basel II pillar 3 disclosure

FOR THE SIX MONTHS ENDED 31 DECEMBER 2010

FIRSTRAND

CONTENTS

FIRSTRAND

1966/010753/06 Share code: FSR ISIN: ZAE 0000066304 ("FSR")
Certain companies within the FirstRand Group are Authorised Financial Services Providers
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INTRODUCTION

Regulation 43 of the revised regulations of the Banks Act, 1990 (Act no. 94 of 1990) requires that a bank shall disclose in its annual financial statements and other disclosures to the public, reliable, relevant and timely qualitative and quantitative information that enable users of that information, amongst other things, to make an accurate assessment of the bank's financial condition, including its capital adequacy position, and financial performance, business activities, risk profile and risk management practice. This disclosure requirement is commonly known as Pillar 3 of the Basel II Accord. The Group's financial performance for the six months ended 31 December 2010 is covered in the "Circular to Shareholders".

This is the Basel II Pillar 3 report of FirstRand Limited ("FirstRand" or "the Group"). This report complies with the risk disclosure requirements of Basel II Pillar 3.

Group structure

Effective 1 July 2010, FirstRand replaced FirstRand Bank Holdings Limited ("FRBH") as the regulated bank controlling company. As part of this process the Group entered into a process to simplify the Group structure, whereby FirstRand Bank Limited ("FRB") disposed of materially all its subsidiaries and associates to fellow wholly-owned Group subsidiary, FirstRand Investment Holdings (Pty) Limited ("FRIHL"). As of 1 July 2010 FRB, FirstRand EMA Holdings Limited ("FREMA"), and FRIHL are all regulated as wholly-owned subsidiaries of FirstRand. A simplified diagrammatic representation of the Group structure is provided on page 80.

The majority of the comparative figures included in this report for December 2009 and June 2010 are for FRBH and are in many instances not comparable to the December 2010 figures, which are FirstRand figures.

Some differences between the practices, approaches, processes and policies of FRB and FirstRand exist and these are highlighted by a reference to the appropriate entity, where necessary. The Pillar 3 disclosures in this report have been internally verified by the Group's governance processes.

For fully consolidated entities in the Group, no difference in the manner in which entities are consolidated for accounting and regulatory purposes exist. Toyota Financial Services, an associate of FRB, is equity accounted for accounting purposes and *pro rata* consolidated for regulatory purposes.

Strategy and risk profile aligned

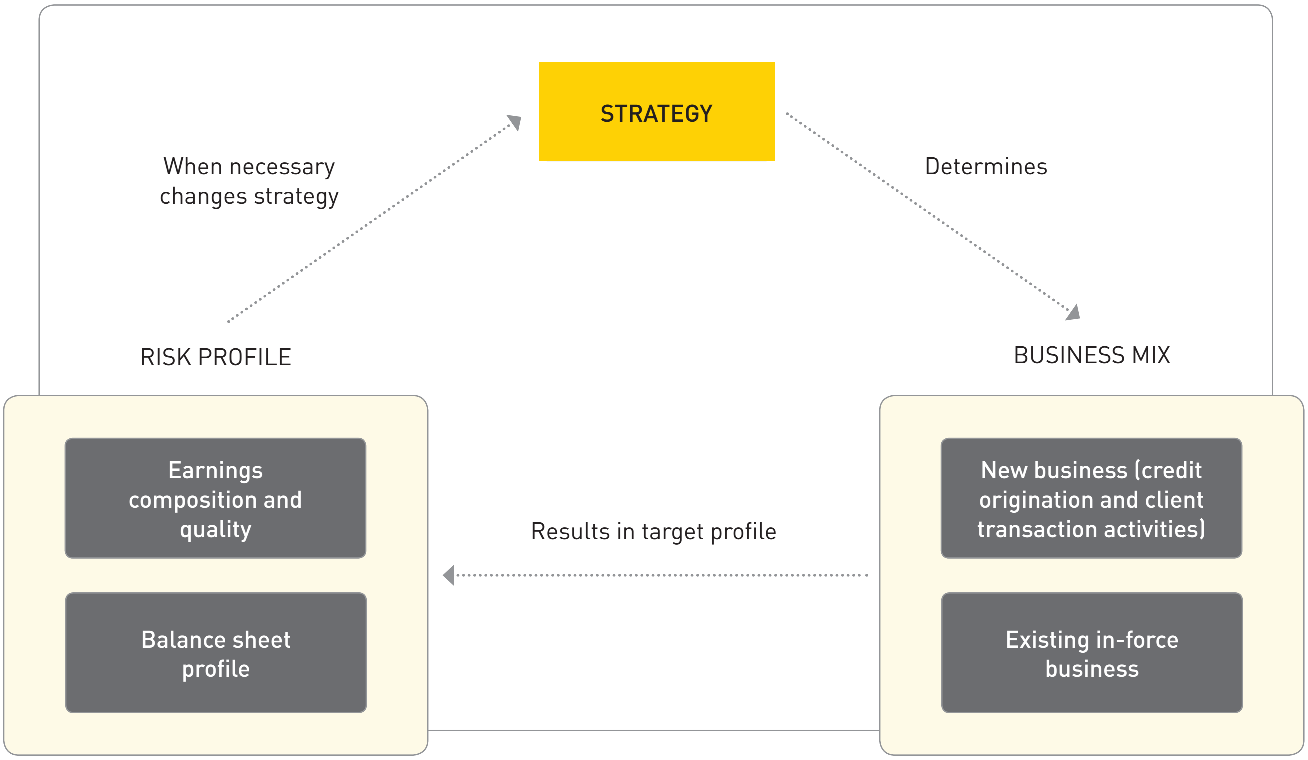
FirstRand believes that effective risk management is of primary importance to the success of the Group and is a key component of the delivery of sustainable returns to its shareholders. It is therefore deeply embedded in the Group's tactical and strategic decision making.

FirstRand's overall objective is to be the African financial services group of choice. To execute on these strategies, the Group will actively assume certain risks – including credit, market and investment risk. As a consequence of its banking activities it also incurs funding and liquidity, operational, interest rate and reputational risk. These risks are predominantly within South Africa and other select African markets.

In addition to the above risks, the Group's strategy can also be affected by external risks such as regulatory changes, political shifts and macroeconomic conditions.

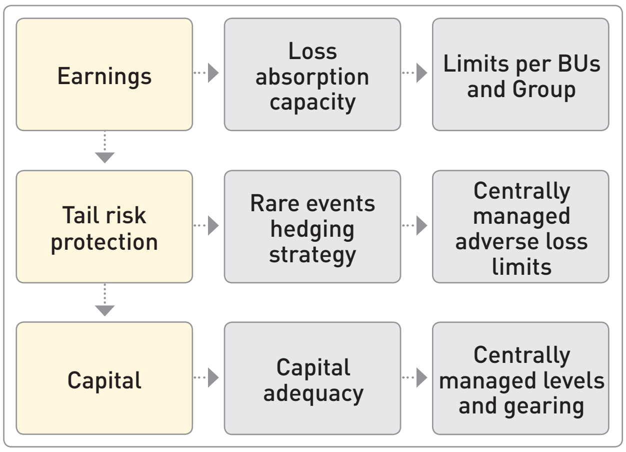
The collective leadership of FirstRand, including the FirstRand CEO, COO and the franchise CEOs, determines the Group's strategy and is accountable for the overall performance of the Group. The strategy is approved by the FirstRand Board. The determination of the Group's strategy is a dynamic process as illustrated by the diagram on page 4. It is designed to achieve superior, sustainable economic returns to shareholders, within acceptable levels of earnings volatility. The Group's strategy is executed through its portfolio of leading franchises. The Group seeks be represented in all significant earnings pools across all chosen market segments playing across the full value chain (lending, transactional, savings and risk taking), therefore, this portfolio must represent the appropriate business mix and risk profile to deliver on this strategy.

Determination of Group strategy



On a regular basis, depending on certain macro dynamics or specific internal issues, the Group assesses whether the risk profile or business mix within its portfolio is optimal to deliver on its strategy; if not, it will take actions to adjust accordingly.

As illustrated in the diagram below, the Group views earnings as its first defence against adverse outcomes.



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 which might have large adverse effects. As an additional layer of defence against tail risk, the Group also implements certain hedges.

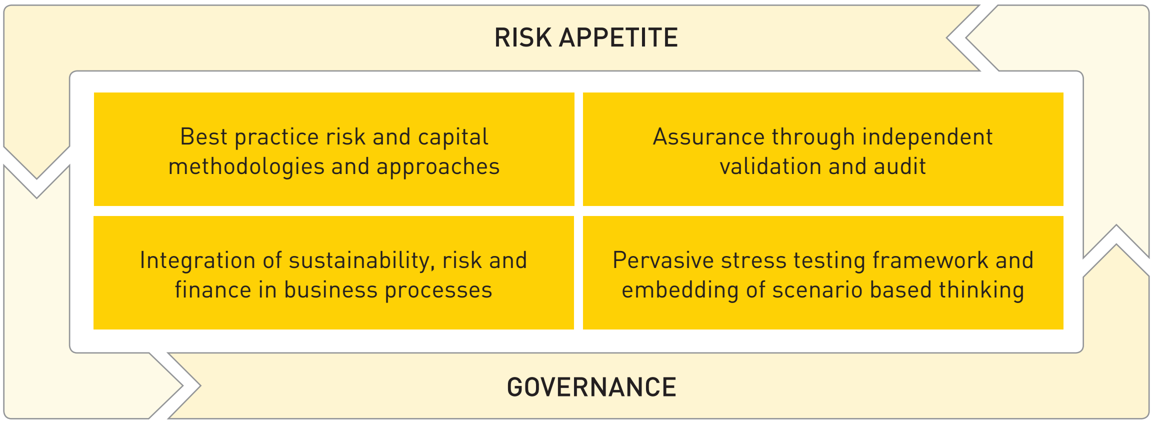
In addition to earnings, capital provides a further buffer against unexpected losses. The Group is appropriately capitalised under a range of normal and severe scenarios, as well as under a range of stress events. The Group aims to back all economic risk with Tier 1 capital, as it offers the only real capacity to absorb losses. Currently, at least 90% of the Tier 1 ratio is equity capital.

FirstRand's approach to risk and capital management

The Group defines risk widely – as any factor that, if not adequately assessed, monitored and managed, may prevent it from achieving its business objectives or result in adverse outcomes, including damage to its reputation.

FirstRand follows a comprehensive approach to risk and capital management that comprises six core components, illustrated in the chart below.

Components of FirstRand's approach to risk and capital management



These core components are discussed further in the major sections of this report:

- FirstRand's risk appetite frames all organisational decision making and forms the basis for the refinement of risk identification, assessment and management capabilities (see page 8).
- A strong governance structure and policy framework foster the embedding of risk considerations in existing business processes and ensure that consistent standards exist across the Group's operating units (see page 11).
- Best practice risk and capital methodologies have been developed in and for the relevant business areas (see page 12).
- An integrated approach to sustainability and managing risk was established to facilitate the proactive exchange of information between individual risk areas and between risk and finance functions (see page 7).
- The Group is deploying a comprehensive, consistent and integrated approach to stress testing that is embedded as a business planning and management tool, emphasising scenario based analyses in all its decision processes (see page 8).
- Independent oversight, validation and audit functions ensure a high standard across methodological, operational and process components of the Group's risk and capital management processes (see page 10).

