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GT FERREIRA / Chairman

Dear Shareholder

The Group's performance

Often a Chairman's statement will start with a long exposition on the state of the economy, something I have also attempted in the past. However, FirstRand benefits from the views of two eminent South African economists, Rudolf Gouws of RMB and Cees Bruggemans of FNB and their extremely comprehensive overview of the SA economy can be found on pages 2 and 3 of this Annual Report.

I would simply like to reiterate that, during my lifetime, the SA economy has never been in better shape and I do believe that we have achieved, through excellent fiscal decision making by the Government, a structurally lower inflation and interest rate environment. This does not of course mean that we will not experience cyclicality and as this year drew to a close we started to see relatively small incremental increases in interest rates. These increases are not, in my view, the beginnings of another boom bust scenario, they are corrections required due partly to concerns of overheating in some segments of the economy but mainly due to significant external issues such as US and global interest rate increases, an increasing oil price and the large deficit on our current account.

With 2010 and the Soccer World Cup on the horizon (something I will return to later in this statement), Government's stated commitment to investment in services and infrastructure, strong corporate balance sheets and a growing consumer base, all contribute to a positive picture in South Africa for the next few years.

FirstRand produced excellent results for the year, growing normalised earnings by 21%. The Banking Group, which produced normalised earnings growth of 20% to R7.268 billion, benefited from an outstanding performance from Rand Merchant Bank ("RMB") and strong performances from First National Bank ("FNB") and WesBank. Sustained low interest rates continued to result in strong advances growth for FNB and WesBank although margin pressure increased. The strong equity markets and a healthy pipeline of BEE transactions underpinned the excellent performance of RMB's businesses.

Momentum delivered strong results in what remained a challenging operating environment, growing normalised earnings 23% to R1.564 billion. The combination of buoyant equity markets and the continued success of Momentum's distribution model resulted in a significant increase in lump sum investment inflows. Sales of recurring premium risk policies continued to also show strong growth, although sales of recurring premium investment products were negatively impacted by a reduction in retirement annuity sales.

Discovery delivered an excellent performance growing normalised earnings by 34% to R424 million. This performance reflects the success of Discovery's organic growth strategy.

Some of the challenges we faced during the year

One of the most significant challenges facing financial services globally is ever increasing regulation and South Africa has not escaped this trend, in both the banking and insurance sectors.

The Centre for the Study of Financial Innovation, in association with PricewaterhouseCoopers Inc., conducts an annual survey on the risks facing the banking industry worldwide, and compiles a document called the Banking Banana Skins Report. This year they surveyed 468 banks in 60 countries. It is interesting to note that for the second year running, banks worldwide regarded excessive regulation as the most important risk factor (ahead of credit and derivatives) facing the banking industry. The reasons include cost, diversion of management time and the sheer volume of regulatory initiatives.

Banking in particular is one of the most regulated industries in the world, which is appropriate given the influence these institutions have within economies. Systemic risk is something to be avoided at all costs but at the same time, it is also critical that financial institutions are profitable.

South Africa is committed to being a free market and therefore banks have to compete for capital, both funding and equity. If the return on the equity portion is inadequate, the banks will not attract further capital and debt funding, thus constraining their ability to lend and therefore grow. This in turn can constrain the growth of the economy.

It is also critical that the banks retain the trust and confidence of depositors that their money is safe and that their capital and interest will be paid. The reputations of banks therefore must be protected.

There is no doubt that over regulation can have a significant impact on profitability. In his introduction to the Banking Banana Skins 2006 report Andrew Hilton, Director of the Centre for the Study of Financial Innovation says "...regulation is not a free good; it is added to the cost of every single financial product and if it is excessive, that excess means we will all earn less from (and pay more for) the financial services we purchase. Over regulation also means that another row of bricks will have been added to the barriers that keep new entrants out of the banking industry – and that, inevitably means less competition, less innovation and generally higher charges".

