Capital:
The crisis and the cycle

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The crisis

The focus on capital has increased

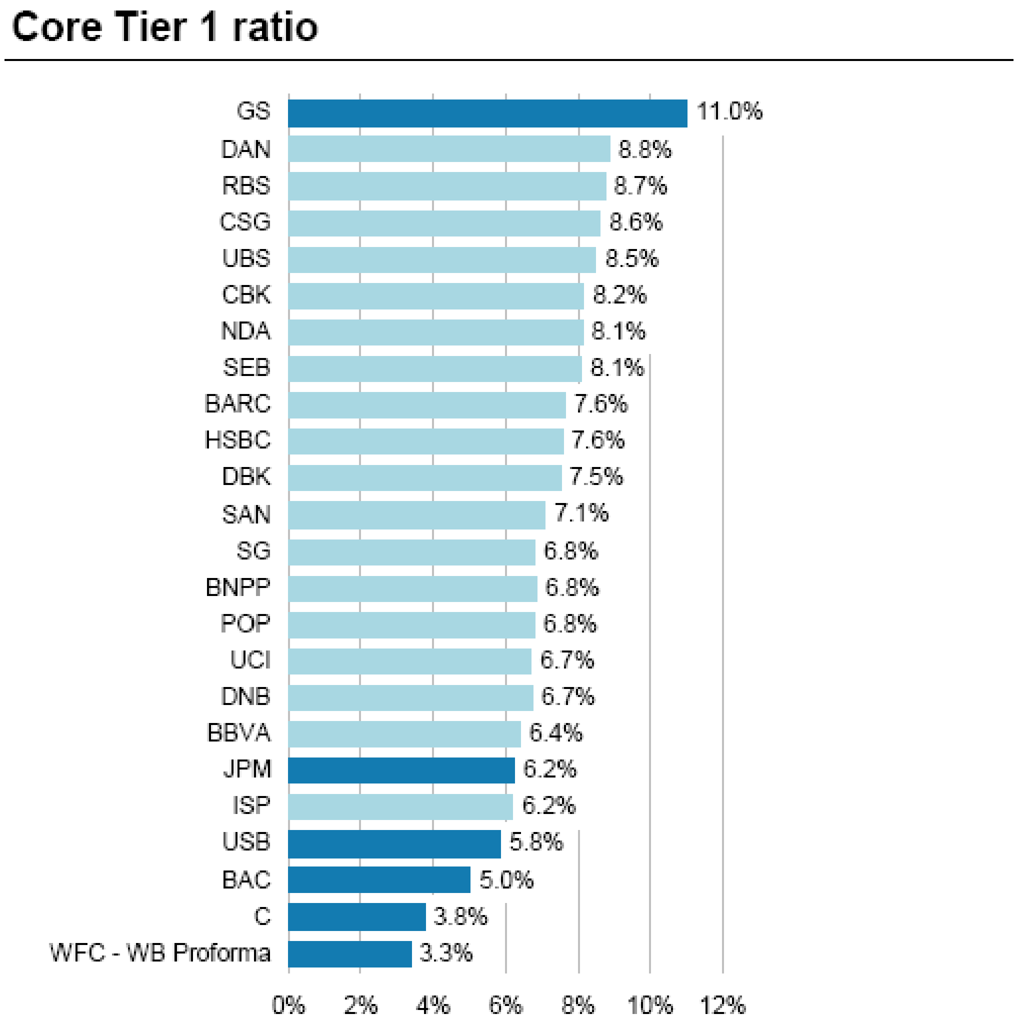
- The issues
  - Liquidity
  - Investment write downs
  - Capital
  - Economic growth
  - Credit write downs
- The stakeholders
  - Regulators
  - Rating agencies
  - The capital markets
- The focus
  - Equity Tier 1
  - Nominal balance sheet measures – leverage
  - Basel II shortcomings
  - Increased regulation

Core is "King"

- Equity capital
  - Loss absorbing
  - Flexible
- Tier I
  - Hybrids questioned
  - Preference shares
- Tier II
  - Disguised leverage
  - Pricing prohibitive
  - Assumptions challenged

The levels have risen globally

Globally capital levels are higher



Note: All data as of 3Q08 except RBS, BARC, BNPP and Soc Gen where balance sheet data is as of 1H08. Pro-forma for capital increases. Source: Company data, Morgan Stanley Research