1. DEFINITIONS

The Group is exposed to a number of risks that are inherent in its operations. Identifying, assessing, pricing and managing these risks appropriately are core competencies of the individual business areas. Individual risk types are commonly grouped into three broad categories, namely strategic and business risks, financial risks and operational risks.

Risk category	Risk components	Definition	Page reference
Strategic and business risks	Includes strategic risk, business risk, reputational risk, macroeconomic risk and environmental, social and governance ("ESG") risks.	**Strategic risk** is the risk to current or prospective earnings arising from inappropriate business decisions or the improper implementation of such decisions. **Business risk** is the risk to earnings and capital from potential changes in the business environment, client behaviour and technological progress. It is often termed volume and margin risk and relates to the Group's ability to generate sufficient levels of revenue to offset its costs.	13
		Reputational risk is the risk of reputational damage due to compliance failures, pending litigations, under-performance or negative media coverage.	
		Macroeconomic risk is the risk to the business due to changes in macroeconomic conditions, global economic conditions or credit shocks.	
		ESG risks focus on the environmental, social and governance issues which impact the Group's ability to successfully and sustainably implement business strategy.	
Financial risks	Capital management	The Group manages capital by allocating resources effectively in terms of its risk appetite and in a manner that maximises value for shareholders. The overall objective of capital management is to maintain sound capital ratios and a strong credit rating, ensure confidence in the solvency of the Group during calm and turbulent periods in the economy and financial markets.	14
	Credit risk	Credit risk is the risk of loss due to the non-performance of a counterparty in respect of any financial or performance 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.	22
	Counterparty credit risk	Counterparty credit risk is defined as the risk of a counterparty to a bilateral contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows.	55
	Market risk in the trading book	Market risk is the risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates.	57
	Equity investment risk	Equity investment risk is the risk of an adverse change in the fair value of an investment in a company, fund or any other financial instrument, whether listed, unlisted or bespoke.	60

Risk category	Risk components	Definition	Page reference
Financial risks	Foreign exchange and translation risk in the banking book	**Foreign exchange risk** is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank has net open positions in foreign exchange, and as such is exposed to currency risk in its foreign currency positions and foreign investments. **Translation risk** is the risk associated with banks that deal in foreign currencies or hold foreign assets. The greater the proportion of asset, liability and equity classes denominated in a foreign currency, the greater the translation risk.	63
	Funding and liquidity risk	Liquidity risk is the risk that a bank will not be able to meet all payment obligations as liabilities fall due. It is also the risk of not being able to realise assets when required to do so to meet repayment obligations in a stress scenario. The definition of liquidity risk is expanded in the *Funding and liquidity risk* section on page 64.	64
	Interest rate risk in the banking book ("IRRBB")	IRRBB is defined as the sensitivity of a bank's financial position and earnings to unexpected, adverse movements in interest rates.	70
Operational risk	Operational risk	Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes and systems or from external events and human error. It includes fraud and criminal activity (internal and external), project risk, legal risk, business continuity, information and IT risk, process and human resources risk, but excludes strategic, business and reputational risks.	75
	Regulatory risk	Regulatory risk is the risk of statutory or regulatory sanction and material financial loss or reputational damage as a result of a failure to comply with any applicable laws, regulations or supervisory requirements.	78

3. INTEGRATED RISK AND CAPITAL MANAGEMENT

Focus on sustainability and integration of risk and finance

The Group considers the sustainability of its earnings within acceptable volatility as a core objective and key performance measure. The value of its franchises is ultimately driven by financial strength and the Group adopts a management approach that seeks to balance independent franchises with strong central oversight aimed at ensuring optimal outcomes.

This is necessary since the optimisation of each individual franchise's value does not necessarily ensure the maximisation of the Group's value, given potential natural offsets as well as concentrations across the businesses and efficiency gains available from aggregating, mitigating and managing risks at a Group level, where appropriate.

The franchises are ultimately responsible for maximising risk-adjusted returns on a sustainable basis, within the limits of the risk appetite. Shifts in the macro environment are also critical to any strategic adjustments. FirstRand manages its business based on the Group's "house view" which inputs into the budgeting and forecasting process, informs credit origination strategies and capital stress testing, directs the interest rate positioning of the banking book, and is used for tail risk strategies.

The Balance Sheet Management ("BSM") unit within the Corporate Centre is tasked with formulating and communicating this macroeconomic 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 macroeconomic environment, a core forecast and two risk scenarios are presented to the business units for each key variable. A severe scenario is also included for stress testing purposes. These scenarios and forecasts are debated and then communicated to the business units. The outlook is monitored on a daily basis and is updated on a quarterly basis, or more frequently if required.

Capital Management and Group Treasury within the Corporate Centre are responsible for the management of the Group's capital and liquidity position. The capital position provides the final buffer against adverse business performance under extremely severe economic conditions.

The Group, through a combined initiative of its finance, capital and risk functions, continues to integrate financial, capital and risk data and information on a common platform. This information, both actual and through the budget process, is used as basis for risk, capital and financial analysis and stress testing.

The practices instituted are intended to ensure that capital and liquidity-related decisions can be taken in a well-coordinated and proactive manner on the basis of a consistent, integrated view incorporating aspects of both finance and risk domains.

Internal capital adequacy assessment process

The Group views the Internal capital adequacy assessment process ("ICAAP") as key to its risk and capital management. The ICAAP allows and facilitates:

- the link between business strategy, risk introduced and capital required to support the strategy;
- the establishment of frameworks, policies and procedures for the effective management of material risks;
- embedding the risk culture at all levels in the organisation;
- the effective allocation and management of capital in the organisation;
- the development of plausible stress tests to provide useful information which act as early warning signs and triggers so that contingency plans can be implemented; and
- the determination of the capital management strategy and how the organisation will manage its capital including during periods of stress.

Stress testing and scenario based analysis

The evaluation of business plans and strategic options at a Group and business level, as well as the choice of tactical steps towards implementing these plans are intrinsically linked to the evaluation and assessment of risk. Thinking through potential scenarios and how these may evolve based on changes in the economic environment, changes in competitors' strategies, and due to potential stress events is an integral part of the strategy-setting, planning and budgeting processes.

The core scenario reflects the Group's view on the risks that are central to its business and which it assumes and manages accordingly. In addition, several stress scenarios are prepared to supplement the core view and inform management action at a business and Group level with respect to potential deviations from budget and the potential implications for earnings volatility. In addition, reverse stress test scenarios provide management and regulators with a structured view on potential developments that may threaten the stability of the institution.

The Group also recognises the fact that it is exposed to a number of risks that are difficult to anticipate and model and that are, therefore, difficult to manage and mitigate economically. These risks are collectively denoted as 'event risks' and are not necessarily strongly related to the economic environment or the Group's strategy. The stress testing framework provides for proactive and continuous identification of such potential events and establishes a process in which these are evaluated, discussed and escalated across the businesses.

Stress testing and scenario analyses have been integrated across the traditionally separate domains of risk and finance.

Risk appetite

The level of risk the Group is willing to take on – its risk appetite – is determined by the Board, which also assumes responsibility for ensuring that risks are adequately managed and controlled through the FirstRand Risk, capital management and compliance committee ("RCC committee") and sub-committees, as described in the *Risk governance structure* section on page 9.

The risk appetite framework sets out specific principles, objectives and measures that link diverse considerations such as strategy, risk, target capitalisation levels and acceptable levels of earnings volatility. As each franchise is ultimately tasked with the generation of sustainable returns, risk appetite acts as a constraint on the assumption of ever more risk in the pursuit of profits – both in quantum and in kind. For example, a marginal increase in return in exchange for disproportionately more volatile earnings is not acceptable. Similarly, certain types of risk, such as risks to its reputation, are incompatible with the business philosophy and thus fall outside its risk appetite.

In addition to these considerations, risk appetite finds its primary quantitative expression in two measures, namely:

- the level of earnings growth and volatility the Group is willing to accept from certain risks that are core to its business; and
- the level of capitalisation it seeks to maintain and the return achieved on capital allocated.

These two measures define the risk capacity and this expression of risk appetite is calibrated against broader financial targets. As a function of the business environment and stakeholders' expectations, together with the primary risk appetite measures, these provide firm boundaries for the organisation's chosen path of growth.

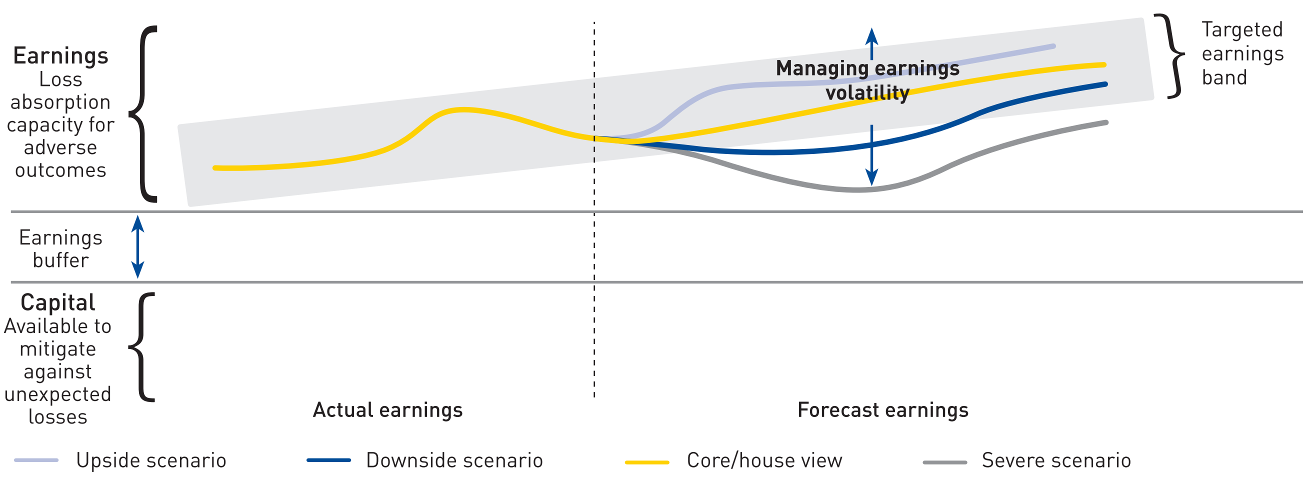
In setting the risk appetite, the Executive committee and Board balance the organisation's overall risk capacity with a bottom up view of the planned risk profile for each business. It is in this process that the Group ultimately seeks to achieve an optimal trade-off between its ability to take on risk and the sustainability of the returns it delivers to its shareholders.

Risk appetite measures are included in risk and management reports across the businesses, as well as at board level. These measures are continually refined as more management information is available and stress test results are reported and discussed.

Within the Group context, earnings are seen as the primary defence against adverse outcomes. The Group's capacity to absorb earnings volatility and fluctuations is therefore supported by the generation of sustainable profits.

The earnings buffer and capital provide protection against unexpected events for stakeholders. The chart below illustrates the strategy to manage earnings volatility through the cycle.

Managing earnings volatility through the cycle



4. RISK MANAGEMENT FRAMEWORK AND GOVERNANCE STRUCTURE

Risk governance

The Group's Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, monitored and managed. The Group believes that effective risk management is predicated on a culture focused on risk, paired with an effective governance structure.

