Chairman's statement

LAURIE DIPPENAAR [CHAIRMAN]

In his Chairman's statement last year, my erstwhile colleague and co-founder of FirstRand, GT Ferreira, remarked that he was glad he was handing me the Chairmanship of the Group, "after, and not before the most difficult year of our short history". Whilst I appreciate his sentiments he proved to be wrong about the year to June 2008 being the most difficult in the Group's short history. The year under review, to June 2009, proved to be much worse, with FirstRand's diverse portfolio of banking and insurance businesses producing a disappointing performance. Normalised earnings decreased 32% to R7.1 billion with a normalised return on equity ("ROE") of 14% compared to 22% in the previous comparative period.

There are two fundamental reasons for this performance. The first relates to the extremely difficult macro environment, and banks in general are true bell weathers of economic health.

Whilst the global economy has continued to stabilise the outlook remains challenging. The Anglo Saxon banks and respective economies have been saved from calamitous collapse by unprecedented government interventions, the US consumer is not spending but saving and governments all over the world have mortgaged the future at the expense of the tax payer. The unwinding of the massive fiscal and monetary stimulus packages, coupled with rebuilding of balance sheets, particularly in the Anglo Saxon economies, will weigh on global demand for a protracted period. It is expected that the East will emerge stronger than the West.

The South African economy is still facing significant difficulties. Job losses are increasing and the manufacturing sector is still contracting. All of these pressures have a negative impact on banks' earnings.

The South African Reserve Bank has continued to reduce interest rates and this is positive in the medium to long term as it eventually results in the reduction of bad debts and non performing loans and improved customer affordability levels. However the short term impact is negative on the margins of the banks' deposits as well as the banks' income on the capital endowment, in other words the benefit to earnings from improving bad debts "lags" the decline in gross interest turn on liabilities. The "endowment impact" has been enormous on the income statements of the local banks.

In the near term house prices are expected to remain under pressure, resulting in depressed recovery rates on mortgage security. Wholesale lending portfolios, which have been resilient for a large part of the economic downturn, are still showing signs of stress and it is not clear that the worst is over.

However, all our peers are operating in this same environment and whilst most of them have also reported significant declines in earnings for the period to June 2009, FirstRand fared worse. This relative underperformance is due to our "own goals" which were a direct result of some flawed strategies within the operating franchises of the Banking Group. In retrospect these strategies can now be seen as "bull market" strategies, and they quickly unravelled with the global crisis.

In some cases these were successful strategies for a number of years. RMB's equities trading business based in the UK, which hit our earnings last year, delivered significant positive returns for two years and on the face of it seemed to be a successful foray into the international equity markets. The skills we deployed had certainly proved themselves in the local markets and appeared to have a competitive advantage initially, however, the positions were ultimately too large and we underestimated just how quickly liquidity could dry up in an extremely severe financial crisis.

The same could be said for the Special Projects International ("SPJi") division within RMB, which also appeared, two years ago, to have a compelling three pronged strategy in the international markets:

- focusing on offshore credit assets leveraging off RMB's fundamental credit skills;
- investing in various asset classes in countries that appeared to have above average growth opportunities; and
- investing in an Indian equity fund to capture the expected growth in the economy.

However, when the global credit and equity markets collapsed, these investments moved to a position of disadvantage. With no franchise value underpin, everything came down to the vagaries of the market, resulting in large losses mainly driven by mark-to-market impairments and lack of liquidity.

What is clear from all of this is that our investment and trading businesses did not travel well. Whilst the global crisis was unexpected and unprecedented in scale and depth, a combination of a lack of a real competitive advantage, no underpin of client flows and no franchise value meant that the earnings streams from these strategies were not only unsustainable, but significant losses were inevitable as liquidity disappeared. These businesses have been closed. The offshore equities portfolio is written down to approximately $18 million, however the legacy portfolios of SPJi will be with us for a while. They are illiquid and valuations are very difficult and as markets remain volatile further mark-to market losses may be incurred.

Other strategies in offshore markets also proved over time to be unsustainable. WesBank's Australian lending business could not fund itself once the securitisation market disappeared, an example of how important it is to have a deposit franchise in a foreign country, particularly if you want to lend.

GOING FORWARD THERE WILL BE AN INCREASED FOCUS ON CLIENT DRIVEN ACTIVITIES, **AND A HEALTHIER BALANCE** BETWEEN THESE ACTIVITIES AND PROPRIETARY TRADING OR INVESTMENT ACTIVITIES, BOTH IN THE SOUTH AFRICAN AND INTERNATIONAL OPERATIONS.