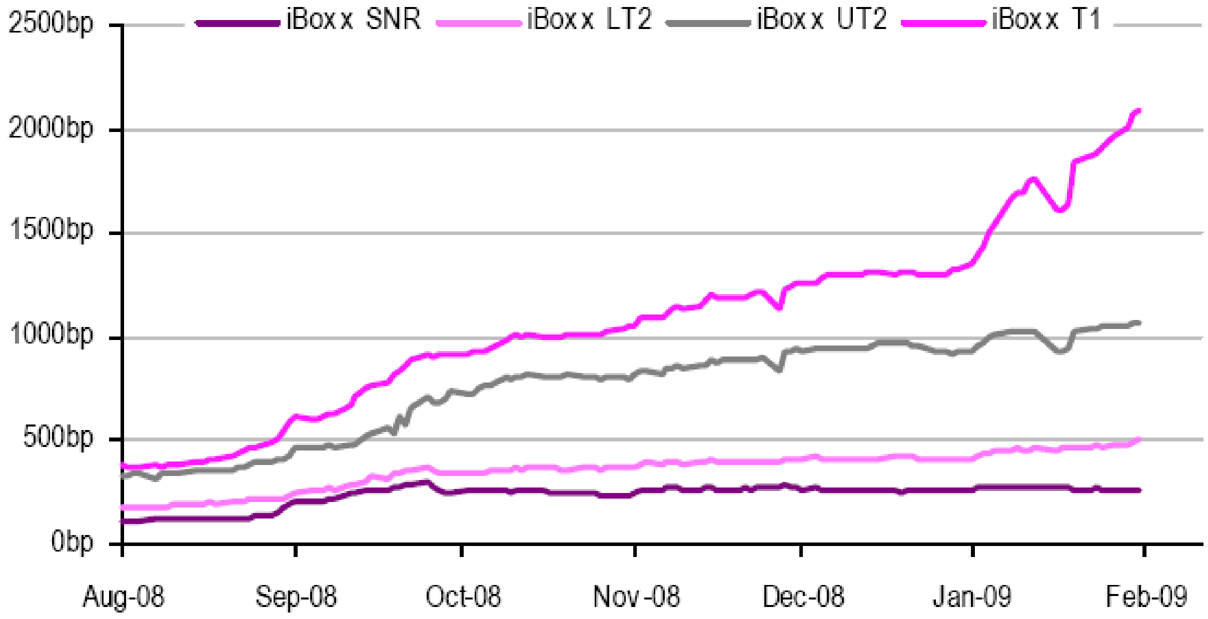
Comparability is difficult

- Capital ratios are difficult to compare
  - Point in time v through the cycle
  - Level of macroeconomic threat
    - Unexpected losses and expected losses
  - Timing and the cycle
  - Regulatory frameworks
  - Qualifying capital
  - Model assumptions
  - Provisioning

