Laurie Dippenaar

chairman's report

POLITICS, THE WHITE MONOPOLY CAPITAL NARRATIVE AND STATE CAPTURE

As I am writing this report, it is mid-year and corruption, state capture and public in-fighting in the ANC have all combined to reduce South Africa to junk status and worsen the already parlous state of our economy. This is a sad outcome for Nelson Mandela's rainbow nation of 1994.

That almost unimaginable amounts of money have been stolen from the fiscus (read – the South African taxpayer) by a few connected individuals, in the most cynical and malevolent manner, is hard to accept. What is even harder to accept is that ultimately it is the poor and the vulnerable members of our society who will be hurt the most.

As this scenario continues to play out, I would like to acknowledge the unstinting efforts of our media as they have relentlessly chased down and exposed those guilty of corruption, despite facing heavy intimidation and threats of physical harm. I would also like to praise the independence and courage of our judiciary and finally recognise the strength of our constitution that has withstood a number of serious attempts to undermine it.

Those corrupt individuals who suddenly felt the heat of media scrutiny were quick to adopt a strategy of misdirection, and this resulted in one of the most divisive media campaigns ever invented – that of "white monopoly capital" or even "white settler monopoly capital". This deeply negative narrative awoke the sleeping giant of apartheid and rapidly found traction in some seriously racist rhetoric, and whilst its origins and intent have now been fully exposed (and heads in a particular PR firm in London have rolled) the damage to our fledgling democracy has been significant.

In addition, despite the efforts of the media, the judiciary and civic society, many of the practical mechanisms of state capture remain in place and until these are properly dealt with and the individuals who stole the assets of this country are brought to account, the country's wounds will not heal. I hope that the ANC finds unity and repairs itself at the end of this year, only then can we look forward with renewed optimism.

Banks must act ethically and within the law as this is key to building trust

BANKS REMAIN FAIR GAME

Unfortunately the banks also came under significant attack during this financial year, with the worst assaults emanating from a certain group of individuals and companies whose bank accounts were closed, and those in government who supported them. The details of this have played out very publicly in the media and in the courts.

It's a very important topic which goes straight to the heart of why banks must act ethically and within the law. I believe this is key to building trust between financial service providers and their stakeholders.

The first point I would like to make is that this was not a capricious decision by the banks in question, they acted in line with the requirements of the Financial Intelligence Centre Act (FICA), a piece of global regulation introduced to fight financial crime, such as money laundering and terrorist financing activities. The individuals I referred to earlier were undeniably politically connected and the banks faced enormous regulatory and reputational risk if they had not acted.

Signed into law by President Zuma earlier this year, the act brings South Africa in line with similar legislation in other countries and it places legal onus on the banks to report "suspicious" transactions or movement of monies to the Financial Intelligence Unit, which is then required to investigate whether these transactions derive from unlawful activities.

However, the actions of the banks unleashed a tsunami of fury from certain quarters of government, in addition and even more worryingly, it precipitated an attack on the South African Reserve Bank (SARB) and the Minister of Finance, and hinted of intended further attacks on the country's constitution.

It also gained further momentum through the white monopoly capital campaign with the banks often singled out as the worst examples. This then morphed into attacks on the oligopolistic nature of the sector and its unwillingness to transform and I would now like to spend a bit of time debunking both of these assertions.

MYTH 1: THE SA BANKS ARE “TOO BIG” AND ANTICOMPETITIVE

Let’s start by quoting the SARB, one of the most well respected central banks in the world.

“One of the advantages to having four large banks is that there’s more resilience in the event of a financial crisis,” said Kuben Naidoo, deputy governor of the SARB, in March this year.

He went on to point out that though market dominance is relevant for competition, it is not necessarily indicative of the “absence” of competition. This resonates with me. I don’t know how many new banking licences have been issued since 1995 but FBC Fidelity, Real Africa Durolink, African Merchant Bank, ABIL and Capitec all come to mind. Indeed, there are currently three new licences waiting in the wings all of which are likely to be ratified before the end of the year. This does not signify a lack of competition or high barriers to entry, this looks healthy.

All regulators seek to balance financial system strength with appropriate competition, both of which are non-negotiables, but this issue of financial strength should not be underestimated. The soundness of the financial system is a necessary pre-condition for favourable economic development and effective monetary policy.