A result of these painful experiences is a fundamental shift in the Group's overall strategy in its banking franchises. Going forward there will be an increased focus on client driven activities, and a healthier balance between these activities and proprietary trading or investment activities, both in the South African and international operations. In addition, secondary market activities will link to client activities or leverage the existing primary market position. Whilst it is likely that this shift may result in lower ROEs, it will improve quality of earnings and reduce volatility, and still produce acceptable returns to shareholders.

With specific reference to our international expansion, the Group will only enter into selected high growth emerging markets where we believe we have a competitive advantage and a "reasonable expectation to win". The one geography outside South Africa where the Group has successfully grown a sustainable business is the African continent and this is where we will focus our efforts, with the objective of becoming one of the pre-eminent African financial services groups. In his report on page 13 the CEO designate Sizwe Nxasana provides more detail on how the Group plans to execute on this strategy.

The changes that we plan to implement at both a strategic and operational level include re-defining the role of the "centre" of the Group. There are many benefits to a federal model such as ours, and it is particularly important to fostering an entrepreneurial and innovative culture. However it is important that the centre ensures alignment of the independent operating franchises within Group strategy, and this is an issue that is currently receiving significant focus from the Group's executive management.

It is also important to recognise that the role of the centre is not only about operational efficiencies and regulatory oversight. In a group that sees a competitive advantage in its integrated strategy, the centre's coordination role is critical. It is possible that we are still not leveraging off all of the revenue opportunities that currently exist in and between our businesses. We believe that the structural changes we are making will allow us to better evaluate our approach to opportunities between the existing franchises. In the past, the franchises may have been left to pursue these individually, in the future the centre will take a more rigorously coordinated approach that avoids a duplication of mandates and ensures that not only the franchise, but the Group overall, can benefit. The value of the Group is not only the simple sum of the values of our individual franchises, but the value that we can create by having these individual businesses work together in a tightly integrated manner. This will allow us to capture more of our clients' business and to do so more efficiently than our competitors can.

The creation of Johan Burger's Chief Operating Officer ("COO") portfolio is critical to unlocking the benefits of integration and in his report he outlines some of the existing and new mandates he will be utilising to pursue the opportunities that we believe exist.

Whilst on the subject of management portfolios, it is appropriate to cover an issue that has been top of mind for our shareholders in recent years, namely the eventual shift from an "owner managed" to a "professional managed" business. This has finally transpired with the retirement of Paul Harris as CEO of FirstRand Limited at the end of this calendar year.

Our philosophy regarding management succession is that when one person moves on and a different person takes over it is not the end of one race and the start of another. It is rather like a relay race where "the baton is passed" from the incumbent to the new manager. In order to maintain continuity and momentum the person passing the baton runs alongside the person receiving the baton before and after passing it over. I believe that the retirement of the founders from executive management roles and the requisite succession planning, has been a seamless process. The empowering culture of the Group has ensured a deep and experienced pool of talent and in addition has attracted individuals of exceptional calibre, such as our CEO designate Sizwe Nxasana.

This brings me to the delicate subject of incentivisation, reward and remuneration.

Worldwide the remuneration of bankers features prominently in the media and the speeches of politicians. The global banking industry's pay structures pre the crisis were deemed to incentivise excessive risk taking, and remuneration has been cited as one of the major reasons for the crisis itself. Unacceptable "golden parachutes" resulted in outgoing bank CEOs being vilified by irate citizens, particularly in the UK and USA, and pay structures last year were contained by poor performances and forgone executive bonuses. We are cognisant of the fact there is an expectation from our stakeholders that the Group's remuneration structures will appropriately reflect performance, and be in line with shareholder returns (or lack thereof).

THE EMPOWERING CULTURE OF THE GROUP HAS ENSURED A **DEEP AND EXPERIENCED POOL OF TALENT** AND IN ADDITION HAS ATTRACTED INDIVIDUALS OF EXCEPTIONAL CALIBER, SUCH AS OUR CEO DESIGNATE SIZWE NXASANA.

The Group is extremely aware of the need to align employee remuneration with shareholder returns. At a board level I can report that the Chairman and the board members of FirstRand Limited waived increases that had been approved by shareholders at the 2008 Annual General Meeting. At an executive management level, Paul Harris Group CEO, Sizwe Nxasana Banking Group CEO and Johan Burger COO, all experienced 40% decreases in their performance bonuses (see page 66 of this report). Other senior management suffered severe reductions in bonuses or, in the case of loss making divisions, zero bonuses. In addition, the 2006 and 2007 Share Appreciation Right grants will now never vest due to the failure to meet normalised earnings per share hurdle rates. The employees of the Group are experiencing the same loss of value that FirstRand shareholders experienced. This is appropriate in an organisation that has consistently believed in the alignment between the needs of shareholders and management, and one that believes in rewarding true performance.

