Report by COO & CFO

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This report represents a high level overview of FirstRand Limited's financial performance, its Balance Sheet Management ("BSM") strategies and how these underpin the overall strategies of the Group and the operating franchises, and the scope and mandate of the newly formed COO portfolio.

Both the BSM strategies and the objectives and deliverables of the COO's portfolio must be seen in the context of the Group's refined strategy, which is covered in detail in both the Chairman's Report on page 6 and the Report of the CEO Designate on page 13.

Financial performance

The Group has experienced its most difficult year, which is reflected in the disappointing financial performance.

Operating in a very difficult macro background, exacerbated by losses from certain international strategies which have now been terminated, FirstRand's diverse portfolio of banking and insurance businesses produced pro forma normalised earnings down 31% to R7.2 billion with a normalised return on equity ("ROE") of 14% compared to 22% in the prior year.

GROUP KEY RATIOS

	Year ended 30 June		%
Unaudited	**2009**	2008	change
Pro forma normalised earnings (R million)	**7 151**	10 398	(31)
Normalised return on equity (%)	**14**	22	

The Group's corporate and commercial banking franchises which operate in the primary and secondary markets, produced acceptable performances, as did the retail franchises, despite the difficult consumer credit cycle. However, the absolute size of retail bad debts, particularly in the residential mortgages portfolio, combined with the losses emanating from the legacy portfolios in the investment bank, significantly impacted overall profitability. The total banking portfolio produced R6.1 billion of normalised earnings, representing a 31% decline on the previous comparative period. Its normalised ROE also declined to 13% (2008: 20%).

BANKING GROUP KEY RATIOS

	Year ended 30 June		%
Unaudited	2009	2008	change
Normalised earnings[1] (R million)	**6 056**	8 814	(31)
Normalised return on equity[2] (%)	**13**	21	
Return on assets (%)	**0.80**	1.50	
Credit loss ratio[3] (%)	**1.81**	1.28	
Cost to income ratio (%)	**58.1**	52.6	

1 *Before deducting preference share dividends.*
2 *After deducting preference share dividends and capital.*
3 *2008 impairment charge after deducting credit insurance amounted to 1.19%.*

The earnings of the insurance subsidiary Momentum were negatively affected by the significant decline and volatility of the equity markets. However, the operational performance remained robust due to the inherent resilience of Momentum's business model, with continued new business growth in the retail and employee benefits businesses. Solid growth in investment income was generated on shareholders' funds resulting from the capital preservation strategy. Overall normalised earnings declined 18% to R1 649 million, with the return on equity at 23%.

MOMENTUM KEY RATIOS

	Year ended 30 June		%
Unaudited	2009	2008	change
Normalised earnings (R million)	**1 649**	2 004	(18)
Normalised return on equity (%)	**23**	30	
Return on embedded value (%)	**3.3**	15	
CAR cover (times) (before dividend)[1]	**1.8**	1.6	

1 *The comparative is pro forma in line with the revised CAR formula that became effective during the current year.*

A breakdown on earnings from the operating franchises is shown below.

	Year ended 30 June		%
Unaudited	2009	2008	change
FNB	**3 756**	4 654	(19)
FNB Africa	**514**	499	3
RMB	**1 536**	3 008	(49)
WesBank	**324**	573	(43)
Group Support	**(74)**	80	>100
Banking Group	**6 056**	8 814	(31)
Momentum Group	**1 649**	2 004	(18)
FirstRand Limited	**(90)**	(11)	>100
Dividends paid on non cumulative non redeemable preference shareholders	**(464)**	(409)	13
	7 151	10 398	(31)

Detailed reviews of the financial and operating performances of the Group's franchises can be found on pages 28 to 48.

FIRSTRAND HAS REFINED ITS OVERALL STRATEGY WITH **THE KEY OBJECTIVE OF IMPROVING BOTH THE QUALITY AND SUSTAINABILITY OF ITS EARNINGS** AND THEREFORE CREATE MORE SHAREHOLDER VALUE OVER THE LONG TERM.

