but not impaired			Impaired	Total
			1 – 30 days	31 – 60 days	> 60 days		
Age analysis of advances							
FNB Retail	**144 068**	**783**	**5 773**	**2 701**	**1 717**	**13 618**	**168 660**
FNB Corporate	**1 862**	**–**	**–**	**–**	**–**	**1**	**1 863**
FNB Commercial	**26 347**	**–**	**261**	**34**	**21**	**1 927**	**28 590**
FNB	**172 277**	**783**	**6 034**	**2 735**	**1 738**	**15 546**	**199 113**
WesBank	**85 316**	**–**	**1 577**	**647**	**118**	**5 098**	**92 756**
FNB Africa	**17 270**	**–**	**1 149**	**459**	**360**	**408**	**19 646**
RMB	**127 357**	**1**	**31**	**17**	**6**	**840**	**128 252**
Other	**1 931**	**–**	**–**	**–**	**–**	**25**	**1 956**
Total	**404 151**	**784**	**8 791**	**3 858**	**2 222**	**21 917**	**441 723**

R million	2009						
	Neither past nor impaired	Renego-tiated but current	Past due but not impaired			Impaired	Total
			1 – 30 days	31 – 60 days	> 60 days		
Age analysis of advances							
FNB Retail	135 348	2 715	6 482	3 170	2 316	16 063	166 094
FNB Corporate	11 327	–	2	1	–	84	11 414
FNB Commercial	24 979	–	125	60	75	1 623	26 862
FNB	171 654	2 715	6 609	3 231	2 391	17 770	204 370
WesBank	84 477	–	2 212	944	95	4 600	92 328
FNB Africa	15 691	–	947	191	260	430	17 519
RMB	111 272	267	62	20	97	1 177	112 895
Other	2 320	64	16	10	6	249	2 665
Total	385 414	3 046	9 846	4 396	2 849	24 226	429 777

The classification of advances past due follows the standards set out in applicable accounting policies. A distinction is drawn between accounts past due for technical reasons (e.g. insufficient payments due to debit orders not having been updated for changes in interest rates) and normal arrears (i.e. accounts in arrears by one to three full repayments). The split provided in the tables above includes both types of arrear accounts. Total exposure to technical arrears included in this analysis was R4.5 billion (2009: R5.3 billion) and was primarily driven by retail exposures.

Renegotiated advances are advances where, due to the deterioration in a counterparty's financial condition, FRB 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. As part of the risk management and workout approach, the Banking 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. Reclassification of NPLs into the renegotiated advances category is not allowed.

The renegotiated advances disclosed above include all loans renegotiated to date and for which the renegotiated terms have not yet expired. All of these advances are within 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.

The 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. The following table presents an analysis of the credit quality of performing advances (i.e. those classified as neither past due nor impaired). Please refer to page 29 for the mapping of FR grades to rating agency scales.

Credit quality of performing advances

	2010							
	Total neither past due nor impaired	**FNB**						
R million		**Retail**	**Corporate**	**Commercial**	**WesBank**	**RMB**	**FNB Africa**	**Other**
FR 1 – 25	**76 467**	**4 864**	**173**	**2 347**	**801**	**67 532**	**59**	**691**
FR 26 – 91	**305 850**	**129 646**	**1 675**	**23 145**	**74 856**	**58 578**	**16 722**	**1 228**
Above FR 92	**21 834**	**9 558**	**14**	**855**	**9 659**	**1 247**	**489**	**12**
Total	**404 151**	**144 068**	**1 862**	**26 347**	**85 316**	**127 357**	**17 270**	**1 931**

	2009							
	Total neither past due nor impaired	FNB						
R million		Retail	Corporate	Commercial	WesBank	RMB	FNB Africa	Other
FR 1 – 25	123 301	49 532	4 730	2 354	1 141	64 076	2	1 466
FR 26 – 91	243 663	81 107	6 597	22 278	72 715	45 296	15 234	436
Above FR 92	18 450	4 709	–	347	10 621	1 900	455	418
Total	385 414	135 348	11 327	24 979	84 477	111 272	15 691	2 320

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. Rating system recalibrations were implemented for the majority of the retail portfolios during the first half of the financial year. The recalibrations incorporated the higher defaults experienced in recent times. This resulted in a once off deterioration in counterparty risk ratings, which explains the migration observed above. Since December 2009, counterparty risk ratings have, however, improved significantly for the majority of the retail portfolios, due to the positive impact from lower interest rates on the existing book and the high quality of new business originated.

The following table provides an overview of the credit quality of other financial assets that are neither past due nor impaired.

Credit quality of other financial assets

	2010						
R million	**Investment securities***	**Derivatives**	**Cash and short term funds**	**Amounts due by fellow subsidiary companies**	**Loans to Insurance Group**	**Re-insurance assets**	**Total**
Credit quality of financial assets (excluding advances) neither past due nor impaired							
AAA to BBB	**40 973**	**18 847**	**19 685**	**1 628**	**1 302**	**524**	**82 959**
BB, B	**46 023**	**20 130**	**2 496**	**–**	**–**	**–**	**68 649**
CCC	**–**	**108**	**25**	**–**	**–**	**–**	**133**
Unrated	**1 298**	**667**	**221**	**–**	**–**	**–**	**2 186**
Total	**88 294**	**39 752**	**22 427**	**1 628**	**1 302**	**524**	**153 927**

	2009						
R million	Investment securities*	Derivatives	Cash and short term funds	Amounts due by fellow subsidiary companies	Loans to Insurance Group	Re-insurance assets**	Total
Credit quality of financial assets (excluding advances) neither past due nor impaired							
AAA to BBB	26 582	19 162	18 797	333	1 868	287	67 029
BB, B	52 437	40 594	2 773	–	–	–	95 804
CCC	102	120	–	–	–	–	222
Unrated	6	337	108	–	–	–	451
Total	79 127	60 213	21 678	333	1 868	287	163 506

* *Excludes non recourse investments.*

Impairment of financial assets and non performing loans

Refer to policy for impairment of financial assets in the Accounting Policy section on page 240 and to Note 12 Impairment of advances on page 294 of the FirstRand annual report for the analysis of movement in impairment of advances and NPLs.

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, the creation of impairments for these differs.

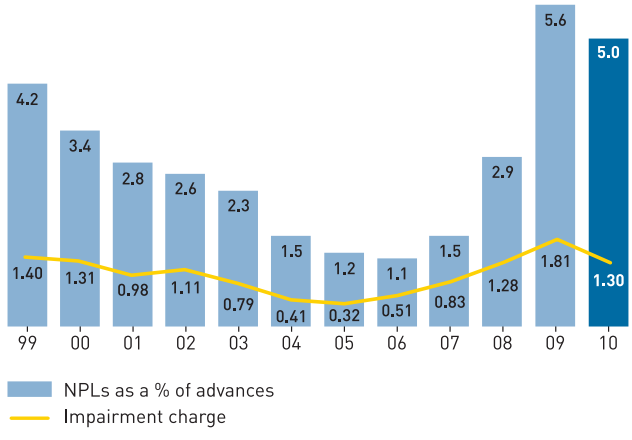
For amortised cost advances, impairments are recognised through the creation of an impairment reserve and an impairment charge in the income statement. For fair value advances, the credit valuation adjustment is charged to the income statement through trading income and recognised as a change to the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

The graph below shows the history of the credit losses reflected by the impairment charge and non performing loans percentages.

NPLs and impairment history



Impairment charges are reflected before insurance proceeds where applicable.

Fair value sensitivity of wholesale advances due to credit risk

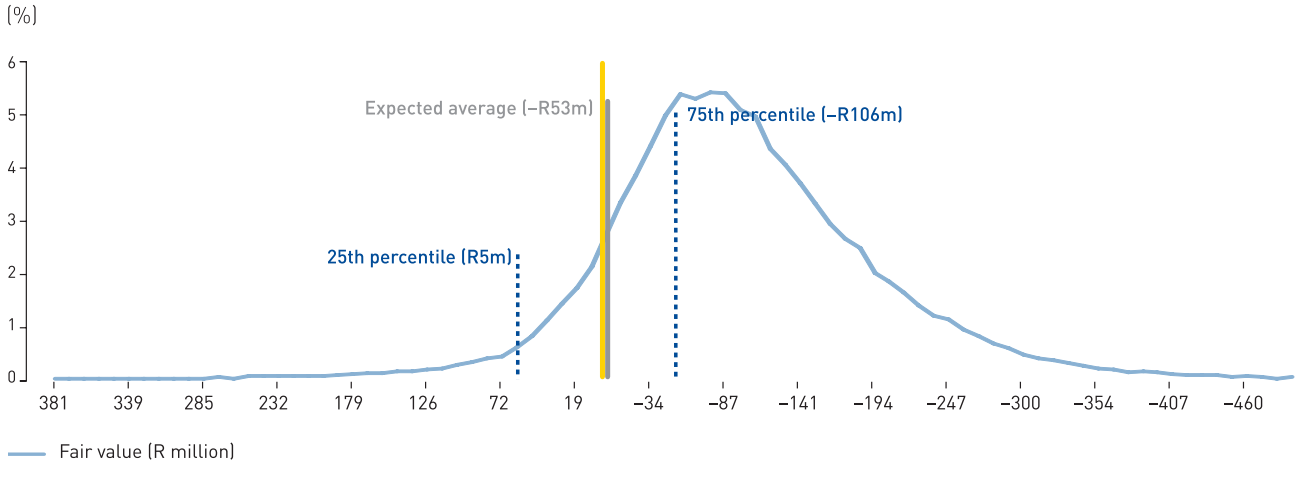
RMB recognises a significant portion of wholesale advances at fair value through profit or loss. The fair value adjustments made to these advances directly impacts the income statement and the value of the advance. For risk management purposes a term structure of default probabilities and migration matrices are used to estimate the fair value impact of changes in credit risk. The matrix contains probabilities of downgrading or upgrading to another rating category.

The main benefits of using the migration matrix to estimate the fair value impact of credit risk are:

- downgrades are more realistic because better rating grades are less likely to be downgraded compared to more risky rating grades;
- migration matrices take into account the higher volatility of more risky rating grades;
- rating migration can be positive or negative;
- rating migration is not restricted to one notch only and in extreme cases includes default risk; and
- migration matrices can be based on different economic conditions.

The graph below sets out the fair value impact based on actual observed rating migrations from Standard & Poor's over the long term. Based on this scenario the average fair value impact is a loss of approximately R53 million while the fair value impact at the 75th percentile (i.e. a 25% probability of exceeding this value) is a loss of approximately R106 million.

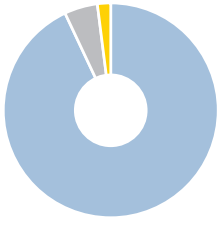
Distribution: fair value impact – long-term scenario (audited)



Geographic and industry concentration risk

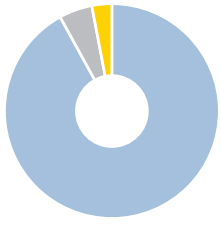
Geographically, most of the Banking Group's exposure originates in South Africa. The following charts provide the geographical and industry split of gross advances after deduction of interest in suspense.

Geographic split by exposure 2010



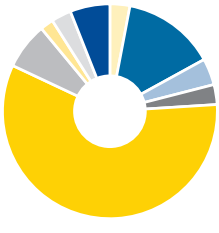
- South Africa / 93%
- Other Africa / 5%
- Rest of the world / 2%

Geographic split by exposure 2009



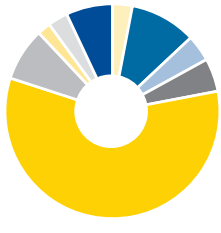
- South Africa / 92%
- Other Africa / 5%
- Rest of the world / 3%

Industry split by exposure 2010



- Agriculture / 3%
- Bank and financial services / 14%
- Building and property development / 4%
- Government, Land Bank and public authorities / 3%
- Individuals / 58%
- Manufacturing and commerce / 7%
- Mining / 2%
- Transport and communication / 3%
- Other services / 6%

Industry split by exposure 2009



- Agriculture / 3%
- Bank and financial services / 10%
- Building and property development / 4%
- Government, Land Bank and public authorities / 5%
- Individuals / 58%
- Manufacturing and commerce / 8%
- Mining / 2%
- Transport and communication / 3%
- Other services / 7%

The Banking Group seeks to establish a balanced portfolio profile and monitors concentrations in the credit portfolio closely.

The following table provides a breakdown of credit exposure across geographies as at 30 June.

Concentration of significant credit exposure

	2010								
R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	408 426	22 741	7 186	68	660	819	391	1 432	441 723
Derivatives	26 352	257	6 128	2	5 070	1 696	11	236	39 752
Debt securities	72 063	7 742	471	–	6 004	999	–	1 015	88 294
Guarantees, acceptances and letters of credit*	26 606	2 608	–	–	282	–	5	350	29 851
Irrevocable commitments*	48 339	3 195	78	–	1 149	38	–	10	52 809

The average advances for the year under review **R417 413 million**

	2009								
R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	393 763	20 965	10 381	381	2 205	320	445	1 317	429 777
Derivatives	37 203	278	12 591	2	8 184	1 874	4	77	60 213
Debt securities	64 081	8 731	357	–	5 005	789	–	164	79 127
Guarantees, acceptances and letters of credit*	22 698	2 153	–	–	–	–	–	15	24 866
Irrevocable commitments*	54 139	3 046	255	13	80	119	8	126	57 786

* *Significant exposures not recognised on the statement of financial position.*

Basel II disclosure

Credit rating systems and processes used for Basel II

The Banking Group uses the AIRB Approach for the exposures of FRB and the Standardised Approach for all other legal entities in the Banking Group for regulatory capital purposes. Due to the relatively smaller size of the subsidiaries and the scarcity of relevant data, the Banking 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.