One of the reasons the South African banking system is dominated by the big four is that over the past two decades they have absorbed the financial fall-out of second-tier bank failures.

Early in September 2002, the Registrar of Banks placed Saambou under curatorship. Authorities were forced to act because the bank was experiencing increasing liquidity problems and it was not certain it would be able to repay deposits. Radical measures were implemented to prevent a run on the bank. This included closing branches across the country to deny customers access to their deposits and the implementation of a staged withdrawal plan.

Fortunately FNB stepped in and took over Saambou’s operations, and in the process, acquired the traditional mortgage book, comprising 60 000 accounts and half of Saambou’s low-cost housing book, which comprised about 20 000 accounts. In total, R12.8 billion of deposits and R4.9 billion of mortgage loans were absorbed. The scale of FNB’s operations and balance sheet enabled it to protect the depositors and whilst its true that over time FNB made money from the Saambou books it could have ended badly for those customers if a bank with the necessary capacity had not been able to step up. BOE was rescued by the SARB and acquired by Nedbank the same year.

In August 2014, the country’s commercial banks stepped in again with a USD1.6 billion plan to rescue ABIL from a flood of bad debts mostly racked up on risky loans to unsecured borrowers. The support measures implemented were welcomed by Gill Marcus, the Governor of the SARB at the time.

“These will further strengthen the resilience of the banking system as a whole, and, importantly, they will provide African Bank with the best chance of a viable future,” she said.

The reality is that the size and scale of the big four banks in South Africa is key to financial and economic stability and to public confidence. This does not mean that competition is killed off in the process. Community banks, specialist banks and fintech banks operate successfully but they certainly do not have the balance sheets to rescue failed institutions or lend billions of rand to state owned enterprises (SOEs), renewable energy programs and BEE deals.

In fact, the country’s renewable energy programme is a good example of why financial strength is important. The programme was a public-private partnership through which private renewable energy producers provided electricity to the national grid. In only five years R194 billion of funding was raised. This represents six times the amount invested in infrastructure for the 2010 World Cup and although much of the funding was sourced from foreign investors, the strength of South Africa’s financial infrastructure was essential to making it happen. By the way, the programme has been recognised as the fastest roll-out of renewable energy generation anywhere in the world.

As much as the white monopoly capital rhetoric tried to tap into the sinister aspects of big business the facts show that banks are **national assets**. They should be preserved by our government, not undermined.

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MYTH 2: THE BANKS "REFUSE" TO TRANSFORM

The second piece to this year's negative narrative on banks was the accusations that the banking sector was refusing to transform, or not taking equality and inclusiveness seriously.

Below is a quote from the Intellidex submission document to the Standing Committee on Finance of the Parliament

"Many BEE deals have used structures that ensure that black beneficiaries are able to access the benefits of ownership of shares, without being fully exposed to the downside risk. South Africa's investment banking industry developed and pioneered the technique of "notional financing" which allowed BEE schemes to gain exposure to shares without the immediate cost of financing. In the event that share price performance was subsequently weak, beneficiaries face no downside risk. When share price performance is good, beneficiaries are able to receive unencumbered shares that then form capital in their hands. There has been significant wealth creation among black beneficiaries specifically because of this form of financial engineering.

Notional financing is a good example of what is made possible by South Africa's extensive capital markets infrastructure. The liquid capital market provides a means for price discovery of the value of shares, which is essential for notional financing schemes to work. Such financial technology would be impossible in any other economy in Africa.

South Africa's financial institutions should therefore be seen as enablers of transformation of the economy. The sophisticated financial infrastructure that the banking, savings and insurance industries collectively represent, in tandem with the capital market, are a national asset. That asset can be utilised in the service of developing, growing and transforming the economy."

This is not the banks arguing for themselves, this is an independent research house which was asked to submit a technical analysis of the level of transformation taking place in the country and the financial services sector's role in that process. It is fascinating that Intellidex's conclusion is that the banks have already proved to be effective instruments of transformation, and their infrastructures are key to unlocking deep and systemic transformation going forward.

One could speculate that the public hearings run by the standing committee in March this year were in some ways an attempt to call the industry to account. This turned out to be a positive exercise as personally I believe the sector gave a good account of itself, and the hearings were professional, factual and in the most part rational.

FirstRand's submission was extremely detailed and for the purposes of this report I would like to just pick up on a few high-level take-outs from our presentation, which demonstrate that this group is definitely using its balance sheet and procurement spend to support and provide opportunities for black entrepreneurs, it is unequivocally putting its innovative minds to work to create access and inclusivity; and it is rapidly transforming on the inside.