In addition, effective risk management requires multiple points of control or safeguards that should be applied consistently at various levels throughout the organisation. There are three primary lines of control across the Group's operations:

1. **Risk ownership** – Risk taking is inherent in the individual businesses' activities. Business management carries the primary responsibility for the risks in its business, in particular with respect to identifying and managing risk appropriately.
2. **Risk control** – Business heads are supported in this by deployed risk management functions that are involved in all business decisions and are represented at an executive level across all franchises. These are overseen by an independent, central risk control function, Enterprise Risk Management ("ERM").
3. **Independent assurance** – The third major control point involves functions providing independent assurance on the adequacy and effectiveness of risk management practices across the Group. These are the internal audit functions at a business and at a Group level.

The risk management structure described above is set out in the Business Performance and Risk Management Framework ("BPRMF"). As a policy of both the Board and the Executive committee, it delineates the roles and responsibilities of key stakeholders in business, support and control functions across the various franchises and the Group. The BPRMF explicitly recognises the three lines of control, illustrated in the chart on page 10.

FIRST LINE OF CONTROL

Head of business: Primary risk owner

Embeds risk management as a core discipline and gives consideration to potential risks in business decisions:

- ensures the entity acts in accordance with mandates approved by the Board or its delegated authority;
- identifies and quantifies key risks to business under normal and stress conditions;
- specifies and implements appropriate risk management processes;
- specifies and implements early warning measures, associated reporting, management and escalation processes;
- implements risk control and mitigation strategies;
- implements corrective actions as required;
- reports risk information to the Executive committee and the governance committee structure as appropriate through to the boards; and
- ensures staff understanding of responsibilities in relation to risk management.

Corporate centre functions

Support business owners, the Board and Executive committee in the implementation of Group strategy across the portfolio and include:

- **BSM** tasked with formulating and communicating the Group's macroeconomic view and associated risk scenarios, used for planning and stress testing purposes.
- **Group Treasury** responsible for management of funding and liquidity, interest rate risk in the banking book and exchange control.
- **Capital Management and performance measurement** is responsible for capital planning and advises the Board and the Executive committee on potential capital actions, dividend strategy and other capital management related topics.

SECOND LINE OF CONTROL

Enterprise Risk Management

Provides independent oversight and monitoring across the Group on behalf of the Board and relevant committees:

- headed by Group Chief Risk Officer ("CRO") who is a member of the Executive committee;
- takes ownership of and maintains risk frameworks;
- agrees deployed and divisional risk plans;
- challenges risk profiles through review of risk assessments, evaluation of risk management processes and monitoring of exposures and corrective actions;
- reports risk exposures and performance vis-à-vis management of risk exposures to relevant committees;
- ensures appropriate risk skills throughout the Group alongside an appropriate risk management culture for risk taking;
- performs risk measurement validation and maintains risk governance structures; and
- manages regulatory relationships with respect to risk matters.

Deployed segment and divisional risk managers

Support business unit management in identifying and quantifying significant risks:

- divisional risk heads have direct reporting line to the Group CRO and head of division;
- represented on divisional executive committees, primary focus on risk identification, measurement and control;
- approve risk assessment and risk management processes;
- ensure that board approved risk policies and risk tools are implemented and adhered to;
- ensure that performance, risk exposures and corrective actions are reported in an appropriate format and frequency;
- monitor appropriate implementation of corrective action;
- identify process flaws and risk management issues and initiate corrective action; and
- ensure all risk management and loss containment activities are performed in a timely manner as agreed with ERM.

Regulatory Risk Management

Ensures that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws:

Regulatory Risk Management ("RRM") is an integral part of managing risks inherent in the business of banking and forms part of the second line of risk control.

THIRD LINE OF CONTROL

Group Internal Audit

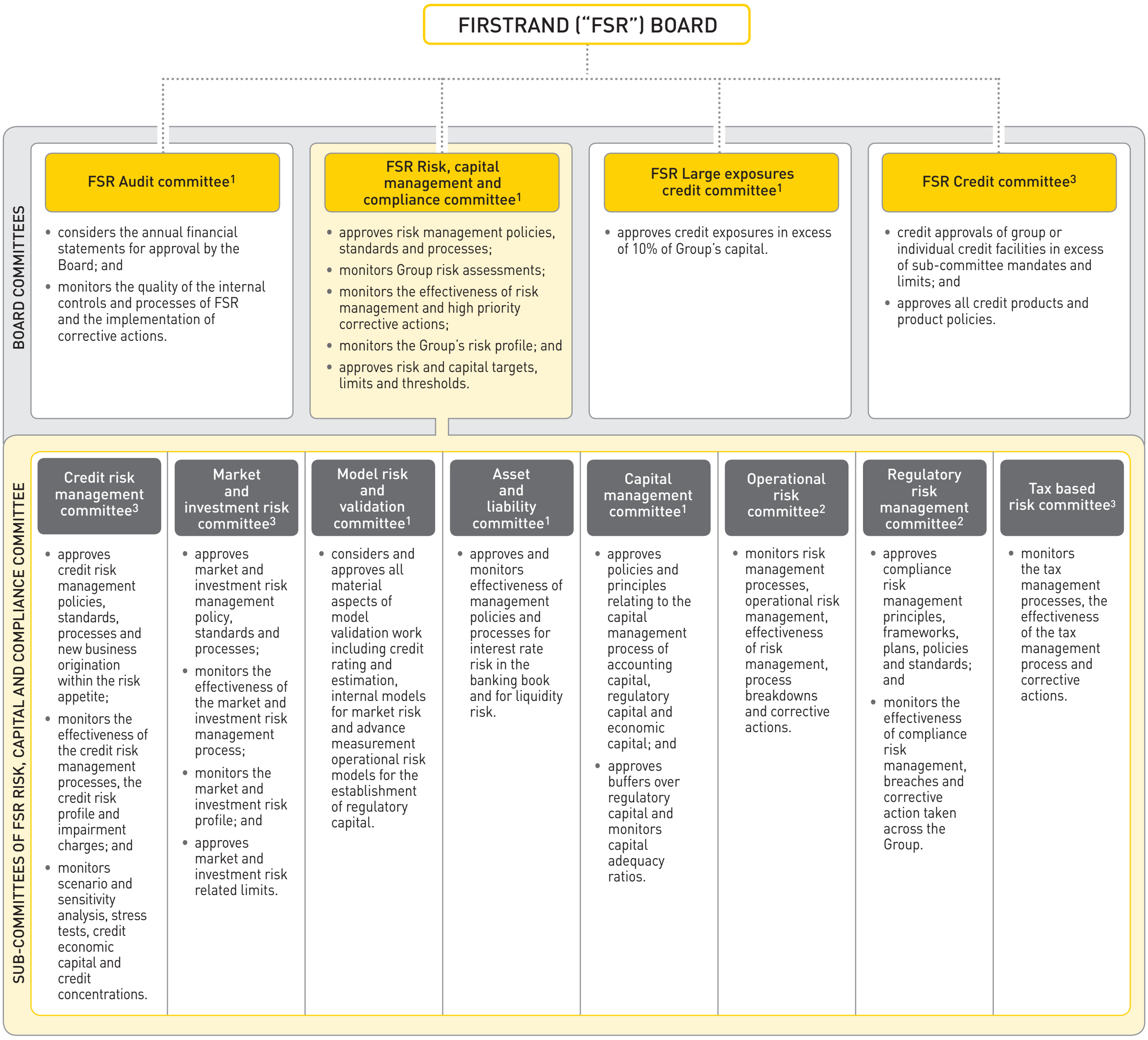
Provides independent assurance of the adequacy and effectiveness of risk management practices:

- headed by Chief Audit Executive and reports to the Board through the FirstRand Audit committee chairman;
- reviews risk assessment results of business entities;
- assesses compliance with the directives of the BPRMF;
- evaluates the development and implementation of policies and procedures for risk management in line with policies of the Board or relevant committees;
- reviews the integrity, accuracy and completeness of risk reports to the RCC committee and the Board;
- monitors results of internal and external audit processes;
- co-ordinates audit process with ERM, RRM and external auditors;
- attends various governance and management committees to remain informed and align risk-based audit approach; and
- conducts work in accordance with globally recognised internal audit standards.

Internal audit practices and activities are annually assessed by external auditors.

In line with the Group's corporate governance framework, the FirstRand Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, managed and monitored across the Group. The Board discharges its duty through relevant policies and frameworks as well as several board committees and sub-committees, as illustrated in the chart below.

Risk governance structure

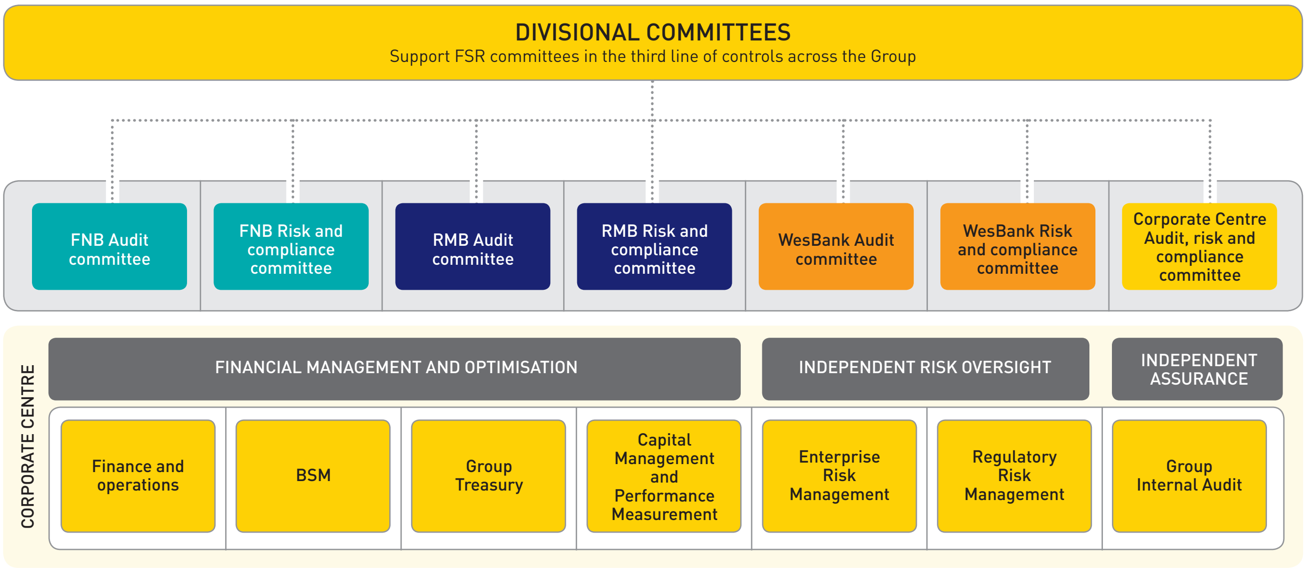


1 *Chairperson is a non-executive board member.*
2 *Chairperson is an independent non-executive board member.*
3 *Chairperson is a member of executive management. The FSR Credit and Credit risk management committees have non-executive board representation.*

The primary board committee overseeing risk matters across the Group is the FirstRand RCC committee. It has delegated responsibility for a number of specialist topics to various sub-committees, as outlined in the chart above. The RCC committee submits its reports and findings to FirstRand's Audit, risk and compliance committee for review. The role of the RCC committee and its sub-committees is described further with reference to the applicable governance structures and processes for each particular risk type in the major risk sections of this report. A number of the individual committees' members are non-executives, further strengthening the Group's central, independent risk oversight and control functions.