Whilst I am not suggesting that we are in a situation of over regulation in South Africa, it is important that our policymakers understand the correct balance between risk and benefit. There may be some practices in the system that must change and the introduction of FAIS, FICA and the National Credit Act are all broadly positive for the banks and the consumer. However, we have a very sophisticated and robust financial services industry in South Africa that is admired in many developed and emerging markets and we must be careful not to regulate that industry out of business or erode its image in the eyes of its customers.

It is also important that policymakers do not fall into the trap of believing that all risks can be "regulated away". Banks are fairly good at managing risk, and it is a key competitive advantage for their business. We are fortunate that we have a regulator that understands the importance of this delicate balance.

Clearly, however, the combination of healthy regulation and consumerism can be a very positive force for change. I believe the investigations by the Pension Funds Adjudicator ("PFA") resulted in good news for the consumer and will ultimately be constructive for the insurance industry as a whole. Momentum is certainly applying its mind to providing value for money products to its customers and whilst this may in the short term impact negatively on margins, it is a fundamentally more sustainable way of dong business.

Banking fees remain a very relevant issue but an emotionally charged one. Those with a vested interest to bash the banks tend to ignore the facts and the media have dedicated thousands of column inches to the topic with varying degrees of insight. There have been a few research papers which have tried to apply a more scientific assessment of South African fees and benchmark them against other markets. For example, in their study for Finmark Trust, Genesis-Analytics noted that "the banks' cost of operations may also have an impact on prices charged to consumers. In Brazil, Kenya and South Africa, where labour costs are high, the bank charges at first glance seem amongst the highest in the accounts surveyed. In contrast Malaysia's low labour costs are reflected in lower bank charges".

There is no doubt that the cost of running a traditional bricks and mortar infrastructure is a large part of a bank's cost base, which ultimately has some impact on fees and FNB, in particular through its pricing strategy, has tried to migrate its customers to cheaper channels such as ATMs, the Internet and cellphones.

There is also much talk about the fact that the UK banks provide "free" banking for individuals (it is not free for SMEs). The fact is that the UK banks have very similar levels of profitability to banks in South Africa but generate their revenues in different ways. UK banks focus more than South African banks on interest revenue (from borrowing and lending) as well as charging more penalty fees. This approach to pricing hides the true costs to consumers and results in borrowing or lending customers cross subsidising transacting customers. It is worth noting that the net interest margins of the South African banks are over a third lower than the average for Global Emerging Markets' banks. These differences as well as many others, such as disparities in demographic profiles (South Africa has high inequality and many lower income consumers), financial literacy, security costs and regulation make simple comparisons difficult and ultimately misleading.

This debate will go on for a long time and in the end, the banks and the policymakers all need to be pragmatic. However, what is important is that the facts must take precedent over fiction particularly if it is designed to place un-commercial pressure on the banks.

There needs to be a resolution where everyone benefits. Such an example is the introduction of the National Credit Act. The Act is somewhat of a double edged sword in that whilst there is a component of FNB's fees which will come under pressure, on the other hand it creates a "level playing field" in certain segments, where the retailers and other non-regulated providers of finance have operated very profitably, which the established players can now enter. My view is that one of the reasons this Act is largely constructive is that there was effective engagement between the regulators and the industry, something that was also a crucial element of the PFA resolution.

We are also fully committed to working with the Competition Commission to ensure that customers get value for money but at the same time South Africa maintains a world-class payment system and highly competitive banking industry.

We believe that competition between the banks is already vigorous. Our view is that a competitive market drives innovation and change, improving our business, our customers' experience and ultimately our country. We will continue to compete aggressively on product, service, channels, price and brand to attract and retain customers.

There is no doubt that regulation and consumerism will continue to be part of the financial services landscape for quite some time. We remain hopeful that regulation will continue to focus on the promotion of a healthy banking and insurance system and not a response to populist thinking or political expediency. This is particularly critical if we wish to maintain shareholder confidence and continue to attract international investors to our banks and insurance companies as this is ultimately what creates capacity to grow.