Exposure by type, segment and Basel II approaches

R million	2010	AIRB	Standardised Approach subsidiaries	
		FirstRand Bank	Regulated bank entities within FNB Africa	London branch and other subsidiaries
Cash and short term funds	**22 427**	18 832	1 820	1 775
– Money at call and short notice	**2 009**	1 230	555	224
– Balances with central banks and guaranteed by central banks	**11 513**	10 605	898	10
– Balances with other banks	**8 905**	6 997	367	1 541
Gross advances	**441 723**	404 339	19 646	17 738
FNB	**199 113**	194 298	–	4 815
– FNB Retail	**168 660**	163 845	–	4 815
– FNB Corporate	**1 863**	1 863	–	–
– FNB Commercial	**28 590**	28 590	–	–
WesBank	**92 756**	85 937	–	6 819
RMB	**128 252**	122 382	–	5 870
FNB Africa	**19 646**	–	19 646	–
Other	**1 956**	1 722	–	234
Derivatives	**39 752**	38 843	50	859
Debt investment securities	**88 294**	73 944	8 328	6 022
Accounts receivable	**4 580**	2 808	235	1 537
Loans due by holding company and fellow subsidiaries	**1 628**	14 396	2 508	(15 276)
Loans to Insurance Group	**1 302**	1 100	–	202
Reinsurance assets	**524**	–	50	474
Credit risk not recognised on the statement of financial position	**84 000**	76 120	5 380	2 500
Guarantees	**24 011**	21 986	2 006	19
Acceptances	**299**	299	–	–
Letters of credit	**5 541**	5 362	179	–
Irrevocable commitments	**52 809**	47 503	3 195	2 111
Underwriting exposures	**–**	–	–	–
Credit derivatives	**1 340**	970	–	370
Total	**684 230**	630 382	38 017	15 831

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 Banking 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%	555
10%	–
20%	3 170
35%	7 360
50%	1 101
75%	2 161
100%	23 472
Specific impairments	198
Total	**38 017**

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 scale used from 1-25 per the Basel II accord is for performing assets, with 1 being the lowest risk and NPL representing the defaulted exposures.

The graphs provide a summary of the EAD distribution by prescribed counterparty risk bands. The EAD weighted downturn LGD and the EAD weighted PD for the performing and total book are also shown. Comparative information for the prior year is provided in the charts.

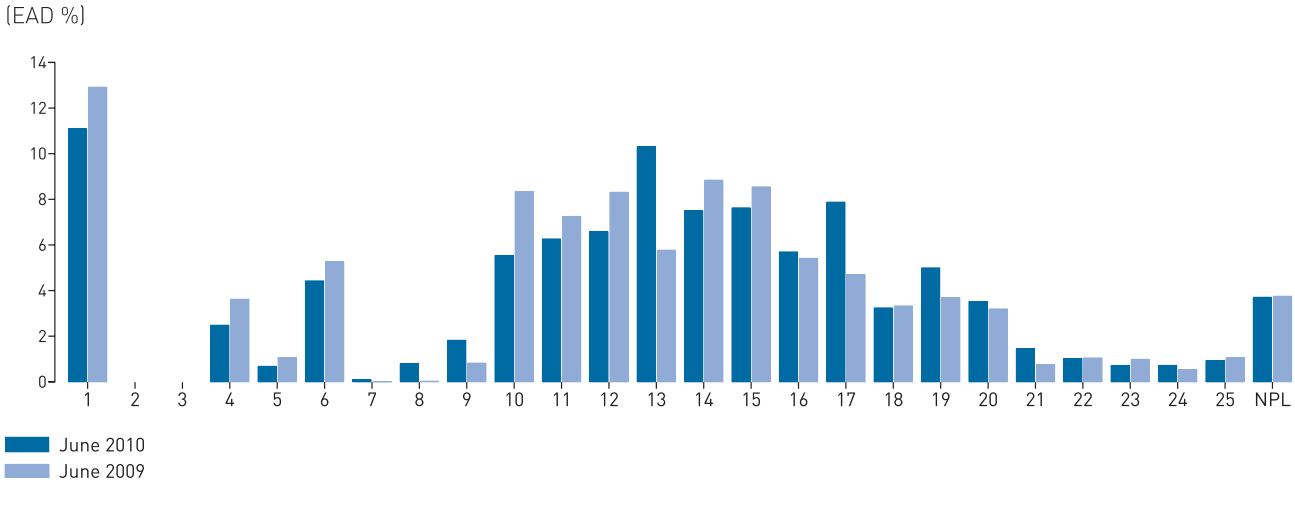
Year-on-year trends will be impacted by the risk migration in the existing book (reflecting changes in the economic environment), quality of new business originated and any model recalibrations implemented during the course of the year.

For the majority of the retail portfolios there was significant positive risk migration since December 2009. This was, however, negated by model recalibrations implemented during the financial year, incorporating relatively high defaults experienced in recent times.

Over the year under review, the performance of the credit portfolio was in line with that of the industry.

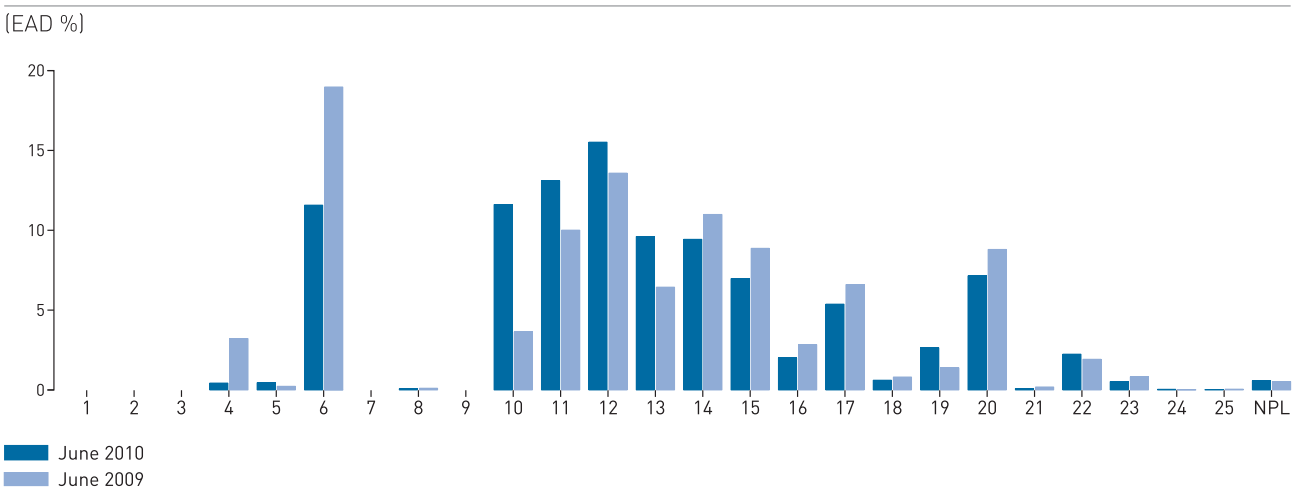
The risk profile reflects the revised credit origination strategy that selectively targets areas providing an appropriate risk/return profile in the current economic environment.

Risk profile for FirstRand Bank: EAD% distribution per Basel risk buckets



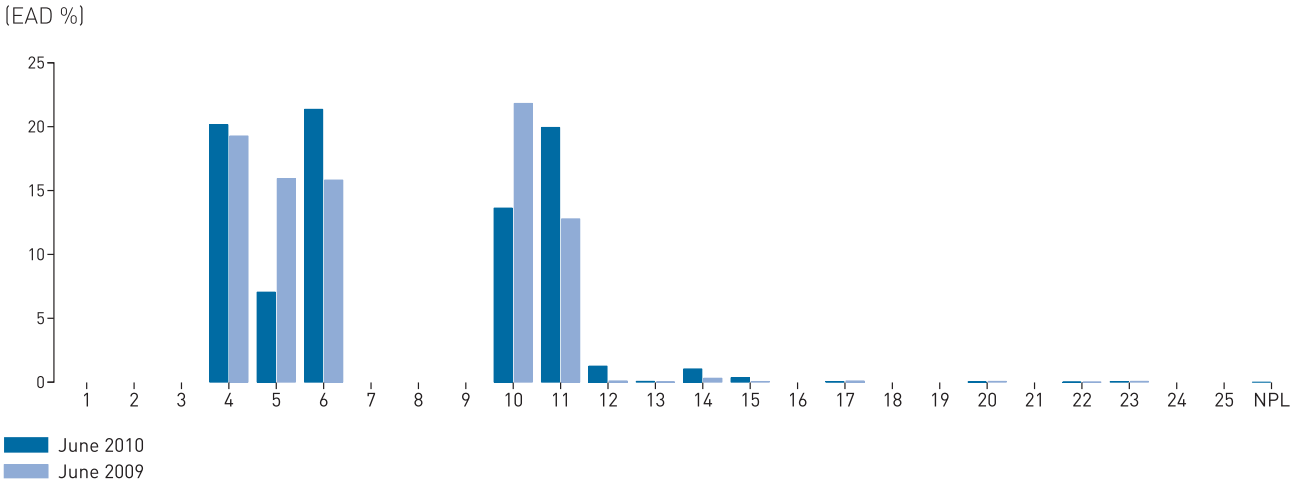
EAD weighted performing PD%	2.66%	EAD weighted total book PD%	6.31%
EAD weighted performing LGD%	28.66%	EAD weighted total book LGD%	28.83%
Performing book EL/EAD	0.76%	Total book EL/EAD	1.82%

Risk profile for Corporate exposures: EAD% distribution per Basel risk buckets



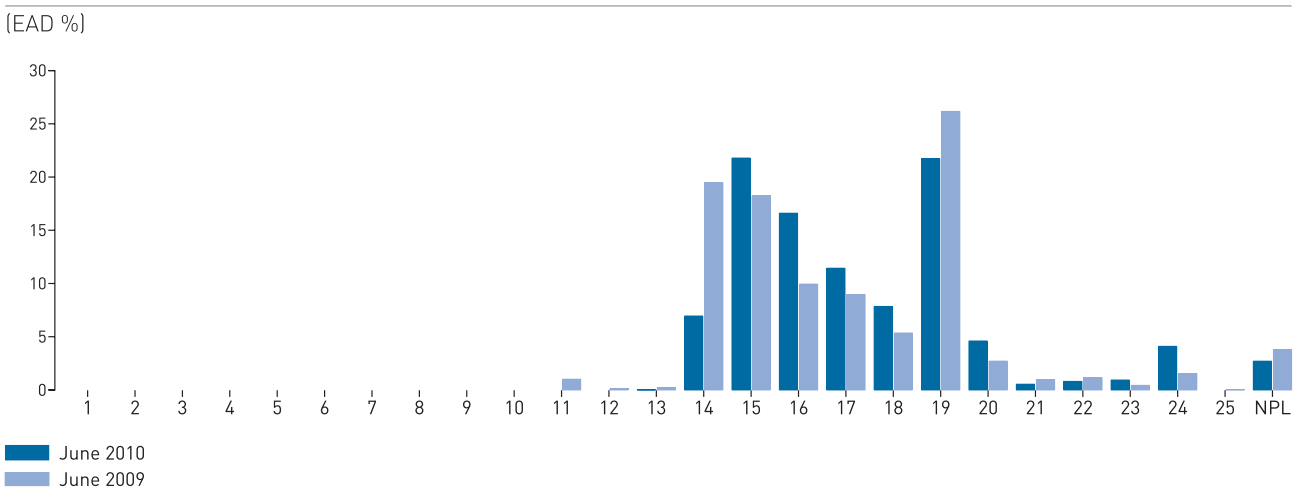
EAD weighted performing PD%	1.64%	EAD weighted total book PD%	2.52%
EAD weighted performing LGD%	37.35%	EAD weighted total book LGD%	37.37%
Performing book EL/EAD	0.61%	Total book EL/EAD	0.94%

Risk profile for Banks exposures: EAD% distribution per Basel risk buckets



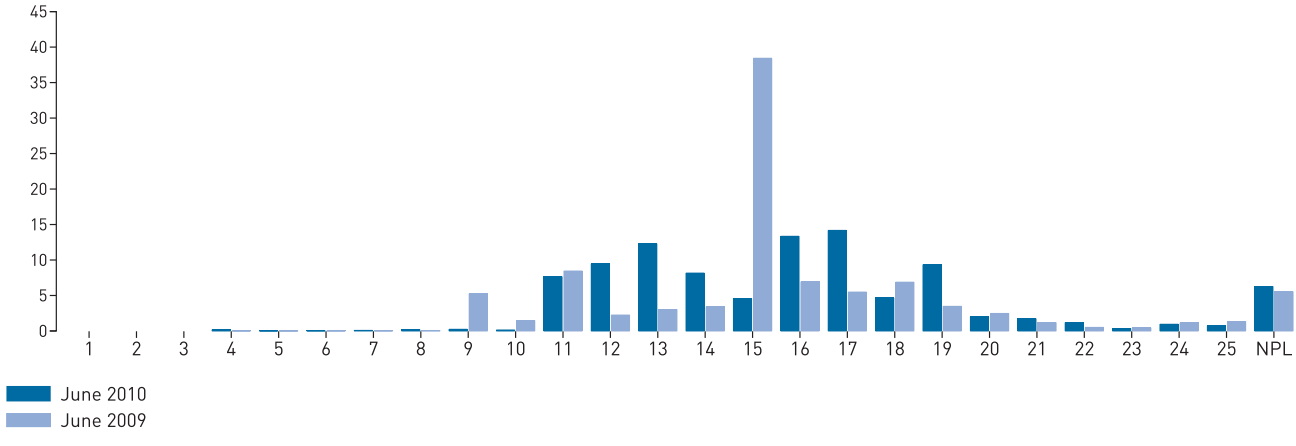
EAD weighted performing PD%	0.14%	EAD weighted total book PD%	0.14%
EAD weighted performing LGD%	32.20%	EAD weighted total book LGD%	32.20%
Performing book EL/EAD	0.05%	Total book EL/EAD	0.05%

Risk profile for SME coporate exposures: EAD% distribution per Basel risk buckets



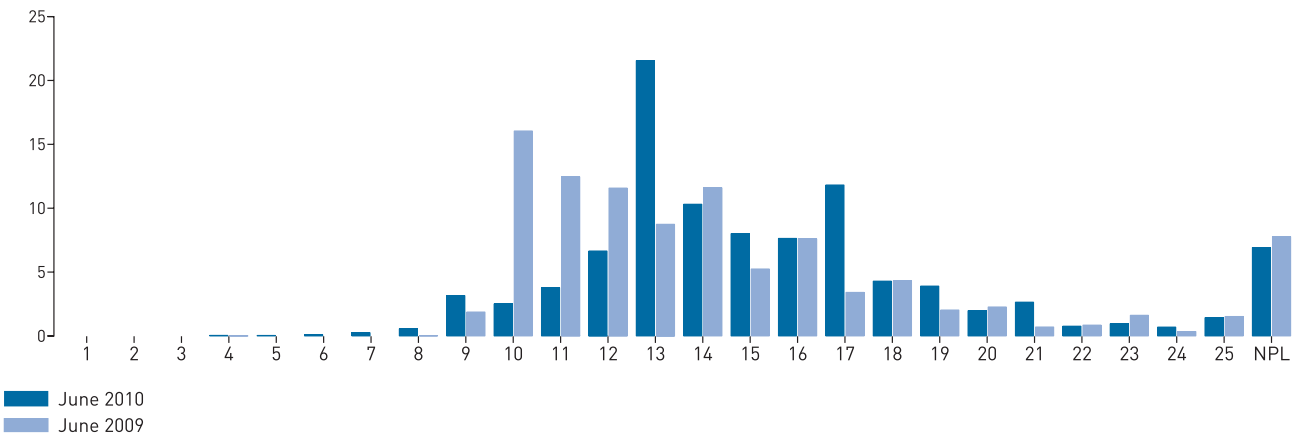
EAD weighted performing PD%	4.63%	EAD weighted total book PD%	5.58%
EAD weighted performing LGD%	34.69%	EAD weighted total book LGD%	34.75%
Performing book EL/EAD	1.61%	Total book EL/EAD	1.94%