5 facts

1. RMB has provided **R53 billion** of funding for transformational infrastructure projects, including South Africa's world leading renewable energy programme.
2. RMB has also provided **R36 billion** of funding for BEE deals.
3. FNB and WesBank have provided **R33 billion** of funding to the SME sector with nearly a third of that (R8.3 billion) to black-owned SMEs.
4. Through its innovative eWallet product, FNB is providing instant cash access to 4.3 million South Africans and 3.2 million people get it for free.
5. Of the group's total workforce **76%** of staff are African, Coloured and Indian.

I could go on and on with more facts but suffice to say, this group and the banking sector as a whole has made, and continues to make, a significant contribution to transformation. Given South Africa's legacy this was never going to be an easy journey and there is still a great deal to be done to ensure that every South African participates fully in our economy. We recognise we have much more to do but we also ask for fair recognition of our intent and what we have already contributed.

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OUR RESULTS – QUALITY OF EARNINGS, QUALITY RETURN

Despite many of the pressures we face as a business, FirstRand's portfolio of businesses produced a resilient performance for the twelve months to June 2017, characterised by quality topline growth, better cost management and conservatism in origination and provisioning.

There is a detailed explanation of the financial performance in the CFO's report and full operational reviews on pages 30 to 65.

Normalised earnings for the year to June 2017 increased 7% with a normalised ROE of 23.4%, and it's very pleasing that the group can continue to produce real growth in earnings and a high return to our shareholders, despite the challenging operating environment.

In addition, the combination of our high ROE, strong capital position and "fortress" balance sheet allowed the board to increase the dividend payout above earnings growth, which we believe is sustainable over the short to medium term.

These results really are testament to the quality of the operational performances of our franchises, RMB, FNB and WesBank, and the financial resource management strategies executed by our group treasury team. FirstRand continues to focus on generating superior returns to shareholders and will not chase unprofitable growth. This has been a consistent theme since inception.

THINGS UNLIKELY TO IMPROVE IN THE YEAR AHEAD

Unfortunately South Africa's growth prospects remain weak and uncertain, particularly given persistent political and policy uncertainty. These pressures will continue to weigh on business and consumer confidence which in turn constrains private sector investment. I therefore foresee ongoing weakening employment and sluggish GDP growth. The combination of these macro trends, combined with lack of fundamental change at the large, financially stressed and the erosion of institutional strength forebodes the high probability of a local currency downgrade next year. In fact some of the comments made by the rating agencies suggest to me that the downgrade is a foregone conclusion.

This will be very negative for the country and will certainly mean growth headwinds for the group, although I do believe the quality of our franchises and the strategies we are executing on means we will weather the storm better than most.

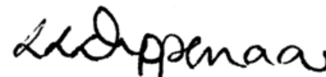
The broader financial services strategy in South Africa, the organic buildout of rest of Africa and the growth opportunities we are considering for our UK franchise are all expected to deliver outperformance over the medium to long term.

IN CONCLUSION

Two long-serving and incredibly active non-executive directors will retire this year. Ben van der Ross has been a member of the group's board since its creation in 1998 and his contribution has been immense; his experience and energy will be sorely missed. As a former South African Registrar of Banks and seasoned World Bank executive, Hennie van Greuning has also provided the board with valuable insight and guidance.

I would like to thank Hennie and Ben for their respective contributions.

I also, once again, want to extend my thanks to every staff member of the group. I know it's been a tough year on many fronts, but FirstRand remains a great business on the back of your hard work and commitment.



LAURIE DIPPENAAR
Chairman

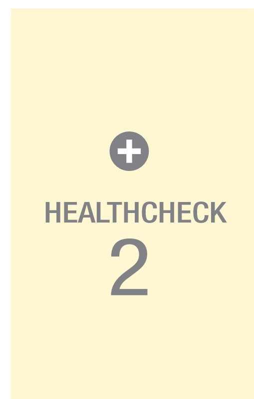
Additional commentary by the chairman on FirstRand's remuneration

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 here 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

FirstRand fundamentally believes that executive remuneration must align with shareholder value creation and the group's key performance measure, 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.



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.