Refined Group Strategy and the role of the COO

As outlined in detail in the CEO Designate Report, given the earnings volatility that the Group has experienced between 2007 and 2009, FirstRand has refined its overall strategy with the key objective of improving both the quality and sustainability of its earnings and therefore create more shareholder value over the long term.

To reiterate, the key components of this refined strategy are:

- through a portfolio of leading franchises, be represented in all significant earnings pools across all chosen market segments playing across the full value chain (lending, transactional, savings and risk-taking)
- effectively leverage off all Group operating platforms and building blocks;
- operate within a shared business philosophy and Group strategy;
- build revenue streams that are diverse and create long term franchise value; and

- deliver sustainable economic profits and returns to shareholders within acceptable volatility.

As stated in the CEO Designate Report the Group remains committed to its integrated financial services strategy as it believes that in the "new world" of financial services there is value to be extracted for shareholders from increased integration between the asset origination capabilities of banks and the gathering of funds by life companies and asset managers. The Group's operating model will provide a platform to participate in all the profit pools associated with lending, transactional and savings activities.

Given this strategic intent one of the key mandates of the COO's portfolio is to systematically and rigorously exploit untapped revenue opportunities presented by the integrated model, particularly those between the separate operating franchises.

The value of the franchises themselves is related to their financial strength, competitive product offerings and ability to generate a particular sustainable return in exchange for a given level of risk. A franchise that is able to generate a higher return for a comparable level of risk to that taken by a competitor is clearly more valuable. Accordingly, one of the Group's objectives is to foster "best-in-class" franchises wherever possible.

However the value of FirstRand is not only the simple sum of the values of the individual franchises' product offerings and returns, but the value that can be created by ensuring these individual businesses work together in a tightly integrated manner.

The COO is also mandated to harness efficiencies from the integration of platforms, processes and functions shared by the individual franchises.

Enhancing performance by realising efficiencies is a process that has already started and initial benefits are likely to be substantial. The Group is currently analysing its investment needs compared to estimated savings and benefits and also any required changes in existing processes. Subsequent phases, such as the continued integration of operational platforms, operating processes and finance systems are naturally more challenging and will require more time, but these should deliver long-run benefits that go beyond simple cost savings. Ultimately the Group seeks to manage and direct its portfolio of businesses much more nimbly and more effectively.

Within the context of the broader Group strategy to play across the profit pools represented by the financial services universe, the COO is also mandated to identify activities that the current portfolio does not cover, and work with the franchises to enter new markets with the appropriate support from the centre.

Holistically and actively managing the earnings profile ultimately relates to creating the optimal structure of the Group's business portfolio, the allocation of resources, risk capacity and the determination of the growth/expansion strategy. The Group benefits from and ultimately creates value for shareholders on the basis of natural hedges in its portfolio that should reduce the overall volatility of its earnings.

Performance measurement and the allocation of capital will be key to ensuring the delivery of an optimal earnings profile.

HOLISTICALLY AND ACTIVELY MANAGING THE EARNINGS PROFILE ULTIMATELY RELATES TO CREATING THE OPTIMAL STRUCTURE OF THE GROUP'S BUSINESS PORTFOLIO, THE ALLOCATION OF RESOURCES, RISK CAPACITY AND THE DETERMINATION OF THE GROWTH/EXPANSION STRATEGY.

The role of the Centre in managing the risk profile of the balance sheet

As outlined in the Chairman's statement many of the changes the Group plans to implement at both a strategic and operational level include redefining the role of the "centre" of the Group. Whilst the Group believes in the benefits of a federal model as it is particularly important to an entrepreneurial and innovative culture, the centre must ensure alignment of the independent franchises with Group strategy and within appropriate risk and performance frameworks.

The centre has ultimate responsibility for the strategic direction of the Group. Furthermore, the centre defines the appropriate risk appetite for the Group and provides a balance sheet and capital strategy to drive financial synergies, ie optimal cost of capital and debt as well as an optional earnings profile.