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



EAD weighted performing PD%	2.69%	EAD weighted total book PD%	11.06%
EAD weighted performing LGD%	40.44%	EAD weighted total book LGD%	41.17%
Performing book EL/EAD	1.09%	Total book EL/EAD	4.55%

Risk profile for Retail mortgage exposures: EAD% distribution per Basel risk buckets

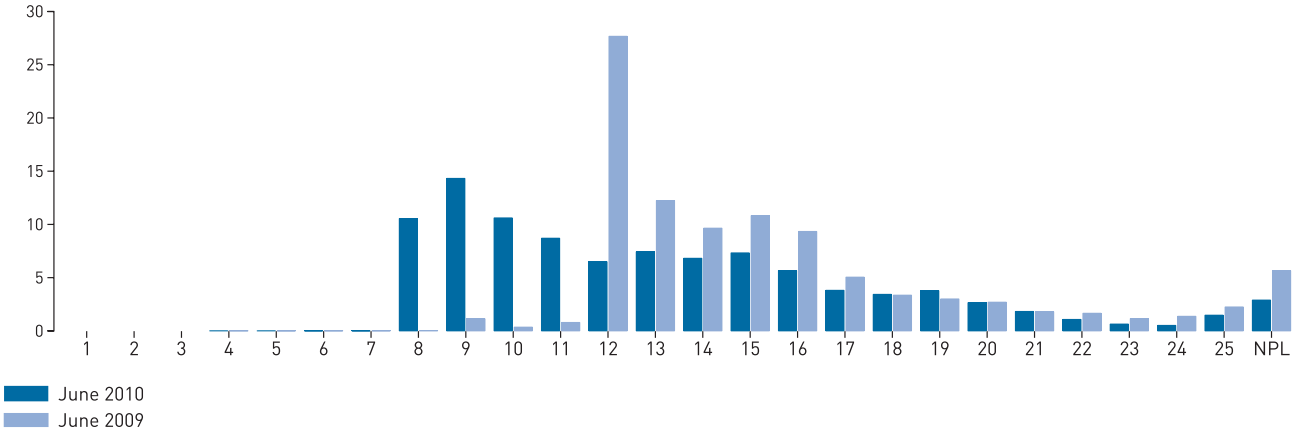


EAD weighted performing PD%	3.47%	EAD weighted total book PD%	13.37%
EAD weighted performing LGD%	13.18%	EAD weighted total book LGD%	13.88%
Performing book EL/EAD	0.46%	Total book EL/EAD	1.86%

The risk profile in the above chart appears to be deteriorating. This is due to rating system recalibrations implemented in September 2009, resulting in an increase in PDs due to the inclusion of the relatively high defaults experienced in recent times.

Subsequent to September 2009, the risk profile improved and PDs decreased consistently, due to positive risk migration, with the lower interest rate environment positively impacting the existing portfolio. In addition, stricter lending criteria resulted in higher quality new business. Monthly trend analyses from July 2009 to June 2010 show a once off increase in PDs in September 2009, due to the recalibration, thereafter a consistent decrease due to the positive migration.

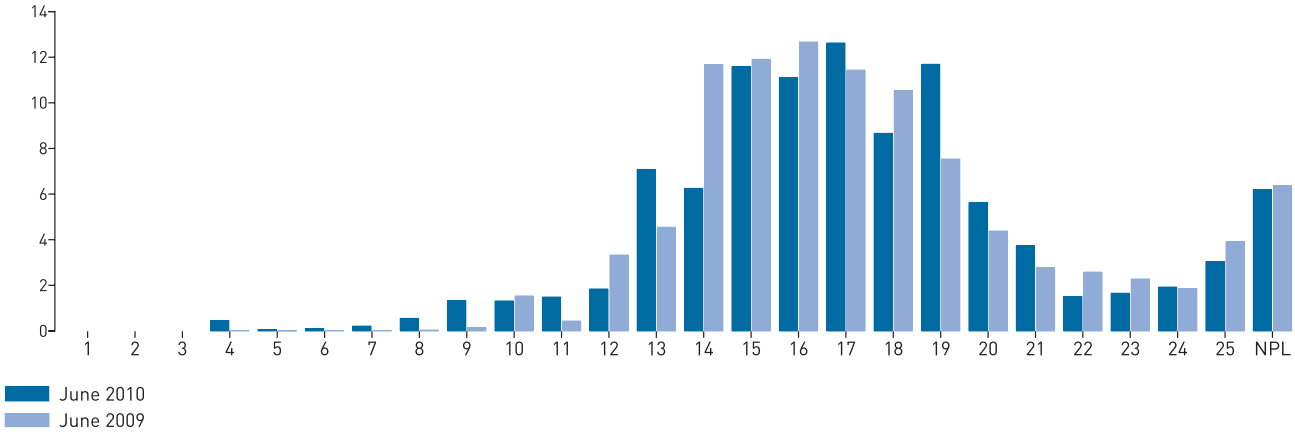
Risk profile for Retail revolving credit exposures: EAD% distribution per Basel risk buckets



EAD weighted performing PD%	2.72%	EAD weighted total book PD%	5.53%
EAD weighted performing LGD%	65.42%	EAD weighted total book LGD%	65.67%
Performing book EL/EAD	1.78%	Total book EL/EAD	3.63%

Risk profile for Retail other exposures: EAD% distribution per Basel risk buckets

(EAD %)



EAD weighted performing PD%	6.85%	EAD weighted total book PD%	13.07%
EAD weighted performing LGD%	30.43%	EAD weighted total book LGD%	31.12%
Performing book EL/EAD	2.09%	Total book EL/EAD	4.07%

A significant proportion of the retail other asset class is made up of vehicle and asset finance which is secured by the underlying vehicle. As such, the LGD is lower than what would be expected in unsecured other retail portfolios.

Maturity breakdown

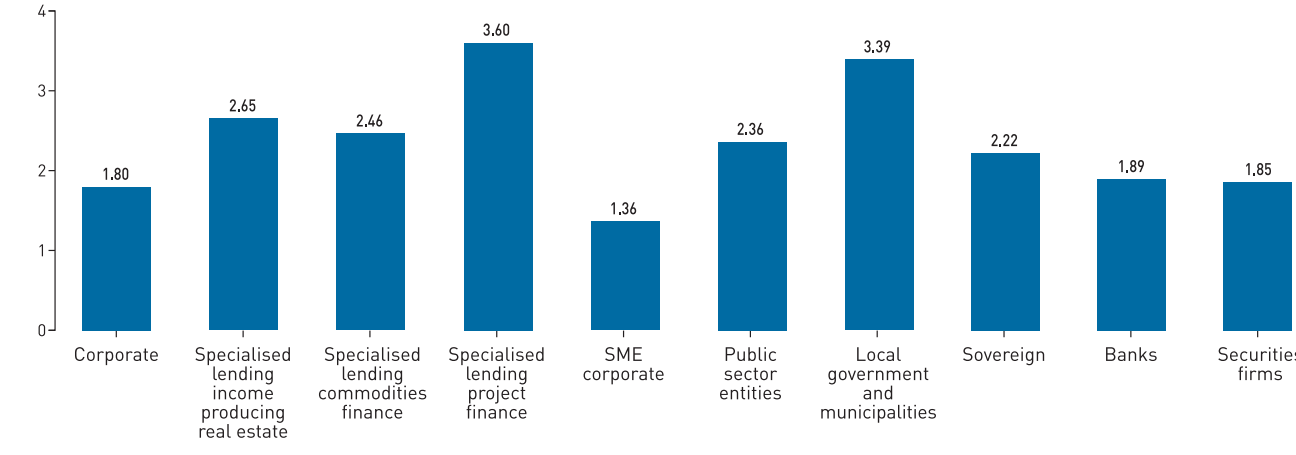
Maturity is defined as the average term to contractual cash flows weighted by the size of each of the cash flows.

Maturity parameters, calculated for each account or exposure, are used as an input in the AIRB regulatory capital calculation for the 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 equal the larger the regulatory capital requirement.

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

Maturity breakdown per wholesale AIRB asset class as at 30 June 2010

(Maturity in years)



Actual vs expected loss analysis

To provide a meaningful assessment of the effectiveness of the 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.

The 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 year consist of both the level of specific impairments at the start of the year 1 July 2009 and the net specific impairment charge recorded through the income statement for the year ended 30 June 2010 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 provisions raised for exposures which defaulted during the year, but which did not exist at 30 June 2009. 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 FRB. With PD models used for regulatory capital purposes being calibrated to long run default experience, it would be expected that actual losses are larger than regulatory expected losses during the top of the credit cycle and lower than expected losses during the bottom of the credit cycle, as is evident from the table below.

Actual vs expected loss per portfolio segment

	2010	
R million	**Expected loss**	**Actual loss**
Corporate (corporate, banks and sovereigns)	**801**	**187**
SME (SME corporate and SME retail)	**1 066**	**977**
Residential mortgages	**3 163**	**4 057**
Qualifying revolving retail	**1 995**	**2 065**
Other retail	**987**	**1 710**
WesBank	**2 471**	**3 519**
Total	**10 483**	**12 515**

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

It should also be noted that the regulatory expected loss shown above is based on the regulatory capital models that were applied as at 30 June 2009. The models currently applied have since incorporated the subsequent increase in defaults and resulted in an increase in expected losses. A restatement of the above comparison using the capital models currently applied would result in a closer alignment of actual vs. expected losses.

This comparison is supplemented with more detailed analysis below, comparing actual and expected outcomes for each of the risk parameters (PD, LGD and EAD) over the year under review.

Expected values are based on regulatory capital models applied as at June 2009. For PDs, this is applied to the total performing book as at June 2009. For LGDs and EADs, it is applied to all facilities that defaulted over the next twelve months.

Actual values are based on actual outcomes over the year July 2009 to June 2010. 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 nominal expected exposure at default (for all accounts that defaulted during the July 2009 – June 2010 time period) to the actual nominal exposure at default for the same accounts. A ratio above 100% indicates an overestimation.

Risk parameters used to determine regulatory expected loss

	2010				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate	1.55	–	37.73	n/a	n/a
Banks	0.15	–	31.00	n/a	n/a
SME corporate	3.45	4.38	44.98	32.07	110.58
SME retail	3.28	4.43	37.80	15.27	107.85
Residential mortgages	2.68	4.48	18.66	12.66	103.92
Qualifying revolving retail	3.53	3.62	64.47	64.82	122.92
Other retail	7.85	8.13	31.84	35.75	104.94
Total	3.06	3.52	32.04	24.66	106.25

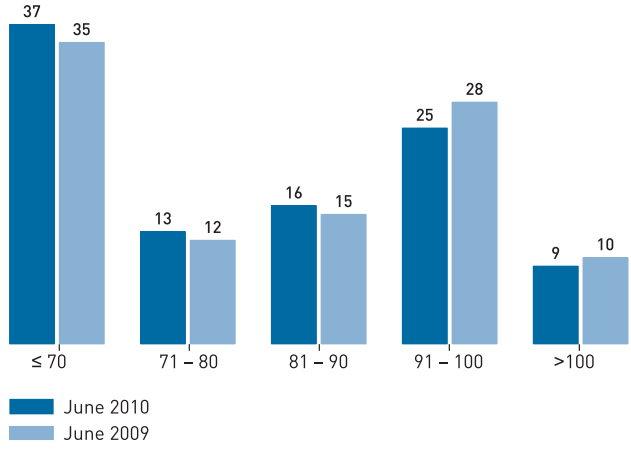
No corporate or bank defaults were experienced during the year under review; hence actual LGDs and EADs are not applicable. PDs used for regulatory capital purposes are based on long run experience and would be anticipated to under predict actual defaults at the top of the credit cycle and over estimate actual defaults at the bottom of the credit cycle. The analysis is based on the regulatory capital models that were applied at 30 June 2009. The models currently being applied have since incorporated the subsequent increase in defaults and resulted in an increase in expected losses. A restatement of the above comparison using the capital models currently applied would result in a closer alignment of actual and expected PDs.

Selected risk analyses

This section provides further information on selected risk analyses of the credit portfolios. The graphs below provide the balance to value distribution for the residential mortgages over time, as well as the aging of the residential mortgages portfolios.

Residential mortgages balance to value – original value

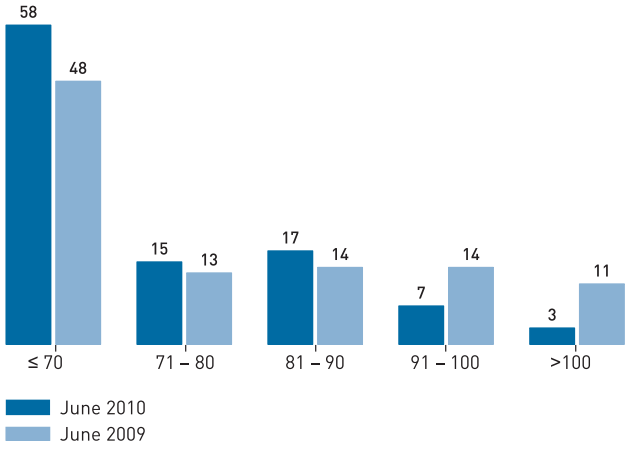
As % of total book (%)



The recent focus on the loan to value ratios for new business resulted in a slight improvement in the balance to original value distribution.

Residential mortgages balance to value – market value

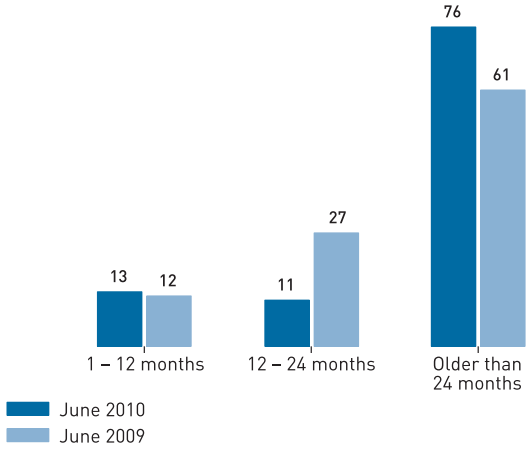
As % of total book (%)



The balance to market value shows a significant proportion of the book in the lower risk category of below 70%.