Additional risk, audit and compliance committees exist in each franchise, the governance structures of which align closely with that of the Group, as illustrated in the chart on the next page. The board committees are typically staffed by members of the respective committees of the individual franchises' boards so as to ensure a common understanding of the challenges businesses face and how these are addressed across the Group.

Divisional and Corporate Centre risk governance structure



Regular risk reporting and challenge of current practices

As part of the reporting, challenge, debate and control process, ERM seeks to drive the implementation of more sophisticated risk assessment methodologies through the design of appropriate policies and processes, including the deployment of skilled risk management personnel in each of the franchises.

ERM, together with the independent review by the Group's internal audit functions, ensure that all pertinent risk information is captured accurately, evaluated and escalated appropriately in a timely manner. This enables the Board and its designated committees to retain effective control over the Group's risk position at all times.

5. RISK AND CAPITAL METHODOLOGIES

The following detailed sections provide in-depth descriptions of the approaches, methodologies, models and processes used in the identification and management each major risk type. Each section also describes the applicable governance and policy framework and provides an analysis of the respective portfolios and the risk profile with respect to the type of risk under consideration and the capital position.

6. STRATEGIC AND BUSINESS RISK

Key developments and focus

Strategic and business risks	The Group continues to focus on its African expansion strategy with a number of opportunities being explored. Although business conditions have improved over the period under review, the risk exists that interest rates could rise faster and higher due to inflation pressures. A number of global factors could result in renewed financial distress and impact the markets in which FirstRand operates. The factors include sovereign debt risk from countries in the European periphery and high current account deficits, social and political risk in the middle east, natural disasters and climate change, global liquidity boom affecting asset prices in emerging markets and economic disparity due to unemployment, food and fuel price increases and social unrest.
Reputational risk	Ongoing emphasis is placed on reputational risk and stakeholder management.
Macroeconomic risk	Over the period under review, the local macroeconomic environment was characterised by increasing gross domestic product growth, low inflation and low interest rates. While the global recovery also strengthened and broadened, concerns about sovereign debt, emerging market inflation and still present structural weaknesses (such as high debt levels and trade imbalances) mean that risks to the recovery to remain elevated.
Environmental, social and governance risks	During the period under review FirstRand's ESG risk profile was evaluated taking into account existing measures for management, mitigation and avoidance. Enterprise-wide management reporting against these risks provides evidence of satisfactory management controls at both franchise and Group level. Ongoing emphasis is placed on continually improving the integrity and efficiency of internal reporting processes supporting the management of ESG risks.

Introduction and objectives

Any business runs the risk of choosing an inappropriate strategy or failing to execute its strategy appropriately. The Group's objective is to minimise this risk in the normal course of business.

Business risk is considered in the strategic planning process and as a part of regular and pervasive stress testing and scenario analyses carried out across the businesses. The objective is to develop and maintain a portfolio that delivers sustainable earnings and thus minimises the chance of any adverse outcome occurring.

Organisational structure and governance

The development and execution of business level strategy is the responsibility of the Strategic Executive committee and individual business areas, subject to approval by the Board. This includes the approval of any subsequent material changes to strategic plans, budgets, acquisitions, significant equity investments and new strategic alliances.

Business unit and executive management, as well as functions within Corporate Centre, review the external environment, industry trends, potential emerging risk factors, competitors' actions and regulatory changes as part of the strategic planning process. Through this review, as well as regular scenario planning and stress testing exercises, the risk to earnings and level of potential business risk faced is assessed. Reports on the results of these exercises are discussed at various business, risk and board committees and are ultimately taken into account in the setting of risk appetite and in potential revisions to existing strategic plans.

Assessment and management

Strategic risk is not readily quantifiable and is, therefore, not a risk that an organisation can or should hold a protective capital buffer for. The risk to earnings on the other hand can be assessed, and this forms an explicit part of the Group's risk appetite and ICAAP.

Business risk is assessed regularly as part of ICAAP. It is managed strategically at a Group level through the development, review and updating of the strategy in light of the organisation's evolving view of the business environment.

For capital purposes the past history of revenues and costs on a suitably adjusted basis are reviewed to determine whether it is likely that revenues would be insufficient to cover costs in a very severe scenario. At present, projections indicate an adequate coverage of the projected cost base and no buffer or additional economic capital is therefore held against this risk type.

Reputational risk

As a financial services provider, the Group's business is one that is inherently built on trust and close relationships with its clients. Safeguarding its reputation is therefore of paramount importance to ensure sustainability and is seen as the responsibility of every staff member. Reputational risks can arise from environmental, social and governance issues or as a consequence of financial or operational risk events.

The Group's reputation is built on the way in which it conducts its business and it protects its reputation by managing and controlling these risks across its operations. It seeks to avoid large risk concentrations by establishing a risk profile in its operations that is balanced both within and across risk types. In this respect, potential reputational risks are also taken into account as part of stress testing exercises. The Group aims to establish a risk and earnings profile within the constraints of its risk appetite and seeks to limit potential stress losses from credit, market, liquidity or operational risks that may otherwise introduce an undesirable degree of volatility in its financial results and adversely affect its reputation.

Environmental, social and governance risk management

FirstRand has formal governance processes for managing ESG risks affecting the organisation's ability to successfully implement business strategy. These processes involve the generation of ESG management reports at franchise and Group level, which detail ESG performance on a six-monthly basis. A combined assurance approach is followed where the reports are scrutinised as follows:

- by management as an internal account of key ESG issues impacting strategy implementation and the success with which these are being managed;
- by ERM which conducts an independent assessment against the integrity of management's ESG controls; and
- by internal audit which conduct an assessment of the accuracy of information presented in these reports and the effectiveness of the control environment supporting the generation of this information.

Accordingly provision is made for the escalation of significant ESG issues to the Board via the Executive committee, the RCC committee and the Audit committee. The Audit committee reports to the Board on the effectiveness of this combined approach to assuring the Group's ESG performance.

The top five inherent ESG risks relate to:

- employment equity;
- employee satisfaction;
- customer satisfaction;
- governance effectiveness; and
- compliance with Equator Principles.

Each business unit defines tolerances for its principle ESG risks and action plans for addressing these in line with particular circumstances and risk appetite. Tolerances and mitigating actions are defined at divisional and Group level, and progress in respect of these is tracked through the existing risk reporting structures.

The impact and likelihood of these risks are evaluated taking into account measures for management, mitigation and avoidance. During the period under review this residual risk profile demonstrates that all risks with a major potential impact are unlikely to arise given the internal controls in place.

7. CAPITAL MANAGEMENT

Key developments and focus

Capital management continues to focus on maintaining strong capital levels, with a particular focus on the quality of capital. This is reflected in the Tier 1 ratios of FRB and FirstRand, which remained above targeted levels throughout the period. Tier 1 continued to exceed economic capital requirements for a range of normal and severe scenarios as well as for stress events. Performance measurement is on a risk-adjusted basis and is continually enhanced to drive the desired behaviour. Economic profit or net income after capital charge ("NIACC") is embedded in the management of the business. For the period ended 31 December 2010, the Group achieved positive NIACC and generated value for shareholders. Although the final Basel III framework was released in December 2010, a number of items remain outstanding. The Group continues to participate in the Basel Committee on Banking Supervision's ("BCBS") quantitative impact study, with updated calculations showing that FRB and FirstRand will continue to operate above the regulatory minimum requirements.

Introduction and objectives

The Group seeks to establish and manage a portfolio of businesses and associated risks that will deliver sustainable returns to shareholders by targeting a particular earnings profile that will allow it to generate those returns within appropriate levels of volatility.

Sustainability also refers to the capacity to withstand periods of severe stress characterised by very high levels of unexpected financial and economic volatility, which cannot be mitigated by earnings alone. Capitalisation ratios appropriate to safeguarding its operations and the interests of its stakeholders are therefore maintained. In this respect, the overall capital management objective is to maintain sound capital ratios and a strong credit rating to ensure confidence in the solvency and quality of capital in the Group during calm and turbulent periods in the economy and the financial markets.

The optimal level and composition of capital is determined after taking into account business units' organic growth plans – provided financial targets are met – as well as expectations of investors, targeted capital ratios, future business plans, plans for the issuance of additional capital instruments, the need for appropriate buffers in excess of minimum requirements, rating agencies' considerations and proposed regulatory changes.

The board-approved capital plan is reviewed as part of the Group's ICAAP, with the stress testing framework being an extension of the process. These processes are under continuous review and refinement and continue to inform the targeted buffer.

Allocating resources, including capital and risk capacity, effectively in terms of the risk appetite targets and in a manner that maximises value for shareholders is a core competence and a key focus area. Sound capital management practices, therefore, form an important component of its overall business strategy. Moreover, performance measurement is aligned with the allocation of risk and continually enhanced to drive the desired behaviour.

The effectiveness of the capital allocation decisions and the efficiency of its capital structure are important determinants of the ability to generate returns for shareholders. The Group seeks to hold limited excesses above the capital required to support its medium-term growth plans (including appropriate buffers for stresses and volatility) and future regulatory changes. The total capital plan includes a dividend policy, which is set in order to ensure sustainable dividend cover based on sustainable normalised earnings, after taking into account volatile earnings brought on by fair value accounting, anticipated earnings yield on capital employed, organic growth requirements and a safety margin for unexpected fluctuations in business plans. Capital is freely transferable within the Group, subject to the approval of exchange control authorities for entities outside the common monetary area.

Organisational structure and governance

Effective 1 July 2010, FirstRand replaced FRBH as the regulated bank controlling company. Data presented relates to the regulated entity FirstRand. The Group restructure also resulted in subsidiaries of FRB moving across to FRIHL. FirstRand operated above its targeted capitalisation range with a total capital adequacy of 15.3% and a solid Tier 1 ratio of 13.6%. Similarly FRB, excluding subsidiaries and branches, operated comfortably above its target with a total capital adequacy of 13.7% and Tier 1 ratio of 11.9%. Ratios and tables for FRB exclude unappropriated profits in this section.

Capital adequacy and planning

The period under review

The Group's capital planning process ensures that the total capital adequacy and Tier 1 ratios remain within the approved ranges or above target levels across the economic and business cycles. FirstRand is appropriately capitalised under a range of normal and severe scenarios as well as under a range of stress events. In the prevailing uncertain environment the Group prefers to maintain strong capital ratios at the upper end of its targeted band.

Entities within the Group are also subject to internal target ranges to ensure adequate capitalisation on a standalone basis.

Stronger internal capital generation through earnings coupled with subdued asset growth, positively impacted the Tier 1 and total capital adequacy ratios for continuing operations of the Group.

Supply of capital – Tier 1

The Group aims to back all economic risks with Tier 1 capital as it offers the greatest capacity to absorb losses. Consequently, required Tier 1 capitalisation levels are used as the primary driver of performance measurement across the various businesses. Tier 1 capitalisation ratios benefited from higher levels of profitability driven by improved volumes in the business units and lower bad debts during the period.

Supply of capital – Tier 2

The uncertainty around the Basel III treatment of Tier 2 instruments made their issuance unattractive during the period under review. Whilst the BCBS has finalised the proposals around new bail-in capital, the South African Reserve Bank ("SARB") has not issued further guidance or interpretation. The Group continues to investigate ways of optimising its capital base and will review the viability of Tier 2 instruments once the Basel III proposals have been incorporated into the SARB regulations.