- Basel II procyclicality is not well understood

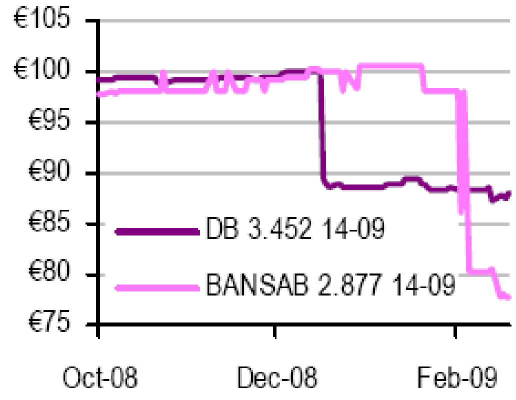
The costs have also gone up

Wider spreads and steeper credit curves across bank capital structure



Source: UBS, Markit

Drop in price post non call



Source: UBS, Bloomberg

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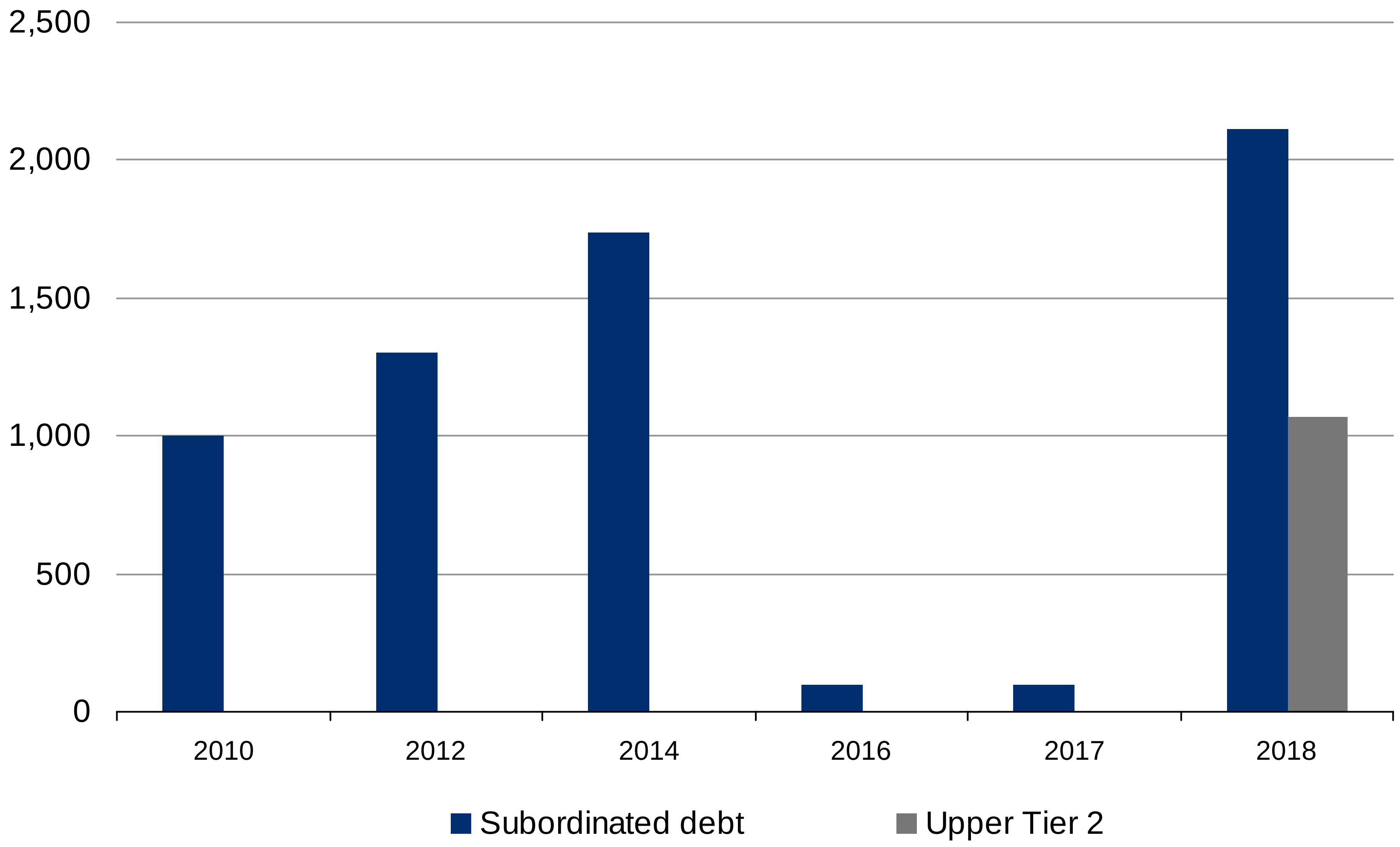
FRB maturity profile



Additional measures need to be added to address the concerns

Core equity ratio	
$\frac{\text{Equity Tier I}}{\text{RWA}}$	
FRBH	10.22%
FRB	8.89%

Tier I ratio	
$\frac{\text{Tier I}}{\text{RWA}}$	
FRBH	11.08%
FRB	9.89%

Leverage ratio	
$\frac{\text{Total Assets}}{\text{Equity Tier 1}}$	
FRBH	16x
FRB	20x

Risk weightings

What are stakeholders concerned about?

- Ability to absorb losses
- Quality of Tier I

The cycle

The cycle and its impact on capital

- Widely know that Basel II introduces greater cyclicality in the capital ratios

- What drives cyclicality?
  - Risk weighted asset growth
  - Expected loss over provision Impairment

- Responses globally

- When the cycle turns

How is it calculated and what drives it?