Residential mortgages age distribution

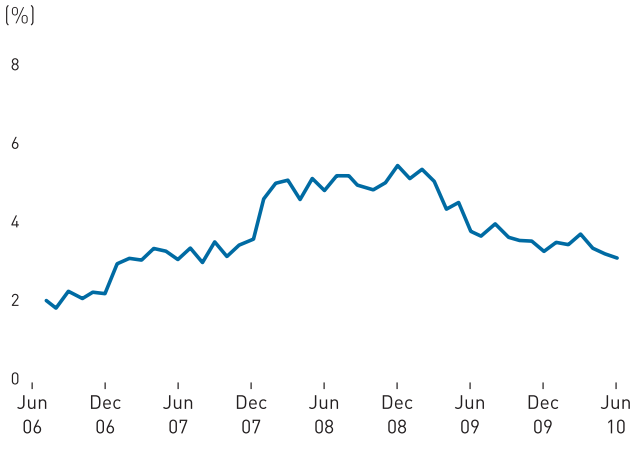
As % of total book (%)



The improvement in the residential mortgages age distribution is a direct result of the reduction in new loans written during the 2009/2010 year due to the credit and pricing policies followed and market demand.

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 (excluding NPLs).

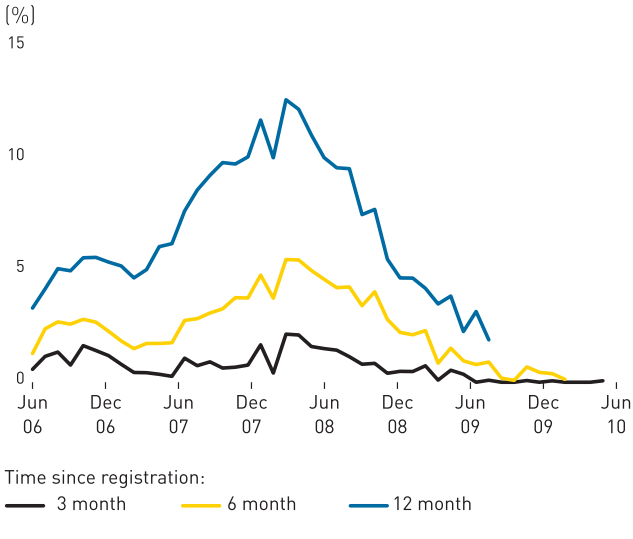
FNB HomeLoans arrears



FNB HomeLoans arrears levels have exhibited a decreasing trend in recent months. Similar trends are also observed in the WesBank and Credit card portfolios.

The following graphs provide vintage analyses for FNB HomeLoans and WesBank Retail respectively. Vintage graphs provide the default experience 3, 6 and 12 months after each cohort of business originated. It indicates the impact of origination strategies and the macro environment.

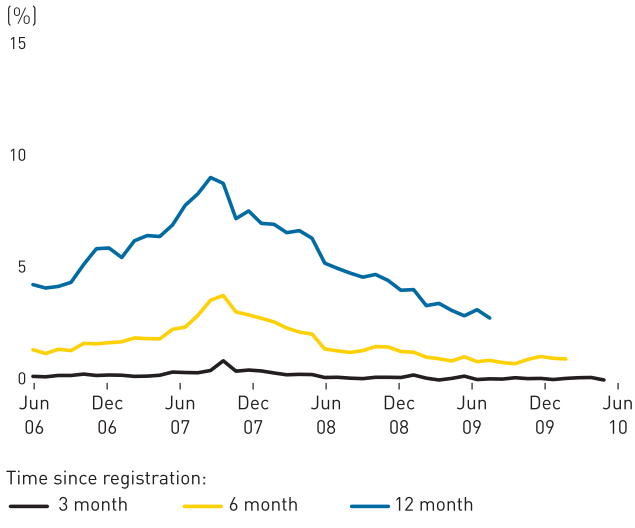
FNB HomeLoans vintage analysis



For FNB HomeLoans the 3, 6 and 12 month cumulative vintage analyses illustrate a marked improvement in the quality of business written since mid 2008, despite further deterioration in macroeconomic conditions. The more recent decreases in the default experience reflect a combination of credit origination strategies and the improvement in macroeconomic conditions.

The Banking Group's South African repossessed properties increased from R178 million (670 properties) at 30 June 2009 to R513 million (1 564 properties) at 30 June 2010.

WesBank retail vintage analysis



The WesBank retail 6 – and 12-month cumulative vintage analyses reflect the noticeable improvement in the quality of business written since mid 2007, and the more benign macro environment (i.e. lower rates).

In the asset finance business, repossession and stockholding levels continued to decline relative to the previous comparative period. The gradually reducing trend is likely to continue into the future as the economic environment improves.

10. SECURITISATIONS AND CONDUITS

Key developments and focus

In July 2009, Moody's downgraded all Aaa – and Aa1-rated notes of South African asset backed securities, residential mortgage asset backed securities, commercial mortgage asset backed securities and repackaged securities to Aa2. This was as a result of Moody's downgrading South Africa's local currency ceiling for bonds and deposits to Aa2 from Aaa. This action aligned the global scale structured finance ratings with the revised ceiling. The rating action affected notes in several of the Banking Group's transactions listed on page 56 of this section.

In November 2009 Nitro International Securitisation Company 1 Plc ("Nitro 1 Plc") redeemed the total outstanding notes, which initiated the dissolution of Nitro 1 Plc. A detailed description of the transaction is provided on page 56.

In September 2009 and May 2010 respectively, the Banking Group brought to a successful close Nitro Securitisation 1 (Pty) Limited ("Nitro 1") and Nitro Securitisation 2 ("Nitro 2"), the first and second securitisations of instalment sale agreements originated by WesBank. The objective of the Banking Group to obtain matched term funding at a time when its retail asset book was growing rapidly was achieved. The structures proved resilient despite the recent difficulties experienced in the retail consumer environment. A detailed description of the transaction is provided on page 56.

Introduction and objectives

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

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

From an accounting perspective, traditional securitisations are treated as sales transactions. At inception, the assets are sold to the special purpose vehicle at carrying value and no gains or losses are recognised. The securitisation entities are subsequently consolidated into FRBH for financial reporting purposes. 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 as well as the rating distribution of any exposures retained by the Banking Group. Whilst national scale ratings have been used in this table, global scale equivalent ratings are used for internal risk management purposes. All assets in these vehicles were originated by FRB and in each of these transactions FRB acted as originator, servicer and swap counterparty.

Securitisation transactions

R million	Asset type	Year initiated	Expected close	Rating agency	
Traditional securitisations					
Nitro 1	Retail: Auto loans	2006	2009	Moody's	
Nitro 2	Retail: Auto loans	2006	2010	Moody's	
Nitro 3	Retail: Auto loans	2007	2011	Moody's and Fitch	
Ikhaya 1	Retail mortgages	2007	2011	Fitch	
Ikhaya 2	Retail mortgages	2007	2012	Fitch	
Synthetic securitisations					
Procul	Retail: Auto loans	2002	2010	Fitch	
Fresco II	Corporate receivables	2007	2013	Fitch	
Total					

Rating distribution of retained securitisation exposure

R million	AAA (zaf)	AA (zaf)	A+ (zaf)	A (zaf)	
Traditional					
At 30 June 2010	**15**	**8**	**–**	**4**	
At 30 June 2009	56	1	–	–	
Synthetic					
At 30 June 2010	**17 991**	**180**	**53**	**–**	
At 30 June 2009	18 083	189	52	4	

It should be noted that while national scale ratings have been used in the information above, global scale equivalent ratings are used for internal risk management purposes.

	Assets securitised	Assets outstanding		Notes outstanding		Retained exposure	
		2010	2009	**2010**	2009	**2010**	2009
	16 784	**3 907**	6 206	**4 276**	7 261	**254**	351
	2 000	**–**	181	**–**	245	**–**	5
	5 000	**–**	847	**–**	1 216	**–**	24
	5 000	**736**	1 688	**1 129**	2 095	**39**	73
	1 900	**1 317**	1 439	**1 321**	1 592	**87**	93
	2 884	**1 854**	2 051	**1 826**	2 113	**128**	156
	22 000	**22 000**	22 000	**22 000**	22 000	**19 138**	19 182
	2 000	**2 000**	2 000	**2 000**	2 000	**875**	1 009
	20 000	**20 000**	20 000	**20 000**	20 000	**18 263**	18 173
	38 784	**25 907**	28 206	**26 276**	29 261	**19 392**	19 533

	BBB+ (zaf)	BBB (zaf)	BBB – (zaf)	BB+ (zaf)	BB (zaf)	Not rated	Total
	15	**–**	**–**	**–**	**–**	**210**	**252**
	–	–	–	–	–	294	351
	–	**–**	**–**	**–**	**–**	**914**	**19 138**
	–	–	–	29	2	823	19 182

Downgrades of South African structured finance ratings by Moody's

The Moody's downgrade affected notes in the following FRB transactions:

- Nitro 1 (Classes A14 and A15 downgraded to Aa2).
- Nitro 1 Plc (Classes A downgraded to Aa2).
- Nitro 2 (Classes A12, A13, A14 and A15 downgraded to Aa2).
- Nitro International Securitisation 2 Plc (Classes A downgraded to Aa2).
- Nitro Securitisation 3 (Pty) Limited (Classes A9, A10, A11, A12, A13, A14 and A15 downgraded to Aa2).

Notably, Moody's did point out that the action was not prompted by concerns on the performance of the underlying portfolios. The rating actions were as result of Moody's downgrade of South Africa's local currency ceiling for bonds and deposits to Aa2 from Aaa. This action aligned the global scale structured finance ratings with the revised ceiling.

Dissolution of Nitro International Securitisation Company 1 Plc

Nitro 1 Plc was launched on 27 November 2006 and issued €212 million in Secured Amortising Floating Rate Notes, due in 2012. On the payment date of 16 November 2009, Nitro 1 Plc redeemed the total outstanding notes, which initiated the process of the dissolution of Nitro 1 Plc. The secured parties (other than the note holders, the trustee and the corporate services company) acknowledged and confirmed that their appointment as per the transaction documents had ended. The dissolution of Nitro 1 Plc is expected to be completed in the next financial year.

Exercise of clean up call option for Nitro 1 and 2

Nitro 1 was launched on 28 March 2006 with a size of R2 billion and a 7% subordination below the Aaa rated notes. The subordinated loan of R20 million and the Class D notes (from March 2008) were held by the originator (FRB). There was an excess spread of 2%. By 14 September 2009, notes to the value of R186.5 million were outstanding, representing less than 10% of the outstanding principal amount of the notes on issue date. Nitro 1 redeemed the total outstanding balance by exercising the clean up call option, as outlined in Clause 7.3 of the Offering Circular. All the outstanding notes were redeemed in full on 14 September 2009, which was also the next interest payment date.

Nitro 2 was launched on 8 September 2006 with a size of R5 billion and an 8% subordination below the Aaa rated notes. FRB, the originator, held the subordinated loan of R95 million. There was an excess spread of 1.2%. By 12 May 2010, notes to the value of R440.9 million were outstanding, representing less than 10% of the original principal amount. On 12 May 2010, the next interest payment date, Nitro 2 redeemed the total outstanding balance by exercising the clean up call option as outlined in Clause 7.3 of the Offering Circular.

This brought to a successful close the first and second securitisations of instalment sale agreements originated by WesBank. The objective of the Banking Group to obtain matched term funding at a time when its retail asset book was growing rapidly was achieved. The structures proved resilient despite the recent difficulties experienced in the retail consumer environment.

Investors in both securitisations were able to, without suffering any losses, realise investments earlier than the legal maturity. Given the recent turmoil in credit markets, credit spreads had widened significantly compared to levels at inception of the transactions. The clean up calls enabled investors to benefit from reinvestment opportunities at more attractive credit spreads for similarly rated instruments.

Conduit programmes and fixed income funds

The Banking Group's conduit programmes are debt capital market vehicles, which provide investment grade corporate South African counterparties with an alternative funding source to traditional bank funding. The programmes also provide 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 lending products on a matched basis.

All the assets originated for the conduit programmes are rigorously evaluated as part of the ordinary credit approval process applicable to any other corporate exposure held by the Banking.

The following tables show the programmes currently in place, the ratings distribution of the underlying assets and the role played by the Banking Group 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	
					2010	2009	**2010**	2009
Conduits								
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**7 373**	7 287	**–**	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**5 772**	5 017	**758**	679
Total					**13 145**	12 304	**758**	679
Fixed income fund								
iNkotha	Overnight corporate loans	2006	Fitch	10 000	**2 164**	**3 623**	**–**	**–**
Total					**2 164**	3 623	**–**	–

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 30 June 2010	–	**1 436**	**633**	**1 487**	**4 683**	**1 480**	**2 592**	**835**	**13 146**
At 30 June 2009	–	1 551	341	2 076	4 640	2 259	1 020	417	12 304
Fixed Income Fund									
At 30 June 2010	–	**656**	**–**	**–**	**1 194**	**–**	**116**	**197**	**2 163**
At 30 June 2009	–	1 209	–	–	1 107	–	1 002	305	3 623

FRB's role in the conduits and the fixed income fund

Transaction	Originator	Investor	Servicer	Liquidity provider	Credit enhancement provider	Swap counterpart
iNdwa			√	√		√
iNkotha			√			
iVuzi			√	√	√	√

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

Liquidity facilities

The table below provides an overview of the liquidity facilities issued by FRB.

Liquidity facilities

R million	Transaction type	2010	2009
Transaction			
Own transactions		**10 442**	9 540
iNdwa	Conduit	**5 898**	5 653
iVuzi	Conduit	**4 544**	3 887
Third party transactions	Securitisations	**1 577**	2 160
Total		**12 019**	11 700

* *It is important to note that from an accounting perspective, upon consolidation the underlying assets in the entities not recognised on the balance sheet are reconsolidated back onto FRB's balance sheet.*

All liquidity facilities in the transactions given 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 FRB. The conduit programmes are consolidated into FRBH for financial reporting purposes.

Additional information

The following table provides the securitisation exposures retained or purchased as well as their associated IRB capital requirements per risk band.

Retained or purchased securitisation exposure and the associated regulatory capital charges

	Exposure		IRB capital		Capital deduction	
R million	2010	2009	2010	2009	2010	2009
Risk weighted bands						
= <10%	**17 840**	17 840	**122**	122	**–**	–
>10% = <20%	**12 042**	11 724	**88**	92	**–**	–
>20% = <50%	**180**	233	**6**	9	**–**	–
>50% = <100%	**931**	1 013	**66**	57	**–**	–
>100% = <650%	**773**	711	**198**	152	**–**	–
1 250%/deduction	**414**	519	**–**	–	**414**	519
Total	**32 180**	32 040	**480**	432	**414**	519

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

Deductions arising from securitisation exposures

R million	Corporate receivables	Retail mortgages	Retail: instalment sales an leasing	Total
Traditional	–	187	38	225
Synthetic	190	–	–	190
Total	190	187	38	415

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

11. COUNTERPARTY CREDIT RISK

Key developments and focus

During the year under review, focus was placed on the interaction of risk factors in the counterparty risk domain. In depth reviews of the business, clients and processes were undertaken in all the trading areas. Improvements were made where necessary and gaps were filled and a new, more conservative margining methodology was implemented to account for the build up of concentrations and illiquidity. Market risk based stress loss methodologies (liquidity adjusted distressed expected tail loss plus event risk) were further embedded in counterparty risk and margining requirement quantification in line with the recommendations of the BCBS. In the next financial year the consequential risk of trading activities will be subject to an in depth review.