On 16 August 2010 SARB approval was received to call the FRB01 and FRB02 subordinated bonds on 31 August 2010. The table below provides more detail on the Group's capital instruments at 31 December 2010.

Characteristics of capital instruments

Capital type	Instrument	Nominal (million)	Rate type	Coupon rate	Maturity date
Other Tier 1	NCNR preference share capital	4 519	Floating	68% of prime	Perpetual
Upper Tier 2	FRBC21	628	Fixed	12%	21 Dec 2018
	FRBC22	440	Floating	3 month JIBAR + 300bps	22 Dec 2018
Lower Tier 2 (Subordinated bonds)	FRB03	1 740	Fixed	9%	15 Sept 2014
	FRB05	2 110	Fixed	9%	21 Dec 2018
	FRB06	1 000	Floating	3 month JIBAR + 65bps	5 Nov 2012
	FRB07	300	Floating	3 month JIBAR + 65bps	6 Dec 2012
	FRB08	100	Floating	3 month JIBAR + 70bps	10 Jun 2016
	FRB09	100	Floating	3 month JIBAR + 70bps	10 Jun 2017
	FNBB001	108	Fixed	11%	1 Dec 2016
	FNB17	260	Fixed	9%	29 Mar 2012

Demand for capital

Capital requirements expressed as a percentage of risk weighted assets ("RWA") remain risk sensitive and cyclical under Basel II. This cyclicality is to a large extent driven by external factors that affect risk measures across various portfolios and therefore drive capital requirements.

FRB's RWA declined year-on-year, but were marginally up from June 2010. Year-on-year decline was driven mainly by lower equity investment risk, which was the result of moving subsidiaries to FRIHL as well as realising part of the VISA Inc holding.

Regulatory developments

Although the final Basel III framework was released in December 2010, a number of items remain outstanding. The Group continues to participate in the BCBS quantitative impact study, which currently focuses on counterparty credit risk. Updated calculations, in line with initial calculations, show a reduction in the Tier 1 and total capital adequacy ratios of the Group. However, both FRB and FirstRand remain above the current regulatory minimum. Targeted capital ratios may be revisited once the Basel III proposals are incorporated into the SARB regulations.

The SARB has issued a draft set of regulations, due to be implemented at the start of 2012, that cover the revised market risk and securitisation proposals. The draft regulations currently do not make provision for the proposed Basel III framework.

Regulatory capital

The targeted capital levels as well as the current ratios at 31 December 2010 are summarised in the table below.

Capital adequacy position

	FirstRand		FRB*		Regulatory minimum
	Actual	Target	Actual	Target	
Capital adequacy ratio (%)	15.3	12.0 – 13.5	13.7	11.5 – 13.0	9.5#
Tier 1 ratio (%)	13.6	10.0	11.9	9.50	7.0

* *Reflects solo supervision, i.e. FRB excluding branches, subsidiaries and associates.*
# *The regulatory minimum excludes the bank specific (Pillar 2b) add on and capital floor.*

The following table shows the composition of regulatory capital for FirstRand at 31 December 2010, while the subsequent tables provide a breakdown of RWA and capital requirement.

Composition of qualifying capital and capital ratios of FirstRand

	FirstRand	
	At 31 December	
R million	2010	%
Ordinary shareholders equity as per IFRS	50 360	
Less: non-qualifying reserves	(3 075)	
Cash flow reserve	561	
Available-for-sale reserve	(612)	
Share-based payment reserve	(2 703)	
Foreign currency translation reserve	(348)	
Other reserves	27	
Ordinary shareholders equity qualifying as capital	47 285	
Ordinary share capital and share premium	5 248	
Reserves	42 037	
Non-controlling interest	2 869	
NCNR preference share capital	4 519	
Less: total impairments	(3 118)	
Excess of expected loss over eligible provisions (50%)	(542)	
First loss credit enhancements in respect of securitisation structures (50%)	(78)	
Goodwill and other impairments	(2 498)	
Total Tier 1 capital	51 555	13.6
Upper Tier 2 instruments	1 068	
Tier 2 subordinated debt instruments	5 692	
Other reserves	199	
Less: total impairments	(620)	
Excess of expected loss over eligible provisions (50%)	(542)	
First loss credit enhancements in respect of securitisation structures (50%)	(78)	
Total Tier 2 capital	6 339	1.7
Total qualifying capital and reserves	57 894	15.3

RWA by risk type of FirstRand

	FirstRand	
	At 31 December 2010	
R million	RWA	Capital requirement#
Credit risk	254 709	24 197
Operational risk	63 163	6 000
Market risk	14 216	1 351
Equity investment risk	27 087	2 573
Other risk	19 315	1 835
Total RWA	378 490	35 956

 # Capital requirement calculated at 9.5% of RWA.

RWA calculation approach for each risk type of the Group

The following table provides a list of the Basel II approaches applied to each risk type for FRB and the other regulated entities of FirstRand.

RWA calculation approach for each risk type

Risk type	FRB	Other FirstRand regulated entities
Credit risk	Advanced Internal Ratings Based approach ("AIRB")	Standardised approach
Operational risk	Advanced Measurement approach ("AMA")	**Domestic operations:** AMA Basic Indicator approach
		Offshore operations: Standardised approach Basic Indicator approach
Market risk	Internal Model approach	Standardised approach

The following table provides the RWA numbers per Basel II approach for each risk type of FirstRand.

R million	December 2010
Credit risk	**254 709**
Advances IRB Approach	**217 912**
Corporate, banks and sovereigns	**85 581**
Small and medium enterprise ("SME")	**41 095**
Residential mortgages	**44 747**
Qualifying revolving retail	**9 123**
Other retail	**31 962**
Securitisation exposure	**5 404**
Standardised approach	**36 797**

R million	December 2010
Equity investment risk	**27 087**
Standardised approach	**17 488**
Simple risk weighted method	**9 599**
Operational risk	**63 163**
Standardised approach	**9 359**
AMA	**50 025**
Basic Indicator approach	**3 779**
Market risk*	**14 216**
Internal Model approach	**7 702**
Standardised approach	**6 514**

* *Includes banking and trading book.*

The following table shows the composition of regulatory capital for FRB at 31 December 2010, while the subsequent tables provide a breakdown of RWA and capital requirement.

Composition of qualifying capital and capital ratios of FRB

	FRB*					
R million	**December 2010**	**%**	December 2009	%	June 2010	%
Ordinary shareholders equity as per IFRS	**36 303**		32 267		33 085	
Less: non-qualifying reserves	**(1 690)**		(2 322)		(477)	
Cash flow reserve	**561**		289		466	
Available-for-sale reserve	**(619)**		(498)		(532)	
Share-based payment reserve	**(355)**		(497)		(411)	
Unappropriated profits	**(1 277)**		(1 616)		–	
Ordinary shareholders equity qualifying as capital	**34 613**		29 945		32 608	
Ordinary share capital and share premium	**11 308**		10 969		10 969	
Reserves	**23 305**		18 976		21 639	
NCNR preference share capital	**3 000**		3 000		3 000	
Less: total impairments	**(2 823)**		(1 828)		(2 323)	
Excess of expected loss over eligible provisions (50%)	**(542)**		(292)		(379)	
First loss credit enhancements in respect of securitisation structures (50%)	**(71)**		–		(45)	
Qualifying capital in branches	**(1 732)**		(1 330)		(1 732)	
Other impairments	**(478)**		(206)		(167)	
Total Tier 1 capital	**34 790**	**11.9**	31 117	10.5	33 285	11.7
Upper Tier 2 instruments	**1 068**		1 068		1 068	
Tier 2 subordinated debt instruments	**4 975**		5 893		5 914	
Less: total impairments	**(613)**		(210)		(424)	
Excess of expected loss over eligible provisions (50%)	**(542)**		(292)		(379)	
First loss credit enhancements in respect of securitisation structures (50%)	**(71)**		–		(45)	
Other impairments	**–**		82		–	
Total Tier 2 capital	**5 430**	**1.8**	6 751	2.3	6 558	2.3
Total qualifying capital and reserves	**40 220**	**13.7**	37 868	12.8	39 843	14.0

* *Reflects solo supervision, i.e. FRB excluding branches, subsidiaries and associates.*
** *Excludes unappropriated profits.*

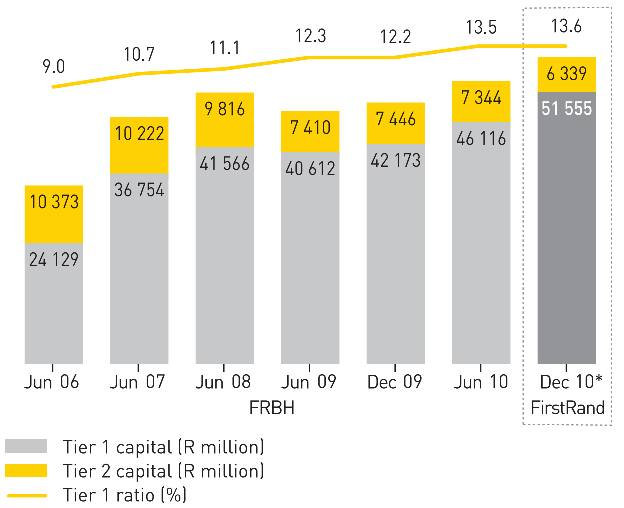
RWA by risk type of FRB

	FRB*					
	December 2010		December 2009		June 2010	
R million	**RWA**	**Capital requirement#**	RWA	Capital requirement#	RWA	Capital requirement#
Credit risk	**217 912**	**20 702**	219 493	20 852	210 328	19 981
Operational risk	**42 992**	**4 084**	35 522	3 375	38 223	3 631
Market risk	**7 702**	**732**	8 251	784	4 669	444
Equity investment risk	**9 599**	**912**	18 120	1 721	16 835	1 599
Other risk	**14 401**	**1 368**	13 660	1 298	13 690	1 301
Total RWA	**292 606**	**27 798**	295 046	28 030	283 745	26 956

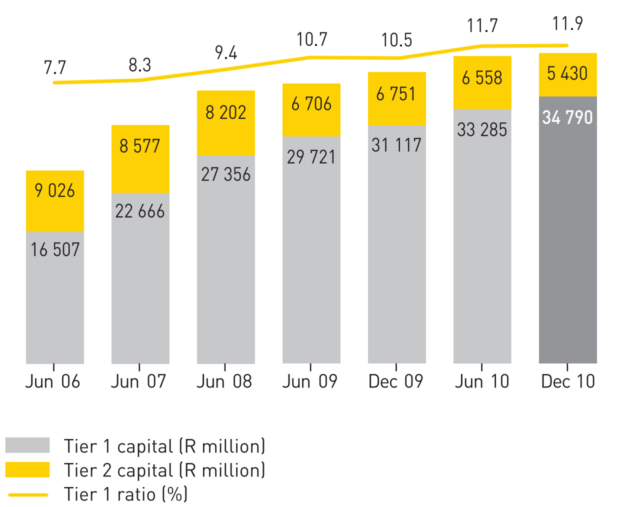
** Reflects solo supervision, i.e. FRB excluding branches, subsidiaries and associates.*
 # Capital requirement calculated at 9.5% of RWA.

The graph below provides a historical overview of the capital adequacy for FirstRand and FRB.