Despite the downturn, the "war for talent" continues. The Group has therefore taken the decision, subject to shareholder approval at the Annual General Meeting, to implement a Conditional Share Plan which is not expected to exceed the cost of the current Share Appreciation Rights (Share Option) Scheme. In addition, a special offering of Conditional Shares will be made to the people we believe will shape the future of the Group. This is an extremely restricted share offer and the Group believes that it is the appropriate mechanism for high level retention.

An important regulatory change that will commence implementation during the new financial year is that FirstRand Limited be registered as the bank controlling company instead of FirstRand Bank Holdings. For some time we have been the only financial services group in South Africa where the bank itself is ultimately controlled by an entity that is not registered as a bank controlling entity. The proposed change, which is to be presented to shareholders for approval at the Annual General Meeting, provides us with the appropriate mechanism to come into line with the rest of the industry. This change in regulatory oversight is appropriate and will not impact the execution of the Group's stated strategy, it will however provide the Group with an opportunity to streamline some of its governance structures.

Despite all of the difficulties we have faced and grappled with this past year, FirstRand's board and management are committed to rebuilding the Group's status with its shareholders. It is clear from feedback we have received directly from investors that the series of negative surprises from the Group throughout 2008 and 2009 created the impression that senior management were not in control of all aspects of the business, especially the risk frameworks. Given this perception, combined with our view that further unexpected volatility in financial markets cannot be ruled out, the Group has elevated the profile of risk management and the ERM function during the past 12 months. The Head of Enterprise Risk Management has been appointed to the Banking Group's executive committee and reports directly to the CEO. Risk management and risk appetite is receiving increased focus at senior management levels.

The performance of the last 18 months, whilst deeply disappointing, does not detract from the robust and established business that we have grown over the last decade. The board and management believe that the actions that are now being taken are an appropriate response to both the mistakes made in the past and the challenging environment we face going forward.

There is no doubt that the year to June 2010 will continue to be difficult with many of the current challenges remaining until the end of 2009 and we anticipate continued subdued economic growth both locally and internationally. By the third quarter of next year, barring any unforeseen circumstances, FirstRand should experience a "mild" turn around as we continue to manage legacy portfolios, and non performing loans and bad debts start to unwind. However, there are many landmines out there – fiscal deficits, inflation fears and imbalances throughout the world – and South Africa is not immune to any of these. Against this background the Group will focus on maintaining a strong balance sheet, preserve its precious capital and execute on its strategy.

WE HAVE A HIGHLY DIVERSIFIED EARNINGS BASE AND **ONE OF THE BEST MANAGEMENT TEAMS IN THE BUSINESS OF BANKING AND INSURANCE** AND THESE ATTRIBUTES WILL BE KEY TO OUR FUTURE SUCCESS. I FEEL CONFIDENT THAT THE GROUP WILL CONTINUE TO SERVE ITS SHAREHOLDERS WELL.

We have certainly felt the effects of this deep and difficult cycle and it has left us wiser and, although slightly bruised, in many ways stronger, and it is important to remember what remains intact. Our entrepreneurial culture, our track record of innovation and the strength of our franchises cannot be disputed. We have a highly diversified earnings base and one of the best management teams in the business of banking and insurance and these attributes will be key to our future success. I feel confident that the Group will continue to serve its shareholders well.

In closing, I would like to propose a vote of thanks to the three directors who retired during the year. Firstly GT Ferreira, who handed over the Group Chairmanship to me in November 2008. GT was Chairman of FirstRand Limited from its inception in 1998, and did an exceptional job steering the business through its first 10 years. I would also like to thank both Robbie Williams, who has also been a non executive director since the creation of FirstRand Limited, and Dennis Falck, for their valuable contributions over the years. Finally I would like to thank FirstRand's outgoing CEO, Paul Harris, whose tenure at the helm coincided with the most challenging financial and economic crisis since the Second World War. Paul's immense energy, vision and true entrepreneurial spirit have been central to the success of this Group, which should not be judged on the past two years – but the past 30 years – and we are extremely fortunate that his knowledge and wisdom will remain available to the Group in his capacity as a non executive.

LL Dippenaar

Laurie Dippenaar

Chairman