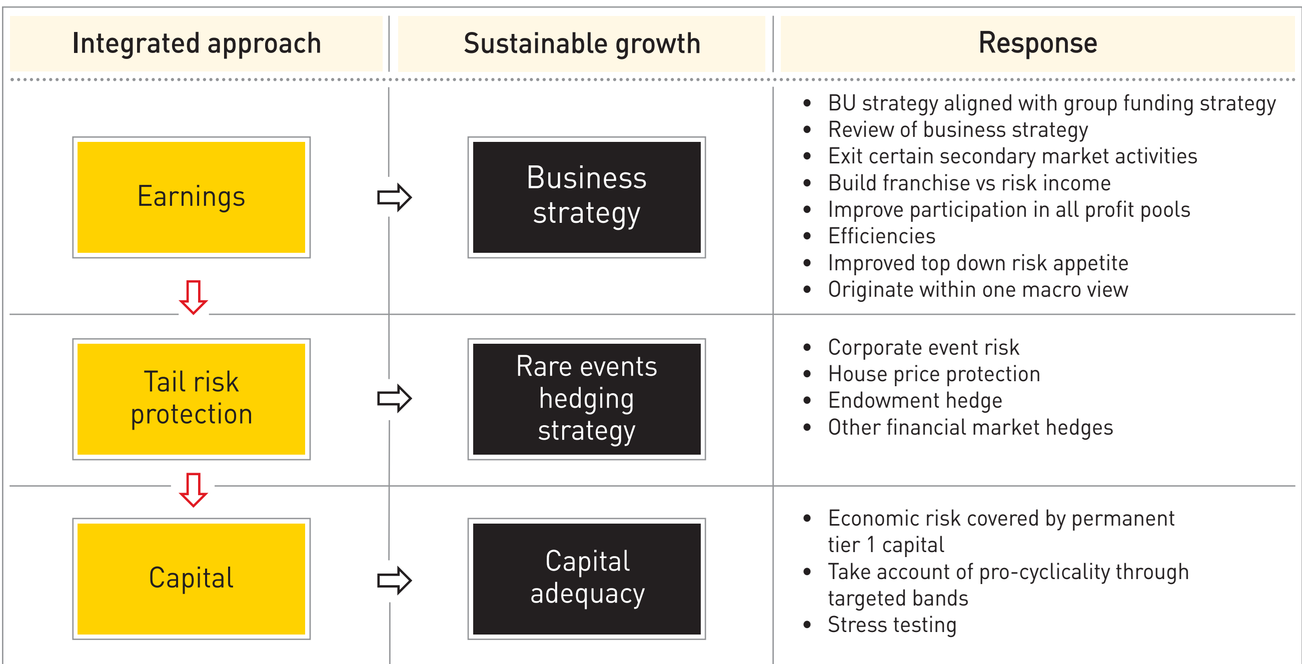
The Group's earnings are substantially driven by the Group's balance sheet – either directly in the form of net interest income or indirectly in the form of fee income, which is in turn ultimately based on credit activities or trading and advisory services that can be tied to the strength of the Group's franchise and its market position.

For example, setting and executing an appropriate credit strategy – with respect to the existing portfolio and with respect to the origination of new assets – is a potential source of substantial value. A number of changes have been made in this area over the last 12 months and the existing teams in BSM ensure that the Group's core macro economic outlook is translated appropriately into adjustments to the credit strategy and linked into capital and funding considerations. In this respect a productive cycle of evaluating the portfolio vis-à-vis the macro view, adjusting the origination strategy, identifying potential areas for additional hedges and executing these respectively, has been put in place with strong involvement between both the business and the central functions.

Aligning BSM and operating franchise strategies

The overall objective of BSM is to maintain a robust balance sheet and earnings profile "through the cycle". The Group formulates a "core" macro view which is designed to ensure alignment between business strategy and more specific credit, capital and funding strategies within the appropriate risk framework. Going forward the Group plans to ensure greater integration between BSM and the operating franchises as this will ensure a more sustainable growth trend in earnings and returns.

This diagram indicates the actions taken within the past 12 months that have created an integrated effort between the BSM strategies and the franchise strategies and operations.