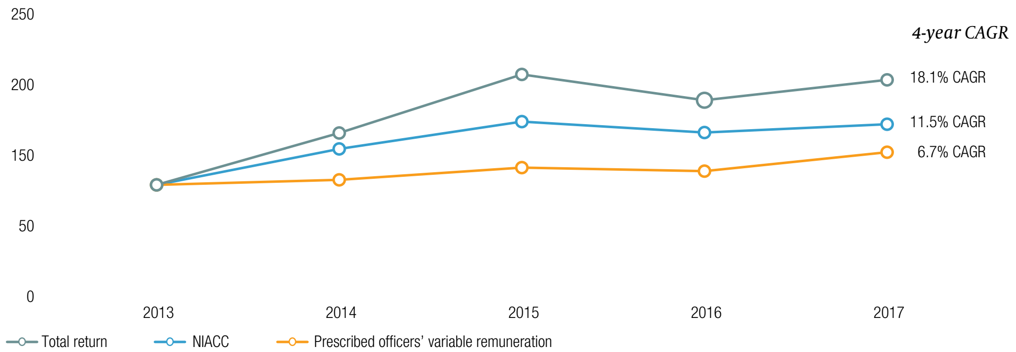
Culture has played a key part in the group's ability to generate superior returns. Management are treated like owners, act like owners and think like shareholders.

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.

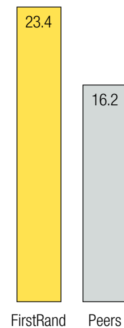
The growth in total return to shareholders and NIACC has significantly exceeded the growth in prescribed officers' variable remuneration.

Prescribed officers' variable remuneration and shareholder return

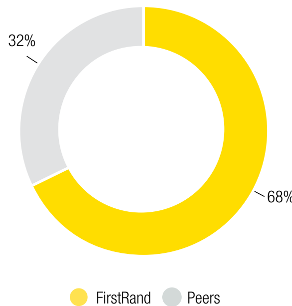
Index, 2013 = 100



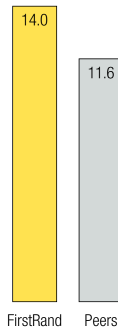
ROE % (post tax)



Five-year cumulative NIACC as a % of peer group's combined five-year cumulative NIACC



Normalised earnings five-year CAGR %

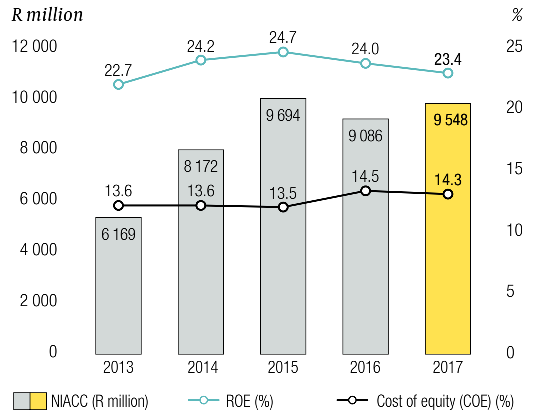


Refer to page 207 for definitions of peer group disclosures.

NIACC

ROE and COE

R million



Issue	Normalised EPS in year of issue	Vesting criteria	NIACC over the period
2013 CIP 3 year	273.5 cents	Nominal GDP + 1.5%	Positive (vested)
2014 CIP 3 year	331.0 cents	Nominal GDP + 2%	Positive
2015 CIP 3 year	378.5 cents	Nominal GDP + 1% and ROE ≥ COE + 5%	Positive
2016 CIP 3 year	407.4 cents	Nominal GDP and ROE ≥18%	Positive

Executive pay and shares allocated (2017)

R thousand	Cash package	Cash bonus	Deferred bonus	Share awards	Total
Johan Burger (CEO)	**9 740**	**13 900**	**11 900**	**18 350**	**53 890**
Alan Pullinger (deputy CEO)	**7 000**	**11 600**	**9 600**	**14 630**	**42 830**
Harry Kellan (financial director)	**6 000**	**5 250**	**3 250**	**8 600**	**23 100**
Jacques Celliers (FNB CEO)	**6 751**	**7 000**	**5 000**	**11 943**	**30 694**
James Formby (RMB CEO)	**3 241**	**12 250**	**10 250**	**7 500**	**33 241**
Chris de Kock (WesBank CEO)	**4 703**	**5 250**	**3 250**	**9 200**	**22 403**