Introduction and objectives

Counterparty credit risk is closely related to credit risk in that it is concerned with a counterparty's ability to satisfy its obligations under a contract that has a positive economic value to a bank at time of settlement. It differs from 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 Banking Group's trading and client execution businesses and the objective of counterparty credit risk management is to ensure that risk is only taken within specified limits in line with the Banking Group's risk appetite framework as mandated by the Board.

Organisational structure and governance

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 Exposure.

In this respect, counterparty credit risk governance aligns closely with the Banking Group's credit risk governance framework, with mandates and responsibilities cascading from the Board through the RCC committee to the respective subcommittees as well as deployed and central risk management functions. Refer to the Risk management framework and governance section (page 12), and the credit risk governance section (page 27) for more details.

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.

To this end, appropriate quantification methodologies of potential future exposure over the life of a product, even under distressed market conditions, are developed by a combined credit and market risk team and submitted to technical risk committees for approval.

Individual counterparty risk limit applications are prepared using the approved risk quantification methodologies and assessed and approved at the relevant credit committees, with appropriate executive and non executive representation.

All counterparty credit risk limits are subject to annual review and counterparty exposures are monitored by the respective risk functions on a daily basis. Overall counterparty risk limits are allocated across a number of products and 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
- 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 respective 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 Finance, risk and capital committee, the ERM function and the RCC committee.

Counterparty credit risk mitigation

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

The Banking 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 setoff and the intention to settle on a netted basis exist.

Discussion of the risk profile

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

Composition of counterparty credit risk exposure

R million	2010	2009
Gross positive fair value	**90 367**	134 055
Netting benefits	**(36 693)**	(60 925)
Netted current credit exposure before mitigation	**53 674**	73 130
Collateral value	**(43 701)**	(54 513)
Netted potential future exposure	**14 511**	16 328
Exposure at default	**24 484**	34 945

There was a change in the methodology used to populate the regulatory returns from product type to asset class, which resulted in a decrease from 2009 to 2010 in the netting benefits and the exposure at default.

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

Credit derivatives exposure

	2010			
R million	**Credit default swaps**	**Total return swaps**	**Other**	**Total**
Own credit portfolio				
– protection bought	**2 681**	**–**	**3 661**	**6 342**
– protection sold	**2 594**	**–**	**–**	**2 594**
Intermediation activities				
– protection bought	**–**	**–**	**–**	**–**
– protection sold	**–**	**–**	**–**	**–**

	2009			
R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	2 264	–	5 694	7 958
– protection sold	–	–	–	–
Intermediation activities				
– protection bought	–	–	–	–
– protection sold	970	–	–	970

12. MARKET RISK

Key developments and focus

RMB's executive management team refined the approach used to determine market risk appetite and capacity. Absolute loss thresholds for market risk, as defined at the beginning of the financial year, were embedded in daily operational processes and performance against these loss thresholds was successfully monitored throughout the year. For the next financial year the Banking Group will be focusing on updating its market risk stress data set in line with the new regulatory requirements released by the BCBS in July 2009, titled "Revisions to the Basel II market risk framework". Furthermore, the Banking Group is focusing on further integrating its global operations, specifically the African and Indian operations, into the overall market risk management process.

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 Banking 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 risk 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 the appetite for market risk vests with the Board, which also retains independent oversight of the market risk related activities through the RCC committee and its Market and Investment Risk subcommittee ("MIRC").

Separate governance forums, such as the RMB 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 expected tail loss ("ETL") measure and ETL limits. The ETL measure used by RMB is a liquidity adjusted 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. 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.

Value at Risk ("VaR") calculations over holding periods of one 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 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 individual 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 regulator for local trading units and is consistent with the methodologies as stipulated under the Basel II framework.

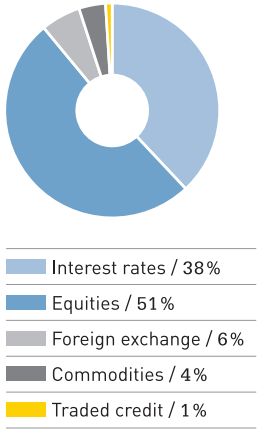
For all international legal entities, the Standardised Approach is used for regulatory market risk capital purposes.

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

Discussion of the trading book market risk profile

The following chart shows the distribution of exposures per asset class across the Banking Group's trading activities at 30 June 2010 based on the ETL methodology.

Composition of ETL exposure (audited)



VaR and ETL analysis by risk type

The tables below reflect the VaR over a 10 day holding period and the liquidity adjusted ETL at a 99% confidence level for trading book activities. Results for 30 June 2010 reflect a downward trend in the second half of the year, predominantly arising from a reduction of risk exposures in the inflation book and the decision to aggregate equity investment risk positions subject to market price risk into a separate classification reporting category (see equity investment risk section on page 64.)

10 day 99% VaR analysis by risk type

	2010				2009
R million	Min[1]	Max[1]	Ave	Period end	Period end[2]
Risk type					
Equities	**19.0**	**303.2**	**130.7**	**66.4**	287.4
Interest rates	**38.5**	**170.3**	**83.1**	**53.3**	158.0
Foreign exchange	**7.1**	**108.1**	**34.6**	**9.0**	117.7
Commodities	**4.0**	**52.0**	**22.3**	**7.1**	71.2
Traded credit	**–**	**3.4**	**0.4**	**0.1**	8.4
Diversification effect				**(52.9)**	(263.7)
Diversified total	**53.2**	**420.3**	**205.8**	**83.0**	379.0

Distressed ETL analysis by risk type

R million	2010 Min[1]	2010 Max[1]	2010 Ave	2010 Period end	2009 Period end[2]
Risk type					
Equities	**104.2**	**535.9**	**343.7**	**160.4**	431.8
Interest rates	**72.7**	**836.4**	**330.6**	**119.1**	525.2
Foreign exchange	**16.9**	**203.7**	**85.0**	**20.2**	169.7
Commodities	**8.3**	**92.8**	**40.5**	**11.1**	108.9
Traded credit	**0.1**	**13.7**	**1.9**	**1.6**	15.0
Diversification effect				**(105.4)**	(457.2)
Diversified total	**134.7**	**1 081.4**	**600.1**	**207.0**	793.4

Notes:

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

2 *ETL measures for the current period are not directly comparable to those reported in prior periods due to changes in the diversification methodology, as well as the introduction of liquidity adjusted ETL measures and the exclusion of banking book exposures managed by Group Treasury as these are reported under the banking book interest rate risk section. The diversified 90 day ETL measure for the equity investment book subject to market price risk as at 30 June 2010 is R574 million (interest rates: R1.4 million, equities: R588 million, foreign exchange: R56 million).*

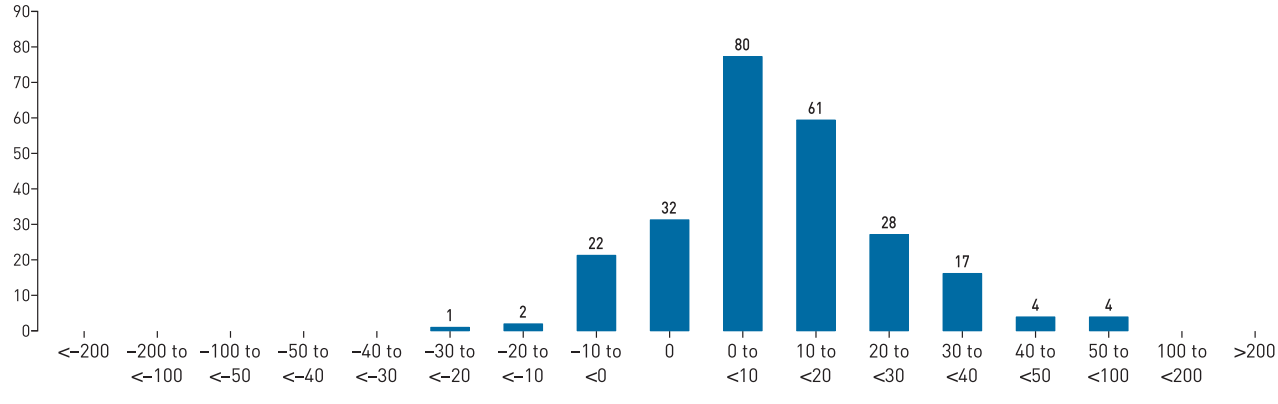
The diversified 1 day 99% VaR as at 30 June 2010 is R43.2 million (interest rates: R21.4 million, equities: R25.0 million, foreign exchange: R6.8 million, commodities: R3.4 million, traded credit: R0.01 million).

Distribution of daily trading earnings from trading units

The histogram below shows the daily revenue for the trading units for the year under review.

Distribution of daily earnings

(Frequency: days in a period)

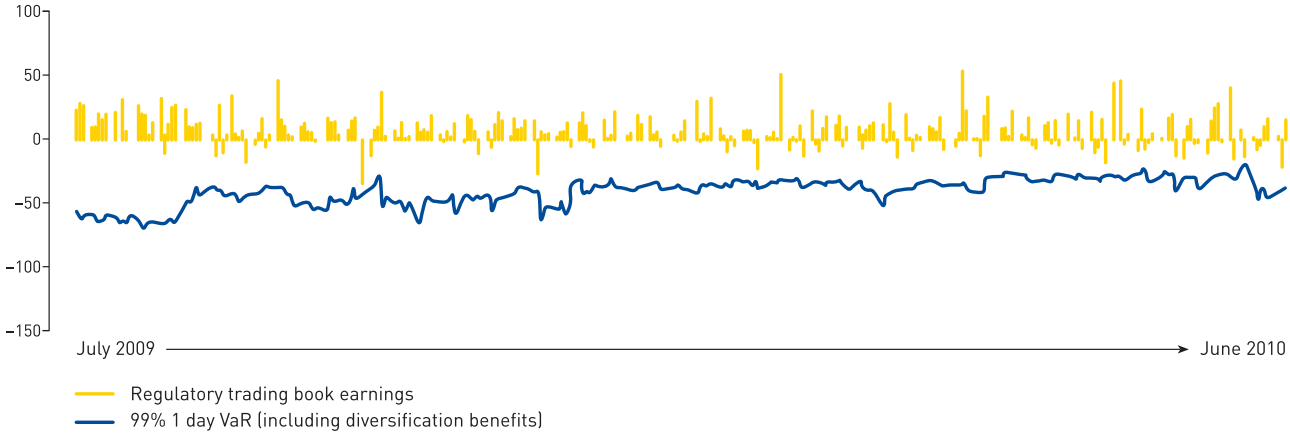


Back testing: daily regulatory trading book earnings and VaR

The Banking Group tracks its daily local earnings profile as illustrated in the chart below. 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 year there were no instances of actual trading losses exceeding the corresponding VaR estimate. This implies that the Banking Group's model provided reasonably accurate quantification of market risk.

FirstRand International

FirstRand Ireland Plc ("FRIE") and FirstRand India ("FRIN") hold the most material exposure to market risk amongst the international subsidiaries. The same approach is employed for the measurement and management of market risk as in the local portfolio. Market risk exposures in FRIE have decreased substantially predominantly due to derisking coupled with the decision to wind down the operation. During the year under review, market risk was contained within acceptable limits.

FNB Africa subsidiaries

FNB Namibia and FNB Botswana are the only African subsidiaries with notable exposure to market risk. Market risk is measured and managed in line with the Banking Group's market risk framework. During the year under review, market risk was contained within acceptable limits and was effectively managed by the Banking Group across its African subsidiaries.

13. EQUITY INVESTMENT RISK

Key developments and focus

Governance and investment processes were robust throughout the year and reporting on this asset class received significant focus. The legacy assets suffered diminution in value for a variety of reasons, most notably the continuing risk aversion and consequent illiquidity in global markets. Private Equity division earnings performance was dominated by the Life Healthcare listing. Updated risk appetite and earnings growth targets were set by executive management. In the next financial year, the Banking Group will focus on refining its portfolio based investment stress testing methodologies.

Introduction and objectives

Portfolio investments in equity instruments are primarily undertaken in RMB, but certain equity investments have been made by WesBank and a small residual portfolio is reported and managed by 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 the 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 Board's Large exposures credit committee, as appropriate.
- The RCC committee and the MIRC are responsible for the oversight of investment risk measurement and management across the Banking Group.
- The RMB CRO, 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 the 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, in 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. The Banking Group seeks to take a number of seats on the company's Board and maintains close oversight through ongoing 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 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 Banking 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 Banking 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 Banking Group has joint control over the economic activity of the joint venture through a contractual agreement.

More detail on accounting policies regarding investments in associates and subsidiaries are discussed in Accounting Policy notes 3 and 4 of the FirstRand annual report.

Measurement of risk exposures

The Banking 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).

Equity investment risk is measured on an ongoing basis in terms of exposure distribution, regulatory and economic capital requirements, as well as scenario analyses of potential event risks and associated write downs in value.

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 weight (300% or 400%) approach or 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 utilised 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 will be measured based on a 90 day ETL calculated using RMB's Internal Market Risk Model. The ETL risk measure will be supplemented by a measure of the specific (idiosyncratic) risk of the individual securities per specific risk measurement methodology.

Discussion of the risk profile

The overall macroeconomic environment resulted in low new business volumes during the year under review.

FirstRand, through its RMB division, increased its stake in Makalani Holdings Limited from 26% to 77% as part of Makalani's delisting on 31 May 2010.

The most notable divestment was through the listing of Life Healthcare as discussed in more detail in the RMB operating review on page 45 of the FirstRand annual report.

A number of listed investment positions were included in the equity investment risk ETL process during the current year, following improvements made in the assessment of underlying liquidity of trading positions, as well as improvements in the quantification of listed investment exposures. These positions were previously reported as part of the trading ETL process. The ETL (on a total listed investment exposure of R1 376 million) amounted to R575 million at 30 June 2010.

The estimated sensitivity of the remaining investment balances (i.e. those not subject to the equity investment risk ETL process) to a 10% movement in market value is an impact of R375 million on investment fair values.

