FirstRand

2021

material risk factor disclosure

as required in terms of paragraph 7.F.7 of the JSE Listings Requirements

for the year ended 30 June

Risk relating to FirstRand Limited (the issuer)

1. *The investments, business, profitability and results of operations of the issuer may be adversely affected as a result of political, social and economic risks in South Africa, the UK and certain countries in sub-Saharan Africa, and general global economic conditions.*

The issuer's operations are predominantly concentrated in South Africa, with the majority of its revenues derived from operations in South Africa. The issuer is, therefore, highly exposed to South African macroeconomic conditions and, as a result of their impact on the South African economy, global economic conditions. Any material deterioration in global or South African macroeconomic conditions could lead to a reduction in business activity, higher impairment charges, increased funding costs, and reduced revenues and profitability.

Beyond the South African economy, the issuer also has operations in the United Kingdom (UK) and several other countries in sub-Saharan Africa. A material deterioration in UK economic conditions or that of the other African countries it operates in could also have a meaningful negative impact on the issuer's performance.

1.1 GLOBAL ECONOMIC CONDITIONS

The South African economy is exposed to the global economy through the current and capital accounts of the balance of payments. South Africa's exports are impacted by economic activity of some of the world's largest economies including China, the United States (the US), the UK and Europe. Commodity prices and the rand exchange rate have a material impact on South African exports. The South African economy is also reliant on foreign capital inflows.

If global economic growth or global financial conditions deteriorate materially, this is likely to have a negative impact on macroeconomic conditions in South Africa.

While the global economy is recovering from Covid-19-related contraction, the longer-term consequences for the macro economy remain uncertain. In addition to concerns around permanent damage to production capacity, there are also concerns about the potential for new variants of Covid-19 and the negative consequences for global economic activity. A fall in global production capacity will have a negative impact on South African economic activity through lower exports and higher import prices. It could also have negative consequences for capital flows towards South Africa. A severe resurgence in Covid-19 will weigh on global risk appetite and capital flows to South Africa, and will likely result in financial market pressure and rand weakness.

Looking beyond the risks to global recovery, permanent global trade impediments (including tariffs), social tensions, natural disasters and environmental damage represent risk factors that could permanently derail global demand for South African goods and global risk appetite towards South Africa.

In addition, a further fall in precious metal and/or base metal prices could also result in a deterioration in the value of the rand, higher interest rates and higher bond yields.

1.2 SOUTH AFRICAN ECONOMIC CONDITIONS

Even before the Covid-19 crisis, the South African macroeconomic environment was characterised by low private sector investment growth, weak employment growth, high levels of public sector debt and downward pressure on domestic demand. In addition, domestic consumer and business confidence was low. Despite a bounce-back in activity from the depths of the Covid-19-related contraction, the issuer expects the longer-term trends to remain in place.

Structural changes, including financial and business reforms at state-owned enterprises, an improvement in the quality of education, much higher fixed capital investment and labour market reforms are now more critical to change the long-term trajectory of the country. The solvency and liquidity challenges at some state-owned enterprises remain a significant concern.

1.3 SOUTH AFRICAN POLITICAL CONDITIONS

The issuer currently anticipates that there will be strong political debates around the need to implement measures to balance fiscal sustainability with increasing socio-economic pressures in the country. These will include debates around the implementation of measures that will lift South Africa's potential growth rate. In addition, the issuer expects debates in respect of various sensitive issues such as land expropriation and the mandate of the South African Reserve Bank (SARB). The impact of Covid-19 on employment and poverty will likely fuel further debate on transfers (either through taxes or intertemporally through borrowing) to the vulnerable in South African society. Ongoing political developments may impact private sector investment, foreign investment and business confidence towards South Africa.

The country's high unemployment rate and unequal wealth and income distribution may fuel socio-economic pressure and encourage the government to change its current macroeconomic policies.

1.4 SOUTH AFRICAN CONDITIONS SPECIFIC TO THE BANKING SECTOR

The South African banking sector remains well capitalised, funded, regulated and managed. The South African financial sector is widely regarded as one of the country's key pillars of economic strength. The banking sector is, however, highly exposed to South African macroeconomic conditions, including the sovereign, and will be impacted by negative macroeconomic developments and a deterioration in the government's fiscal position.

Although household and corporate affordability conditions are currently benefiting from low inflation and low interest rates, weak economic growth and increased unemployment have pushed household and corporate income growth towards decade lows. A deterioration in the country's institutions, especially the independence of the SARB and policy conduct at National Treasury, could also have a negative impact on the banking sector.

The issuer's financial performance has been and is likely to remain linked to the performance of the South African and global economy.

1.5 UK ECONOMIC CONDITIONS

Economic activity in the UK is recovering steadily from the Covid-19-related contractions of last year. That said, the issuer expects unemployment to increase as soon as policy support starts to unwind. Higher unemployment and related risk to household disposable income could have negative consequences for the operating environment.

Other risks to the UK economy include:

- risks that the UK services sectors are unable to comply with the terms of the Brexit agreement. Failure could result in a slowdown in UK business and consumer confidence, the pound and overall economic activity; and
- a reversal of the policy support that was put in place to cushion households and businesses in the face of the Covid-19 growth slowdown.

1.6 ECONOMIC CONDITIONS IN THE REST OF AFRICA

Several other countries that the issuer operates in on the sub-Saharan African continent face macroeconomic risks that could have a negative impact on the issuer's operating environment. These include (listed per country):

- Zambia: Significant risk to sovereign debt sustainability and associated macroeconomic pressure. Volatility in copper prices, drought and uncertainty around the policy environment add to the heightened risk associated with the Zambian macroeconomic outlook.
- Nigeria: Potential oil price volatility and policy uncertainty pose downside risks to the growth outlook.
- Ghana: The Ghanaian economy is exposed to fluctuations in oil, gold and cocoa prices. A fall in the price of these commodities will have negative consequences for the operating environment. The Ghanaian economy is also exposed to fiscal risks.
- Namibia, Eswatini and Lesotho: These economies are particularly exposed to the South African economy and the rand. A severe fall in South African growth and trade, and/or rand weakness will have adverse consequences for their outlooks. In addition, the Eswatini government faces fiscal challenges while fiscal risks in Namibia are also increasing.
- Botswana: A significant fall in diamond prices and/or activity in the South African economy will have adverse consequences for the Botswana operating environment.
- Mozambique: High levels of policy uncertainty, commodity prices and global economic activity pose a risk to the Mozambican outlook. Insurgent activity in northern Mozambique in another risk factor in the operating environment.

2. *Risk management*

The issuer, in common with other issuers in South Africa and elsewhere, is exposed to commercial and market risks in its ordinary course of business, the most significant of which are credit risk, market risk in the trading book, operational risk, equity investment risk and insurance risk.

Credit risk is the risk of loss due to non-performance of a counterparty in respect of any financial or other obligation. For fair value portfolios, the definition of credit risk is expanded to include the risk of losses through fair value changes arising from changes in credit spreads. Credit risk also includes credit default risk, pre-settlement risk, country risk, concentration risk and securitisation risk.

Counterparty credit risk is the risk of a counterparty to a contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows. Counterparty credit risk measures a counterparty's ability to satisfy its obligations under a contract that has positive economic value for the group at any point during the life of the contract. It differs from normal credit risk in that the economic value of the transaction is uncertain and dependent on market factors that are typically not under the control of the issuer or the client.

The issuer distinguishes between traded market risk and non-traded market risk. Traded market risk is the risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates. For non-traded market risk, the issuer distinguishes between interest rate risk in the banking book (IRRBB) and structural foreign exchange risk. IRRBB relates to the sensitivity of a bank's balance sheet and earnings to unexpected, adverse movements in interest rates. Foreign exchange risk is the risk of an adverse impact on the issuer's financial position or earnings or other key ratios as a result of movements in foreign exchange rates impacting balance sheet exposures.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Equity investment risk is the risk of an adverse change in the fair value of an investment in a company, fund or listed, unlisted or bespoke financial instrument.

Insurance risk arises from the inherent uncertainties of liabilities payable under an insurance contract. These uncertainties can result in the occurrence, amount or timing of the liabilities differing from expectations. Insurance risk can arise throughout the product cycle and is related to product design, pricing, underwriting or claims management.

Any failure to control these risks adequately, or unexpected developments in the future economic environment, could have an adverse effect on the financial condition and reputation of the issuer.

2.1 CREDIT RISK

Credit risk arises primarily from advances and certain debt investment securities. Other sources of credit risk include reinsurance assets, cash and cash equivalents, accounts receivable, off-balance sheet exposures and derivative balances.

