As I think about the future, I too try and see the black swans that could influence our world, our society and this company. It is an extremely difficult exercise.

Laurie Dippenaar

chairman's report

YOU CAN TRUST A CRYSTAL BALL ABOUT AS FAR AS YOU CAN THROW IT

In his book "The Black Swan: The Impact of the Highly Improbable," finance professor and former Wall Street trader Nassim Nicholas Taleb, describes an event or occurrence that deviates beyond what is normally expected of a situation and that would be extremely difficult to predict.

Taleb took the basis of his book and the idea of a 'black swan event' from the shock that Europeans experienced when they discovered black swans in Australia. Until then, their data told them that all swans were white, so the discovery was unexpected.

Mr Taleb suggests that black swan events can have truly catastrophic and unpredictable effects and yet, as he laments, "in spite of the empirical record we continue to project into the future as if we were good at it" and we continue to expect all swans to be white and are shocked when a black swan swims by.

Also, according to Taleb, history actually proceeds by "jumps," triggered by "the singular, the accidental, the unseen and the unpredicted" and, whilst gradual change remains our normality, in fact, actual change is almost always outlandish. Take for instance 9/11 or the rise of Google, these are very different types of black swan events that have had wide-ranging, society-changing effects that will extend far beyond their initial apparent import.

As I think about the future, I too try and see the black swans that could influence our world, our society and this company. It is an extremely difficult exercise.

A black swan event in markets is one that has not occurred in the past, thus rendering risk management models, based on historic data, utterly useless as such a risk model would assume that all swans were white. We actually experienced one in December 2015 when President Zuma fired Minister Nene, absolutely no one saw that coming and the markets reacted accordingly – characterised by panic, volatility and massive risk aversion. This was closely followed by threats of a sovereign downgrade (something that as I write this statement today is still a strong possibility) and a fundamental downward shift in international investor confidence.

"In spite of the empirical record we continue to project into the future as if we were good at it" and we continue to expect all swans to be white and are shocked when a black swan swims by.

South Africa continues to live with the legacy of the President's actions, and it is clear that the market is relying heavily on Finance Minister Gordhan to navigate the country out of its current precarious position, and yet certain factions continue to mess with this very fragile situation. Our currency reflects that fragility.

FirstRand as a large economic player also continues to navigate its way through this difficult scenario. "Nenegate" was a body blow to the banking sector which saw billions wiped off valuations. The cost of capital has structurally moved higher, which makes it even harder to deliver economic value to our shareholders. A downgrade will definitely impede our ability to raise hard currency funding, which in turn will constrain our ability to grow in the rest of Africa region.

A BANK'S REPUTATION IS EVERYTHING

The turmoil of Nenegate was quickly followed by massive press scrutiny on the government's reaction to the termination of certain bank accounts. There was an unbelievable amount of misinformation swirling around at the time so I thought it would be helpful to explain to our stakeholders under what circumstances banks consider parting company with a customer. Given strict client confidentiality requirements, which for banks are set down in law, I am only commenting on generic frameworks and principles.

To provide some kind of context to the potential risks banks run if they fail to "do the right thing", $290 billion represents the approximate value of fines paid over the past few years by global banks that have contravened regulations, including those that relate to responsible customer conduct. This is an almost incomprehensible number, but as a reference, it represents the total GDP of Angola, Morocco and Kenya combined.

These fines decimated banks' profits, deeply eroded their capital bases, permanently destroyed massive amounts of shareholder value and dramatically affected their reputations. One further downstream impact included the loss of thousands of banking jobs.

This level of punishment should not really surprise anyone. Banks function on the back of customer trust and confidence, which comes with the role they play in the economy of taking deposits and transferring funds. Billions of people place their precious salaries and savings with banks, in return banks provide customers with safe and effective mechanisms to access or move these funds around or assist customers to leverage them through credit. Given this background, banks have developed massive risk mitigation departments and processes and absolutely everything gets tested rigorously and this would include any decision relating to taking on or parting with a customer.

