chairman's report

> "We are the first generation to feel the effect of climate change and the last generation who can do something about it."
>
> ~ Barack Obama

I am going to use much of this year's report to tackle the two topics that have dominated governance conversations with our shareholders during the year. The first topic is the one I consider to be the single most profound challenge facing the world – climate change. Why is it the single most profound challenge? Because the consequences of climate change represent a real threat to the sustainability of humanity and they are already exacerbating the unacceptably high levels of inequality, poverty and human misery suffered by millions of people, many of them living on the African continent.

As former President Obama says, we are living with the realities of climate change now, which are manifesting in rising global temperatures, desertification, wildfires and flooding, to name a few. According to scientific data from around the globe, if the world does not act quickly, life for future generations will be very bleak and under certain scenarios climate change could lead to a global crisis.

Here in South Africa, whilst it is fair to say we have seen a dramatic shift in the narrative on climate policy, we must tackle with increasing urgency the need to transition our economy away from its reliance on fossil fuels and, at the same time, deal with the social consequences of that transition. Indeed, the political economy of a just transition is set to dominate our public discourse for the foreseeable future.

The tenor of the discussion on this issue has changed markedly in recent months in South Africa, in part because global policy direction has become clearer as we approach the 2021 United Nations Climate Change Conference (COP26). Local factors, however, have also added much-needed momentum. In particular the space opened for private power generation and increased procurement of renewable energy championed by Operation Vulindlela, a government initiative led by the Presidency and the National Treasury to accelerate the implementation of structural reforms and support economic recovery. This has been supported by the Presidential Climate Commission and Eskom, both of whom have started to demonstrate strong leadership in thinking about how the country should reduce its carbon intensity.

The result has been a greater appreciation not just of the risks but also the positive economic and social benefits that could arise from a transition to net zero in the next 30 years. These outcomes include industrialisation, employment and the cost and reliability of energy, key corner-stones to a just energy transition.

Energy transitions are ostensibly about people, the ones who make the big calls and the ones impacted by the effects of those decisions. In South Africa, ensuring a just transition is non-negotiable, given the already high levels of unemployment and poverty, and I think this country's just transition journey will be particularly complex.

We especially need to fully understand the full supply chain, and what the transition's impact would be on communities and the wider ecosystems they work in. This is to draw out the implications of the choices we make as a country.

The process is not without its risks. Importantly, there are huge implications for workers and communities from the transition – especially in coal mining and coal power-generating areas. We must ensure they are not left behind and must constantly consider what impact policy and business decisions will have on these communities, particularly in Mpumalanga, but also upstream and downstream throughout our entire economy.

The group's board and management are deeply cognizant that a systemic financial services business such as FirstRand needs to play a significant role in a just energy transition, and we have been focused on where we can bring solutions to different components of the journey. We want to support job creation through industrialisation and by funding entrepreneurial small businesses, in the green economy. We will also fund new energy generation in the public and private sectors as we reduce the funding of carbon-generative businesses, in line with the public commitments we have made in our climate and fossil fuels policies.

ROGER JARDINE ~ Chairman

These commitments have involved a great deal of discussion with clients and other key stakeholders, such as our equity and debt holders, non-governmental organisations (NGOs), climate activists and international development institutions.

There are some reasons to be optimistic about the changes that are happening globally and in our economy.

The National Climate Change Bill now before Parliament after agreement from social partners in the National Economic Development and Labour Council (NEDLAC) and Cabinet will give a greater sense of the pathway from here to net zero that we as a country and as sectors and as companies must travel. It will also mean necessary but challenging decisions for large emitters such as Eskom and Sasol.

I think excellent work on a just transition is being undertaken by Eskom and backed up by the Presidential Climate Commission. However, we must see real solutions to the sustainability of Eskom's balance sheet and its decommissioning path. Resolving these issues will allow Eskom to focus on the urgent need for more investment to support transmission system strengthening, which is key to securing a sustainable energy source for the future.

Substantial funding will need to be raised over multiple years. It was estimated in a recent paper released by Meridian Economics that Eskom alone would require R240 billion ($16 billion) in financing to adhere to a carbon-mitigated pathway, and that investment of R500 billion would need to be made in the power sector in renewable energy and similar investments. This will require capital market developments to crowd in local and international investors, concessional and grant funding in the debt space, and new and diverse equityholders will be crucial.

> "South Africa must arrive at COP26 with an impressive team and senior representation to present our case as a country."

COP26 in November potentially provides South Africa with an opportunity to raise international funding to support a just transition. Such funding opportunities will undoubtedly play a key role in developing a structured approach to protect the livelihoods of those impacted. Crucially, we must never forget the importance of balanced outcomes and ensure environmental and social (including community and labour) transitions happen in parallel, appropriately paced so neither gets left behind. Furthermore, as an economy that relies on coal for approximately 90% of its energy production, we cannot cut off carbon-generative businesses in the short term without considering the broad consequences for our economy and society. South Africa must arrive at COP26 with an impressive team and senior representation to present our case as a country.