The issuer's lending and trading businesses are subject to inherent risks relating to the credit quality of its counterparties and the recoverability of loans and advances due from these counterparties. Changes in the credit quality of the issuer's lending and trading counterparties or those arising from systemic risk in the financial sector could reduce the value of the issuer's assets, resulting in increased credit impairments.

Many factors affect the ability of the issuer's clients to repay their loans, including adverse changes in consumer confidence levels due to local, national and global factors; levels of consumer spending; bankruptcy rates and increased market volatility. These

factors might be difficult to predict and are completely beyond the issuer's control. The issuer performs regular stress tests on its credit portfolios to identify the key factors impacting the credit risk profile in order to anticipate possible future outcomes, and to implement necessary actions to constrain risk.

The issuer continues to apply origination strategies which are aligned to its broader financial resource management processes and macroeconomic outlook. Based on the issuer's credit risk appetite, measuring ROE, net income after cost of capital (NIACC) and earnings volatility, credit risk management principles include holding the appropriate level of capital and pricing for risk on an individual and portfolio basis. The scope of credit risk identification and management practices across the group, therefore, spans the credit value chain, including risk appetite, credit origination strategy, risk quantification and measurement, as well as collection and recovery of delinquent accounts. Credit risk is managed through the implementation of comprehensive policies, processes and controls to ensure a sound credit risk management environment with appropriate credit granting, administration, measurement, monitoring and reporting. Credit risk appetite measures are set in line with overall risk appetite. The aim is to deliver an earnings profile that will perform within acceptable levels of volatility determined by the issuer.

Within South Africa, persistent political and policy uncertainty, ongoing governance issues at state-owned enterprises and continued erosion of confidence in institutional strength and independence all continue to have a negative impact on confidence, which in turn constrains private sector investment, places pressure on employment and ultimately undermines GDP growth. Such a macroeconomic environment will be characterised by low domestic demand growth (consumption, investment and government spending) and downward pressure on personal income. This could result in increased levels of impairment in the issuer's South African credit portfolio, which could have an adverse impact on the issuer's ability to grow its revenues and manage its credit impairments and could therefore negatively affect its financial condition.

The impact of Covid-19 on the economy and on companies and individuals increased the credit risk in advances and investment securities, especially in certain high-contact sectors such as leisure, hotels and tourism.

2.2 CONCENTRATION RISK

Credit concentration risk is the risk of loss arising from an excessive concentration of exposure to a single counterparty, industry, market, product, financial instrument, type of security, country or region, or maturity. This concentration typically exists when a number of counterparties are engaged in similar activities and have similar characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

The issuer's business is significantly focused on the South African market and the issuer, therefore, faces a geographic concentration risk. Operations in South Africa are subject to various risks which include political, social and economic risks, such as general economic volatility, low growth, relatively high inflation, exchange rate risks, exchange controls, crime and diseases (including, for example, HIV/AIDS). The existence of such factors may have a negative impact on South African economic conditions generally, and more specifically on the business and results of the issuer in ways that cannot be predicted.

Any adverse changes affecting the South African economy are likely to have an adverse impact on the issuer's ability to grow revenues as well as credit impairments and, therefore, on its financial condition.

2.3 LIQUIDITY RISK

Structural characteristics impacting the funding profile of South African banks

South Africa is an emerging market with significant socio-economic challenges. These include high levels of poverty and social security needs. Addressing these challenges requires a high level of funding which constrains domestic savings and results in low household savings rates.

In addition to a low domestic savings rate, South Africa's financial system is characterised by structural features which pose additional liquidity challenges for the domestic banking system. A key characteristic is the fact that the available savings in the economy are mostly contractual savings and funded pension liabilities. These savings are concentrated in institutions such as pension and provident funds as well as providers of asset management services. In addition, they tend to have a higher allocation to the equities market relative to fixed income assets (relative to developed market norms) and are invested at banks in the form of institutional funding, comprising wholesale funding from financial institutions across a range of deposits, loans and other financial instruments.

Furthermore, the operational liquidity management needs of institutions are largely met by their investments in the banking sector via the money market. These institutional deposits have a higher liquidity risk than retail deposits.

Given the relative reliance on institutional deposits, liquidity risk in the South African banking system is structurally higher than in most other markets.

However, this risk is to some extent mitigated by the following market dynamics:

- the closed rand system, where rand transactions are cleared and settled through registered banks and clearing institutions domiciled in South Africa. FirstRand Bank Limited is one of the major clearing/settlement banks;
- concentration of customer current accounts with the large South African banks;
- the prudential exchange control framework; and
- South African banks' low dependence on foreign currency funding.

These factors contributed to South Africa's resilience during the 2007-2008 global financial crisis. While Covid-19 initially resulted in liquidity stress for financial market participants, as many funds shortened their duration to remain liquid and meet margin calls as well as client requirements, these effects, however, remained short-lived. The SARB introduced various actions to support the markets through this stress. The after-effects of the pandemic and SARB interventions included a reduction in bank funding spreads as the Covid-19 lockdown resulted in increased deposit levels because of precautionary savings and reduced spending. Risks remain that funding costs could increase as the country emerges from the crisis and growth begins to pick up.

Foreign currency funding risks

The low level of discretionary savings in South Africa, and its high investment and social welfare requirements, increase the economy's reliance and vulnerability to foreign capital inflows, driven by the country's fiscal and current accounts.

The issuer seeks to mitigate its exposure to its foreign currency funding by operating a prudent foreign currency management framework and operating within limits on its foreign currency borrowing that are more conservative than the macroprudential limits applied by the SARB. The issuer seeks to avoid exposing itself to undue liquidity risk and to maintain liquidity risk within the risk appetite approved by the board and risk committees.

The issuer believes that its level of access to domestic and international interbank and capital markets will allow it to meet its short-term and long-term liquidity needs due to the strategy, flexibility and diversification of its liquidity risk management policy in both foreign and domestic currencies. However, any maturity mismatches may have a materially adverse effect on its financial condition.

Funding and other risks relating to securitisations

Securitisation is the process whereby loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities to investors. The issuer makes use of securitisations to complement its overall funding strategy. This can, however, constitute a significant proportion of a particular asset class within the broader group balance sheet.

While an important component of its overall funding strategy, the issuer limits the use of securitisation to ensure appropriate strategy diversification and agility. Further, the issuer does not aim to execute securitisations specifically for credit or capital relief purposes, however investor appetite and pricing will dictate the distribution of lower-rated subordinated tranches. These would typically be retained within the wider FirstRand group. Consequently, the FirstRand group retains all risks and rewards associated with the underlying assets. In addition, the use of securitisation transactions as part of the issuer's funding strategy generates risks such as:

> funding and liquidity risk in respect of any potential repurchase of the transferred assets (for example, in circumstances where there is a breach of contractual representations and warranties relating to the underlying assets);

> operational risks related to the servicing of the transferred assets; and

> interest rate and other risks through derivatives transacted with the securitisation entities.

The issuer engages in securitisation transactions to manage and mitigate rather than add to the funding and liquidity risk profile.

2.4 OPERATIONAL RISK

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. It includes, for example, fraud and criminal activity (internal and external), project risk, legal risk, business continuity, information and IT risk, process and human resources risk.

The principal operational risks currently facing the issuer are:

> **business continuity risk** due to future waves of the Covid-19 pandemic;

> **cyber-risk** (including information security), given the growing sophistication of cyberattacks both locally and globally;

> **technology risk** due to the pace of technology change and increasing digitisation;

> **payment risk** due to the manual nature of certain payment processes, the associated change management risk due to the redesign of payment processes for greater automation and control enhancements, and ongoing regulatory change;

> **vendor risk** due to a lack of direct control over an external service;

> **people risk** due to the impact of the prolonged pandemic on the physical and emotional well-being of employees over time, and potential employee non-adherence to health and safety protocols in the workplace; and

> **execution, delivery and process management risk** (risk of process weaknesses and control deficiencies) as the business continues to employ a risk-adjusted approach through the blended working model, while still trying to grow and evolve the business under tough economic conditions.

The issuer may suffer a failure of, interruption in or breach of its information technology systems.

Information technology (IT) risk encompasses both IT risk and IT change risk. The issuer's IT risk refers to the risk associated with the use of, ownership of, operation of, involvement in, influence over and adoption of IT. It consists of IT-related conditions that could potentially impact the business. IT change risk refers to the risk arising from changes, updates or alterations made to the IT infrastructure, systems or applications that could affect service reliability and availability.

The issuer's main IT risks include cybercrime, the failure or interruption of critical systems, unauthorised access to systems and the inability to serve customers' needs in a timely manner.

