Laurie Dippenaar / chairman

CHAIRMAN'S STATEMENT

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Regular readers of my chairman's statement (I believe one or two such people do exist) will know that I have covered the topic of bank bashing a number of times over the years. In this financial year alone, I don't think many days have gone by when I haven't read some negative commentary or editorial on banks – sometimes this commentary is considered and insightful, sometimes it verges on hysterical ranting. Banks are deeply unpopular and yet all over the world they continue to survive and (in some instances) thrive. This seems paradoxical and not particularly logical and it led me to ask myself the question why, if they are so maligned and so damaging, do banks exist at all?

They have certainly been around for a very long time – in fact since ancient times. In 1800 BC in Egypt and Mesopotamia, gold was compressed into a convenient form and deposited in certain temples for safekeeping, and around the same time the first loan ever recorded was granted in Babylon. Much later, in the 4th century BC, Greeks and Romans introduced services such as deposit taking, making loans, testing coins for weight and purity and also changing money from one currency to another. Moreover, book transactions were made such that a payment was accepted in one city and a credit was arranged in another, thereby avoiding the transportation of gold. To assist me further in answering the question I then hit Google and typed in "why do banks exist?" Google answered:

"Banks exist first and foremost as a secure place to store wealth held in the form of readily available money.

Banks make money by granting loans from a portion of the deposits and charging interest on those loans. Banks compete for deposits through interest rates offered on deposits. Banks also charge fees for various services, all of which involve moving money from one account to another or making payments. Plus there are fees for processing these activities.

As a result of these various activities banks are considered vital to economic development through their prudent investment of portions of the wealth stored in them. Banks are also considered integral to various other functions related to the management of the nation's money supply and systems of credit."

On this basis banking would seem a vital and constructive force in the economy. It doesn't, therefore, explain the fact that banks are currently not perceived that way, in fact the other day I read an article with the headline *Doctors are rapidly becoming as unpopular as bankers.* So what has gone so badly wrong in the world of banks?

The answer is both simple and complex. The first thing that went wrong was that in the late 1990s many of the world's large banks stopped focusing on their core business and became overly enamoured with something called the "leveraged return". The timing was perfect – low borrowing costs and a willingness by the banks to lend lots of money – both of these conditions came together perfectly in the years leading up to the global credit crisis.

The second thing that happened was an expectation from equity markets that earnings in any year must be greater than in the prior year. In pursuit of growth, assets rocketed to historical highs and leverage at major financial institutions increased from around 20 to 35 times capital. Management teams felt immense pressure to keep profits growing. More leverage was piled upon leverage to keep the house of cards intact; eventually it all came crashing down. The rest, as they say, is history.

So what is the point of this? Well one of the lessons learned was that when banks focus on their core business of making money by granting loans from a portion of deposits and charging interest on those loans and charging fees for various services, which involve moving money from one account to another or making payments, they are an incredibly useful instrument – the oil that lubricates the wheels of the economy. That is why banks exist.

A renewed focus on the basics of banking is what I believe the Group has achieved since 2010 when we restructured our business model in response to the global crisis. Whilst excessive leverage was not a characteristic of the South African banking system, over heated asset prices and cheap money was – and it proved to be unsustainable. When I consider the Group's performance for the year to June 2013 I am struck by the degree to which going back to basics; such as winning new customers, providing them with channels to transact on that are cheap, user friendly, convenient and rewarding; lending good customers money at the right price; and building a deposit franchise – has benefited FNB. This approach, combined with a deeply embedded culture of innovation, has allowed them to take significant but profitable market share. I am also struck by the high quality of the earnings RMB now generates, particularly when compared to 2009 when 39% was from client activities and 32% from proprietary trading activities. Today 84% of RMB's income is generated from client activities, resulting from some definitive management actions to deliver less volatile and more sustainable returns to shareholders.

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On the back of these strategies the Group has again produced a very strong financial and operational performance, achieving normalised earnings of R15 323 million, an increase of 20% on the previous period and a normalised ROE of 22.2% (2012: 20.7%).