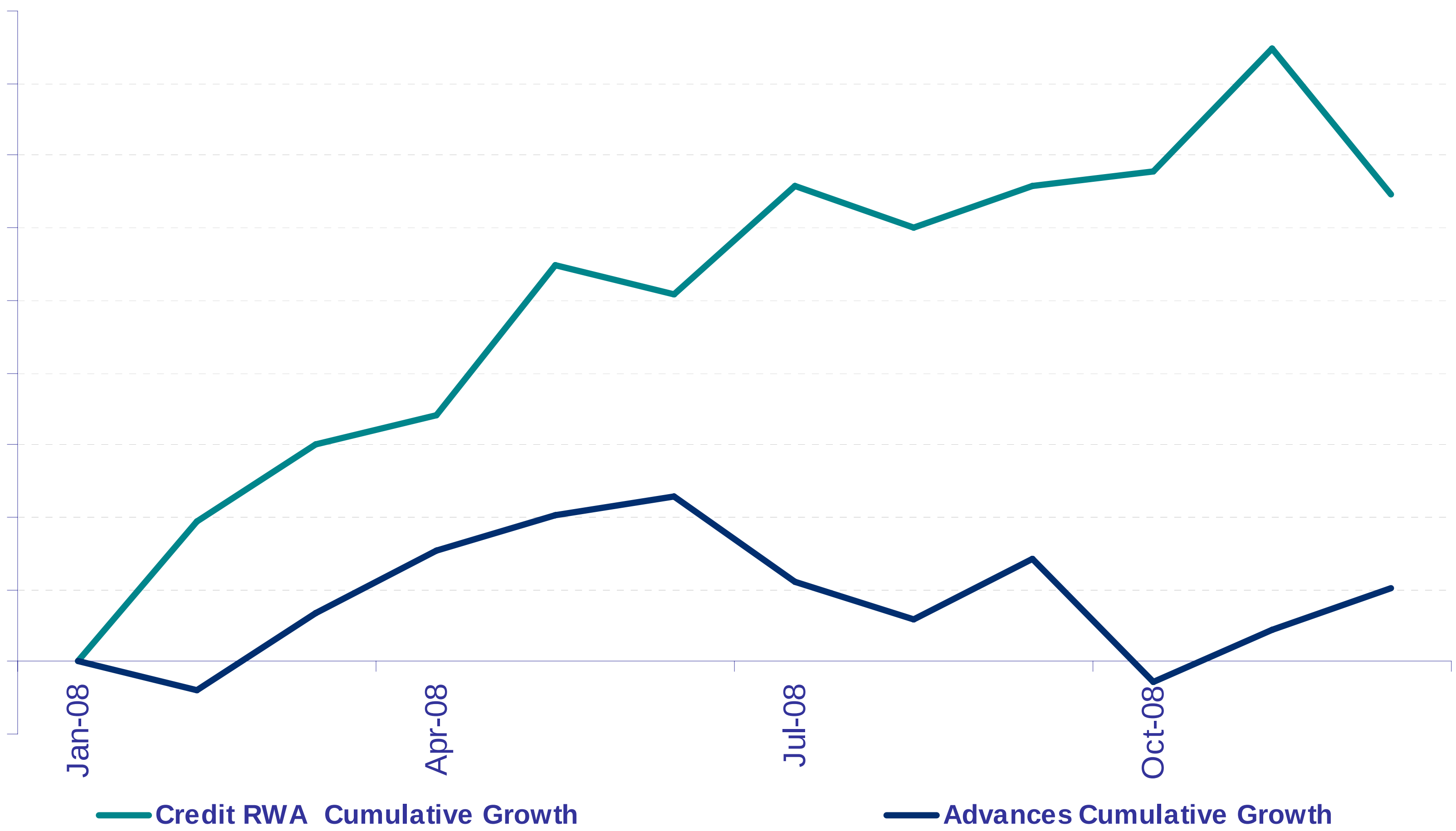
- Risk weighted asset growth

EAD	x	PD x stress factor ↑	x	LGD ↑
Exposure at default		Probability of default		Loss given default
				Downturn