Innovation will also be required across every component of the transition. The rapid transformation of the global automotive industry from internal combustion engines to new energy vehicles (NEVs) is of particular interest to South Africa. Currently the South African automotive industry contributes 4.9% (6.4% in 2019) of GDP (2.8% manufacturing and 2.1% retail), with all the major European, American and Japanese motor vehicle manufacturers represented. South Africa is on track to export over 300 000 vehicles this year, with three out of four exported to the EU, where ambitious targets have been set to migrate all new vehicle sales to NEVs within the next decade. For our local industry to remain relevant it is critical that our unique migration challenges are addressed, including clean power generation, building charging infrastructure and providing financial incentives to manufacturers and consumers to adopt this new technology.

Utility-scale batteries should become important in both public and private procurement. There is huge potential for exports of green hydrogen and sustainable aviation fuels, leveraging technologies available in South Africa. There is a growing opportunity set for new industries in both South Africa as well as the rest of Africa. In a recent research paper titled *Africa's green manufacturing crossroads: Choices for a low-carbon industrial future*, McKinsey identified 24 new business opportunities in Africa across several sectors including agriculture, biofuels, basic materials, energy, packaging and plastics, transportation, and textiles and apparel – each having substantial potential for green growth.

As part of our process to better understand the complexity of a just transition and the solutions required to deliver sustainable social outcomes, during the year the group commissioned Intellidex to undertake research on the community trusts set up under South Africa's renewable energy independent power producer procurement programme (REIPPPP).

The problem statement for this research was whether community ownership through trusts is an effective tool for energy projects to deliver community development.

Intellidex's research investigated the extent to which the potential of community ownership through trusts is being realised. It looked at issues such as the challenges in establishing and operating community trusts, and what is best practice, and whether the REIPPPP's community development work provides a model that can be applied more widely in South Africa's just energy transition.

Unfortunately, the research showed that many of the trusts are not functioning as well as they could, especially where the trust depends entirely on the independent power producer (IPP) rather than the active participation of communities.

Interestingly, the successful trusts demonstrated that when they are structured appropriately and can promote the participation of communities, they work well. In these cases, trustees – often in collaboration with the IPPs – can effectively wield resources for the benefit of their constituencies and contribute to improving well-being.

The final report from Intellidex provided a comprehensive set of recommendations on how the community trust model can function better. One of the more interesting and potentially easily implementable ideas would be to establish an NGO that is financed using blended funds from the public and private sectors.

"This NGO's purpose would be the capacitation of trusts and trustees, in all aspects of governance. One option for the funding of such an entity would be through social impact investment. Impact-minded investors could earn returns based on the extent to which predefined outcome metrics are achieved. In our separate research on South Africa's first two social impact bonds, we have seen the benefits of this approach in rallying investors, service-providing NGOs and government around results, and innovating to ensure services are effective."

~ Intellidex Communities in Transition Report

I believe that the challenges facing these trusts need to be resolved as they clearly have an important role to play in ensuring impacted communities participate in a just transition.

I would like to acknowledge the constructive dialogues about climate change we have had this year with our shareholders on our responsibilities to them. We have certainly recognised the need to improve disclosure on how the business is responding. I have already referred to our recently published climate policy and updated fossil fuels policy. In addition, we are imminently publishing our first TCFD report. Our hope is that this disclosure will enable stakeholders to understand and track FirstRand's progress against its climate roadmap and its approach to climate risks and opportunities, as well as short-, medium- and long-term targets.

FirstRand recognises that climate change is a rapidly evolving area and is committed to publishing annual TCFD reports. The insights provided in these reports will evolve and deepen as the group builds out its climate risk, climate-related product development and scenario analysis capabilities.

FirstRand has also engaged extensively with industry experts and think-tanks such as the National Business Initiative to understand the nuances of the overall transition process, and with government departments and regulators on envisaged policy approaches.

The group is actively working with clients to better understand their transition plans and needs. We are also encouraging our clients to adopt TCFD and to increase their public disclosure of climate strategies and metrics (including scope 1, 2 and 3 emissions), as we believe this increased market transparency will allow for better product design to support the transition.

Although 2050 is many years away and should provide enough time for South Africa to achieve an appropriate mix of environmental and social outcomes, echoing the words of Obama: as the last generation who can do anything about climate change, we must act now. Or, in the more combative words of Greta Thunberg:

"This is all we have heard from world leaders, 30 years of blah, blah, blah and where has that led us? We can still turn this around – it is entirely possible. It will take immediate, drastic annual emission reductions. But not if things go on like today. Our leaders' intentional lack of action is a betrayal toward all present and future generations."