FirstRand regulatory capital position



FRB regulatory capital position



** Information for comparative years – prior to the Basel II implementation on 1 January 2008 – is on a Basel I basis.*

The capital adequacy position of FirstRand and its subsidiaries is set out below.

RWA and capital adequacy position for FirstRand and its subsidiaries

	December 2010		December 2009		June 2010	
	RWA R million	Total capital adequacy %	RWA R million	Total capital adequacy %	RWA R million	Total capital adequacy %
Basel II						
Bank controlling company*	**378 490**	**15.3**	346 049	14.3	341 608	15.6
FirstRand Bank Limited (South Africa)	**292 606**	**13.7**	295 046	12.8	283 745	14.0
FirstRand Bank UK (London Branch)	**5 372**	**11.6**	4 356	14.6	5 210	12.8
FirstRand India	**756**	**69.3**	83	266.2	241	247.5
FirstRand (Ireland) PLC	**2 810**	**47.5**	6 903	22.7	5 042	31.0
RMB Australia Holdings Limited	**6 084**	**25.1**	5 885	18.1	4 887	21.5
FNB (Namibia) Limited**	**12 330**	**17.2**	9 144	19.7	9 910	20.1
Basel I**						
FNB (Botswana) Limited	**7 295**	**17.4**	6 232	17.3	6 834	17.4
FNB (Lesotho) Limited	**210**	**22.5**	220	18.5	228	17.9
FNB (Moçambique) S.A.	**634**	**10.6**	522	17.0	699	12.9
FNB (Swaziland) Limited	**1 555**	**21.1**	1 239	22.1	1 467	20.9
FNB (Zambia) Limited	**260**	**27.7**	119	71.3	173	64.5

* *Effective 1 July 2010, FirstRand became the new regulated entity. Prior to 1 July 2010, FRBH was the bank controlling company. Basel II was successfully implemented at the beginning of January 2008. The registered banks in FirstRand must comply with the SARB regulations and those of their home regulators, with primary focus placed on Tier 1 capital and total capital adequacy ratios.*

** *Entities operating under Basel II are subject to a minimum capital requirement of 9.5% (excluding the bank specific Pillar 2b add on). FNB Africa subsidiaries (excluding FNB (Namibia) Limited), currently report under Basel I – these entities are subject to a 10% minimum capital requirement in terms of local rules, except FNB (Botswana) Limited and FNB (Swaziland) Limited, where the minimum capital requirement is 15% and 8%, respectively. These entities also report under Basel II and are included on this basis for the consolidated position of FirstRand. FNB (Namibia) Limited implemented Basel II on 1 January 2010.*

Economic capital

In addition to the regulatory capital requirements disclosed in the previous section, economic capital requirements are also calculated on the basis of a number of internally developed models. Economic capital is defined as the level of capital that must be held commensurate with its risk profile under severe stress conditions. This will provide comfort to a range of stakeholders that it will be able to satisfy all its obligations to third parties with a desired degree of certainty and will continue to operate as a going concern.

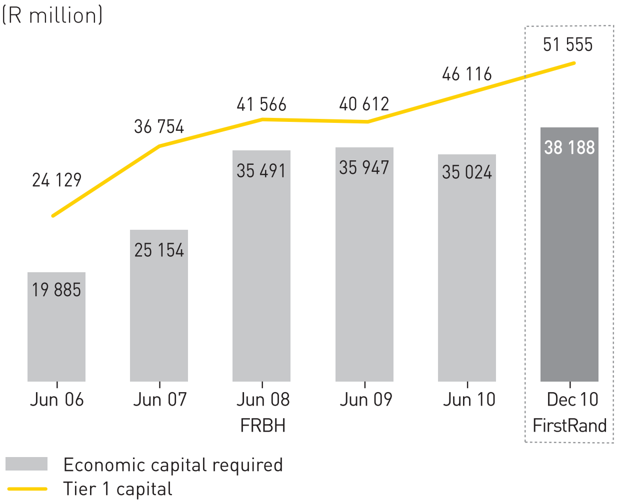
Regular reviews of the economic capital position are carried out across the businesses and the Group remains well capitalised in the current environment, with levels of Tier 1 capital exceeding the economic capital required. The Group aims to back all economic risks with Tier 1 capital. Furthermore, it uses the allocation of capital based on risk capacity as a steering tool and for performance measurement purposes.

ICAAP assists in the attribution of capital in proportion to the risks inherent in the respective business units with reference to both normal economic circumstances and times of potential stress, which may lead to the realisation of risks not previously considered. This process is also supported by the stress testing and scenario analysis framework described previously.

The graph below provides an overview of the evolution of economic capital requirements and Tier 1 capital:

Economic capital

(R million)



* *Effective 1 July 2010, FirstRand became the regulated bank controlling entity. Information prior to 1 July 2010 relates to the previously regulated bank controlling entity, namely FRBH.*

8. CREDIT RISK

Key developments and focus

During the period under review there was ongoing focus on further refining the risk appetite framework and ensuring that the corresponding origination strategies are aligned with and remain within the risk appetite. Strengthening of FirstRand's credit risk management and governance included enhancements to the Group impairment framework and the Retail Credit Portfolio governance structure.

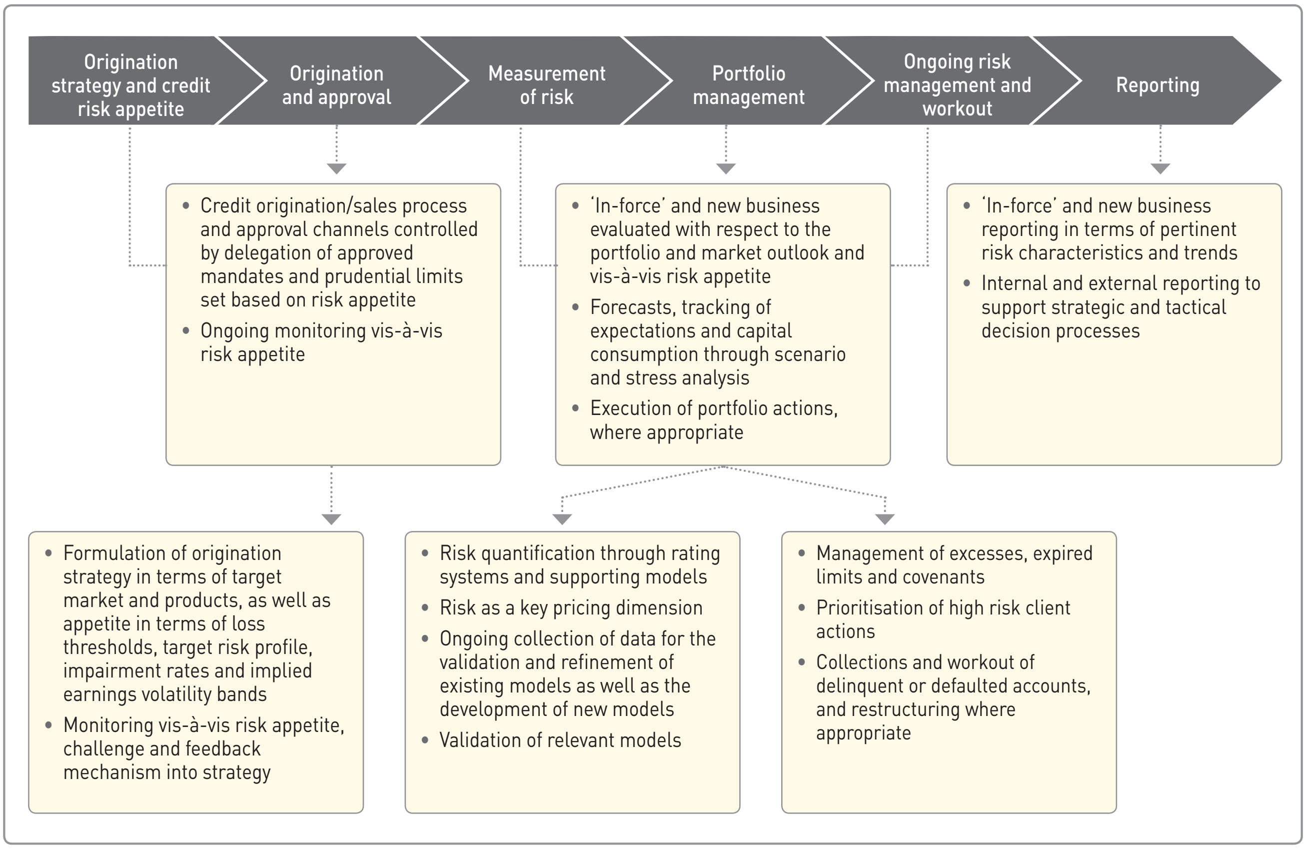
Introduction and objectives

Credit risk is one of the core risks assumed in pursuit of the Group's business objectives. It is the most significant risk type in terms of regulatory and economic capital requirements. The objectives of its credit risk management practices are two-fold:

- **Risk control:** Appropriate limits are placed on the assumption of credit risk and steps are taken to ensure the accuracy of credit risk assessments and reports. Deployed and central credit risk management teams fulfil this task.
- **Management:** Credit risk is taken within the constraints of the risk appetite framework. The credit portfolio is managed at an aggregate level to optimise the exposure to this risk. Business units and deployed risk functions, overseen by the Group Credit Risk Management ("GCRM") function within ERM and relevant board committees, as well as BSM and the Performance Measurement function within the Corporate Centre, fulfil this role.

The scope of credit risk identification and management practices across the Group therefore spans the entire credit value chain, as illustrated in the chart below.

Scope of credit risk management and identification practices



Organisational structure and governance

The RCC committee regularly receives and reviews reports on the adequacy and robustness of credit risk identification, management and control processes, as well as on the current and projected credit risk profile across the various businesses. The credit risk management governance structures, related roles and responsibilities as well as lines of accountability are set out in the Credit Risk Management Framework ("CRMF"). Approved by the RCC committee, the CRMF is a policy of the Board and integrates with the BPRMF (see page 9).

Two credit-focused board committees, the FirstRand Credit committee and the Large exposures credit committee, as well as two sub-committees of the RCC committee, the FirstRand Credit risk management committee and the Model risk and validation committee ("MRVC"), support the RCC committee in its task. For a description of the role and responsibilities of these committees refer to the governance structure on page 11.

The Group Credit Risk Management function

The GCRM function in ERM provides independent oversight of credit risk management practices in the deployed risk management functions. It is the owner of the CRMF and related policies and monitors the implementation of credit risk related frameworks. In addition, its responsibilities include:

- active participation in the formulation of credit and origination strategies, in particular with a view to the implementation and management of the Group's credit risk appetite across the business units;
- credit risk related stress testing and scenario analysis;
- monitoring of the credit components of the risk appetite framework;
- monitoring and reporting of the credit risk profile;
- reviewing all credit rating systems and independent revalidation of credit rating systems;
- management of relationships with external stakeholders such as relevant regulators with respect to credit matters;

- supervision of the credit impairment process; and
- regulatory reporting.

The GCRM function is supported by deployed, segment level credit functions that are responsible for the implementation of relevant credit risk frameworks and policies in the various businesses, including the implementation of adequate credit risk controls, processes and infrastructure required to allow for the efficient management of credit risk. Responsibilities specifically include:

- formulation of credit strategy and assessment of business level credit risk appetite (together with BSM and Performance Measurement and within the constraints of the overall credit risk appetite, see below);
- maintaining and monitoring implementation of methodologies, policies, procedures and credit risk management standards;
- validation of credit rating systems and associated processes as well as other decision support tools, such as economic capital, stress testing and provisioning models;
- ownership of the credit regulatory reporting process; and
- maintaining the credit governance structure.