The issuer has a high dependency on its IT systems and operations infrastructure in order to conduct its business. The issuer regards these systems as critical to improving productivity and maintaining the issuer's competitive edge. Any failure, interruption or breach in security of these systems could result in failures or interruptions in its risk management, general ledger, deposit servicing, loan servicing, debt recovery, payment custody and/or other important systems. If the issuer's information systems fail, even for a short period of time, it could be unable to serve some or all customers' needs on a timely basis, which could result in a loss of business. In addition, a temporary shutdown of the issuer's information systems could result in costs that are required for information retrieval and verification. The occurrence of any failures or interruptions in the issuer's IT systems and operations infrastructure could have a materially adverse effect on the issuer's business, financial condition and/or results of operations.

Cybercrime could have a negative impact on the issuer's operations.

The issuer's operations are dependent on its own IT systems and those of its third-party service providers. The issuer could be negatively impacted by cyberattacks on any of these. As the issuer moves banking to digital and mobile platforms, the risk of cybercrime increases, especially as infiltrating technology is becoming increasingly sophisticated. There can be no assurance that the issuer will be able to prevent all threats.

Technology has been central to the way people, companies and governments have managed the Covid-19 pandemic. The contact-free economy could also create new employment opportunities in the post-pandemic world. However, a greater dependence on technology has increased cybersecurity risks and privacy concerns. New working patterns may increase cyberattacks and data fraud. The scope of cyber events has also expanded to include attacks on critical infrastructure, which may result in supply chain impacts for the issuer and broader economic disruptions.

The issuer's business is subject to its ability to quickly adapt to disruptions while maintaining continuous business operations.

The issuer has established a business resilience policy and standards to govern business continuity (including disaster recovery) and to improve the capability of the business to effectively respond to disruptive events from internal failures or external events. This is achieved through its business continuity strategies including regular review of business continuity plans (including disaster recovery) and testing. Any failure in the continuity of the issuer's operations and services could have a material adverse effect on its business, financial condition and/or results of operations.

The issuer may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose it to additional liability and have a materially adverse effect on it.

The issuer is required to comply with applicable anti-money laundering and anti-terrorism laws and other regulations in all of its operating jurisdictions insofar as reasonably practicable. These laws and regulations require the issuer, among other things, to adopt and enforce "customer due diligence" policies and procedures and to report suspicious and large transactions to the applicable regulatory authorities. While the issuer has adopted policies and procedures aimed at detecting and preventing the use of its banking platforms for money-laundering and terrorist-related organisations and individuals generally, such policies and procedures may not completely eliminate instances in which the issuer may be used by other parties to engage in money laundering or other illegal or improper activities. To the extent that the issuer may fail to fully comply with applicable laws and regulations, the relevant government agencies to which it reports have the power and authority to impose fines and other penalties on the issuer. In addition, the issuer's business and reputation could suffer if customers use it for money laundering or illegal or improper purposes.

The issuer may be unable to recruit, retain and motivate key personnel.

An engaged workforce is critical to the successful delivery of the issuer's objectives. The issuer's performance is dependent on key personnel. The issuer's continued ability to compete effectively and further grow its businesses also depends on its ability to attract new staff. In relation to the development and training of new and existing employees, the issuer is reliant on the continued development of South Africa's educational sector, including access to facilities and educational programmes.

Terrorist acts, hostility arising from competing political groups, acts of war, and other types of event risk could have a negative impact on the business.

Acts of terrorism, hostility from competing political parties, acts of war, government expropriation or confiscatory acts, currency inconvertibility, financial market closure, health pandemics and other types of event risk and responses to those acts and events may have both direct and indirect negative impacts on the economic conditions of South Africa, the rest of Africa and internationally, and more specifically on the business and results of the issuer in ways that cannot be predicted.

2.5 EQUITY INVESTMENT RISK

Equity investment risk in the issuer arises primarily from equity exposures from private equity and investment banking activities, e.g. exposures to equity risk arising from principal investments or structured lending. Other sources of equity investment risk include strategic investments which are core to individual businesses' daily operations and are managed as such.

The issuer's asset management business also contributes to equity investment risk. This risk emanates from long-term and short-term fund seeding activities both locally and offshore. Short-term seeding typically ranges between one and three years. Long-term seeding is provided if there is alignment with the business strategy, the business case meets the group's internal return hurdle requirements, and the liquidity and structure of the funds imply that an exit will only be possible over a longer period. This maturity period typically ranges from five to eight years post investment in the fund.

Equity investment risk is managed through a rigorous evaluation and review process from inception to exit of a transaction. All investments are subject to a comprehensive due diligence, during which a thorough understanding of the target company's business, risks, challenges, competitors, management team and unique advantage or value proposition is developed.

The impact of Covid-19 on the economy is expected to increase the equity investment risk in vulnerable sectors within the portfolio.

2.6 INSURANCE RISK

Insurance risk arises from the issuer's third-party insurance operations housed in FirstRand Insurance Holdings Limited. Long-term insurance operations are underwritten through its subsidiary FirstRand Life Assurance Limited, and short-term insurance operations are underwritten through its subsidiary FirstRand Short Term Insurance Limited.

Insurance risk manifests when the decrement rates (e.g. mortality rates, morbidity rates, etc.) and associated cash flows are different from those assumed when pricing or reserving.

These risks can further be broken down into parameter risk, random fluctuations and trend risk. As a result of these insurance risk exposures, the issuer is exposed to catastrophe risk stemming from the possibility of an extreme event such as Covid-19.

The issuer manages its insurance risk to be within its stated risk appetite. This is translated to risk limits for various metrics that are monitored and managed. The assessment and management of risk focuses on a rigorous and proactive process to ensure sound product design and pricing, management of the in-force book, and reinsurance agreements to manage catastrophe risk.

2.7 ENVIRONMENTAL, SOCIAL AND CLIMATE RISK

Environmental risk is defined as the impact of the natural environment on business as well as the impact and dependencies of the business on the environment and natural capital. These impacts can manifest in legal or regulatory requirements, material financial losses, operational costs, physical damage, credit risk or loss of reputation that a financial institution may suffer because of an issuer's failure to comply with responsible environmental practices, laws, regulations, rules, related self-regulatory organisational standards and codes of conduct applicable to its activities. Environmental risks can be grouped into two areas of impact for the issuer, namely direct environmental risk (own operations and climate resilience), and indirect environmental and climate risk (lending, financing and investment).

Social risk references social impacts associated with activities conducted through a business relationship with customers, investee companies or stakeholders as a result of financial exposure, lending/financing, investment and equity interest that may lead to a risk of legal or regulatory sanctions, material financial loss, or reputational damage. The issuer may suffer in any of these aspects because of its client or stakeholder organisation's failure to comply with all applicable laws, voluntary agreements, regulations and/or supervisory requirements. Social risks include product responsibility and inclusion issues, labour-related issues, occupational health and safety, community involvement, community security, human resettlement, indigenous people's rights and human rights. These risks could lead to criminal sanction, termination of operations or production losses, and subsequently pose a financial, reputational or credit risk to the group.

Climate risk, a subset of environmental risk, is defined as a risk resulting from climate change causing an increase in physical risks (stemming from increased incidences of natural disasters), transition risks (resulting from changes in laws, regulations or customer preferences) and third-party liability risks (due to non-compliance with climate regulations). The impact of climate change is expected to prompt substantial structural adjustments to the global economy. Several sectors, such as fossil fuels, are expected to experience disruption from changes in investor or end-user preferences, or changes in regulations, whilst others, such as renewable energy and other green energy sources, and carbon capture and adaptation technologies, are likely to benefit. Such fundamental changes will inevitably impact the balance sheets and operations of banks, leading to both risks and opportunities. Regulators are beginning to act, and investors, clients and civil society are looking for actions, mitigation, adaptation and transparency on the issue.

Environmental, social and climate risk is typically a cross-cutting risk issue and therefore cannot be managed in a single risk function. The issuer's environmental, social and climate risk management framework consists of an outline of programmes and initiatives which are designed to manage and mitigate the following areas and types of environment-related risk.

- Reputational: Damage to reputation from association with environmental and social impacts.
- Market and liquidity: Higher levels of market volatility, shift in asset valuations, dislocations and shifts in market appetite with regards to type of assets funded.
- Credit: Adverse impact on customers' ability to pay, impaired collateral values mainly driven by an increase in physical risks (e.g. drought or property damage) or transition risks (lower demand for product).
- Legal action, regulatory sanction or reputational damage may occur as a result of the issuer's approach to environmental risk.
- Policy risk due to the impact of new requirements, such as the impact of carbon taxes, prudential requirements and emissions reporting.
- Substitution of a client's existing products and services with lower-emission options, or the unsuccessful investment in new technologies.
- Disruptions to the group's operations, infrastructure, workforce, processes and supply chain may result from acute environmental events.