During the past year RMB's Dealstream portfolio was further derisked through additional impairments raised. This portfolio was taken over in terms of Dealstream's futures clearing agreement and applicable JSE rules when Dealstream, a former clearing client, was placed into default in 2008. RMB continues to hold and manage these exposures as part of its legacy portfolio to realise value over the longer term. Remaining exposures, in the legacy portfolio, amounted to R1 602 million at 30 June 2010 (R3 166 million at 30 June 2009).

Total realised gains for the Banking Group recognised directly in the income statement for the year amounted to R567 million.

The following table provides information relating to equity investments in the banking book of those entities regulated as banks within the Banking Group.

Investment valuations and associated economic capital requirements

	2010			2009		
R million	**Publicly quoted**	**Privately held**	**Total**	Publicly quoted	Privately held	Total
Carrying value disclosed in the balance sheet	**2 415**	**4 106**	**6 521**	2 179	4 861	7 040
Fair value*	**2 415**	**6 708**	**9 123**	2 179	7 958	10 137
Total unrealised gains recognised directly in the balance sheet through equity instead of the income statement**	**769**	**93**	**862**	666	132	798
Latent revaluation gains not recognised in the balance sheet**	**–**	**2 602**	**2 602**	–	3 097	3 097

* *Fair values for listed private equity associates based on their values in use exceeded the quoted market prices by R72 million (2009: R511 million).*

** *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*

14. FOREIGN EXCHANGE AND TRANSLATION RISK

Key developments and focus

As an authorised dealer in foreign exchange, the Banking Group has a restriction on the gross amount of foreign currency holdings and other foreign exposure it may hold, which is capped at 25 per cent 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 per cent 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. 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 and allowing opportunity for expansion and growth. The internal limits and utilisation are continuously monitored and reviewed when necessary.

The Banking Group's NOFP position is also well within the regulatory limits of approximately $500 million. Senior management has also implemented an internal prudential limit, again well below the regulatory limit but large enough to cater for the hedging, settlement and execution positions of the business units. Group Treasury is the clearer of all currency positions in FirstRand and manages foreign currency related risks and is, therefore, tasked with the responsibility for both the prudential limits on foreign exposure and the overnight open positions.

Introduction and objectives

Foreign exchange risk arises from placement, lending and investing activities in a currency other than the presentation currency, foreign currency funding, from facilitating client foreign exchange transactions and from authorised trading and hedging activities in a currency other than the presentation currency. The objective of foreign exchange risk management is to ensure that currency mismatches are managed within the risk appetite for such risk 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 consequent of having offshore operations. It is not an actively hedged risk in its own right in terms of Banking Group policy.

Organisational structure and governance

Foreign exchange risk results from the activities of all the franchises, but management and consolidation of all these positions occur at present in one of two business units. Client flow is consolidated under and managed by RMB FICC. Foreign currency funding, foreign exposure and currency 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 is overseen by MIRC, a subcommittee of the RCC committee, and mismatch risk is governed through the Asset and liability management committee ("ALCO") process and its International ALCO subcommittee. In addition to the committee structures, business units charged with frontline management of the risks have deployed risk managers within their units who assess the risks on an ongoing basis.

Assessment and management

Group Treasury and RMB's FICC manage the mismatch and open positions on a daily basis within limits. Any breaches are reported through the risk management structures and remediation is monitored by both the deployed risk manager and ERM.

Discussion of risk profile

Over the past year no significant foreign exchange positions have been run apart from the translation risk in strategic foreign investments and 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 Bank and to cater for increased buffers and trading positions for RMB divisions. In addition, the macro foreign exposure of the Banking Group remained far below both regulatory and board limits and there is significant headroom for expansion into foreign assets.

15. FUNDING AND LIQUIDITY RISK

Key developments and focus

During the year, a number of additional measures were taken to further protect the Banking Group against negative stress events:

- During January 2010 an exercise was undertaken in conjunction with members of the Banking Supervision Division of the SARB, external consultants and FirstRand senior executives. The exercise simulated a live stress event (based on a bank specific event) which resulted in a perceived loss of confidence in the Banking Group, and simulated how it would have managed over a four day period. The exercise proved highly successful and this method of readiness testing will be revisited from time to time.
- Liquidity buffers have been enhanced, both in terms of quantum and nature of the assets in the portfolio, which is now predominantly comprised of government treasury bills, stocks and debentures.
- Additional internal sources of stress funding were identified.
- Emerging effects of proposed new legislation, such as Basel III proposals received attention. The Banking Group has been closely engaged with regulatory authorities both locally and internationally in order to gauge the effect on it and the markets in which it operates.
- The international financial position has also been carefully managed, with liquidity buffers placed in European Central Bank stocks considered to be safe havens even under stress conditions.

Overall the Banking Group has not experienced untoward pressure in any of the jurisdictions it operates in.

Introduction and objectives

The Banking Group applies a comprehensive definition of liquidity risk and distinguishes two 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; and
- 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.

The Banking 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 an ancillary framework to the BPRMF, the LRMF is approved by the Board and sets out consistent and comprehensive guidelines for outlining the standards, principles, policies and procedures to be implemented throughout FRBH to effectively identify, measure, report and manage liquidity risk.

The FRBH 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 the FRBH ALCO. FRBH ALCO's primary responsibility is the assessment, control and management of both liquidity and interest rate risk for FRB, FNB Africa and international subsidiaries and branches, either directly or indirectly, through providing guidance, management principles and oversight to the ALM functions and ALCOs in these subsidiaries and branches.

FirstRand Bank Limited

Liquidity risk for FRB (RMB, FNB and WesBank) is centrally managed by a dedicated liquidity risk management team in Group Treasury. It is this central function's responsibility to ensure that the liquidity risk management framework is implemented appropriately. ERM provides governance and independent oversight of the central liquidity management team's approaches, models and practices.

The Banking Group's liquidity position, exposures and auxiliary information are reported bi-monthly 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 FRBH ALCO, which is the designated governance and risk management forum for liquidity risk.

FNB Africa

Individual ALCOs have been established in each of the FNB African 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 presented to FRBH ALCO on a regular basis and the management and control of liquidity risk in the subsidiaries follow the guidance and principles that have been set out and approved by FRBH ALCO.

International subsidiaries and branches

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

An application was lodged with the Financial Services Authority ("FSA") seeking a waiver on a "Wholefirm Liquidity Modification application" basis in respect of dispensation granted where the FSA considers local risk reporting and compliance of the parent bank sufficient to waive FSA requirements for the London branch. The outcome of the application is still pending.

Assessment and management

As indicated in the preceding section, liquidity risk for FRB is managed centrally by a team in Group Treasury. The Banking 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 Banking 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.

Measurement and assessment

The following are the primary tools and techniques employed for the assessment of liquidity risk:

Liquidity mismatch analyses

The purpose of these analyses is to anticipate the mismatch between payment profiles of balance sheet items under normal, stressed and contractual conditions. Three forecasting models for this purpose have been developed:

- *Business as usual model:* Forecasting the liquidity situation on an ongoing basis. This model provides an estimate of the funds required to be raised under routine circumstances, taking into account behavioural assumptions around the optionality inherent in some products.
- *Contractual maturity model:* This model provides a forecast of the liquidity position based on the assumption that assets and liabilities will be liquidated at the contracted date.
- *Stress test and event model:* This model provides forecasts of the potential outflow of liquidity under extraordinary circumstances such as times of economic stress or event related adverse impacts on the Banking Group's reputation.

For each of these categories, multiple key risk indicators are defined that highlight potential risks within defined thresholds that distinguish two levels of severity 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 FRBH ALCO and the RCC committee on a monthly and a quarterly basis, respectively.

Stress testing and scenario analysis

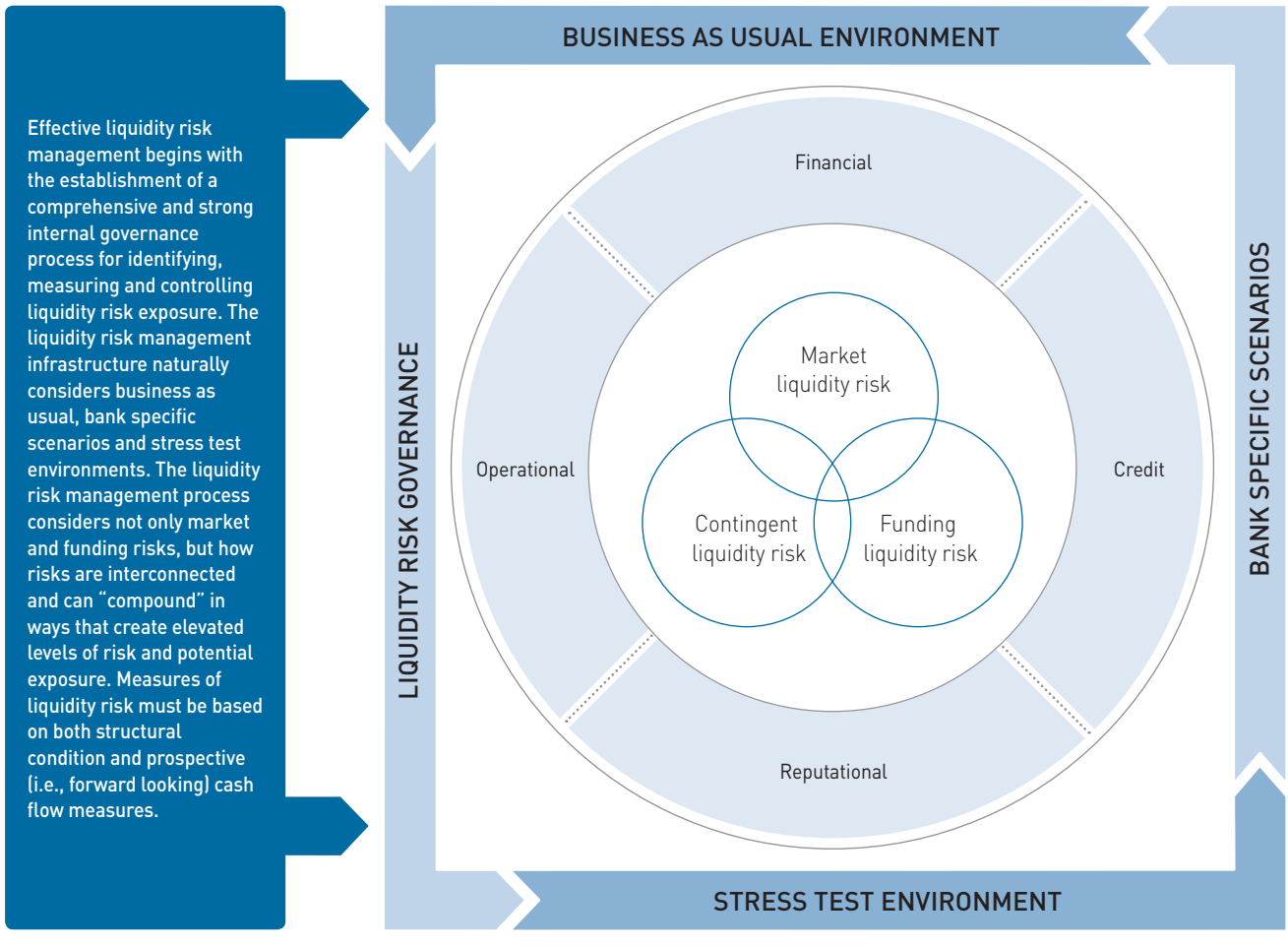
Regular and rigorous stress tests are conducted on the funding profile and liquidity position as part of the overall stress testing framework with a focus on:

- 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 Banking Group.

Effective liquidity risk management

Effective liquidity risk management begins with the establishment of a comprehensive and strong internal governance process for identifying, measuring and controlling liquidity risk exposure. The liquidity risk management infrastructure naturally considers business as usual, bank specific scenarios and stress test environments. The liquidity risk management process considers not only market and funding risks, but how risks are interconnected and can "compound" in ways that create elevated levels of risk and potential exposure. Measures of liquidity risk must be based on both structural condition and prospective cash flow measures.

Liquidity risk governance



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

MANAGEMENT OF LIQUIDITY RISK		
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.

Liquidity contingency funding planning

The formal contingency funding plan sets out policies and procedures as a blueprint for handling a potential liquidity crisis. Addressing both temporary and long range 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 Banking Group.

Liquidity risk management cycle

These management activities are part of the liquidity risk management cycle, which is illustrated in the chart below.

Liquidity risk management lifecycle

The target liquidity risk profile is determined by the risk appetite framework. It is compared to the current risk profile as set out in the LRMF and evaluated under a range of scenarios and business conditions, including economic and event stresses. These analyses in turn inform the size of liquidity buffers held in excess of statutory requirements. Liquidity buffers are actively managed, high quality, highly liquid assets that are available as protection against unexpected events or market disruptions.

As an outcome of these analyses, the current funding profile is adjusted through a range of short, medium and long term actions to ensure that the Banking Group remains within its chosen risk profile. The cost of these actions is then transferred to the business units through the internal matched maturity funds transfer pricing mechanism. It should be noted in this context that financial transactions using special purpose vehicles are treated as part of the balance sheet and are considered in the liquidity risk management cycle and thus managed consistently and conservatively across the Banking Group.

Regulatory developments

The recent global financial crisis is expected to result in increased political and regulatory pressure on banking systems worldwide. Some of these pressures are likely to materialise in South Africa, particularly given its G20 membership. For example, the SARB is expected to implement the BCBS proposals on capital and liquidity (the so called "Basel III" proposals).

The impact of the proposed new requirements is expected to be especially significant from a liquidity perspective and is discussed in the High level overview of the risk profile section on page 7.

Discussion of the risk profile

Undiscounted cash flow

The table below presents the undiscounted cash flows of liabilities and includes all cash outflows related to the principal amounts as well as future payments. These balances will not agree with the balance sheet for the following reasons:

- the balances are contractual, undiscounted amounts whereas the balance sheet is prepared using discounted amounts;
- the table includes contractual cash flows with respect to items not recognised in the balance sheet;
- all instruments held for trading purposes are included in the "call to 3 month" bucket and not by contractual maturity because trading instruments are typically held for short periods of time; and
- cash flows relating to principal and associated future coupon payments have been included on an undiscounted basis.