I believe the group has a sound approach to this complex and far-reaching challenge and is adopting appropriate science-based responses, utilising all the tools at its disposal.

I would now like to turn briefly to a more immediate deliverable, the group's results for the 2021 financial year.

When interpreting the results for the year to 30 June 2021, it's important to remember that the comparative period, in particular the second half of the year to 30 June 2020, included the first three months of the pandemic and the lockdown introduced in March 2020. This resulted in increased impairments and reduced volumes, and led to a significantly depressed performance for that financial year. As a result of that base effect, the group's normalised earnings increased 54%, with this performance also reflecting the sharp rebound in economic activity levels across the jurisdictions in which the group operates.

However, the group produced R4.9 billion of economic profit, or NIACC, which is its key performance measure. It is impressive that FirstRand's normalised ROE recovered strongly to 18.4%, which is back within the stated range of 18% to 22%.

The group's Common Equity Tier 1 (CET1) ratio increased to 13.5% (2020: 11.5%) and the board was able to pay a full-year dividend at the bottom end of its cover range (56% payout).

It is remarkable how the business has withstood the Covid-19 onslaught and emerged in such good shape. In the board's view it is testament to the underlying quality of the group's portfolio of businesses and, as importantly, how the FirstRand management team has executed on specific strategies to protect and grow shareholder value under extremely challenging circumstances.

This brings me to the second topic I referred to at the beginning of this report that has dominated governance conversations with shareholders. That topic is executive remuneration.

Like climate change, the topic of executive remuneration has generated significant column inches in the media and stakeholders are strenuously holding boards accountable for both.

As outlined in the group's 2021 remuneration report, following the results of last year's voting on both remuneration policy and implementation, a remuneration subcommittee engaged extensively with our shareholders. This process was designed to garner shareholder feedback on our remuneration practices, which was subsequently incorporated into the remuneration committee's deliberations.

I would like to thank shareholders for the time they spent engaging with the subcommittee and the valuable feedback provided.

In response we have made material changes to both design and disclosure, and a detailed explanation of these changes is outlined in the remuneration committee chair's letter in the remuneration report published on the group's website on 16 September 2021.

We have noted that over the year a number of companies have failed their remuneration votes despite what they have described as extensive engagement with shareholders. This is a worrying trend, as it suggests that shareholder concerns are still not being resolved notwithstanding time and effort invested by both parties.

We hope that our shareholders, once they have read our remuneration report, will acknowledge the efforts made by the remuneration committee to address their concerns, and appreciate the meaningful changes to reward structures as well as the enhanced disclosures. We firmly believe all substantive issues have been addressed.

Looking forward to the 2022 financial year, it's fair to say that the operating environment will remain challenging even though we have seen a strong economic rebound from the depths of the Covid-19 pandemic. Needless to say, national efforts to ensure that everyone eligible for vaccination is encouraged to get vaccinated will support public health objectives and stimulate economic recovery.

Last year in my report I extensively covered the need for government to foster an environment conducive to creating growth opportunities for both state-owned enterprises and the private sector. I also unpacked some of the reforms required to jump-start sustained economic development.

There are signs that some of these reforms are getting traction, particularly with regards to the modernisation of South Africa's network sectors. These developments, together with the progress in the energy sector that I covered earlier, will hopefully provide the necessary business confidence underpin to increase private sector participation.

The proposed reforms to the transport sector seem to present promising opportunities for private sector participation in the country's ports and railways, which could boost broader productivity gains in the economy.

It is, however, still frustrating to witness the lack of progress on telecommunications reforms and the country's broadband rollout. Legal challenges are now exacerbating the effects of years of policy inaction. This means that the country continues to face inadequate telecommunications infrastructure, which in turn delays implementing digital technology solutions to drive greater productivity.

The benefit of accelerating the delivery of infrastructure projects is that it increases private sector interest, as project developers do not want to spend sizeable amounts of money developing projects that are likely to drag on for years without conclusion. It can take as much as four years and sometimes much longer from the request for proposal (RFP) stage for a public-private partnership (PPP) project to reach financial close. It is very important that the government moves swiftly to create an enabling environment for private sector investment in infrastructure development.

In closing, I extend my gratitude to my fellow board members who continue to provide steady guidance and oversight at a time when the group has been navigating unprecedented uncertainty.

In terms of changes to the board during the year I would like to welcome Dr Sibusiso Sibisi who was appointed on 1 April 2021. Dr Sibisi brings significant technology skills to the board, as well as important perspectives on the climate change journey.

I would like to acknowledge the immense efforts by the FirstRand leadership team, which has been instrumental in delivering the group's strong recovery in earnings and superior returns for shareholders.

Finally, I thank each and every employee for their commitment and hard work, our customers for continuing to trust us with their financial services needs and our shareholders for engaging with us in a rigorous and honest manner.

ROGER JARDINE ~ Chairman