The issuer has established a climate change policy to guide the businesses' approach to climate change risk, including short-, medium- and long-term commitments to support clients' and society's climate resilience and a just transition to a low-carbon world. This policy is supported by sector-specific policies and limits that address industries that are more sensitive to transition risk, such as thermal coal. Across operating jurisdictions, the issuer is focusing on adapting strategies to respond to emerging climate risks and opportunities.

2.8 THE ISSUER'S RISK MANAGEMENT POLICIES AND PROCEDURES MAY NOT HAVE IDENTIFIED OR ANTICIPATED ALL POTENTIAL RISK EXPOSURES

The issuer has devoted significant resources to developing its risk management policies and procedures, particularly in connection with credit, concentration and liquidity risks, and expects to continue to do so in the future. Nonetheless, its risk management techniques may not be fully effective in mitigating its risk exposure in all market environments or against all types of risk, including risks that are unidentified or unanticipated. Some of the issuer's methods of managing risk are based upon its use of observed historical market behaviour. As a result, these methods may not predict future risk exposures, which could be greater than historical measures indicate. Other risk management methods depend upon evaluation of information regarding the markets in which the issuer operates, its clients or other matters that are publicly available or otherwise accessible by the issuer. This information may not be accurate in all cases, complete, up to date or properly evaluated. Any failure arising out of the issuer's risk management techniques may have an adverse effect on the results of its operations and financial condition.

2.9 THE ISSUER IS SUBJECT TO CAPITAL REQUIREMENTS THAT COULD AFFECT ITS OPERATIONS

In South Africa the issuer and its regulated banking entities are subject to capital adequacy guidelines adopted by the Prudential Authority (PA), which provide for minimum capital requirements for Common Equity Tier 1 (CET1), Tier 1 and total capital. Any failure by the issuer to maintain its minimum capital in terms of Basel III and the PA Regulations relating to Banks (the Regulations), for example the capital conservation and countercyclical buffer (CCyB), could result in restrictions being placed on distributions, including dividends and other discretionary payments.

The Regulations (as amended from time to time) are based on the Basel III framework and provide the minimum risk-based capital ratios. The minimum requirements for the issuer on a consolidated basis are CET1, Tier 1 and total capital of 8.0%, 10.0% and 12.0%, respectively. These minimum ratios exclude the confidential bank-specific individual capital requirements but include the domestic systemically important bank (D-SIB) requirement for the issuer.

In response to the Covid-19 pandemic, the PA implemented temporary measures to provide additional capacity to counter economic risks to the financial system and promote ongoing lending to the economy. The PA published *Directive 2 of 2020, Matters related to temporary capital relief to alleviate risks posed by the Covid-19 pandemic*, which temporarily reduced the Pillar 2A capital requirement from 1% to 0%, effective 6 April 2020. It also allows banks to draw down against the capital conservation buffer as the PA considers this to be a period of financial stress. The minimum leverage ratio requirement was not adjusted for any Covid-19 relief measures. The issuer's internal capital targets were not adjusted following the temporary Covid-19 capital relief measures, as the issuer aligns its capital targets to the minimum requirements incorporating a fully phased-in Pillar 2A capital requirement.

The PA published *Directive 5 of 2021, Capital framework for South Africa based on the Basel III framework*, reinstating the Pillar 2A requirement of 1% in 2022, as well as requiring the first 1% of the bank's D-SIB add-on to be met with CET1 capital.

Directive 4 of 2020, Capital framework for South Africa based on the Basel III framework, was published on 27 August 2020, and incorporated the reduction in the Pillar 2A capital requirement to 0%. Directive 4 of 2020 required banks to also disclose their D-SIB add-ons as part of its regulatory disclosures. The D-SIB requirement for both the group and bank is 1.5%.

In addition, the Prudential Regulation Authority reduced the UK CCyB requirement from 1% to 0% in March 2020. The reduction in the CCyB requirement impacts the issuer's UK operations, i.e. Aldermore and the bank's London branch.

In addition, the issuer's sub-Saharan African and UK operations are also subject to the relevant regulatory capital requirements in each jurisdiction. Entities are required to comply with both the PA and in-country regulations in the rest of Africa and UK. Failure to comply with the minimum requirements in each jurisdiction could result in loss of banking licences and restrictions being placed on distributions, including dividends and other discretionary payments.

2.10 THE ISSUER IS SUBJECT TO LIQUIDITY REQUIREMENTS THAT COULD AFFECT ITS OPERATIONS

Basel III prescribes two minimum liquidity standards for funding and liquidity:

> Liquidity coverage ratio (LCR), which aims to ensure that banks maintain an adequate level of high-quality liquid assets (HQLA) to meet liquidity needs for a 30-calendar-day period under a severe liquidity stress scenario.

> Net stable funding ratio (NSFR), which aims to promote medium- and long-term funding of banks' assets and activities.

In order to allow markets to continue to operate smoothly and provide banks with temporary liquidity relief during the crisis, the PA issued *Directive 1 of 2020, Temporary measures to aid compliance with the liquidity coverage ratio during the Coronavirus (Covid-19) pandemic stress period*, which temporarily reduced the prudential LCR requirement from 100% to 80%, effective 1 April 2020. The PA released a proposed directive on 1 September 2021 to withdraw the temporary relief measures and phase in the LCR requirement as follows:

> 1 January 2022: minimum LCR of 90%; and

> 1 April 2022: minimum LCR of 100%.

The PA introduced the committed liquidity facility (CLF) to assist banks in meeting the LCR. *Guidance Note 8 of 2020, Continued provision of a committed liquidity facility by South African Reserve Bank to banks* was released on 9 September 2020, and provided revised guidelines and conditions relating to the continued provision of the CLF, specifically covering the period from 1 December 2020 to 30 November 2021, confirming withdrawal thereafter.

Guidance Note 8 also noted the introduction of a restricted-use committed liquidity facility (RCLF) to be made available to all banks by the PA annually from 1 December 2020 onwards. The provision and terms of the RCLF is legislated in the Regulations. Similar to the CLF, the facility is made available contractually for a year, covering the period 1 December 2020 to 30 November 2021. The collateral eligible for both facilities are the same, though unlike the CLF, the RCLF is included in level 2B HQLA and is subject to the overall limit of 15% of level 2B HQLA. Collateral for the RCLF attracts a 50% haircut irrespective of the quality of the underlying instruments.

The NSFR is a structural balance sheet ratio focusing on promoting a more resilient banking sector. The ratio calculates the amount of available stable funding relative to the amount of required stable funding. The issuer supports the amended framework issued by the PA in August 2016, whereby funding received from financial corporates, excluding banks, maturing within six months receives an available stable funding factor of 35%. These changes have been anchored in the assessment of the true liquidity risk and assist the South African banking sector in meeting the NSFR requirements.

2.11 DOWNGRADE OF THE ISSUER'S CREDIT RATINGS OR CREDIT RATING OF SOUTH AFRICA COULD HAVE AN ADVERSE EFFECT ON THE ISSUER'S LIQUIDITY SOURCES AND FUNDING COSTS

FirstRand Bank Limited (the bank) remains the rated entity within the group from which debt is primarily issued, and its credit ratings affect the cost and other terms upon which the issuer can obtain funding. Rating agencies regularly evaluate the issuer, and the ratings of its long-term debt are based on a number of factors, including capital adequacy levels, quality of earnings, business position, credit exposure, funding and liquidity risks and the risk management framework, as well as the sovereign ratings and the macro risk profiles for its country of incorporation and those of its operating jurisdictions. These parameters and their possible impact on the issuer's credit ratings are closely monitored and incorporated into its liquidity risk management and contingency planning considerations. In particular, as rating agencies impose a cap on the issuer's rating at the level of the sovereign rating, a change to the sovereign rating will, therefore, impact the issuer's rating.

In addition, a downgrade or potential downgrade of the South African sovereign rating, or a change in rating agency methodologies relating to systemic support provided by the South African sovereign, could also negatively affect the perception by rating agencies of the ratings of the issuer and the bank. Any downgrade of the credit ratings of the issuer and/or the bank would likely increase its borrowing costs and could require the issuer or the bank to post additional collateral or take other actions under some of its derivatives contracts and could limit the issuer's access to capital markets.