Despite the fact that the operating environment continues to be challenging, and it gets tougher every year to grow, somehow the business gathers momentum and delivers superior profits and returns to shareholders. This year, the level of profitability has also allowed us to create meaningful impairment overlays, which I believe will stand us in good stead in the next few years as, when assessing the operating environment going forward, there is no doubt that some of the tail winds the economy has benefited from are rapidly disappearing. More detail on these overlays can be found in the *COO & CFO's report*.

Our economy continues to be negatively impacted by shifts in both global and domestic risk dynamics. Previous high levels of capital inflows, a strong rand, low bond yields, elevated commodity prices and robust growth in household incomes created good opportunities for growth. However, the US economy has recently started to improve and its central bank may start to unwind current monetary policy stimulus. Just the suggestion of such a development immediately impacted emerging market flows, which had previously benefited from low US rates, and for South Africa this has already resulted in some currency weakness. If this trend continues and the currency weakens further, the country may be forced to raise interest rates, which, in turn, would negatively impact internal growth generation. There are some significant vulnerabilities in our macro environment which we need to take cognisance of. Domestic GDP continues to slow as a result of lower levels of activity in both the household and business sectors of the economy. Slowing consumer and investment spend is resulting in lower credit extension and a muted housing market.

Given these issues many South African corporates with large shares of the domestic market are seeking growth in the rest of Africa. FirstRand is no exception, although I believe our approach to growth on the rest of the continent is differentiated from our peers.

In the 2011 annual integrated report both myself and the FirstRand CEO, Sizwe Nxasana, commented in some detail on how we would approach growing the Group's franchise outside of South Africa. I actually relooked at my Chairman's statement that year and our position has remained very consistent.

My statement in 2011 reads "what really matters to us is that as we grow in Africa, we create long-term value and returns for our shareholders. We are, therefore, committed to a highly disciplined approach, which I believe we demonstrated when we did not proceed with the Sterling Bank transaction in Nigeria".

FirstRand has been recently criticised in some quarters for "failing to complete transactions in Nigeria, Zambia and Ghana". We do not see it that way at all, particularly as our strategic preference has always been to grow organically. However, we always consider acquisitions if they make commercial sense – and in both instances Sterling and MBG did not. This is not "failing" this is success! This is what management teams must do; deploy capital into assets and activities that will generate a proper return.

The other "conventional wisdom" we are often offered is that a large physical footprint is the golden key to growing in Africa. Given what is happening throughout the world – banking on electronic and mobile devices is growing exponentially and every bank in the world is shrinking branch networks – the traditional infrastructure may turn out to be very, very expensive and ultimately redundant. Africa is no different to other markets. In fact the geographical challenges in some African countries make mobile banking very attractive. Large distances between communities can be effectively addressed through mobile technology, particularly given the high penetration of cellphones in all of the countries we are targeting for growth.

In his *CEO report* this year, Sizwe provides a more comprehensive overview of what our franchises are achieving in the rest of Africa. As a board we are very comfortable with the approach; an incremental growth strategy in the main, a mix of organic, bolt-on acquisition and the utilisation of skills and balance sheet. Growing quality earnings anywhere is tough, growing quality earnings in new territories requires patience and discipline – we will continue to exercise both on behalf of our shareholders.

During the year patience and discipline finally played out in our long-standing legal dispute with a former service provider linked to the "International Tax Institute". This litigation has been ongoing for over ten years and resulted from the termination of a contract for non-performance. The litigant spent many of those years using the media to embarrass and malign FirstRand, accusing the Group of a number of very serious offences such as money laundering and tax evasion.

Our strategy was always to fight our case in the Law Courts rather than in the media. This approach was eventually vindicated and for the record, below is an extract from the recent judgement exonerating FirstRand from any wrongdoing relating to allegations against the company, its clients and its officials.

"…there is absolutely no evidence of whatever nature that supports the repeated attacks upon the defendant or the FirstRand Group by the plaintiffs, accusing the former of being involved in Exchange Control violations, money laundering, dealing in embezzled funds, fraud, and unlawful destruction of statutory records or maintaining bogus accounts. The gratuitous accusations levelled at the defendant's clients and the defendant itself, intended to tarnish captains of industry and defendant's employees and directors with the brush of dishonesty, were and remain baseless and unsubstantiated."