Performance Measurement function

The Performance Measurement function within Corporate Centre is responsible for balance sheet management with respect to credit risk and fulfils both an operational and a central co-ordination role. Its mandate includes:

- the quantification and allocation of credit economic capital including the credit risk assessment employed for ICAAP and the assessment of appropriate capital buffers;
- assessment, analysis, forecasting and reporting of impairments; and
- credit risk reporting to stakeholders such as the Credit risk management committee.

Assessment and management

Calculation of internal ratings and rating process

The assessment of credit risk across the Group relies heavily on internally developed quantitative models for regulatory purposes under Basel II, as well as for addressing business needs.

Credit risk models are widely employed in a number of areas such as the assessment of capital requirements, pricing, impairment calculations and stress testing of the portfolio. All of these models are built on a number of client and facility rating models in line with Basel II AIRB requirements and the FRB Model building framework. The Group was granted regulatory approval under Basel II for the approaches as shown in the table below.

Basel approach	FRB	Remaining FirstRand subsidiaries
AIRB	√	
Standardised Approach		√

Even though only FRB has regulatory approval to use the AIRB approach, the same or similar models in FRB are applied for the internal assessment of credit risk in the remaining FirstRand subsidiaries on the standardised approach. The models are used for the internal assessment of the following three primary credit risk components discussed in the following sections:

- probability of default ("PD");
- exposure at default ("EAD"); and
- loss given default ("LGD").

Management of the credit portfolio is heavily reliant on these three credit risk measures. PD, EAD and LGD are inputs into the portfolio and Group-level credit risk assessment where the measures are combined with estimates of correlations between individual counterparties and industries to reflect diversification benefits across the portfolio of credit risks.

Probability of default

PD is defined as the probability of a counterparty defaulting on any of its obligations over the next year and is a measure of the counterparty's ability and willingness to repay facilities granted to it. A default, in this context, is defined along two dimensions:

- time driven: the counterparty is in arrears for more than 90 days or three instalments as appropriate; and
- event driven: there is reason to believe that the exposure will not be recovered in full, and has classified it as such (this includes the forfeiting of principal or interest as well as a restructuring of facilities resulting in an economic loss).

This definition of default is consistently applied across all credit portfolios as well as in the recognition of non-performing loans ("NPLs") for accounting purposes.

For communication and reporting purposes, the Group employs a granular, 100 point, master rating scale which has been mapped to the continuum of default probabilities, as illustrated in the table below.

Mapping of FirstRand ("FR") grades to rating agency scales

FR rating	Midpoint PD	International scale mapping*
FR 1 – 12	0.04%	AAA, AA, A
FR 13 – 25	0.27%	BBB
FR 26 – 32	0.77%	BB+, BB
FR 33 – 37	1.34%	BB-
FR 38 – 48	2.15%	B+
FR 49 – 60	3.53%	B+
FR 61 – 83	6.74%	B
FR 84 – 91	15.02%	B-
FR 92 – 94		Below B-
FR 95 – 100	100%	D (defaulted)

** Indicative mapping to the international rating scales of Fitch and Standard & Poor's.*

An FR rating of 1 is the lowest PD and a FR rating of 100 is the highest. External ratings have also been mapped to the master rating scale for reporting purposes. These mappings are reviewed and updated on a regular basis.

In line with international best practice, the Group distinguishes between the two measures of PD, both used for the management of exposure to credit risk:

- Through-the-cycle ("TTC") PD measures reflect long-term, average default expectations over the course of the economic cycle. TTC PDs are typically an input to economic and regulatory capital calculations.
- Point-in-time ("PIT") PD measures reflect default expectations in the current economic environment and thus tends to be more volatile than TTC. PIT PDs are typically used in the calculation of impairments for accounting purposes.

Exposure at default

The EAD of a particular facility is defined as the expected exposure to a counterparty through a facility, should the counterparty default over the next year. It reflects commitments made and facilities granted that have not been paid out and that may be drawn over the time period under consideration (i.e. off-balance sheet exposures). It is also a measure of potential future exposure on derivative positions.

Tailored to the respective portfolios and products employed, a number of EAD models are in use across the Group. These have been developed internally and are calibrated to the historical default experience.

Loss given default

LGD is the third major credit risk component estimated on the basis of internal models. It is defined as the economic loss on a particular facility upon default of the counterparty. It is typically expressed as a percentage of exposure outstanding at the time of default.

In most portfolios, LGD is strongly dependent on:

- the type, quality, and level of subordination;
- the value of collateral held compared to the size of the overall exposure; and
- the effectiveness of the recovery process and the timing of cash flows received during the workout or restructuring process.

A number of models are used to assess LGDs across various portfolios. These models were developed internally and the outputs are calibrated to reflect both the internal loss experience, where available, and external benchmarks, where appropriate.

Typically, a distinction is made between the long run expected LGDs and LGDs reflective of downturn conditions. The latter is a more conservative assessment of risk, which incorporates a degree of interdependence between PD and LGD that can be found in a number of portfolios (i.e. instances where deteriorating collateral values are also indicative of higher default risk). It is this more conservative measure of LGD applicable to downturns, which is used in the calculation of regulatory capital estimates.

Expected loss ("EL")

EL, the product of the primary risk measures PD, EAD and LGD, is a forward looking measure of portfolio or transaction risk. It is used for a variety of purposes across the businesses alongside other risk measures.

Specialised lending

Where the Group finances an entity created to finance and/or operate physical assets, the slotting approach is applied where:

- the primary source of repayment of the obligations is the income generated by the assets (i.e. specialised lending); and
- the PD and LGD cannot be determined.

Specialised lending relates mainly to project and commodity finance. In terms of the slotting approach the exposure is rated, after assessing the risks and mitigations applied to reduce/eliminate the risk and mapped to one of four supervisory categories. Less than 1% of the book is subject to the slotting approach.

Rating process

A consistent rating process is employed across the various businesses, differentiated by the type of counterparty and the type of model employed for rating purposes. For example, retail portfolios are segmented into homogeneous pools in an automated process. Based on the internal product level data, PDs are then estimated (and continuously updated) for each pool. The following table summarises the processes and approaches employed and provides an overview of the types of exposures within each of the portfolios.

Rating process of credit portfolios

Portfolio and type of exposures	Description of rating system
Large corporate portfolios (Wholesale: FNB Corporate, WesBank Corporate, Corporate Centre and RMB) Exposures to private sector counterparties including corporates and securities firms and public sector counterparties. A wide range of products give rise to credit exposure, including loan facilities, structured finance facilities, contingent products and derivative instruments.	The default definitions applied in the rating systems are aligned to the requirements of Basel II. **Rating process:** • The rating assignment to corporate credit counterparties is based on a detailed individual assessment of the counterparty's creditworthiness. • This assessment is performed through a qualitative analysis of the business and financial risks of the counterparty and is supplemented by internally developed statistical rating models. • The rating models were developed using internal and external data covering more than 10 years. The qualitative analysis is based on the methodology followed by international rating agencies. • The rating assessment is reviewed by the FSR Credit committee and the rating (and associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee. • LGD and EAD estimates are based on modelling of a combination of internal and suitably adjusted international data.
Low default portfolios: sovereign and bank exposures (Wholesale: FNB Corporate, Corporate Centre and RMB) Exposures to sovereign and bank counterparties.	The default definitions applied in the rating systems are aligned to the requirements of Basel II. **Rating process:** • Expert judgement models are used in combination with external rating agency ratings as well as structured peer group analyses which form a key input in the ratings process. The analysis is supplemented by internally developed statistical models. • The calibration of PD and LGD ratings is based on a mapping to external default data as well as credit spread market data. • The rating assessment is reviewed by the FSR Credit committee and the rating (as well as the associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee.
Specialised lending portfolios (Wholesale: FNB Corporate, RMB and FNB Commercial) Exposures to private sector counterparties for the financing of income producing real estate.	The default definitions applied in the rating systems are aligned to the requirements of Basel II. **Rating process:** • The rating system is based on hybrid models using a combination of statistical cash flow simulation models and qualitative scorecards calibrated to a combination of internal data and external benchmarks. • The rating assessment is reviewed by the FSR Credit committee and the rating (as well as the associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee.

Portfolio and type of exposures	Description of rating system
Commercial portfolio (SME corporate and SME retail counterparties in FNB Commercial and WesBank) Exposures to SME clients. A wide range of products give rise to credit exposure, including loan facilities, contingent products and term lending products.	The default definitions applied in the rating systems are aligned to the requirements of Basel II. **SME retail rating process:** • The retail portfolio is segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, customer behaviour and delinquency status. • PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools. • LGD and EAD estimates are applied on a portfolio level, estimated from internal historical default and recovery experience. **SME corporate rating process:** • PD: Counterparties are scored using Moody's RiskCalc, the output of which was calibrated to internal historical default data. • LGD: Recovery rates are largely determined by collateral type and these have been set with reference to internal historical loss data, external data (Fitch) and Basel II guidelines. • EAD: Portfolio level credit conversion factors ("CCF") are estimated on the basis of the Group's internal historical experience and benchmarked against international studies.
Residential mortgages (Retail portfolios in FNB HomeLoans, RMB Private Bank exposures and mortgage exposures in the Mass segment) Exposures to individuals for the financing of residential properties. **Qualifying revolving retail exposures (Retail portfolios in FNB Card, FNB Consumer overdrafts and RMB Private Bank)** Exposures to individuals providing a revolving limit through a credit card or overdraft facility. **Other retail exposures (Retail portfolios in FNB Personal Loans, Smart Products and WesBank retail auto finance and personal loans)**	**Rating process and approach:** • These retail portfolios are segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, loan characteristics, customer behaviour, application data and delinquency status. • PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools. • No overrides of the PD's are possible. The only potential override is not that of the PD, but rather of the automated decision to lend or not. Such overrides may be done on the basis of the credit manager's judgement in a structured process supported by pertinent business reasons. • LGD and EAD estimates are based on subsegmentation with reference to the collateral or product type as well as associated analyses and modelling of historical internal loss data. **Additional notes on qualifying revolving retail exposures:** • These exposures are unsecured and therefore only the efficiency of the recovery processes impacts on the level of LGD. • EAD measurement plays a significant role in the assessment of risk due to the typically high level of undrawn facilities that are characteristic for these product types. EAD estimates are based on actual historic EAD, segmented appropriately (e.g. straight vs. budget in the case of credit cards).

Model validation

Rating models are recalibrated and independently validated on an annual basis to ensure validity, efficacy and accuracy. The rating models used across the credit portfolios incorporate an appropriate degree of conservatism, which was achieved through the prudent choice of model parameters and the inclusion of downturn periods such as 2001 and 2007 – 2009 in calibration.