The macro view

FirstRand has implemented a single house view to manage both its balance sheet and operating franchise activities. The macro view is a key input into the budgeting and forecasting process, informs credit origination strategies and capital stress testing, directs the interest rate positioning of the banking book and endowment portfolios and is used for tail risk strategies.

BSM is tasked with formulating and communicating this macro economic view. It provides the business units with a forecast of key variables that impact the balance sheet and spans a three year forecast horizon.

Given the volatility of the macro economic environment, a core forecast and two risk scenarios are presented to the business units for each key variable. A severe scenario is also forecast for balance sheet and income statement stress testing purposes. BSM draws on its own research, research from the Group's economists and the research of external research providers in formulating these scenarios and forecasts. Once formulated, the scenarios and forecasts are debated and then communicated to business units.

Credit portfolios are evaluated by analysing the in-force portfolio performance against the current economic environment as set out by the BSM macro economic view. Thereafter strategic and tactical origination decisions are made based on the core view, taking cognisance of the risk view to align portfolios' performances to the Group's overall risk appetite and strategic intent. The positioning of the banking book is also evaluated against the macro view and positioned to optimise earnings against the background of the interest rate forecast, the expected credit environment and the Group's risk appetite.

The macro economic scenarios are also utilised for stress testing purposes. All four scenarios are used in the corporate centre to test the impact of the macro scenarios on the capital and liquidity position and on earnings. The results of the stress testing inform strategy and management actions to mitigate the impact on the balance sheet and income statement.

Credit

The Group has refined its credit risk management approach over the past 18 months and strategies have been put in place for the management of the "in-force" credit portfolio, and for new business origination.

A key area of focus for the "in-force" credit book is careful monitoring of early warning triggers for potential retail delinquencies or corporate credit deterioration. This allows for pro-active identification of potential problem accounts and remedial actions to be taken early on. For example, this has allowed for pro-active restructuring of corporate exposures to improve the credit position. The improvements made to the retail workout process over the past year have also already resulted in a more efficient and effective workout process.

New business origination continues to be closely linked to the Group's medium term macro economic view. This has allowed for more active lending in selected market segments in recent months, given the improved macro economic outlook.

To mitigate the risk of too low loan growth, and the potential spill-over that this may have in exacerbating the economic crisis, the Group is currently looking at a number of initiatives in terms of credit strategy to capture an appropriate level of new business.

Whilst the Group's current new business strategy remains cautious given the house view of lower economic growth, there are a number of areas in the market which still represent the appropriate risk return even in the current market environment. For this reason, the Group is looking to selectively target such areas for more active lending and to ensure that its credit policies are appropriately aligned to this goal, without compromising on the overall credit quality criteria that has been set.

Recent focus areas and actions include:

- an assessment and careful identification of inherently more defensive industries in the large corporate arena where the banking franchises can lend more actively,
- a combination of measures in residential mortgages including:
  - refocusing business origination to lower risk customers;
  - changing the channel mix of business through originating more via branches than through originators. This is a deliberate strategy as existing customers have historically been of a better risk quality;
  - re-contracting of arrangements with mortgage originators to ensure a better alignment of interest in terms of the risk management and cost of loans submitted for approval through this channel;
  - improved granular pricing in home loans resulting in an improvement of average margin relative to prime on new business. New business margin has ranged between prime minus 0.8% to prime minus 1.2% over the last 6 months, compared to prime minus 1.5% for parts of 2007/2008;
  - recognising the benefits from recent interest rate cuts in the assessment of customer affordability, but maintaining an overall conservative approach to affordability on other expense items; and
  - adjusting the loan to value criteria for new loans therefore not applying an "across the board" approach of required deposits but to consider more carefully the circumstances of customers in good standing.

FirstRand maintains its overall cautious stance on new credit origination. However, it will continue to identify attractive sub-sectors in the overall credit market where it can lend more actively without compromising on its credit standards.

Liquidity and funding

The funding and liquidity strategy is integrated within the BSM functions and the strategies of the underlying franchises. The Group funding strategy is to build a very strong retail and commercial deposit franchise and to ensure a flexible and diversified funding base with a strong liquidity underpin.