- Expected loss over provision impairment

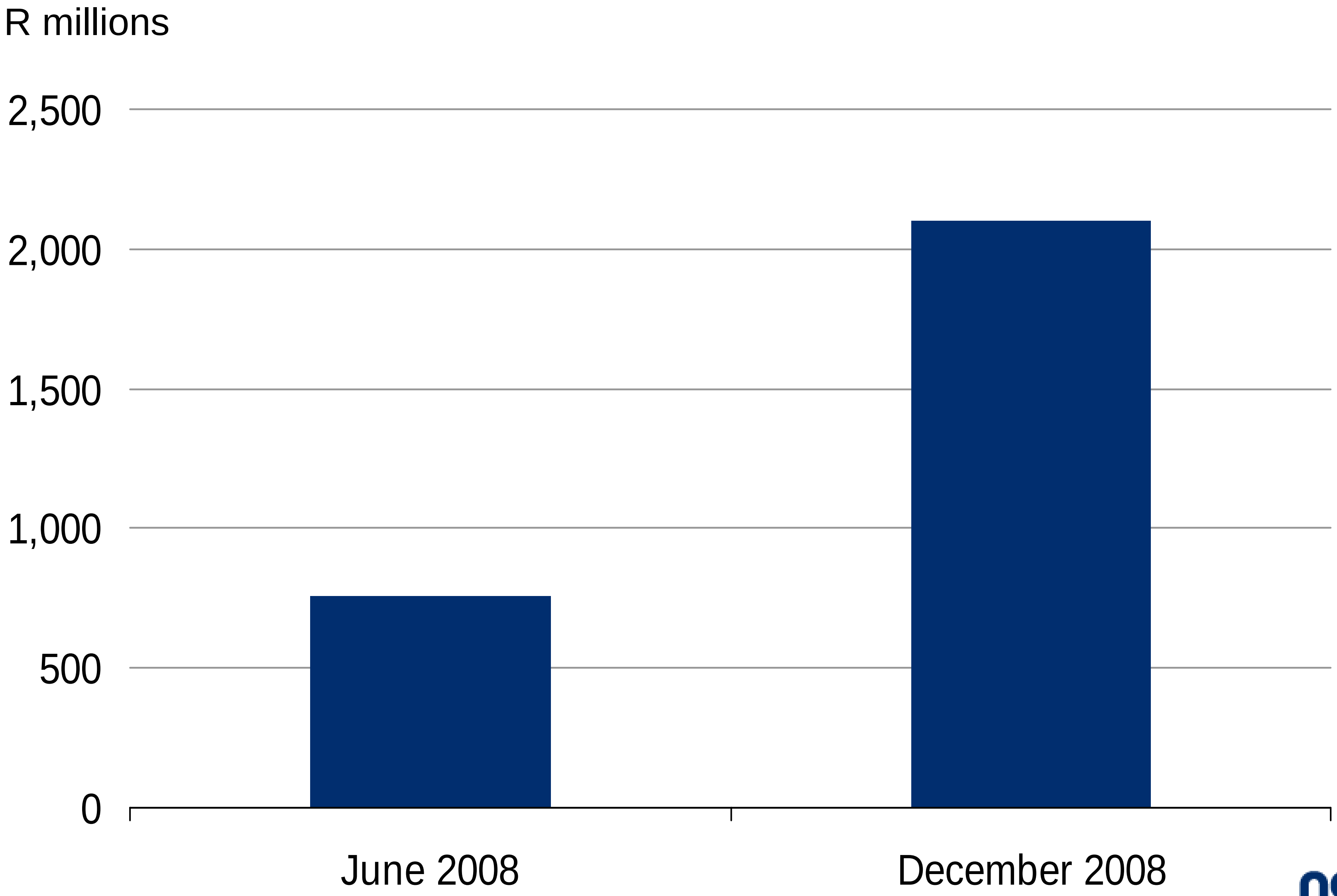
EAD	x	PD ↑	x	LGD ↑
Exposure at default		Probability of default		Loss given default
				Downturn

Risk weighted assets growing despite flat advances



Growth rates for FirstRand Bank

Significant increase in the EL > Provision impairment



Consider our provisioning in the context of Basel II

	December 2008
Advances (R millions)	441,886
Balance sheet impairment (R millions)	8,543
Balance sheet impairment ratio (%)	1.9
EL> Provision impairment (R millions)	2,110
Adjusted impairment ratio (%)	2.4