There can also be no assurance that the rating agencies will maintain the current ratings of the bank or the issuer or the ratings outlooks, or those of South Africa. Failure to maintain favourable ratings and outlooks could increase the issuer's cost of funding and adversely affect interest margins, which could have a materially adverse effect on the issuer. Ratings are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency. Each rating should be evaluated independently of any other rating.

2.12 COMPETITIVE LANDSCAPE

The issuer is subject to significant competition from other banks operating in all of its operating jurisdictions, including competitors that may have greater financial and other resources, particularly in the corporate and investment banking market. Many of these banks operating in the issuer's markets compete for substantially the same customers as the issuer. The issuer also faces competition from other non-bank entities that increasingly provide similar services to those offered by banks, e.g. asset managers, insurers, retailers, mobile phone operators, shadow banking players and fintech companies. Increased competition from non-bank entities in the money and capital markets could impact the issuer's ability to attract funding.

To the extent that state-owned enterprises will be licensed as banks in future, competition in the South African banking landscape will increase further. Increasing competition could also require that the issuer increases its rates offered on deposits or lower the rates it charges on loans, which could also have a materially adverse effect on the issuer, including on its profitability.

Although the issuer's financial resource management approach requires it to price appropriately for financial resources, should competitive forces prevent it from pricing for these resources appropriately it may withdraw from offering certain products, which may also negatively affect its business results and prospects by, among other things, limiting its ability to generate revenue, increase its customer base and/or expand its operations.

If the issuer's customer service levels were perceived by the market to be materially below those of its competitor financial institutions, the issuer could lose existing and potential new business. If the issuer is not successful in retaining and strengthening customer relationships, the issuer may lose market share, incur losses on its activities or fail to attract new deposits or retain existing deposits, which could have a materially adverse effect on its operating results, financial condition and prospects.

2.13 CHANGING REGULATORY ENVIRONMENT

The issuer is subject to applicable laws, regulations and related matters, including the possibility of administrative actions, in South Africa and in each of the other jurisdictions in which it operates.

Changes in legal and regulatory requirements in South Africa and the various jurisdictions in which the issuer operates may materially affect the issuer's business, products and services being offered, the value of its assets and its financial condition. Although the issuer works closely with its regulators and continually monitors regulatory feedback and proposals, changes in applicable legal and regulatory requirements and related frameworks or other policies cannot be predicted and are beyond the control of the issuer.

The issuer has devoted significant resources to developing its compliance risk management governance arrangements, which include, among others, policies and procedures particularly in connection with the laws listed below, and subordinated regulatory instruments issued in terms thereof. Nonetheless, its compliance risk management governance arrangements may not be fully effective in mitigating all compliance-related risk exposures, including compliance risks that are unidentified or unanticipated. It follows that any failure arising out of the issuer's compliance risk management governance arrangements may have an adverse effect on its operations and financial condition.

Applicable laws and other requirements, as amended from time to time, include:

- Financial Sector Regulation Act, 2017
- Banks Act, 1990
- Companies Act, 2008
- Competition Act, 1998
- Collective Investment Schemes Control Act (CISCA), 2002
- Financial Intelligence Centre Act (FICA), 2001
- Insurance Act, 2017
- Long-term Insurance Act, 1998
- Short-term Insurance Act, 1998
- Financial Advisory and Intermediary Services (FAIS) Act, 2002
- National Credit Act (NCA), 2005
- Consumer Protection Act, 2008

- Financial Markets Act (FMA), 2012
- Foreign Account Tax Compliance Act, 2010
- Protected Disclosures Act, 2000
- Protection of Personal Information Act (POPIA), 2013
- Prevention and Combating of Corrupt Activities Act (PRECCA), 2004
- Currency and Exchanges Act, 1933
- Exchange Control Regulations, 1961
- National Payment System Act, 1998
- King Code on Governance Principles for South Africa, 2016 (King IV)
- Legislation and rules related to listed instruments on various exchanges
- Statutory codes of conduct, standards, joint standards and other subordinate legislation issued by, among others, the Financial Sector Conduct Authority (FSCA) and the PA
- Applicable regulations and other regulatory instruments
- Applicable laws, regulatory instruments and related requirements of the foreign jurisdictions in which the issuer has operations

The issuer is subject to applicable regulatory instruments issued in terms of or related to, among others, any of the above-mentioned laws. The above-mentioned list of applicable laws is not exhaustive but merely indicates that the operations of the issuer are highly regulated.

The South African PA's approach to the Covid-19 impact on the banking sector was largely aimed at temporary relief measures in the form of lower capital and liquidity requirements, thereby facilitating the orderly use of buffers to support the economy during the downturn which resulted from the Covid-19 pandemic. In this regard, the temporary regulatory relief measures can be viewed as having been designed to ensure that financial institutions, such as banks, could support and fund their clients and the real economy throughout the ongoing Covid-19 crisis. It should, however, be noted that financial institutions, including banks, were required to maintain compliance with prudential requirements aimed at ensuring long-term safety and soundness. The measures were also aimed at ensuring that financial institutions had sufficient capital resources to absorb losses incurred during the Covid-19 crisis.

2.14 REFERENCE RATE REFORM AND TRANSITION

The London Interbank Offered Rate (LIBOR) is one of the most widely used interest rate benchmarks by banks globally. Given that the underlying market from which LIBOR is derived is no longer used in any significant volume, submissions made by banks to sustain the LIBOR rate are often based (at least in part) on expert judgement, rather than actual transactions. The UK's Financial Conduct Authority (FCA) has concluded that the way in which LIBOR is calculated in practice results in non-compliance of internationally accepted principles for robust interest rate determination. In 2017, the FCA announced it would no longer compel panel banks to continue to provide LIBOR submissions beyond the end of 2021.

On 5 March 2021, LIBOR's administrator, the ICE Benchmark Administration Limited, confirmed the intention to cease the publication of dollar LIBOR (one-week and two-month tenors); pound, euro, swiss franc and yen LIBOR for all tenors after 31 December 2021; and dollar LIBOR for the remaining tenors after 30 June 2023.

The FCA's announcement of LIBOR's cessation will have far-reaching results for financial services worldwide, including FirstRand Bank Limited. Regulators expect financial services firms to take timely, appropriate and transparent steps to transition away from LIBOR to the replacement alternative reference rates (ARRs). The onus is on financial institutions to make the necessary operational changes and implement the most appropriate alternative benchmark rate(s). The issuer is actively involved in the industry transition with regulators, central banks and industry bodies, and supports the transition to the ARRs. It has launched a LIBOR reform programme to help clients navigate the challenges resulting from the transition.

The following five ARRs are currently set to replace to the following LIBORs which the issuer is exposed to. These ARRs differ by region, currency, tenor, and basis.

- $ – Secured Overnight Financing Rate (SOFR) (overseen by the Federal Reserve Bank of New York – secured rates)
- £ – Sterling Overnight Index Average (SONIA) (Bank of England - unsecured rates)
- € – Euro short-term (European Central Bank – unsecured rates)
- ¥ – Tokyo overnight average rate (Bank of Japan – unsecured rates)
- CHF – Swiss average rate overnight (Zurich-based SIX Exchange – secured rates)

The ARRs are structured differently from LIBOR rates and impact the calculations of interest and other payments for transactions and products as follows:

- LIBOR is a forward-looking term rate, which means that the LIBOR rate for an interest period or calculation period is set at the start of that period and payment due at the end. This provides certainty of funding costs to assist cash flow management. LIBOR also embeds a credit premium (it implies bank credit risk) and a liquidity premium (it includes a premium for longer-dated funds).
- The nominated ARRs are mostly backward-looking overnight rates, and designed to be near risk-free, with no premium for term.

The transition of existing LIBOR-based contracts to contracts referencing ARRs involve the payment of a spread adjustment and may impact the operation of certain financial covenants. There may also be cash flow and hedge accounting impacts if a mismatch arises on the transition between a loan and a related derivative.

Risk relating to South Africa

1. *Risks relating to emerging markets*

South Africa is an emerging market with significant socio-economic challenges. Investors in emerging markets such as South Africa should be aware that these markets carry risks which are different from those that apply to investing in more developed markets. These risks include economic and financial market volatility which may be exacerbated by global economic volatility, as well as, in some cases, significant legal and political risks.

Economic and financial market instability in South Africa has been caused by many different factors, including:

> high interest rates;
> high levels of inflation;
> exchange rate volatility;
> exchange controls;
> commodity price fluctuations;
> industrial action;
> the slowdown in the economic activity of its trading partners;
> wage and price controls;
> changes in economic and tax policies;
> the imposition of trade barriers;
> wide current account deficit;
> capital outflows;
> perceived or actual internal security issues; and
> general social, economic and business conditions.