2010 a catalyst for growth

Moving on to a very different topic, I was particularly fortunate this year to attend the Soccer World Cup in Germany. Not only was it a truly memorable sporting experience but it provided me with a real sense of the benefits the hosting of this event will bring to South Africa and the rest of Africa. It will certainly put the Continent, and especially the region, "on the map" with millions of people who have only a very limited appreciation of how exciting Africa can be. As a veteran spectator who attended three Soccer World Cups, four Rugby World Cups and six Olympic Games I think I have a valid perspective.

Can we handle the World Cup? I have no doubts that we can. I believe we will provide the venues, manage the logistics and provide a safe and efficient environment for the expected 500 000 visiting spectators during their 30-day stay in South Africa. Whilst we cannot afford to underestimate the challenges, Danny Jordaan has already stated publicly that he will pull together a "dream team" of local and international experts to ensure that we host an outstanding event. In addition, Government is behind it, business is behind it and over the next four years and beyond the economy will benefit from the anticipated investment required in roads, airports and technology, to deliver it. The transport and accommodation market has a way of sorting itself out (with a little bit of help from the authorities).

Michael Jordaan, the CEO of FNB, was with me in Germany while FNB was successfully negotiating to become an official National Sponsor of the FIFA 2010 World Cup. Michael lived in Germany at the time the Berlin Wall came down and he commented that in his view the real unification of East and West Germany finally happened in June this year courtesy of one of the greatest German soccer sides in recent history. I think therefore that in 2010 we could experience a further cementing and celebration of the South African unification story – although Bafana Bafana will need to get down to some serious training to make the semi-finals as the Germans did in 2006. At least we seem to have the right coach on board!

FNB was successful in its bid to become the first South African corporate to sign up as the financial services National Supporter of the 2010 World Cup for a total cost of $30 million. A key business benefit is that FNB takes on the role of the Official Bank of the 2010 FIFA World Cup and will be well positioned to compete for all business related opportunities. These range from tourism and hospitality to forex, transport and infrastructure and returns from these activities are expected to be well in excess of the sponsorship cost.

Major marketing benefits include access to tickets, direct association with FIFA and the official emblem and official provider of all event related financial services products. Ultimately, we believe that FNB's high profile association with the event will significantly enhance its brand and market share in the growing black middle market.

Management and vote of thanks

In September 2005, we announced that Laurie Dippenaar had decided to step down from his position as CEO at 31 December 2005. He remains on the board of FirstRand as a non-executive director and retains his position as chairman of Momentum Group, Discovery Holdings and OUTsurance. He also serves in a non-executive capacity on the board of FirstRand Bank Holdings and certain other group subsidiaries.

As a result of Laurie's decision, Paul Harris CEO of FirstRand Bank Holdings was appointed to replace Laurie at the FirstRand level and Sizwe Nxasana, previously a non-executive director of the Banking Group and CEO of Telkom, replaced Paul effective 1 January 2006.

The Group's succession plans have worked well and the changes have been relatively seamless.

Laurie Dippenaar has served our Group well in various executive and non-executive positions over the past 30 years. He was appointed CEO of FirstRand when the company was formed in 1998 and during his tenure as CEO, group earnings grew by an annual compound rate of 20%. We are delighted that the Group still enjoys his strategic input and in recognition of the remarkable contribution that he has made over the last eight years have decided to establish a post-graduate scholarship fund in his honour, with an initial seed capital contribution from the Group of R12 million. Laurie will contribute an additional R1 million of his own money to the fund. The scholarship, to be known as the FirstRand/Laurie Dippenaar Scholarship will form part of the FirstRand Foundation Educational Trust. It is envisaged that the Trust will grant one or two post-graduate scholarships each year for study at overseas universities. Details of the scholarships will be announced in due course and will be targeted at benefiting the brightest minds in South Africa.

Lastly, I wish to thank our shareholders, board of directors and last, but not least, our management and staff, for their efforts and contribution over the last year. Without your assistance FirstRand could never be the special company that it is and it is indeed an honour and a privilege for me to serve as the Chairman of the FirstRand Group and I am incredibly proud to do so.

GT Ferreira
Chairman