EL>Provision impairment relates to FRB Ltd SA entities

FirstRand's response

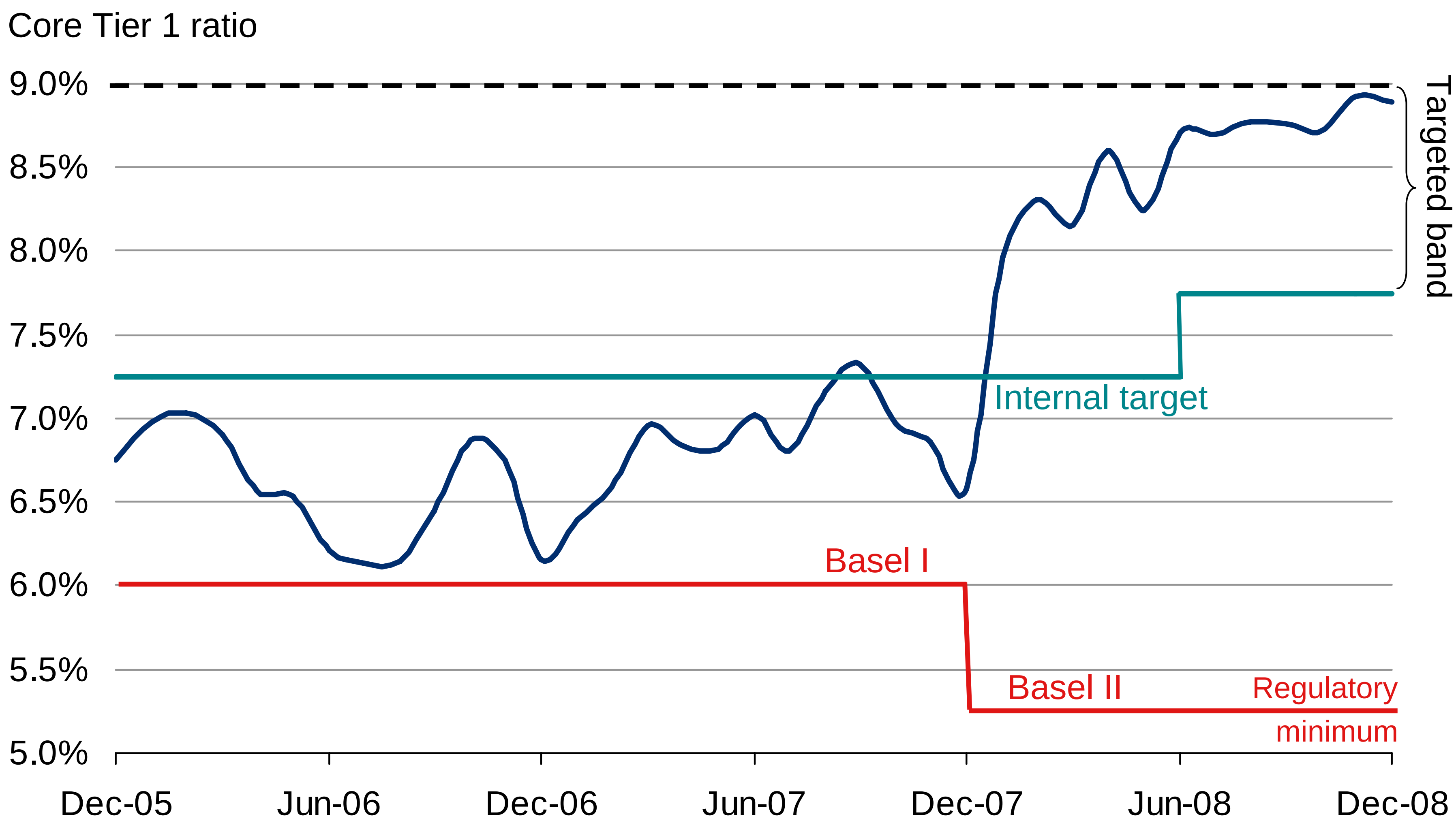
Targeted capital levels have been increased

	2008		2009	
%	FRB Ltd	FRBH	FRB Ltd	FRBH
Core equity	5.25	5.25	5.25	5.25
Buffer	2.00	2.00	2.50	3.00
Target core equity	7.25	7.25	7.75	8.25
Other Tier 1	1.75	2.00	1.75	1.75
Total Tier 1	9.00	9.25	9.50	10.00
Tier 2	2.50	2.75	3.50	3.50
Total	**11.50**	**12.00**	**11.5 -13.0**	**12.0 - 13.5**