Any of these factors, amongst others, as well as volatility in the markets for securities, may adversely affect the value or liquidity of the securities issued.

Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved. Prospective investors are urged to consult with their own legal and financial advisers before making an investment in the securities.

Investors should also note that developing markets such as South Africa are subject to rapid change, and that the information set out in this document may become outdated relatively quickly.

2. *Exchange controls*

Non-residents may freely invest in South Africa, provided that suitable documentary evidence is viewed, and the transaction adheres to certain accepted market principles such as settlement at fair and market-related prices. Similarly, the local sale or redemption proceeds of non-resident-owned assets in South Africa may be regarded as freely transferable abroad provided prescribed market-related principles alluded to above are adhered to. In certain circumstances where matters may not meet prescribed requirements but there is merit in the transaction, relief may be sought from the SARB with assistance provided by authorised dealers.

The South African Minister of Finance is supportive of exchange controls in South Africa being gradually relaxed. The extent to which the South African government (the government) may further relax such exchange controls cannot be predicted with absolute certainty. However, recent relaxations in respect of capital restrictions on emigrants and the abolishment of previously prohibited structures known as “loop structures” are positive signs of ongoing intended relaxations.

A new draft capital flow management framework is under development by the SARB in conjunction with the South African Minister of Finance and National Treasury. Authorised dealers and other interested parties have been granted the opportunity to provide comments in support of its development. This framework is intended to replace the existing currency and exchanges manual and it is anticipated to be implemented in the near term.

3. *Regulatory environment*

The issuer and its subsidiaries are subject to formal regulation, directly and/or indirectly, as the case may be, in both South Africa and in the foreign jurisdictions in which the group operates. Regulatory agencies have broad jurisdiction over many aspects of the issuer’s business, which include capital adequacy, premium rates, marketing and selling practices, advertising, licensing, policy forms, terms of business and permitted investments.

Changes in government policy, legislation, regulatory requirements and interpretations applying to the sectors, markets and jurisdictions in which the issuer operates may adversely affect the issuer’s product range, distribution channels, capital requirements, environmental and social obligations and, consequently, reported results and financing requirements. In this regard, any change in regulation to increase the requirements for capital adequacy or liquidity, or a change in accounting standards, could have a materially adverse impact on the issuer’s business, results, financial condition or prospects.

Having regard to the large volume and complexities of legal and regulatory requirements which apply to the issuer’s business operations, the issuer may not be able to detect, in a timely manner, all instances of non-compliance and/or related matters which require improvement. This can also expose the issuer and its operations to regulatory sanctions and additional liability which may have a materially adverse effect on its business, financial condition and/or results of operations.

From a South African perspective, the implementation of the Twin Peaks system of financial sector regulation in South Africa has resulted in numerous new and/or amended regulatory objectives and legal, regulatory and supervisory requirements. In addition, ongoing amendments to regulatory and supervisory requirements are also informed by the need to align to international best practice requirements. These are informed by, among others, jurisdictional member requirements of international standard-setting bodies such as the Bank of International Settlements (BIS), including the Basel Committee on Banking Supervision (BCBS), the International Organisation of Securities Commissions and the International Association of Insurance Supervisors. Banks and banking groups in South Africa are governed by a comprehensive legislative framework, most significantly the Financial Sector Regulation Act 2017, read with the Banks Act, which is comparable to similar legislation in BCBS member jurisdictions such as the UK, Australia and Canada.

3.1 FINANCIAL STABILITY

The overarching objective of the implementation of Twin Peaks was to make the South African financial sector safer and to ensure that the South African financial system remained effective, insofar as it would serve the interests of all South Africans. In broad terms, important objectives in relation to Twin Peaks are financial stability, the safety and soundness of financial institutions, the fair treatment and protection of financial customers, responsible lending and the combating of money laundering and terrorist financing.

It is important to note that a key objective of the Twin Peaks system of financial regulation in South Africa is to ensure that there is effective cooperation and collaboration among the SARB, the PA, the FSCA, the National Credit Regulator (NCR), the Financial Intelligence Centre (FIC), the Competition Commission and other authorities, local and abroad, as the case may be, which may result in additional complexities in relation to the issuer's ability to effectively manage its legal and regulatory obligations and related risks. The issuer will continue to work closely with its regulators, both locally and abroad, on matters pertaining to the above.

In accordance with its Basel III and Group of Twenty (G20) commitments, the SARB is also developing a resolution framework. The Financial Sector Laws Amendment Bill, 2018 (FSLAB) was tabled in Parliament. The bill is part of the Twin Peaks reforms of the South African financial sector regulatory system and will reinforce and strengthen financial stability in South Africa. It introduces critical elements relating to, among others, how to deal with failing banks and other systemically important financial institutions, the ultimate objective of which is to ensure financial stability in South Africa. Aligned to the aforesaid, the creation of the new resolution regime in South Africa requires several amendments to various other Acts. The bill provides for the establishment of a framework for the resolution of designated institutions to ensure that the impact or potential impact of a failure of a designated institution on financial stability is managed appropriately. In addition, the bill also provides for the designation of the SARB as the resolution authority, and for the establishment of a deposit insurance scheme (DIS), including a corporation for deposit insurance (CoDI) and a deposit insurance fund. The bill is also necessary to enable South Africa to meet certain post-2008 global financial crisis international standards, as endorsed by the G20 countries and outlined in the Financial Stability Board's document, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, which sets out the international standard for resolution regimes to address challenges in relation to banks which are considered "too big to fail". Although the bill has not yet been enacted, the relevant regulatory authorities are continually engaging with industry on matters relating to the intended resolution framework.

The SARB has published a series of discussion papers focusing on the key aspects that will affect and facilitate the implementation of a resolution framework in South Africa, and also commenced projects to consider the complexities of operationalising the DIS in South Africa. Discussion papers released in 2021 for comment include:

- *Data definition and reporting requirements for deposit insurance in South Africa (February 2021)*: Provides banks' data and technical experts with an understanding of the CoDI's data requirements, reporting options and technology proposals.
- *Proposed requirements for funding in resolution (April 2021):* Sets out the proposed requirements for designated institutions to estimate, assess and report on their potential funding and liquidity needs in resolution.
- *Proposed principles and requirements for Flac instruments (May 2021):* Outlines the characteristics, calibration and implementation period for proposed Flac instruments.
- *Using the deposit insurance fund to reimburse covered depositors (May 2021):* Provides details about the processes to be followed to utilise the deposit insurance fund and the reimbursement methods to be used by the CoDI. This paper is also referred to as the "payout paper".
- *Deposit insurance coverage paper feedback and survey (June 2021):* Provides feedback on the comments the banking industry previously submitted on the current DIS coverage and reporting proposals. The final part of the document includes details on the 2021 deposit insurance survey which banks will be required to complete towards the end of the year.

3.2 PRUDENTIAL REGULATION

After the 2007-2008 global financial crisis, various international standard-setting bodies agreed to comprehensive measures and reforms to promote financial stability, and the safety and soundness of financial institutions. The BCBS also issued various new frameworks, standards and requirements for implementation by member jurisdictions. In addition, amendments to existing frameworks, standards and requirements were also proposed. In this regard, the outbreak of the Covid-19 pandemic necessitated revised proposed implementation dates for specified regulatory reforms in South Africa. These reforms include changes to the South African prudential frameworks and/or prescribed requirements in relation to, among others, large exposures, total loss-absorbing capacity (TLAC) holdings, interest rate risk in the banking book (including disclosure requirements), revisions to the securitisation framework, a revised standardised approach for the credit risk framework, a revised internal ratings-based approach framework and a revised operational risk framework. Expected implementation dates are from 1 January 2022 to January 2024.

3.3 CONDUCT STANDARD FOR BANKS

The FSCA published Conduct Standard 3 of 2020 (Conduct Standard for Banks) which is considered to be the first step towards rolling out a comprehensive market conduct regulatory framework for the banking sector in South Africa. The conduct standard introduced, among others, requirements to ensure fair treatment of financial customers of banks. The Conduct of Financial Institutions Bill (COFI) was introduced as another overarching piece of intended legislation to amend and/or repeal certain existing financial sector laws. Once enacted and effective, COFI will, to a large extent, substantially reduce current fragmentation in the South African market conduct regulatory framework. COFI provides for the establishment of a consolidated, comprehensive and consistent regulatory framework for the conduct of financial institutions and thereby, among others, aims at protecting and promoting the fair treatment of financial customers; promoting innovation and the development of and investment in innovative technologies, processes and practices, trust and confidence in the financial sector; and assisting the SARB in maintaining financial stability.

