chairman's report

"The socio-economic fallout of the COVID-19 pandemic has brought forward the inevitable inflection point that our country was bound to eventually face. Confronted by an accelerating unemployment rate, falling economic activity and an ever-rising government debt burden, economic change has become inevitable as the burden of these developments are becoming too heavy for the current system to carry. At this juncture we still have the opportunity to choose how we would best effect the changes necessary to reverse the trajectory."

Roger Jardine | CHAIRMAN

"Our world is in turmoil. Our economies are in free fall. People are scared, grieving and anxious. The COVID-19 pandemic is causing enormous suffering, and the measures to contain and overcome it are testing societies to the breaking point. This is above all a human crisis that is affecting everyone, everywhere.

This comment by the United Nations (UN) Deputy Secretary-General, Amina J. Mohammed, reminds us how the COVID-19 pandemic has profoundly shocked the world, and how the social and economic fabric of multiple countries and communities (particularly the most vulnerable) has been devastated.

Within this report are pages and pages of narrative and data points that reference how the pandemic impacted FirstRand's financial performance (I will get to this a bit later), however, we must not underestimate or ignore the wider humanitarian crisis that unfolded before us.

In March 2020, South Africa implemented one of the most comprehensive lockdowns in the world. The message from government was clear: we need to protect lives at all cost. The underlying worry was that the country's public hospitals were completely under-resourced to deal with thousands of COVID-19 cases, and that time was needed to try and limit the infection rate and scale up the frontline healthcare capacity ahead of winter.

March and April were particularly surreal months. Our cities were ghost towns and our roads deserted. Only supermarkets were open, the police and army were deployed to enforce the lockdown's travel restrictions, with bans on the sale of alcohol and tobacco put in place. Citizens were remarkably cooperative, with companies only allowing essential workers to travel to their premises and then rapidly mobilising technology solutions for employees to work remotely.

I am proud of how South Africans respected the government's decisions, and I was broadly supportive of the government's position. The President showed early decisiveness and moved quickly to protect all South Africans. However, there were certain aspects of the government's response that unnecessarily compounded the resultant impact on our economy, which was already extremely weak before the onset of lockdown. At the end of March, just as the hard lockdown was starting, Moody's became the final rating agency to downgrade South Africa's sovereign credit rating to sub-investment grade.

While it must be acknowledged that many governments around the world struggled with an appropriate response to COVID-19, by the time we reached mid-May there were clear signs that the government should adopt a more nimble style, without jeopardising lives. Thankfully, after May the overly prescriptive approach and slow-to-implement regulations were gradually eased. However, some of the earlier measures, particularly the inexplicable regulatory interventions in specific industrial sectors, undoubtedly aggravated the economic crisis that we continue to face.

The dedication and excellent work by our clinicians and frontline healthcare workers must be acknowledged. Through the group's SPIRE fund, which Alan Pullinger describes in his *CEO's report*, we experienced the amazing doctors, nurses and general hospital staff in our public hospitals. They are undoubtedly leading experts in their field and caregivers with an unmatched spirit of public service. They refused to buckle under the weight of a crumbling public healthcare system and have remained focused on saving lives. Together, with input from our universities on treatment protocols, their hard work, especially during the peak of June and July, helped to avert a health disaster.

Based on international experience, there is an expectation that there will be more waves of COVID-19 for us to weather. It is important that we build on our successes and learnings to date – both epidemiological and economic – as we confront these new waves. Active testing, tracking and sound isolation practices must remain key elements of our response. Active collaboration between clinicians and academia, and leveraging our strong industrial base will assist us in fighting future waves of the pandemic. Partnerships such as these, formed during wave 1 of this pandemic, were an important part of the success so far and we must strengthen the cohesion between government and business. Targeted economic stimulus to impacted people and industries must also be mobilised. The successful implementation of these measures will support the rebuilding of confidence in our economy, the health and wellbeing of our people and ultimately allow us to win the fight against COVID-19.

This pandemic clearly illustrated why public-private partnership must be at the core of South Africa's national policy responses to the many burning issues of our time. The private sector was not sitting on the sidelines during this pandemic, it was actively engaged in assisting government with its healthcare and social responses. Many corporates in the country stepped in and invested significant amounts of time, money, resources, networks and skills. Whether through contributions to the Solidarity Fund (which has to date deployed R2.5 billion), or other initiatives, the private sector voluntarily tackled healthcare challenges, food shortages and supply chain breakdowns, to name a few. All of this was done as companies worked to run their businesses, protect their employees, service customers and keep the wheels of commerce turning as best they could.

One of the topics I covered at length in last year's report was the need for government to "crowd in" the private sector to assist building much-needed capacity. It took a once in a 100-year crisis for this to actually happen "on the ground" and proved how this partnership can rapidly scale solutions across the country.

It's extremely important that as we move back to some level of normality we do not lose this momentum. South Africa is in a parlous state and needs to rapidly rebuild. Government cannot and should not do this alone as it is now in a worse fiscal position with depleted capacity.