Everyone knows why customers choose to leave banks: poor service, unwillingness to grant credit or a better offering from a competitor. What seems to be less well known is why a bank would even consider parting with a customer. It seems very counter-intuitive for a client-centric business to take such action.

In reality, there are many, many reasons, some seemingly mundane, such as accounts that show long periods of dormancy. There are, however, also instances where customer behaviour requires action or

Whilst total cost growth **continues to trend above inflation** it's important to differentiate between the cost of running the business and the cost of growing the business.

The overall credit picture continues to remain **in line with our expectations** and reflects origination actions taken in the different segments of the group's customer base throughout the current credit cycle.

Our ability to allocate capital to maximise shareholder returns, is demonstrated through our **superior ROE of 24% and the 10% growth achieved** in net asset value per share.

there is potential reputational risk for the bank. This is because South African banks operate in a globally integrated system. The South African Reserve Bank is a signatory to many international standard setting bodies such as the G20, the Financial Stability Board, the International Monetary Fund, the Bank for International Settlements and the Basel Committee. In addition, South Africa is a member of the Financial Action Task Force, a global body which develops international customer acceptance standards for regulators.

If the South African banks do not comply with local and global regulations and do not take principles regarding reputational risk management seriously, foreign investment flows to the country will be significantly reduced. This will be disastrous for the country's fiscal health which remains extremely reliant on these flows. International investors run their own risk dashboards for South Africa and responsible banking conduct is a key input. The South African banking sector scores very highly on every international governance index and should never ever compromise on this.

FIRSTRAND'S PERFORMANCE REFLECTS OUR RESILIENCE IN THE FACE OF THESE EXTERNAL SHOCKS

Below is a high-level overview of how the group performed in the year under review. In the *CFO's report* on page 38 there is significant detail on the key financial metrics, including how we have allocated our financial resources, which is a key component to our outperformance in terms of return on equity.

FirstRand's portfolio produced a very resilient performance, growing normalised earnings 7% and producing an ROE of 24.0%. Our net interest income increased 13% driven by good growth in advances and deposits, and earnings benefited R1.1 billion due to the positive endowment effect of an average 68 bps increase in the repo rate for the year and higher capital levels.

Non-interest revenue growth of 7% was very robust, and particularly impressive at FNB (+8%) given the regulatory impact of reduced interchange fees, and was achieved on the back of good growth in volumes (particularly in electronic channels) and increased product cross-sell and up-sell. Non-interest revenue also benefited from RMB's private equity and investment banking businesses, both of which grew off high bases, and WesBank's insurance businesses.

Whilst total cost growth continues to trend above inflation it's important to differentiate between the cost of running the business and the cost of growing the business. We remain committed to investing in our future growth strategies which are outlined in more detail in the *CEO's report* on page 14.

The overall credit picture continues to remain in line with our expectations and reflects origination actions taken in the different segments of the group's customer base throughout the current credit cycle. Whilst we have consistently adjusted credit appetite in the high risk segments of the retail market, we have experienced robust growth in lending on the back of FNB's strategy to focus on selling more products into its core transactional customer base.

It is worth mentioning that for the first time since the previous credit cycle of 2009 and 2010, the group's earnings growth has not significantly outperformed that of the peers, however, we did tell our shareholders to expect this. Following at least five years of outperformance, the group is still showing good growth in earnings off a very high base, so given all the economic and regulatory headwinds we face, 8% growth in diluted normalised earnings per share is a very good outcome. This performance was also achieved whilst the group is investing heavily in future growth strategies that we believe will ensure outperformance over the longer term.

All of this demonstrates the quality of the group's portfolio of businesses, which, when combined with our ability to allocate capital to maximise shareholder returns, is demonstrated through our superior ROE of 24% and the 10% growth in normalised net asset value per share.

It's also worth remembering that management's key performance measure is to beat cost of capital, which has resulted in a remuneration strategy closely aligned to the requirements of our shareholders. On page 12 there is more detail on our philosophy on remuneration and how it drives performance.