I mention this issue because as a direct result of the actions of this one litigant, much has been written in the media about the Group which was designed to question our credibility and cast aspersions on our honesty. We are very pleased to lay this long-standing issue to rest.

This year I am not planning to cover executive remuneration again, we continue to work on increased disclosure in the report of the remuneration committee (see page 81) and our philosophy remains intact – management reward must be directly aligned to shareholder returns.

What I would like to cover, however, are the various management changes we recently announced.

In May we informed shareholders that after ten years in the role, Michael Jordaan is stepping down as CEO of FNB at the end of this calendar year to spend more time with his family.

Michael's tenure at FNB has been incredibly successful. Much of which can be attributed to his passion for innovation which, backed up by his knowledge of the intersection of banking, technology and social media, has delivered strong growth and excellent returns for the Group and its shareholders.

Jacques Celliers, who replaces him as CEO, is a member of the FNB executive committee and we expect this to be a very smooth succession. Jacques joined FNB 12 years ago and has managed a number of initiatives particularly focusing on innovative entry strategies in new markets. During his career at FNB Jacques has demonstrated a unique ability to bring leadership and innovative thinking to many aspects of FNB's operations. He is one of FNB's most seasoned and "highly decorated" innovators. I am confident that the FNB management team, under his leadership, will continue on its successful growth path.

In September we announced that Johan Burger, currently FirstRand Group Financial Director and Group COO is appointed Group Deputy CEO from 1 October 2013, although he will retain the Group Financial Director role until 31 December 2013. Following his appointment as Group CFO and COO in 2009, Johan's role and responsibilities expanded significantly. We believe this new role (which also incorporates the COO role) frees him up to spend more time on managing the financial resources of the Group, namely capital, funding and risk, and driving strategic cross-franchise initiatives.

At the same time Harry Kellan was appointed FirstRand Bank CFO and will take over the role of Group Financial Director from Johan effective 1 January 2014. Harry joins the Group from our largest franchise FNB, where he was CFO since 2007.

Brian Riley retires as CEO of WesBank on 31 December 2013 and Chris de Kock, who is currently General Manager: Sales and Marketing at WesBank, replaces him as CEO from 1 January 2014.

This probably seems like a great deal of change over a relatively short period, but the board is very comfortable with these appointments. Given our owner manager culture and the level of empowerment that our management teams enjoy, moving people into senior roles is quite straightforward and seamless. We have overseen many changes in our management teams – at both a Group and franchise level – over the past ten years, and, thanks to the depth and quality of our people, these transitions have been smooth and have ensured continuity and momentum in our operations.

Looking forward, we see some headwinds emerging in our operating environment; however, we expect to continue to produce good organic growth. I believe that our businesses are extremely well positioned to weather a difficult cycle; our balance sheet is strong in that we are well capitalised and well provided. Our operating franchises are in great shape and our growth strategies are playing out as expected. This does not mean that we can be in any way complacent. We have very fierce competition in all of our markets and we must never underestimate them.

In closing I would like to thank Tim Store, who having reached retirement age, retired from the board on 31 May 2013. He has been a stalwart of the board and other Group committees for many years.

During this tenure he was chairman of the audit, risk, capital management and compliance, the social and ethics large exposure and model risk valuation committees. He also played a leading role in developing the mandates of some of these committees. His wisdom and experience will be missed and we wish him a happy retirement.

I also wish Brian Riley, the very best in his retirement, he has overseen an incredibly successful period of growth at WesBank.

I would like to thank Michael Jordaan for the ten years he has spent at FNB, building the business into one of the most powerful financial services franchises in South Africa. We fully understand Michael's desire to spend more time with his young family, and recognise that his five years of commuting weekly from Cape Town has been a significant sacrifice. We wish him luck in his new ventures, which no doubt will be successful and highly innovative in nature.

Finally, thank you to all of the employees of FirstRand, for your hard work and commitment. It is reflected in the Group's performance – let's keep it up!

Laurie Dippenaar
Chairman