Domestically the banking sector has a structural reliance on wholesale funding, which is more expensive and short term in nature, therefore the Group aims to create a more balanced funding profile over time. Given the short term nature of wholesale funding, in order to ensure liquidity and a lengthening of the term profile, the Group has built appropriate liquidity buffers, and aims to decrease the reliance on wholesale funding through innovative retail products.

During the year, the Group reduced its international balance sheet asset position, increased liquidity buffers and matched funded the profile to underlying assets. The international balance sheet was surplus funded.

The Group recognises that its international expansion strategy requires an appropriate funding strategy. Given the changes in international markets the Group cannot be competitive if reliant on wholesale funding, therefore matched funding, or the creation/acquisition of a localised deposit franchise in some chosen markets, will be key.

The international platforms in the UK, Dubai and Australia support the funding of the Group's international strategy in so far as they facilitate corporate client business, trade finance and treasury flows.

Tail risk

Beyond targeting suitable earnings streams, the Group can also enhance value by understanding, managing and mitigating tail risks to earnings stability.

As part of its forecasting process, the Group considers outcomes beyond its core and risk scenarios that have large, adverse effects. While earnings absorb expected losses, capital provides a buffer against unexpected losses. As an additional layer of defence against tail risk, the Group has also, in the past, implemented macro economic hedges and endowment hedges with some success.

Capital management

During the global financial crisis the Group met its goal of operating at the upper end of its targeted capitalisation range. Recent events in the international financial markets have increased the focus of stakeholders on both the level and quality of capital in banks. The Group aims to back all economic risks with Tier 1 capital as it offers the greatest capacity to absorb losses. Currently at least 90% of the Tier 1 ratio is equity capital.

The Group is appropriately capitalised under a range of normal and severe scenarios as well as under a range of stress events. It aims to operate within its risk appetite and the associated limits in terms of earnings volatility and the variability of returns on capital in excess of the weighted average cost of capital.

Within the insurance business specifically, the reformulated targeted capital range satisfies the same risk appetite as the previous targeted range and reflects a conservative investment strategy for capital.

SOUTH AFRICAN BANKS HAVE HISTORICALLY REMAINED RELATIVELY UN-GEARED COMPARED TO INTERNATIONAL PEERS. THEREFORE REGULATORY **PRESSURES TO INCREASE TIER 1 CAPITAL LEVELS ARE LIKELY TO HAVE ONLY A MARGINAL IMPACT ON BANKING ROE'S.**

With the introduction of Basel II, capital requirements have become more risk sensitive and thus more cyclical than under the previous regime. This cyclicality is to a large extent driven by external factors that affect the Group's risk measures across various portfolios and that thus drive its capital requirements. In 2008, the targeted capital ratios were raised and at the same time a range for total capital adequacy was introduced, which allows the Group's capital ratios to move within a range through the cycle. The Group expects to operate at the upper end of the range in favourable conditions and for levels to move lower when the cycle turns.

South African banks have historically remained relatively un-geared compared to international peers. Therefore regulatory pressures to increase Tier 1 capital levels are likely to have only a marginal impact on banking ROEs.

The crisis in the financial markets resulted in many banks, including FirstRand, incurring losses in international trading and investment portfolios. This has led to questions from stakeholders regarding lower ROEs going forward as banks reduce risk appetite. From a FirstRand perspective, the component of ROE represented by offshore trading and investment activities, even at the earnings peak, was between 2% and 3% of the Group's total ROE. The Group remains in the business of market and investment risk as it has a particularly good track record in local primary markets. However, as outlined in the CEO Designate Report, these activities will refocus to markets where the business has a real competitive advantage.

The real issue when considering sustainable ROEs going forward is the ability to price appropriately for credit. The current downturn has clearly demonstrated that large parts of the credit market were systematically underpriced in recent years. The Group's ability to price new lending at significantly improved margins is expected to offset higher funding costs and capital levels and should provide support to ROEs going forward.

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