LOOKING FORWARD, OUR BUSINESS IS AS WELL POSITIONED AND WELL PREPARED AS IT CAN BE

In his *CEO's report* this year, Johan Burger unpacks in some detail the revised model and framework the group has adopted in order to deliver growth and returns going forward. The past decade has been an excellent period of performance for the group and its shareholders, particularly as our banking franchises have optimised their market leadership positions to participate in many of the growth opportunities that have presented themselves in South Africa and those countries in the rest of Africa where we operate. However, the absolute size of these franchises combined with the regulatory costs they need to absorb, means that we have to look at more cost-effective platforms to serve our customers, particularly as we plan our attack on the broader financial services profit pools.

Since inception, the group has always sought to optimise the many building blocks its portfolio provides, whether these are customer bases, technology platforms, distribution networks, skills or licenses. We have been quite effective at using these platforms in innovative and efficient ways in the past, either to build completely new businesses like OUTsurance and Discovery or strengthen existing businesses. For example I think it is a little known fact that the group employs more actuaries in the bank than any insurance company in South Africa. These skills have been well deployed into our credit risk functions, which I believe has helped the group to position its balance sheet better than its peers in this current credit cycle.

The group's new model and strategy takes this idea of building blocks to another level and will be key to our ability to grow in our domestic market.

The rest of Africa continues to represent a challenge for us. Three years ago, when Africa was the "next big thing" the group was often described as a "laggard" in the region, or we were criticised for our "failure" to acquire something in Nigeria. How things can change and change quickly! Falling commodity prices resulted in extreme economic pain for many of the economies we were looking to expand into. As China's appetite for commodities reduced, so has investors' love affair with rest of Africa, and certainly risks have elevated and growth projections have dropped sharply.

However, despite this current scenario, FirstRand remains committed to growing outside of South Africa, on the back of a strategy that is both organic and acquisitive. Whilst we will remain disciplined and definitely not squander shareholders' capital on seemingly cheap earnings, we do see the region as a long-term growth opportunity, and are very focused on creating more of a "portfolio" effect to reduce concentrations and diversify risk. We believe that asset prices in jurisdictions, such as Nigeria, have recently become much more realistic and we feel more comfortable to look for opportunities to deploy shareholder capital for acquisitions to assist us in scaling up our operations.

SOUTH AFRICA IS A RESILIENT COUNTRY, BUT THE RISKS CONTINUE TO RISE

When we engage with international investors they often comment that one of the reasons South Africa remains such an attractive investment proposition is the quality of its corporations and their management teams. Despite our incredibly volatile currency, which can decimate dollar returns overnight, our companies enjoy significant support, particularly when emerging markets get shocked, as investors take flight to quality.

That's why it's so important that the government sends the correct signals to the world's capital markets. These signals must be actions, not words, and they are critical to the country's credibility. I would like to quote from a man I admire very much, Adi Enthoven, the chairman

of Hollard who gave the van Zyl Slabbert memorial lecture at Stellenbosch University recently. He said many wise things in his speech, but I wanted to draw attention to something he said that particularly resonated with me.

"There can be little doubt that, as in many of the State Owned Enterprises, there are some of our institutions that have been undermined and captured, and there are some that are under extreme duress. It is no coincidence that the targeted institutions are those that present either the greatest opportunity to wield patronage power and/or the greatest threat to patronage.

The principle tactics have included bullying, intimidation and manufacturing allegations of misconduct in order to either gain acquiescence or failing that the appointment of compliant individuals. This is not an outright attack on the institutions and the Constitution, but has the same effect.

We cannot stand by and allow this systematic raid on our institutions to succeed. The South African democratic project is not a project of a political party, or government or parliament.

It is our project. As citizens, we collectively own and are the ultimate custodians and guardians of our democracy. They must not be subverted on our watch. There needs to be a clear metaphorical "line in the sand" that cannot be crossed."