Market conduct regulators and/or central banks, as the case may be, in South Africa and in the jurisdictions in which the issuer operates, require the issuer to provide assurance that the fair treatment of customers is embedded within the culture of the group and that due procedures and controls exist to provide demonstrable evidence that the group is treating its financial customers fairly, throughout the product life cycle, from product design to after-sales service.

The FSCA issued various conduct standards, including the Conduct Standard for Banks referred to above, the Conduct Standard on Requirements for Delegation of Administration Functions by a Manager of a Collective Investment Scheme, the Conduct Standard on Net Asset Valuation Calculation and Pricing for Collective Investment Scheme Portfolios, and the Conduct Standard for Authorised OTC Derivative Providers. The FSCA also rolled out an extensive engagement calendar with the issuer, covering wide-ranging topics, including governance in respect of complaints management, information technology, advertising, financial inclusion, product design and pricing, with specific focus on customer outcomes and experiences.

There are various regulatory developments with themes similar to those covered by the FSCA in some of the jurisdictions in which the issuer operates. In the UK, the FCA is consulting on a new consumer duty, which will directly impact the issuer's Aldermore business. This will require a higher level of consumer protection and standard of care for retail financial markets, to enable customers to make informed decisions. The principle will also apply to firms that manufacture products for or supply them to retail financial markets, even if there is no direct relationship with end customers.

Non-compliance with requirements imposed in terms of the conduct standards may result in enforcement actions being taken against the issuer, which may include, among others, fines and penalties.

3.4 ANTI-MONEY LAUNDERING REGULATIONS

The South African government identified the combating of financial crime as a policy priority. South Africa has a well-established anti-money laundering (AML) and counter terrorist financing (CTF) legislative framework (which includes but is not limited to the FICA, as amended from time to time). The last mutual evaluation report issued in relation to South Africa by the Financial Action Task Force (FATF), the purpose of which is the development and promotion of national and international AML and CTF policies, confirmed that South Africa has demonstrated a strong commitment to implementing AML/CTF systems facilitated by close cooperation and coordination among a variety of government departments and agencies. The authorities sought to construct a system which uses, as its reference, the relevant United Nations Conventions and the international standards as set out by the FATF. In this regard, to the extent that the FATF had *inter alia* made recommendations on improvements to the legislative environment, these were affected by the authorities. In terms of the FIC Act, the SARB, through the PA, is mandated to supervise and enforce banks' compliance with the FIC Act. In line with this mandate, the PA will continue to conduct inspections on banks with the aim to assess whether appropriate measures and controls are in place to ensure compliance with the provisions of the FIC Act and related regulations and regulatory requirements. The PA, as a financial sector regulator, is by law required to cooperate and collaborate with the FIC when performing its functions in terms of the FIC Act.

The issuer has implemented an AML framework which includes CTF policies and takes measures to effect continual improvement in its processes to address its money laundering and terrorist financing risks.

3.5 NATIONAL CREDIT ACT

The NCA came into effect on 1 June 2007. In terms thereof, interest rates, costs and fees which retail banks and other credit providers may charge are regulated. By way of example, maximum prescribed interest rates which may be levied in terms of credit agreements are set out in the regulations to the NCA. The NCA further stipulates a closed list of costs and fees which may be recovered under credit agreements, in addition to the capital amounts and interest charges. These relate to initiation fees, monthly service fees, default administration costs and collection costs. Initiation fees for arranging credit agreements may not exceed the maximum prescribed amount, whilst monthly service fees in relation to the administration of credit agreements are capped. Administration charges must be levied in accordance with the Magistrates' Courts Act, 1944 and collection costs are also limited. The NCA also prescribes matters in relation to the registration of specified credit providers, which has the effect that credit agreements entered into by credit providers who are in non-compliance with registration requirements will be void *ab initio*. In addition, credit agreements which contain unlawful provisions in contravention of the NCA could potentially be rendered void *ab initio*.

The NCA has strict provisions in relation to the prohibition of selling and collecting outstanding debts which have prescribed. This means that credit providers can no longer collect on loans where no legal actions were taken and no payments were received for a period of more than three years. This applies to all loans which were in existence as of 13 March 2015 as well as to new loans granted thereafter. The said provisions may therefore impact on the ability of banks to collect existing non-performing and written-off loans which have prescribed. In addition, affordability assessment regulations, which came into effect on 13 March 2015, and credit providers' commitments to combating over-indebtedness, are important considerations for the NCR. These matters form part of considerations in relation to the registration of credit providers, in terms of the NCA. The National Credit Amendment Act 7 of 2019 was promulgated during August 2019. The effective date has not yet been proclaimed by the Minister of Trade and Industry. The proposed amendments include, among others, a debt intervention measure to assist consumers to whom insolvency measures are not accessible in practice. This process will involve the extinguishment of debt, where applicable. The NCR will implement a debt intervention process and refer matters to the National Consumer Tribunal to adjudicate on debt intervention applications. Debt counsellors will be required to investigate reckless credit agreements and report such to the NCR in respect of consumers who apply for debt review. The possibility of extinguishment of debt, though limited to certain income thresholds and unsecured debt, may result in negative consumer payment behaviour which can result in the adjustment of credit risk appetites by the credit industry.

3.6 COMPANIES ACT

The Companies Act 71 of 2008, as amended (the Companies Act) by the Companies Amendment Act 33 of 2011, became effective from 1 May 2011. The Companies Act provides for the incorporation, registration and management of companies, capitalisation of profit companies, shareholder provisions, accountability and transparency, corporate finance, directors' duties and board governance, mechanisms for efficient business rescue of financially distressed companies, fundamental transactions, takeovers and share purchases that could potentially have an impact on the rights and duties of the issuer and noteholders.

3.7 CONSUMER PROTECTION ACT

The Consumer Protection Act, 2009 (CPA) came into effect on 1 April 2011. The CPA gives consumers the right to demand quality service and requires full disclosure of the price of goods and services. The CPA also protects consumers against false, misleading and deceptive representations. The CPA fundamentally changed the way in which business is conducted in South Africa. It requires businesses to transform the way in which they interact with consumers and also demands that consumers are treated in a fair, reasonable and honest manner. Although credit agreements which are governed by the NCA do not fall within the ambit of the CPA, goods or services which were provided in terms of credit agreements are not excluded from the ambit of the CPA. The CPA provides that certain industries may be exempted from specific provisions of the CPA where there are existing consumer protection regimes in place in respect of those industries. By way of example, banks are exempted from section 14 of the CPA, which deals with fixed-term contracts. In this regard, concerns were previously expressed by the banking sector that the said provision would adversely impact fixed-term deposits and thus bank customers' abilities to withdraw such deposits early. Amendments to the CPA are required to adequately and appropriately provide for matters relating to the manner in which business is conducted in a digital environment.

3.8 PROTECTION OF PERSONAL INFORMATION ACT

One of the key purposes of POPIA is to give effect to the section 14 constitutional right to privacy and ensuring harmony with international standards on data privacy. POPIA was enacted during 2013 and all private and public bodies were required to ensure compliance with the provisions of POPIA by 1 July 2021. POPIA specifically regulates the processing of personal information, which is broadly defined as information relating to an identifiable, living, natural person, and where applicable, an identifiable, existing, juristic person. The term applied to these natural and juristic persons is "data subject".

In terms of section 3(1) of POPIA, its provisions apply to the processing of personal information entered in a record by or for a responsible party, using automated or non-automated means, where the responsible party is either domiciled in South Africa or makes use of automated or non-automated means to process personal information within South Africa. Each of the subsidiaries of the issuer can be considered a responsible party (also acting in conjunction with other entities) when determining the purpose of and means for processing personal information of its customers, employees and suppliers.

POPIA establishes eight minimum conditions for the lawful processing of personal information. These conditions can be summarised as follows:

(a) Accountability: The responsible party must comply with all the conditions for lawful processing.

(b) Processing limitation: Personal information must only be collected for a specific, explicitly defined lawful purpose related to a function or activity of the responsible party.

(c) Purpose specification: Processing must be justified on grounds recognised under POPIA (e.g. consent/legitimate interests of the data subject, responsible party or the third party to whom the information is supplied).

(d) Further processing limitation: Processing must be in accordance with or compatible with the purpose for which it was initially collected, subject to limited exceptions.

(e) Information quality: Steps must be taken to ensure that the personal information is complete, accurate, not misleading and updated where necessary.

(f) Openness: Notification or disclosure requirements must be complied with when collecting personal information.

(g) Security safeguards: Appropriate and reasonable technical and organisational measures must be implemented and maintained to prevent loss of, damage to, unauthorised destruction of or unlawful access to personal information.