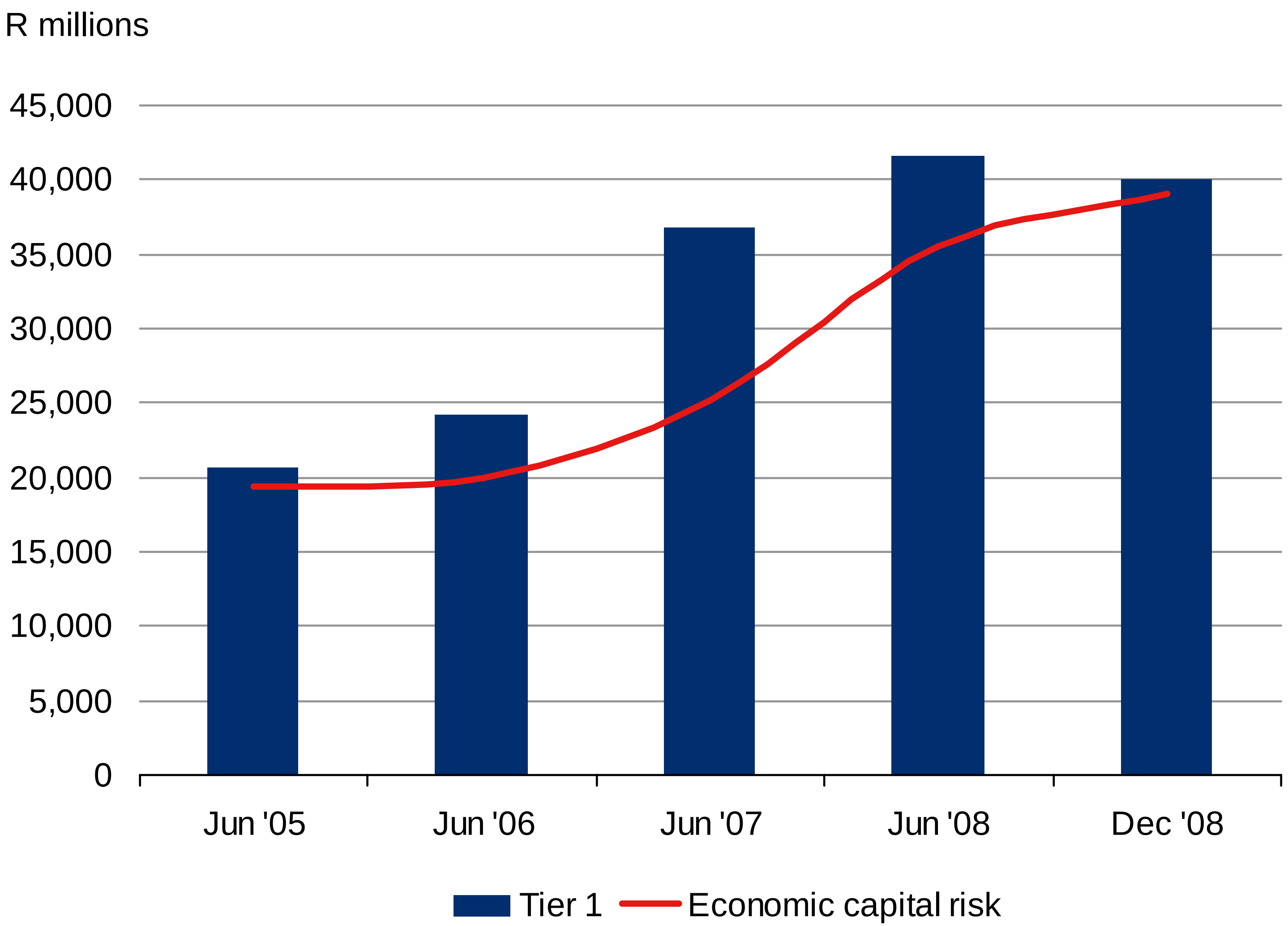
The higher targeted ratios have been met

	2009 targets		December 2008 actual	
%	**FRB Ltd**	**FRBH**	**FRB Ltd**	**FRBH**
Core equity	5.25	5.25	8.89	10.22
Buffer	2.50	3.00		
Target core equity	7.75	8.25	8.89	10.22
Other Tier 1	1.75	1.75	1.00	0.86
Total Tier 1	9.50	10.00	9.89	11.08
Tier 2	3.50	3.50	1.92	1.89
Total	**11.5 -13.0**	**12.0 - 13.5**	**11.91**	**12.97**