Sometimes when I read the newspapers, I find myself fearful that the "line in the sand" has already been crossed. Indeed as I write this statement, the Minister of Finance is under attack again from forces that seek to remove him from his position and replace him with a potentially more pliable individual. Our National Treasury is the richest prize yet for those who seek full state capture, and is also the key to unlocking the massive value sitting in our state-owned enterprises.

So it really is up to the citizens of this country to stand firm. We owe it to the generations that will come after us. And there is some light at the end of the tunnel. August's municipal elections were a strong message that the general population is tired of the plunder, the non-delivery and the self-interest. This wasn't a message based on race, income groups or political factions – it was a message from the collective, whose patience is running out.

IN CONCLUSION

During the year, Leon Crouse and Kgotso Schoeman retired from the FirstRand board after serving since 2008. Leon has provided valuable technical insights and a truly balanced perspective in board deliberations. Kgotso has deepened the group's understanding of socioeconomic development issues and opportunities both in South Africa and other emerging markets. We are extremely grateful to Leon and Kgotso for sharing their wisdom with us so generously, and to their families for the time that they have dedicated to FirstRand and its stakeholders. I wish you long, happy and productive retirements.

Finally, I would also like to extend my thanks to each and every employee of FirstRand. It is your hard work and total commitment that allows me to present such a resilient set of results to our shareholders.

LAURIE DIPPENAAR
Chairman

ADDITIONAL COMMENTARY BY THE CHAIRMAN ON FIRSTRAND'S REMUNERATION

> I have on many occasions in my statement attempted to explain in simple terms why I am comfortable with our remuneration philosophy. The rigorous health checks we apply are demonstrated below and, in my view, have been consistently applied through the years and have directly driven the outperformance our shareholders have enjoyed. The board is extremely cognisant of the levels of scrutiny required on compensation and we believe our frameworks stand up to scrutiny.
>
> – *Laurie Dippenaar*

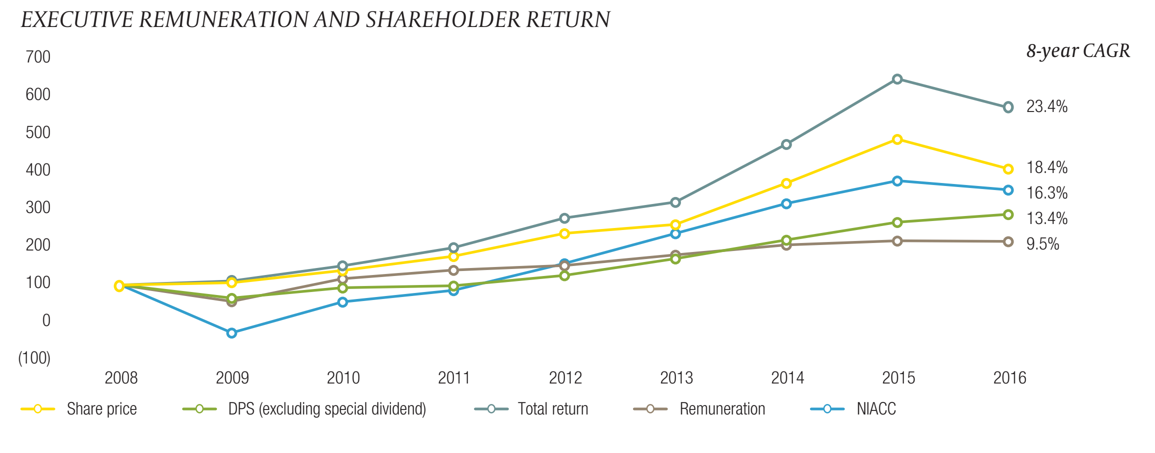
HEALTHCHECK 1

FirstRand fundamentally believes that executive remuneration must align with shareholder value creation and the group's key performance measure, net income after cost of capital (NIACC), ensures that the link between pay and performance is direct.

If there is one cornerstone to FirstRand's approach to employee remuneration it is that management must never do better than shareholders.

The growth in total return to shareholders as well as the growth in NIACC has significantly exceeded management remuneration.