(h) Data subject participation: Data subjects have the right to request details of the personal information that a responsible party holds about them and, in certain circumstances, request access to such information.

Further conditions are specified for the processing of information relating to children, special personal information, direct marketing, transborder information flows, automated processing of information, and other specified matters and privacy rights afforded to data subjects.

It is within each of these conditions that material risks can emerge if the responsible party does not adhere to the corresponding requirements and provisions. Such risks can attract sanctions for the responsible party, which includes a fine, imprisonment, or both a fine and imprisonment, for a period of no longer than ten years, or alternatively may lead to an administrative fine. Security compromises can also result in irreparable reputational damage. Currently the maximum fine that can be issued is R10 million.

3.9 NATIONAL PAYMENT SYSTEM ACT

The National Payment System Bill (NPS bill) is intended to amend the existing National Payment System Act, 1998 (NPS Act). The drafting process, led by National Treasury, is ongoing, and the bill is yet to be published for public comments before tabling in Parliament. The draft bill follows the publication by National Treasury and the SARB of a policy paper titled *Review of the National Payment System Act 78 of 1998*, for public comment, during late 2018. Amendments to the NPS Act is expected to determine how the payments industry will be regulated, particularly new non-bank entrants. It is also expected that the SARB's NPS department will continue to work closely with the South African FIC on relevant requirements emanating from recommendations issued by the FATF. Non-adherence or non-compliance with payments-related requirements by the issuer can be expected to result in administrative and enforcement actions taken against the issuer.

In addition to proposed amendments to the NPS Act, it is expected that further changes will impact the South African payments landscape and how it operates. The role and operating model of the Payments Association of South Africa (PASA), a payment system management body, is currently being reviewed. The review is expected to result in current payment clearing house rules being incorporated in regulations and/or operating standards. The Banking Association South Africa (BASA) embarked on a programme to define and outline the payments modernisation journey for South Africa, focusing on identifying capabilities that must be developed and shared by banks to ensure that banks remain relevant and competitive. This initiative was informed by the entrance of multiple new types of payment services competitors. It is also expected that the legal definition of a payments service will be amended and ultimately be included in the COFI Act, once the COFI bill is enacted.

Banking sector in South Africa

Similar to other jurisdictions, prior written approval from the PA, on application, is required for both local entities and banking institutions from other countries to conduct the business of a bank in South Africa. In this regard, and according to the latest available information, which is subject to change, the South African banking sector comprises, among others, locally controlled banks, foreign controlled banks, branches of foreign banks and foreign bank representatives. Other deposit-taking institutions include mutual banks and co-operative banks.

The South African banking system is well developed and effectively regulated by, among others, the South African PA, which is a juristic person operating within the administration of the SARB, and the governance arrangements of which are prescribed in the Financial Sector Regulation Act 9 of 2017. According to information published by the PA in its 2021 annual report, South Africa's banking sector is still dominated by the five largest banks which collectively held approximately 90 per cent of the total banking sector assets at 31 March 2021. Local branches of international banks accounted for approximately 5.9 per cent of the banking sector assets and other banks for approximately 4 per cent. Although the South African banking sector remains well capitalised, funded, regulated and managed, it is highly exposed to South African macroeconomic conditions and it will be impacted by negative macroeconomic developments.

SARB

The SARB is, as South Africa's central bank and macroprudential regulator, responsible for, among others, contributing towards the achievement and maintenance of a stable financial system, protecting and enhancing financial stability, and restoring and maintaining financial stability in relation to systemic events. The SARB has a long and proud history of serving, chairing and actively contributing to the work of international and regional bodies, organisations and standard-setting bodies. In this regard, the SARB is represented on prominent regional and international forums such as the G20, the International Monetary Fund (IMF), the World Bank, the Financial Stability Board (FSB), the BIS, the BCBS, the International Association of Insurance Supervisors (IAIS), the Committee on Payments and Market Infrastructures (CPMI), the International Organization of Securities Commissions (IOSCO), the FATF, the International Association of Deposit Insurers (IADI), the Committee of Central Bank Governors (CCBG), the Southern African Development Community (SADC), the Association of African Central Banks (AACB), the Common Monetary Area (CMA) and Brazil, Russia, India, China and South Africa (BRICS).

Prudential Authority

The South African PA, which is a juristic person operating within the administration of the SARB, took effect on 1 April 2018. The SARB has, prior to the implementation of South Africa's Twin Peaks regulatory framework on 1 April 2018, performed its function as banking regulator through its bank supervision department. The PA is responsible for, among others, the licensing of banks and the prudential regulation and supervision of banks, banking groups (consolidated supervision), licensed insurers and financial conglomerates in South Africa. The PA is responsible for the prudential regulation and supervision of the issuer in accordance with applicable financial sector laws, on a solo and consolidated basis. The PA's duties and responsibilities include the promotion and enhancement of the safety and soundness of financial institutions in support of the SARB's mandate of achieving and maintaining financial stability.

It has extensive regulatory and supervisory powers which, among others, oblige banks to furnish certain prescribed financial and risk returns to it, to enable it to monitor compliance with the various prudential and other regulatory requirements imposed on banks in terms of the Banks Act, the Regulations, and other applicable regulatory instruments. The chief executive officer of the PA is a deputy governor of the SARB and a member of the SARB's Financial Stability Oversight Committee. The PA is also a member of the Sustainable Insurance Forum, the BCBS and the Network of Central Banks and Supervisors for Greening the Financial System.

The PA has memoranda of understanding (MOUs) with other regulators in South Africa, such as the FSCA, the NCR, the FIC and the SARB. It is also responsible for the supervision of compliance by specific institutions, with AML/CFT legal and regulatory requirements. The global AML/CFT standard-setting body, the FATF, of which South Africa is a member, assessed South Africa during 2019. The final report in relation to this assessment had not been published at 30 September 2021.

In addition to the above, the BCBS monitors the timely adoption of regulations by its members and assesses its member jurisdictions' consistency with the Basel framework through the committee's regulatory consistency assessment programme (RCAP). The RCAP assessments are conducted by a team of regulatory specialists from other Basel committee member countries. The objective of the RCAP is not to assess individual banks or system-wide preparedness to meet Basel standards, but rather to assess the consistency of domestic regulations with Basel standards and prescribed phase-in periods. South Africa was also subjected to an RCAP assessment, which commenced during the latter part of 2014. The RCAP for South Africa focused on both risk-based capital and Basel III standards on liquidity. The outcome of South Africa's assessment was published on 15 June 2015 and the local implementation of the Basel III framework (including Basel 2 and 2.5) was found to be compliant with the Basel standards.

National payment system department

The SARB's NPS department has responsibility for the national payment system, which it operates, regulates, supervises and oversees. It is also responsible for related policymaking. Since the NPS department regulates, among others, payment and settlement systems, the issuer's conduct in relation to payments and related services is also regulated, directly and indirectly, by the NPS department.

Financial Sector Conduct Authority

The FSCA is, similar to the PA, the other pillar of South Africa's Twin Peaks financial sector regulatory architecture. The FSCA is the South African market conduct regulator of financial institutions which are licensed in terms of South African financial sector laws. These include, among others, banks, insurers, managers of collective investment schemes and market infrastructures. The FSCA's mandate includes enhancing and supporting the efficiency and integrity of financial markets, assisting in maintaining financial stability, protecting financial customers by promoting their fair treatment by financial institutions, and promoting and providing financial education to financial customers to ensure that these customers are adequately informed, and that the financial system is more efficient. The FSCA supervises, among others, how financial institutions conduct their business and treat their customers. The FSCA is also responsible for the efficiency and integrity

of financial markets in South Africa. Various aspects of the issuer's market conduct are regulated by the FSCA and it works closely with, among others, the PA on various matters.

General

The issuer's relationships with its regulatory authorities are largely managed by a dedicated regulatory and conduct risk management function and FirstRand Limited's Public Policy and Regulatory Affairs Office. The issuer views its relationship with its regulators as being of the utmost importance. The issuer is a member of the BASA, which is effectively the mandated representative of the banking sector in South Africa, as it facilitates the enablement of a conducive banking environment through robust engagement with government and relevant stakeholders. The issuer is supportive of the Twin Peaks regulatory objectives and endorses, as an active participant in the new regulatory landscape, improvements in risk management, governance and market conduct practices. The same approach is also applied in respect of the issuer's cooperation with other regulatory authorities. Much effort and resources are dedicated in a cost-efficient manner in order to reap maximum benefits emanating from the implementation of best practice and the resultant enablement of its global business activities.

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