Operating at the higher end of the Core Tier 1 band



Economic risk is backed with Tier 1 capital

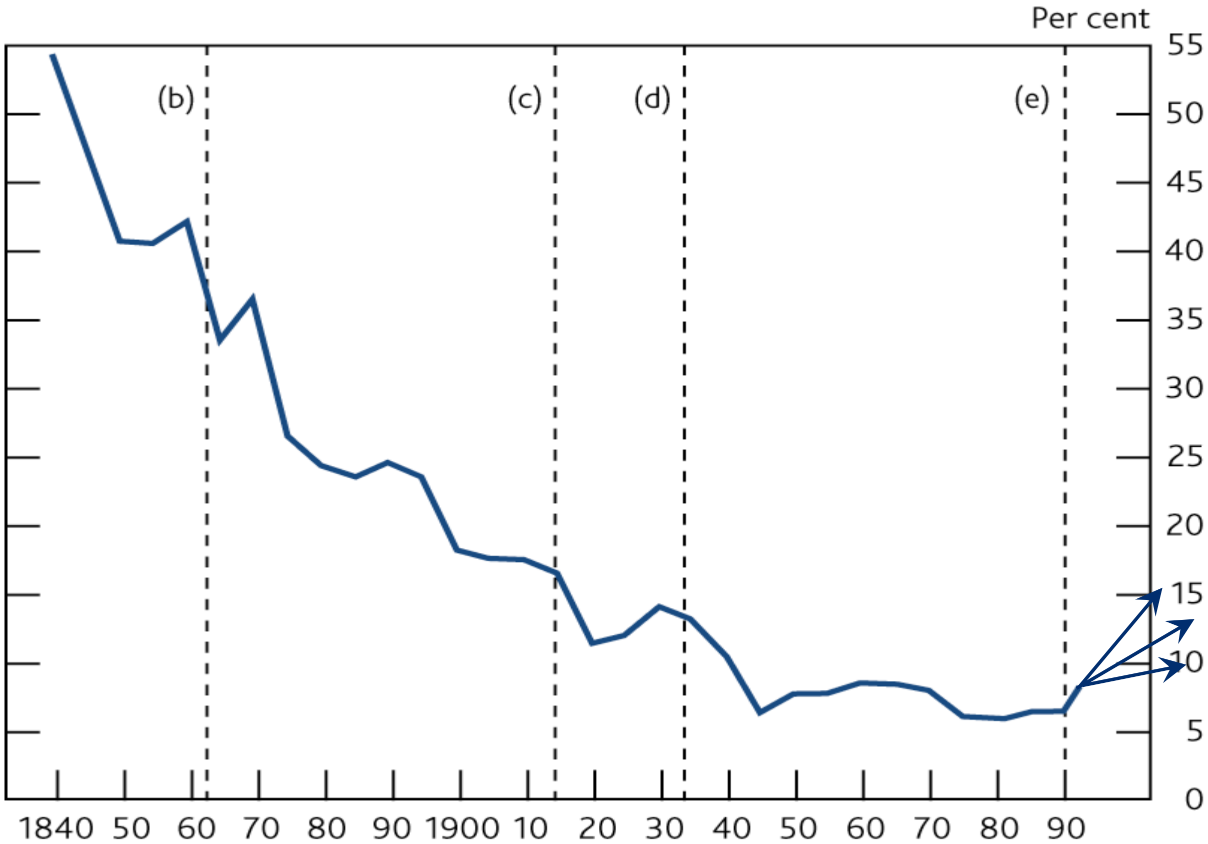


Data shown for FirstRand Bank Holdings Limited

Conclusion

The rules of the game are still changing…

Long-run capital levels for US commercial banks 1840–1993



Equity as % of assets

Source: Berger, A, Herring, R and Szegö, G (1995), 'The role of capital in financial institutions', Journal of Banking and Finance, pages 393–430.
(a) Equity as a percentage of assets (ratio of aggregate dollar value of bank book equity to aggregate dollar value of bank book assets). (b) National Banking Act 1863.
(c) Creation of Federal Reserve 1914. (d) Creation of Federal Deposit Insurance Corporation 1933. (e) Implementation of Basel risk-based capital requirements 1990.