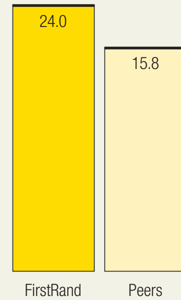
EXECUTIVE REMUNERATION AND SHAREHOLDER RETURN



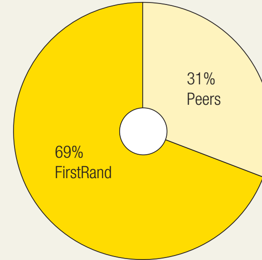
HEALTHCHECK 2

FirstRand's remuneration on a "relative" basis to peers is not out of line, particularly given the level of outperformance the group has delivered over the past five years.

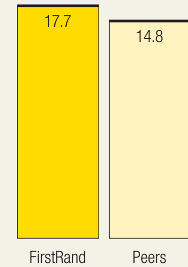
ROE % (post tax)



FIVE-YEAR CUMULATIVE NIACC as a % of peer group's combined five-year cumulative NIACC

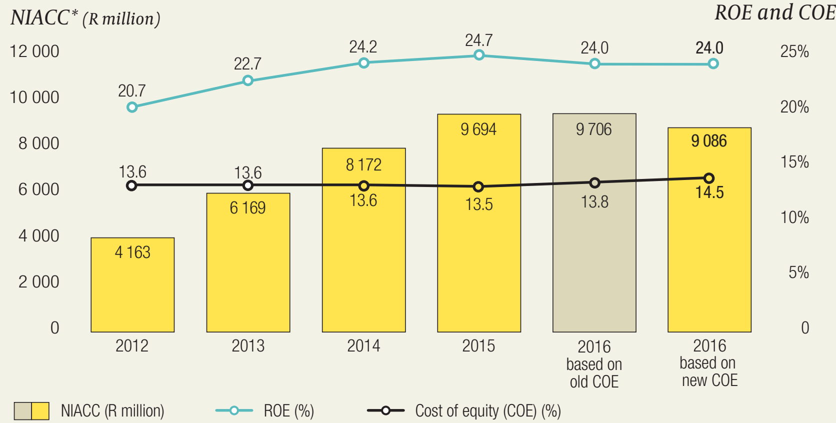


NORMALISED EARNINGS FIVE-YEAR CAGR %



Refer to page 99 for definitions of peer group disclosures.

NIACC (R million)* / *ROE and COE*



Culture has played a key part in the group's ability to generate superior returns. Management are treated like owners, act like owners and think like shareholders.

HEALTHCHECK 3

Targets set for management are always "stretch" but achievable and long-term performance alignment is guaranteed through a large "deferred" component of management remuneration, directly linked to performance. Share options do not vest if performance criteria are not met. The 2008 options did not vest in 2011.

Issue	Normalised EPS in year of issue	Vesting criteria	NIACC over the period
2012 CIP 3 year	225.8 cents	Nominal GDP + 3%	Positive (vested)
2013 CIP 3 year	273.5 cents	Nominal GDP +1.5%	Positive
2014 CIP 3 year	331.0 cents	Nominal GDP + 2%	Positive
2015 CIP 3 year	378.5 cents	Nominal GDP +1.0% COE + 5%	Positive

EXECUTIVE PAY AND SHARES VESTED

R thousands	Cash package	Cash bonus	Deferred bonus	Shares vested*	Total
Johan Burger (CEO)	9 617	13 165	11 165	28 504	62 451
Alan Pullinger (deputy CEO)	6 661	11 000	9 000	27 988	54 649
Harry Kellan (financial director)	5 461	4 937	2 938	12 600	25 936
Jacques Celliers (FNB CEO)	6 567	6 625	4 625	15 623	33 440
James Formby (RMB CEO)	3 044	10 625	8 625	15 922	38 216
Chris de Kock (WesBank CEO)	4 417	5 000	3 000	9 119	21 536

* *Reflects three years of value accretion.*