Liquidity cash flows (undiscounted cash flows)

R million	2010 Carrying amount	Term to maturity: Call – 3 months	3 – 12 months	>12 months
Maturity analysis of liabilities based on the undiscounted amount of the contractual payment				
EQUITY AND LIABILITIES				
Liabilities				
Deposits and current accounts	**511 343**	**349 752**	**86 690**	**74 901**
Short trading positions	**16 735**	**16 735**	**–**	**–**
Derivative financial instruments	**36 923**	**32 916**	**2 151**	**1 856**
Creditors and accruals	**7 894**	**4 475**	**3 104**	**315**
Long term liabilities	**10 714**	**–**	**–**	**10 714**
Amounts due to holding and fellow subsidiary companies	**3 154**	**437**	**78**	**2 639**
Policyholder liabilities under insurance contracts	**2 141**	**410**	**48**	**1 683**
Policyholder liabilities under investment contracts	**102**	**7**	**6**	**89**
Loans from insurance group	**3 717**	**1 792**	**1 406**	**519**
Financial and other guarantees	**29 851**	**23 414**	**3 511**	**2 926**
Facilities not drawn	**52 808**	**35 725**	**968**	**16 115**

R million	2009 Carrying amount	Term to maturity: Call – 3 months	3 – 12 months	>12 months
Maturity analysis of liabilities based on the undiscounted amount of the contractual payment				
EQUITY AND LIABILITIES				
Liabilities				
Deposits and current accounts	491 785	344 593	85 359	61 833
Short trading positions	23 434	23 434	–	–
Derivative financial instruments	55 369	50 639	1 222	3 508
Creditors and accruals	6 002	2 363	2 658	981
Long term liabilities	13 352	18	61	13 273
Amounts due to holding and fellow subsidiary companies	–	–	–	–
Policyholder liabilities under insurance contracts	1 669	202	27	1 440
Policyholder liabilities under investment contracts	77	5	8	64
Loans from insurance group	4 165	3 533	–	632
Financial and other Guarantees	24 868	21 937	1 190	1 741
Facilities not drawn	57 786	48 851	215	8 720

Contractual discounted cash flow analysis

The following table represents the contractual discounted cash flows of assets, liabilities and equity for the Banking Group. Relying solely on the contractual liquidity mismatch when assessing a bank's maturity analysis would overstate risk, since this represents an absolute worst case assessment of cash flows at maturity.

Due to South Africa's structural liquidity position, banks tend to have a particularly pronounced negative (contractual) gap in the shorter term as more short term obligations than short term assets tend to mature.

In addition, therefore, to the analysis shown in the table above, the Banking Group carries out an adjusted liquidity mismatch analysis, which estimates the size of the asset and liability mismatch under normal business conditions. This analysis is also used as a framework to manage this mismatch on an ongoing basis.

Contractual discounted cash flow analysis

	2010			
		Term to maturity		
R million	**Carrying amount**	**Call – 3 months**	**3 – 12 months**	**> 12 months**
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	**638 818**	**223 439**	**67 789**	**347 590**
Total equity and liabilities	**638 818**	**419 094**	**93 687**	**126 037**
Net liquidity gap	**–**	**(195 655)**	**(25 898)**	**221 553**
Cumulative liquidity gap	**–**	**(195 655)**	**(221 553)**	**–**

	2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	> 12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	634 398	246 868	56 040	331 490
Total equity and liabilities	634 398	437 349	86 551	110 498
Net liquidity gap	–	(190 481)	(30 511)	220 992
Cumulative liquidity gap	–	(190 481)	(220 992)	–

As illustrated in the table above, the negative contractual liquidity short term gap has improved in short end on a cumulative basis during the year under review. This is a consequence of the following market conditions and management actions during the year under review:

- growing stable and long term funding;
- building up stress funding buffers both locally and offshore; and
- muted asset growth in the banking sector.

16. INTEREST RATE RISK IN THE BANKING BOOK

Key developments and focus

IRRBB is predominantly driven by the endowment effect caused by liabilities and capital that are rate insensitive. The effect arises where falling interest rates result in lower interest earned, but interest paid does not drop to the same extent. To mitigate the effect, hedges are put into place that protect against falling interest rates. Conversely rising rates result in higher margins (before bad debts) and do not require the same degree of hedging. Hedging can be performed in a number of ways. The two most common are to put derivative instruments into play (usually receive fixed, pay float interest rate swaps) or to structure the financial position to maximise fixed interest receipt product mix. Given the general consensus view held by the market for some time as to the direction of interest rate movements, it was very difficult to hedge economically. Nevertheless, by entering the market at opportune times, some derivatives hedging was achieved. These transactions were timed to mature when the interest rate is expected to turn. In addition, particularly in entities where no derivative markets exist, the structure of the financial position has shifted as indicated. This is particularly the case in the sub Saharan African subsidiaries. The Banking Group also looks for natural hedges between its credit and endowment portfolios, but notes that there are normally large lead and lag effects.

Introduction and objectives

This risk is identified and categorised in the following components:

- interest rate repricing risk arises from the differences in timing between repricing of assets, liabilities and positions not recognised in the balance sheet;
- yield curve risk arises when unanticipated changes in the shape of the yield curve adversely affects the income or underlying economic value;
- basis risk arises from an imperfect correlation in the adjustment of the rates earned and paid on different instruments with similar repricing characteristics; and
- optionality is the right, but not the obligation, of the holder to alter the cash flow of the underlying position, which may adversely affect the Banking Group's position as the counterparty to such a transaction.

The assumption and management of interest rate risk can be an important source of profitability and shareholder value, but excessive interest rate risk positions may pose a significant threat to the Banking Group's earnings and capital base. Effective interest rate risk management practices that contain the interest rate risk exposure within prudent levels, as stipulated by the risk appetite, are essential to the safety and soundness of the enterprise. To this end, various board and internal limits exist which limit both current and long term risk taken. Where practical, the internal measures also include fair value limits of the banking book instruments that can be fair valued.

The objective of interest rate risk management is, therefore, to protect the financial position and earnings level from potential adverse effects arising from exposure to various components of interest rate risk as described above.

Organisational structure and governance

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. Due to regulatory requirements and the structure of the Banking Group, different management approaches, reports and lines of responsibility exist across the various parts of the Banking Group, as discussed below.

All IRRBB related activities are overseen and reported to the FRBH ALCO, a subcommittee of the RCC committee, as illustrated in the governance structure on page 12. The FRBH ALCO is also responsible for the allocation of sublimits on the basis of mandates given by the RCC committee and it approves proposed remedial action for any limit breaches, as appropriate.

Whilst the margin and performance management aspects of interest rate risk management fall within the purview of the respective businesses and the central Group Treasury function, ERM provides central oversight and control across the activities of the deployed risk management functions and Group Treasury.

Interest rate risk, unlike credit risk, can only be sensibly assessed and managed at an aggregate level. The net interest rate risk profile of the domestic banking book (i.e. FRB, excluding RMB) is centrally managed by the unit responsible for the house macro view in Corporate Centre and Group Treasury.

RMB has a delegated mandate from FRBH ALCO for the management of its interest rate risk (under the market risk framework) as well as for ensuring that the limits of the Banking Group's risk appetite are observed. Interest rate risk management of both Group Treasury and RMB is overseen and controlled by a team in the central ERM function. The RMB banking book interest rate risk exposure was R69.5 million on a 10 day ETL basis at 30 June 2010. The Market risk section of this report provides a description of the ETL methodology on page 61.

Individual ALCOs exist in each of the FNB Africa subsidiaries for the purpose of interest rate risk monitoring and management.

Relevant reports are submitted by the subsidiaries to FRBH ALCO on a monthly basis. International subsidiaries and branches are overseen by the International ALCO, a subcommittee of FRBH ALCO, which provides central oversight and monitoring reflective of each region's specific issues and requirements.

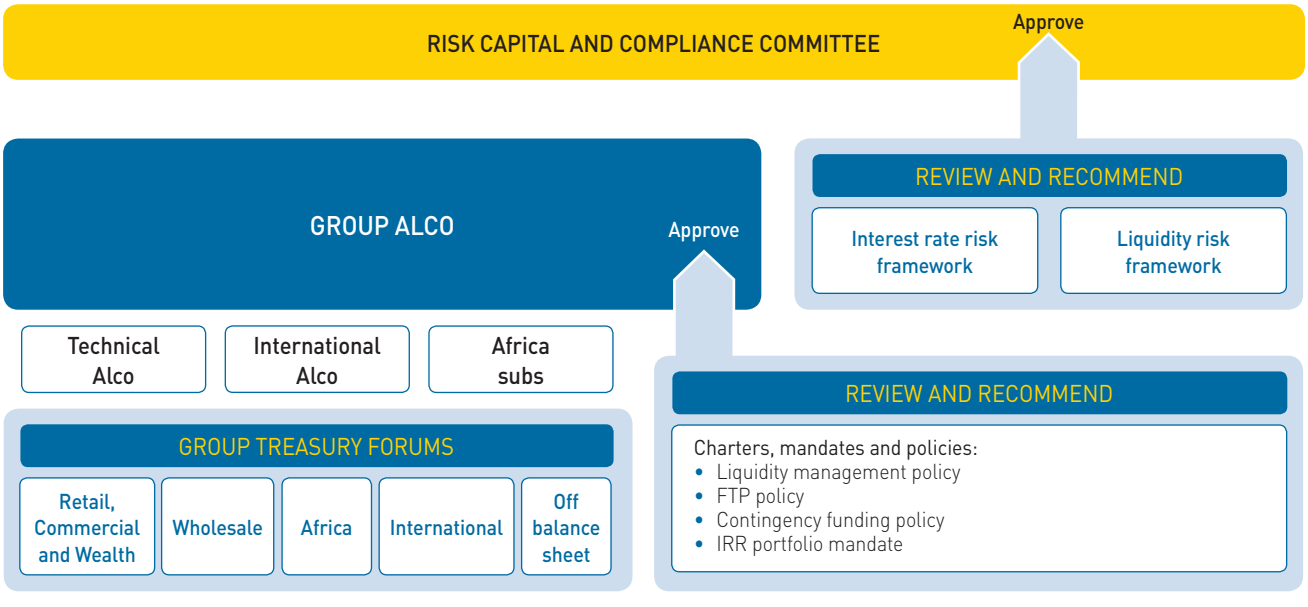
Assessment and management

A number of measurement techniques to quantify interest rate risk as defined above, are employed focusing both on the potential risk earnings as well as the potential impact on overall economic value.

In line with industry practice the pertinent analysis includes parallel rate shocks, yield curve twists, complex stress tests and static repricing gap analysis. Results from these analyses are reported to FRBH ALCO for review on a monthly basis. Additionally, daily MTM positions of the main risk portfolios are monitored daily and all risk measures are managed within defined risk appetite levels.

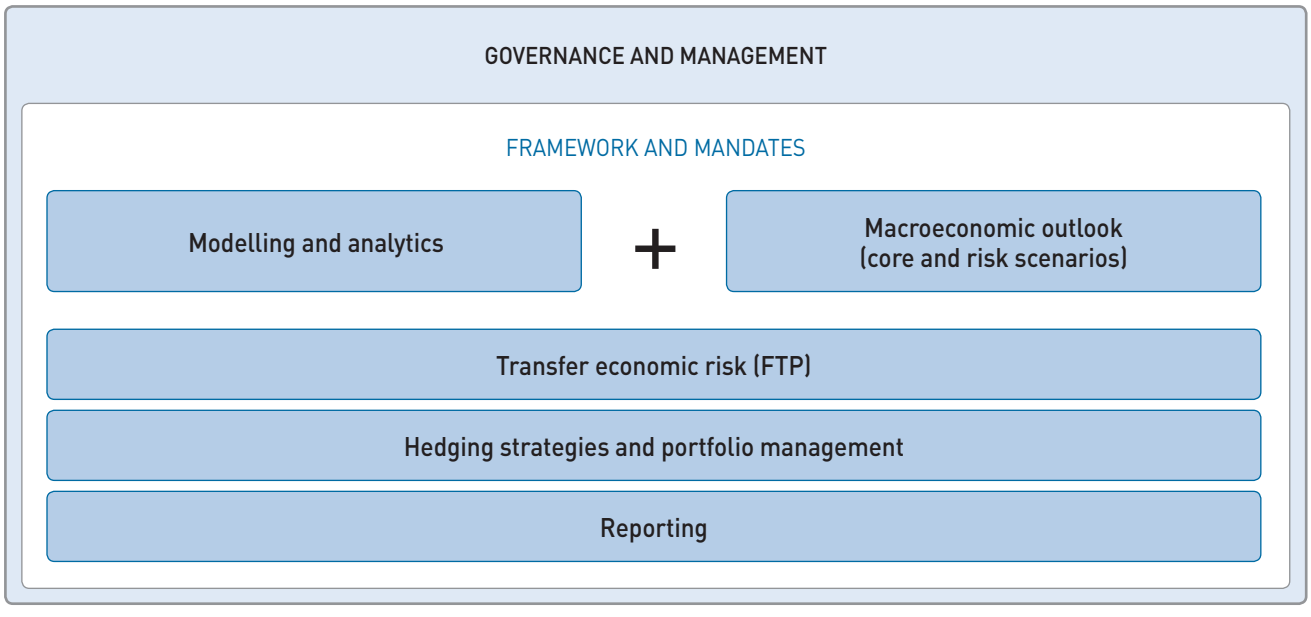
The management and governance of interest rate risk is delegated by FRBH Board to the RCC committee, which in turn delegates the responsibility to ALCO, Group Treasury, RMB and the regional ALCOs as illustrated in the following chart.

Interest rate risk management and governance structure



The Banking Group's activities around the management and assessment of interest rate risk are summarised in the following chart.

Interest rate risk management and assessment



The risk profile is adjusted by changing the composition of the Banking Group's liquid asset portfolio or through derivative transactions where possible based on the interest rate outlook as well as its view on potential other risk factors that may impact its balance sheet. In this respect, it is important to highlight that interest rate risk can, in the Banking Group's view, only be effectively managed if it is understood in the context of other risks and how the interaction may adversely impact its financial position and, ultimately, its interest rate risk profile.

In addition to measuring and hedging risk at an aggregate (net position) level, individual, large and complex transactions may be hedged at a micro level where appropriate. Management of the interest rate risk profile is carried out within the limits approved by the ALCOs. The Investment committee ("Invesco") oversees these activities for the domestic banking operations, challenges and debates the macroeconomic view and proposed portfolio actions as well as existing and proposed management strategies from a business perspective.

As indicated in the section covering liquidity risk, the costs of the portfolio level risk management actions are transferred through the internal funds transfer pricing mechanisms and contribute to a suitable measurement of risk adjusted performance across the various businesses.

Cash flow hedge accounting is applied for derivatives used in the hedging strategies for the banking book. Where hedges do not qualify for this treatment, mismatches may arise due to timing differences in the recognition of income from the fair valued hedges and the underlying exposures, which would be accounted for on an accrual basis.

Assumptions relating to loan repayments and behaviour of core deposits

Modelling assumptions are made that affect both the determination of interest rate risk incurred in the banking book and the hedging activity that takes place in mitigation of the exposures. These include:

- 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;
- presettlement 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. Similarly, several interest rate shocks and scenarios are

modelled, with disclosure of the sensitivity to a 200 basis point parallel shift in the yield curve (and assuming no new management action to mitigate the impact).