One area where we can immediately make inroads is rebuilding the country's infrastructure. In 2018, the government announced its Infrastructure Fund, with the key objectives of stimulating economic growth and job creation. We acknowledge the work that has been done by the Infrastructure Office in the Presidency and the Development Bank of South Africa (DBSA), however, progress to implement the fund has been slower than originally anticipated and needs to be accelerated.

South Africa's public sector infrastructure spend as a percentage of GDP has averaged 5.9%, which sits well below the National Development Plan's (NDP's) target for infrastructure investment of 30% of GDP by 2030. The bulk of the public infrastructure budget has been allocated to the upgrade of Eskom's power stations and Transnet's infrastructure, and late delivery in some instances has resulted in significant cost overruns. In addition, there are still a number of real "obstacles" to practically delivering infrastructure projects. I have already mentioned the lack of public funding due to budgetary constraints. Other issues include the slow implementation of infrastructure projects and a significant decrease in the use of public-private partnerships (PPPs).

This brings me back to my point regarding the need to "crowd in" the private sector. The country's use of PPPs as a percentage of the total infrastructure budget currently sits at 2%, which is well below the global average of 5% – 15% for countries with a robust PPP framework such as ours.

Since the establishment of the PPP framework in 1998 – 1999, 34 projects with a total value of R91 billion have been completed successfully, with 85% delivered in the first decade. During this period, infrastructure spend was heavily weighted towards transport (over 50% was spent on the Gautrain) and health, which has a broader impact on job creation and economic growth. The second decade saw a significant decline in projects, with 83% of infrastructure spending being directed at office accommodation PPPs – which have a limited impact on sustainable job creation and economic growth.

The use of PPPs to deliver key infrastructure projects remains underutilised in South Africa. As the country finds itself in a low-investment, low-growth trap, the public sector needs to urgently leverage the private sector to create an ecosystem of shared risk, accountability and a deeper pool of skills and expertise. A shift is required in the current government and private sector engagement model. Whilst the private sector is willing, able and deeply capacitated to partner with government, it cannot be a model based on crowding out the private sector wherever possible and only finding a useful space for the private sector when convenient or in times of desperation (for example, the current health pandemic).

I am fully supportive of the President's absolute and public commitment to rid the government of rent extraction and corruption."

In my view there are some immediate quick wins. Through consultation, government and the private sector should agree on projects to prioritise. These should be projects with accelerated delivery times and maximum potential for job creation, and scalable projects that can be delivered rapidly, providing incentive to the private sector to invest or participate. Social infrastructure projects in the water, education and healthcare sectors should also be top of the list along with renewable energy projects under the independent power producer programme.

Infrastructure spending has been identified as one of the key pillars for the implementation of the NDP as it not only leads to quicker economic development and higher employment, but also promotes inclusive growth and boosts household income levels. The NDP aims to create 11 million jobs by 2030, and of these jobs 1.1 million are expected to be created by infrastructure spend. We need to make these projections a reality!

One of the other obstacles to the implementation of large projects is the fear that they become vehicles for graft, given the astounding level of corruption that has taken place in South Africa over the past decade. If our assumption is that corruption is endemic in both the public and private sector, this also makes a strong case for more PPPs where the potential for the abuse of tender processes is significantly reduced.

Depressingly, corruption continues to be an ongoing and toxic reality for the country, and even more distressing is the absolute callousness demonstrated during the COVID-19 pandemic, with the disappearance of personal protective equipment (PPE) and food for the poor. I am fully supportive of the President's absolute and public commitment to rid the government of rent extraction and corruption. The granting of the International Monetary Fund (IMF) loan is one indication that the President has convinced some external funders that he is serious about this topic and he has certainly made some progress. Until corrupt people, both in the public and private sector, are successfully prosecuted and punished appropriately, the pervasive culture of looting will persist. It is therefore very important that the criminal justice system and the National Prosecuting Authority (NPA) be properly resourced to enable them to do their jobs without any institutional constraints.

As I pointed out last year, action has been taken at the NPA and SARS and the boards at Eskom, Transnet and the Public Investment Corporation (PIC) have been overhauled. For many South Africans, however, progress remains depressingly slow.

The President must continue to push hard for resolution and accountability as it will be extremely positive for the country's psyche to see people brought to account. It would also be an important signal for inward investment which is another much needed impetus for economic recovery.

For a systemic financial services group like FirstRand, an economic recovery is vital to our ability to grow earnings and deliver returns to our shareholders. This is not only important for institutional investors (who, by the way are the custodians of our pensions), it also important for broader stakeholders. For example, our corporate foundations will receive lower proceeds from group earnings and dividend yield in the coming year, which has a knock-on effect on their ability to fund social change and upliftment.

In the *CFO's report* on page 40, Harry Kellan unpacks the group's financial performance in detail.

The 38% decline in FirstRand's normalised earnings and the reduction in ROE to 12.9% was mainly due to the much higher than expected credit impairment charge, which was driven by forward-looking economic assumptions required under IFRS 9. During the year we revised our economic assumptions materially, currently forecasting an 8% contraction in real GDP, higher unemployment and weak property markets for the calendar year 2020.

The group's pre-provision operating profit decreased 2%, which points to a resilient operating performance from the underlying businesses FNB, RMB, WesBank and Aldermore. These performances are described on pages 55 to 71.

FirstRand's capital position remained strong, with a Common Equity Tier 1 (CET1) capital adequacy ratio of 11.5%. However, despite this healthy position, the board decided not to declare a final dividend given the Prudential Authority's (PA's) current guidance to preserve capital.

This performance had an impact on remuneration; with no salary increases granted to senior management. The total short-term incentive pool reduced 43%, which is more than the decline in normalised earnings, with incentives for executive directors and prescribed officers down 48%.

The remuneration committee and the board believe that these outcomes are appropriate. We took the view that management should be recognised for navigating a severe operational challenge, which whilst not reflected in this year's ROE and earnings, is key to the future sustainability of the business. The group pleasingly grew shareholder NAV 6%.

The performance conditions for the maturing 2017 long-term incentives were not met and failed to vest. However, given that the impact of COVID-19 could result in multiple years of non-vesting of long-term incentive plans, with the concomitant risk of talent leakage, a separate retention instrument was created to secure certain senior management. The details of this instrument can be found on page 126 of the remuneration report.

In addition to the above actions, the group has in this year's remuneration report enhanced disclosure with regard to its performance scorecards. This was in response to shareholder views that short-term incentives could not be properly calibrated to performance key performance indicators (KPIs). These scorecards remain dynamic, but I believe they are a significant improvement on those of previous years.

Similarly, the group has also worked hard to address the climate-related shareholder resolutions raised at the previous year's annual general meeting (AGM) by the Raith Foundation and Just Share. At the time we promised that by October 2020 we would publish coal and fossil fuel policies and incrementally improve disclosure on our lending to fossil fuels activities. In addition, we undertook to publish our roadmap to developing a complete framework for managing all climate-driven financial risks, driving investment, credit and insurance underwriting decisions, and addressing and overseeing these risks within the group's overall business strategy and risk appetite.

I am pleased to report that our coal and fossil fuel policies were published on our website earlier this year. In his *CEO's report*, Alan Pullinger covers how climate change is now a strategic focus area for the group from both a risk and opportunity perspective, and FirstRand has now become a signatory to the reporting framework of the Task Force on Climate-related Financial Disclosures (TCFD).

On pages 32 to 39 we have published new disclosure covering governance, risk management and performance, including the roadmap we committed to disclose to shareholders last year. We expect that next year this section will be replaced by more comprehensive disclosure aligned to the formal TCFD reporting framework.

As I look forward to the 2021 financial year, the outlook remains challenging. We expect conditions to remain tough, especially for the first six months to December 2020 as the full impact of the lockdown becomes increasingly visible.

The socio-economic fallout of the COVID-19 pandemic has brought forward the inevitable inflection point that our country was bound to eventually face. Confronted by an accelerating unemployment rate, falling economic activity and an ever-rising government debt burden, economic change has become inevitable as the weight of these developments is becoming too heavy for the current system to carry.

At this juncture we still have the opportunity to choose how we would best effect the changes necessary to reverse the trajectory. These choices cannot be wasted and need to be executed in a manner that optimises the roles of each of the social partners. The government should set the rules of the game by fostering an environment characterised by sound fiscal management, safety and security, intolerance for corruption, certainty of property rights, delivery of common goods, and protection of the poor and vulnerable. This will create an environment for businesses to play their part in delivering goods and services through employing skills, capital and technology. Labour should play its part by ensuring that South Africa has a highly competitive labour force.

Given the current state of the economy and government finances, time to implement these choices is running out. However, by executing on a few reforms, such as fiscal restraint, successful auctioning of spectrum, allowing business to generate electricity and attracting highly skilled people from the international labour markets, the government will send a strong signal of intent which can gain us some valuable time to implement the rest of the necessary reforms. The good news is that most of these measures have been suggested by government, it is now simply a matter of implementing them.

Our private sector remains ready to partner with government to rebuild this economy and make job creation and social upliftment a reality, not just another projection.

In closing, our board colleagues Ms Mary Bomela and Ms Tandi Nzimande will retire as directors at the annual general meeting, in line with Directive 4. Mr Herman Bosman resigned from the board, effective 30 June, pursuant to the unbundling of FirstRand shares by Rand Merchant Holdings Limited, and Mr Paballo Makosholo also resigned, effective 30 June, as he had been requested by his employer to serve on the board of another financial services institution. I thank them for their outstanding service as directors and wish them well in their future endeavours.

On behalf of the board, I also welcome Ms Zelda Roscherr, who joined on 1 April.

I want to thank each and every employee for their courageous response to the COVID-19 pandemic and their commitment to continuing to provide our customers with outstanding service, despite social and economic disruptions since March. I also want to thank all of our customers, as our business is successful because of their trust and loyalty.

ROGER JARDINE
Chairman