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 Banking 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 Banking Group's discretion; and
- prime linked products are assumed to reprice immediately whenever the Repo rate changes.

Discussion of the risk profile

The natural position of the banking book is asset sensitive, since interest earning assets tend to reprice faster than interest paying liabilities in response to interest rate changes. This results in a natural exposure of net interest income ("NII") to declining interest rates, which represents the largest component of interest rate risk. The Banking Group seeks to use hedges against this exposure, wherever economically feasible. These hedges tend to be predominantly interest rate swaps (receive fixed, pay floating).

The change to the interest rate gap shown in the tables below can be ascribed to this maturing profile of the hedges compared to the period six months ago. The hedges were primarily put in place prior to the commencement of the 2010 financial year.

Repricing schedules for FRBH banking book

	2010				
	Term to repricing				
R million	<3 months	>3 but ≤6 months	>6 but ≤12 months	>12 months	Non rate sensitive
FirstRand Bank Limited					
Net repricing gap	**(14 385)**	**11 987**	**15 999**	**2 085**	**(15 686)**
Cumulative repricing gap	**(14 385)**	**(2 398)**	**13 601**	**15 686**	**–**
African subsidiaries					
Net repricing gap	**5 608**	**(960)**	**(1 141)**	**693**	**(4 200)**
Cumulative repricing gap	**5 608**	**4 648**	**3 507**	**4 200**	**–**
Total cumulative repricing gap	**(8 777)**	**2 250**	**17 108**	**19 886**	**–**

	2009				
	Term to repricing				
R million	<3 months	>3 but ≤6 months	>6 but ≤12 months	>12 months	Non rate Sensitive
FirstRand Bank Limited					
Net repricing gap	2 401	14 101	(527)	127	(16 102)
Cumulative repricing gap	2 401	16 502	15 975	16 102	–
African subsidiaries					
Net repricing gap	2 693	212	(479)	1 393	(3 819)
Cumulative repricing gap	2 693	2 905	2 426	3 819	–
Total cumulative repricing gap	5 094	19 407	18 401	19 921	–

This repricing gap analysis excludes the banking books of RMB and the international balance sheet, both of which are separately managed on an ETL and VaR basis.

Sensitivity analysis

Net interest income sensitivity decreased in Rand terms compared to the previous period. The sensitivity is subject to approved internal board limits. Utilisation of the risk limit was well within permitted exposures at year end and throughout the year. Assuming no management action in response to interest rate movements, a hypothetical immediate and sustained parallel decrease of 200 basis points in all interest rates would result in a reduction in projected 12 month NII of R913 million. A similar increase would result in an increase in projected 12 month net interest income of R922 million.

Sensitivity of FRBH projected NII

	2010		
	Change in projected 12 month NII		
R million	**FRB**	**African subsidiaries**	**FRBH**
Downward 200 bps	**(789)**	**(124)**	**(913)**
Upward 200 bps	**798**	**124**	**922**

	2009		
	Change in projected 12 month NII		
R million	FRB	African subsidiaries	FRBH
Downward 200 bps	(1 111)	(74)	(1 185)
Upward 200 bps	1 123	74	1 197

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

The following represents the sensitivity of available-for-sale assets and cash flow hedges to interest rate movements. The valuation is based on a static balance sheet and measures the expected decrease or increase in valuation due to a parallel movement in the yield curve of 200 basis points.

Sensitivity of FRBH reported reserves to interest rate movements

	As % of total shareholders' equity	
	2010	2009
Downward 200 bps	**0.39%**	0.41%
Upward 200 bps	**(0.11%)**	(0.25%)

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

17. OPERATIONAL RISK

Key developments and focus

During the year the Banking Group continued to refine its operational risk assessment approaches, statistical models and process of capturing and collating relevant internal and external operational risk loss data.

The Banking Group's Information Technology Governance and Information Security Framework ("IT Governance framework") and IT risk assessment methodology is currently being reviewed to ensure coverage of new requirements from King III. Criminal loss levels have reduced during the year under review, however, the risk relating to fraud (including internal fraud and application fraud) and other crimes is increasing. This is managed through a number of specialist fraud combating units and coordinated through the appropriate risk committees.

Introduction and objectives

FRBH has approval from the SARB to apply the AMA for operational risk on a partial use basis from 1 January 2009. This achievement highlights the sound operational risk governance practices across the Banking Group's operations, which are aimed at ensuring the proper identification of all operational risks, mitigation where appropriate and management as part of the business operations.

Unlike other major risk types, operational risk is not assumed deliberately in pursuit of a commensurate return. It exists, to a varying degree, in all organisational activities. Major sources of this risk include:

- fraud;
- recruitment, training and retention of talent;
- operational process reliability;
- information technology and security;
- outsourcing of operations;
- dependence on key suppliers;
- implementation of strategic change;
- integration of acquisitions;
- human error;
- customer service quality; and
- regulatory compliance.

Organisational structure and governance

Operational risk is managed on the basis of the policies, standards, approaches and procedures set out in the Operational Risk Management Framework ("ORMF"), a subframework of the BPRMF, which is a policy of both the Board and Executive committee.

The FRBH 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 risk processes as set out in the framework. To ensure appropriate visibility at board level, the ORC includes two non executive committee members, one of which is a member of the FirstRand Board. Other members include the divisional heads of risk, divisional heads of operational risk and senior personnel of the central ERM function.

As is the case with other risk types, ERM provides independent supervision over the business implementation of the respective frameworks and policies. Apart from operational risk governance, these teams also oversee business continuity, legal risk, information risk services, and forensic services as these are integral to the operational risk management process.

Assessment and management

Operational risk assessment approaches and tools

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

Operational risk tools and approaches

OPERATIONAL RISK TOOLS AND APPROACHES		
Risk control self assessments	**Key risk indicators ("KRI")**	**Audit findings**
• Integrated in the business and risk management processes. • Assist risk managers in identifying key risk areas and assess the effectiveness of existing controls. • Other risk self assessments include business continuity self assessments, risk effectiveness reports for IT ("RERIT") and physical security self assessments.	• In place across all businesses as an early warning measure. • Highlight areas of increasing potential exposure to operational risk. • KRI reports are included in regular management reports to support ongoing risk identification and mitigation by the business.	• GIA acts as the third line of risk controls across the organisation . • Verify whether controls in place are appropriate to mitigating risks associated with key and supporting processes. • The number of findings issued and audit findings not resolved before the due date are tracked, monitored and reported on through the risk committee structures.
Internal loss data	**External loss data**	**Incident and issue reporting**
Loss data reporting and analyses are used by risk managers to understand: • the root causes of loss incidents; and • where corrective action should be taken to mitigate losses.	External loss data bases are used to: • derive lessons from other organisations and loss events; and • inform quantitative operational risk assessments through risk scenario analyses.	A a well defined and embedded process for the reporting of incidents and potential issues is in place to: • ensure that operational risk losses can be managed and potentially mitigated; and • facilitate a feedback of any lessons learned into the organisation's operational risk management practices.

Operational risk is recognised as a consequential risk that cannot be avoided or mitigated entirely. Accordingly, frequent operational risk events resulting in small losses are expected as part of business operations (e.g. fraud) and are budgeted for appropriately. The businesses seek to minimise these 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 Banking Group seeks to minimise the incidence and contain the severity within its risk appetite limits.

Given the ever changing and complex nature of its business and its processes, the Banking Group employs a dynamic approach to managing operational risk and this approach results in almost continuous change or renewal. It is common practice, when implementing change of this nature, to proactively address less than optimal operational procedures with meaningful adjustments to risk management. The Board and management are not satisfied with the current level of operational losses, albeit in line with industry experience, and have therefore embarked on a consistent and disciplined approach of linking business processes to the operational risk and control environment.

Basel II – Advanced Measurement Approach

As is the case for other risk types, regulatory and economic capital requirements are established to provide a buffer against

very rare and severe loss events. FRBH began applying the AMA under the Basel II framework from 1 January 2009 for the Banking Group's domestic operations. Offshore subsidiaries and operations continue to utilise the Standardised Approach for operational risk, as was the case for all domestic operations until the end of 2008.

The AMA allows the Banking Group to use a sophisticated, statistical model for the calculation of capital requirements, which enables more granular and more accurate, risk based estimates of the capital requirements of all the business lines. 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 were derived through an extensive analysis of the Banking Group's operational risks in consultation with business and risk experts from the respective business lines. All scenarios were subsequently cross referenced to external loss data, internal losses, the control environment and other pertinent information about relevant risk exposures. To ensure the ongoing accuracy of the capital assessment, all scenarios are reviewed, supplemented or updated semi-annually, as appropriate.

The modelled operational risk scenarios are combined with modelled loss data in a simulation engine to derive the annual, aggregate distribution of potential operational risk losses. Regulatory capital requirements are then calculated (for the Banking Group and each franchise) as the potential loss at the 99.9^{th} percentile of the aggregate loss distribution, excluding the effects of insurance, expected loss and potential diversification effects.

Using the AMA capital model, capital requirements are calculated for each franchise on a FRBH level. In order to then allocate capital to FRB the gross income ratio of FRB to FRBH is calculated. This income ratio is then applied to FRBH capital to split FRB specific capital requirements out of the originally calculated Banking Group capital. This split of capital between legal entities is required for regulatory reporting and internal performance measurement.

The loss data used for this purpose 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 risk control function.

Business practices evolve continuously 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 associated capital requirements takes the following into account:

- changes in the risk profile, as measured by various risk measurement tools;
- material effects of expansion into new markets, new or substantially changed 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 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

As indicated in a preceding section, the ERM function also oversees a number of areas closely related to or integrated with the operational risk management processes. These are described in the following subsections.

Business continuity management

Business continuity management ("BCM") is focused on ensuring that the Banking Group's operations are resilient to the risk of severe disruptions caused by internal failures or external events. The organisation carries out regular reviews of BCM practices, and any disruptions or incidents are regularly reported to a number of relevant risk committees. Over the reporting period, all areas remained at an acceptable status of readiness.

Legal risk

The organisation is counterparty to a large number of contractual agreements and is, therefore, at risk of loss due to deficient contractual arrangements, due to legal liability (civil and criminal) that may be incurred by its inability to enforce its rights or by its failure to address and remedy concerns about proposed changes in applicable law (existing law is covered by compliance risk, managed by RRM).

This risk is managed on the basis of the Legal Risk Management Framework, which prescribes activities such as the monitoring of new legislation, creation of awareness, identification of significant legal risk, as well as the monitoring and managing of the potential impact of these risks. The organisation strives to maintain appropriate procedures, processes and policies that enable it to comply with applicable regulation and that minimise any potential exposure to legal risk. During the year under review there were no significant incidents related to legal risk.

Information risk

The Banking Group's clients entrust it with highly sensitive information and the Banking Group accepts its fiduciary duty to safeguard this information in the course of its business activities. Information risk is the risk of adverse business impacts, including the loss of reputation caused by a failure of data confidentiality, integrity and availability controls and is therefore a key area of ongoing focus.

The organisation's Information Technology Governance and Information Security Framework ("IT framework") is a customisation of ISACA's Control Objectives for Information and related Technology ("COBIT®") framework and the Information Security Forum's Standard of Good Practice for the Banking Group. The IT framework is approved by the Technology and Information Management Risk committee, a subcommittee of the ORC and applies to all operations within FRBH.

The IT framework clearly defines the objectives for managing information risk, outlines the processes that need to be embedded, managed and monitored across the organisation and it also sets out a measurement framework for information risk across FRBH.

The Information risk team in ERM is tasked with ensuring compliance to the principles set out in the IT framework by developing appropriate policies and validating the implementation in the respective functions across the Banking Group.

Like many other large organisations, a number of new and changing threats across the evolving IT landscape are constantly faced. 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 Banking Group is committed to creating an environment that safeguards its customers, staff and assets through policies, frameworks and actions. To this end, it distributes and communicates its ethics policy to existing staff members on a quarterly basis. The ethics policy reiterates commitment to a stance of "zero tolerance" towards crime. Executive management throughout the Banking Group is committed to living the values of "zero tolerance" and enforcing them stringently.

The organisation 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.

18. REGULATORY RISK

Key developments and focus

The regulatory landscape has changed significantly as a direct consequence of the recent financial crisis. The banking industry, in particular, has experienced a wave of new legislation and regulatory requirements that will impact on areas such as capital adequacy, liquidity, and funding. Key changes include BCBS proposals (capital, liquidity, market risk and compensation), King III, the new Companies Act, the Consumer Protection Act, and proposed amendments to the Banks Act and Regulations, to name but a few. The increased requirements will need significant resources to ensure that the Banking Group responds meaningfully and adjusts its internal processes and procedures to comply with the new requirements. The banking industry is conducting a regulatory impact assessment to determine the cost of compliance and the impact that increased regulation has on the industry.

Introduction and objectives

Regulatory risk management is an integral part of managing the risks inherent in the business of banking. 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 Banking Group therefore aims to establish a compliance culture in its operations that contributes to the overall objective of prudent regulatory compliance and risk management.

The objective of the compliance and regulatory risk management is to ensure that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws and that any risks to compliance can be identified and managed proactively prior to incurring a potential liability.

It is of paramount importance to ensure compliance with the requirements of the Banks Act 94 of 1990 (as amended) and the Regulations thereto, and to ensure that all non compliance risks identified in this context are addressed and managed in accordance with these rules and regulations and are in line with international best practice.

To achieve this, all staff must be aware of compliance requirements, have a high level of understanding of the regulatory framework applicable to the Banking Group, and they must be aware of the potential regulatory risks to which it is exposed. Ethical behaviour is both a keystone and an important contributor to the success of the entire compliance process. The Banking Group expects all its staff members to maintain standards of

honesty, integrity and fair dealing and to act with due skill, care and diligence.

Organisational structure and governance

While the responsibility for ensuring compliance with all relevant laws, internal policies, regulations and supervisory requirements rests with the Board, the role of monitoring, assessing and reporting the status of compliance is delegated by the Board to the Head of RRM. The RRM function carries out its duties in terms of Regulation 49 of the Banks Act, and its mandate is set out in the Compliance Risk Management Framework, a subpolicy of the BPRMF.

Supervision of regulatory risk is provided and managed by a number of committees such as the Regulatory risk committee, the RCC committee and the FRBH Audit committee, which receive detailed reports on the status of compliance and instances of material non compliance from RRM on a regular basis.

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

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

Assessment and management

The RRM function and the Board mandate prescribe a "zero tolerance" approach to compliance breaches. To achieve this, RRM has implemented appropriate structures, policies, processes and procedures to identify regulatory risks, monitor the management thereof and report on the status 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 FRBH;
- 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.

In support of the Compliance Risk Management Framework, a compliance manual was drafted which also fulfils the function of assisting the businesses in addressing all material compliance risks.

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.