The independent validation of the rating systems is carried out by GCRM in ERM. It is responsible for reviewing all rating systems and a comprehensive revalidation of all material rating systems on an annual basis. An actuarial auditing team in Group Internal Audit ("GIA") carries out additional reviews of the rating systems as well as sample revalidations. The results of these analyses are reported to the MRVC. As part of this process, extensive documentation covering all steps of the model development lifecycle from inception through to validation is maintained. This includes:

- developmental evidence, detailing processes followed and data used to set parameters for the model. GCRM is the custodian of these documents, which are updated on at least an annual basis by the model development teams;
- independent validation reports, documenting the process followed during the annual validation exercise as well as results obtained from these analyses; and
- model build and development frameworks are reviewed and, where required, updated annually by GCRM. These frameworks provide guidance, principles and minimum standards which the model development teams are required to adhere to.

Credit risk mitigation

Since the taking and managing of credit risk is a core component of the Group's business, it aims to optimise the amount of credit risk it takes to achieve its return objectives. The mitigation of credit risk is an important component of this process, which begins with the structuring and approval of facilities for only those clients and within those parameters that fall within the risk appetite.

In addition, various instruments are used to reduce the exposure in case of a counterparty default. These include, amongst others, financial or other collateral, netting agreements, guarantees and credit derivatives. The type of security used depends on the portfolio, product or customer segment, for example:

- mortgages and instalment sale finance are secured by the assets financed;
- personal loans, overdrafts and credit card exposures are unsecured or secured by guarantees and suretyships;
- FNB Commercial credit facilities are secured by the assets of the SME counterparties, and commercial property transactions are typically supported by the property financed and the cash flows generated by it;
- working capital facilities in FNB Corporate are often not secured by claims on specific assets, but risk in structured facilities granted by RMB is mitigated by financial or other collateral such as guarantees or credit derivatives; and
- credit risk in RMB's Fixed Income, Currency and Commodities ("FICC") business is mitigated through the use of netting agreements and financial collateral.

The Group employs strict policies governing the valuation and management of collateral across all business areas. Collateral is managed internally so as to ensure that title is retained over collateral taken over the life of the transaction. All items of collateral are valued at inception of a transaction and at various points throughout the life of the transaction, either through physical inspection or indexation methods, as appropriate. For wholesale and commercial portfolios, valuations are reassessed as part of the annual facility review. For mortgage portfolios, collateral valuations are updated on an ongoing basis through statistical indexation models. For all retail portfolios, collateral is also revalued by physical inspections in the event of default and at the start of the workout process.

Management of concentration risk

Aggregated monitoring of concentration risk takes place at Group level through the GCRM function of ERM and the Performance Measurement function. Concentration risk is managed in the respective credit portfolios as outlined below.

In the wholesale credit portfolio through:

- single name limits for large exposures;
- evaluation of country and industry concentrations;
- a sophisticated, simulation based portfolio model;
- securitisation structures; and
- credit derivatives.

In the commercial portfolios through:

- maintaining an appropriate balance of exposures across industries with a view to mitigating residual risks at a Group level, where appropriate and economically feasible;
- reliance on a small number of collateral types; and
- monitoring and management in the respective business segments (e.g. exposure to geographical areas and loan to value ("LTV") bands for mortgage portfolios).

Monitoring of weak exposures

Credit exposures are actively monitored throughout the life of the respective transactions. As indicated above, the management of credit risk is largely carried out at a business unit level, and, therefore, the processes for the identification and management of weak exposures differ slightly across the various franchises.

Across the wholesale credit portfolios:

- watch lists of high risk clients;
- specific and detailed action plans for each client which are actively monitored and updated on at least a monthly basis;
- restructuring of facilities where appropriate;
- use of credit derivatives;
- an efficient workout; and
- the realisation of collateral value in the event of default.

In retail credit portfolios:

- monitoring on a (homogeneous) portfolio basis;
- restructuring of weak exposures to increase the projected realised value;
- reduction or removal of undrawn facilities in areas such as HomeLoans and Credit Cards; and
- revaluation of properties before approval of additional facilities.

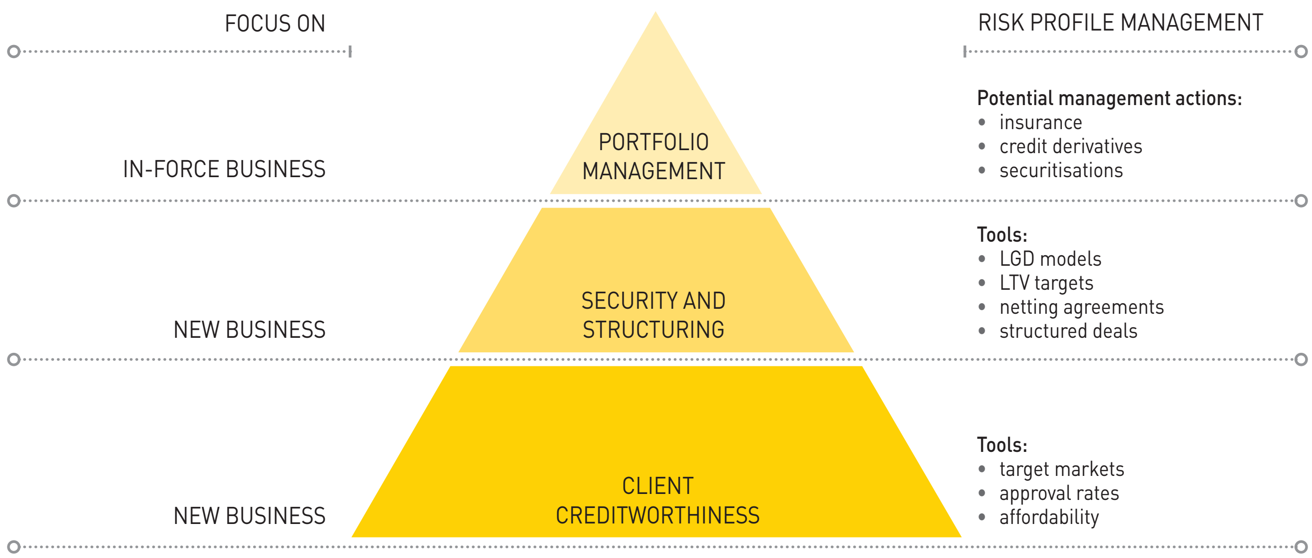
Commercial and other portfolios of clients that fall between the corporate and retail segments are treated in a hybrid manner, dependent on the number of exposures and the size of individual transactions.

Reports on the overall quality of the portfolio are monitored closely at a business unit as well as at a Group level. As indicated previously, the Performance Measurement function within Corporate Centre is actively involved in the determination of credit strategy and required changes thereto, so as to ensure that the credit portfolio is managed within the constraints of the Group's credit risk appetite.

Use of credit risk tools and measures

Credit risk measures are used in a large number of business processes, including pricing, the setting of impairments, in determining capitalisation levels and in determining business strategy, risk appetite and the choice of appropriate return targets. Credit risk tools and measures are used extensively in the determination of its current credit risk profile and credit risk appetite (see chart below).

Use of credit risk tools and measures



The following table describes the use of credit risk concepts and measures across a number of key areas and business processes related to the management of the credit portfolio.

Use of credit measures in the credit lifecycle

Area	Wholesale	Retail
Credit approval	Ratings form an explicit and integral component of the approval decision, both with respect to the targeted portfolio composition in terms of applicable risk appetite limits (e.g. ratings profile) and with respect to the value proposition based on the projected risk adjusted return on economic capital (for which PD, EAD and LGD are key inputs).	Credit approvals are largely automated on the basis of application scorecards and applicable policy. These are reflective of PD, EAD and LGD.
Determination of individual and portfolio limits	The setting of limits at a client level and the ongoing evaluation of industry and geographical concentrations are key aspects of the determination of the overall credit strategy (see below). Ratings are an important consideration in this process and risk related limits on the composition of the portfolio are used to ensure compliance with the Group's credit risk appetite.	See Wholesale. In addition, retail portfolios are regularly evaluated with respect to modelled vs. actual experience in the setting of credit risk appetite.
Reporting to senior management and the Board	Portfolio reports are collated on an ongoing basis and these are presented to and discussed regularly at relevant business and deployed risk committees. Quarterly portfolio reports are also submitted to the FSR Credit risk committee, the Wholesale credit technical committee and the RCC committee.	See Wholesale. Reports are also submitted to the Retail and SME credit risk technical committee and the RCC committee.
Provisioning	PD and LGD estimates are used extensively in the assessment of impairments and thus in the calculation of provisions.	Loss Identification Period ("LIP") PD, LGD and roll rates are used in the derivation of specific, portfolio and incurred but not reported ("IBNR") provisions.
Regulatory and economic capital allocation	As the primary credit risk measures PD, EAD and LGD are the most important inputs for both regulatory and economic capital models.	See Wholesale.
Profitability analysis and pricing decisions	The primary risk measures are the core parameters of the pricing calculator used for each transaction. For each application a value proposition section has to be completed that provides a cogent rationale for the transaction on a risk adjusted basis.	PIT PDs, downturn LGDs and EADs are used in assigning appropriate price points to each risk rating. Profitability is assessed in terms of economic profit.
Credit monitoring and risk management	The monitoring of exposures is dependent on the risk assessment as given by PD, EAD and LGD. FR grades are updated on a regular basis to reflect the organisation's assessment of obligor risk. The risk parameters are also used in the Group's portfolio model as well as other tools which attribute additional capital to large transactions or to deals that further increase the concentration of risk in the portfolio.	See Wholesale. Extensive analysis of portfolio and risk movements is carried out on a monthly basis. These are used in portfolio management and credit strategy decisions.
Determination of portfolio and client acquisition strategy	Credit portfolio strategy is driven by the assessment of overall portfolio credit risk, which is based on a portfolio model driven by the primary risk measures. In this context, acquisition and overall strategy are set in terms of appropriate limits so as to ensure that the credit portfolios remain within the overall risk appetite prescribed by the Board.	See Wholesale. Credit models are also used to determine loss thresholds across retail portfolios, which are a direct consideration in the setting of credit risk appetite.
Performance measurement and compensation	The primary risk measures are key parameters for the calculation of deal pricing and are also used in the assessment of economic value added by a transaction or a business unit. From an operational perspective, each deal is evaluated with respect to the value added and compensation structures are tied to the measures.	See Wholesale. By necessity, analyses tend to be carried out at a portfolio level but performance is measured consistently on the basis of capital consumption and economic value added in the form of economic profit.

Overview of credit risk portfolio

Credit strategy is managed as part of the broader balance sheet management process and is aligned with the Group's view of trends in the wider economy. The Group's current origination strategies are resulting in improving credit quality across all retail portfolios (as evidenced in the vintage analyses for the large retail portfolios on page 49).

The credit strategy and the series of interest rate reductions from 2008 into 2010 has facilitated a reduction in new NPL inflows and credit impairment charges in most of the retail portfolios. These portfolios were also positively impacted by interest rates continuing to trend downwards, positive income growth and increased wages.

Although investment spending by business remains subdued, advances growth in the wholesale portfolios was resilient during this reporting period mainly due to new investment grade deals that were approved.

Retail credit portfolios

Strong growth was delivered by the vehicle and asset finance portfolio and sub-sets of the residential mortgages portfolio while the performance of the Africa portfolio has been robust with low credit losses. The level of NPL balances in the secured portfolios remains high due to accounts under debt counselling and the lengthening of recovery processes. The FNB HomeLoans NPL levels were positively impacted by lower new defaults and improved levels of write-offs during the period under review. Lower new defaults are the key driver of the substantially improved income statement impairment charge for most of the retail portfolios. The impairment charge further benefited from increased post write-off recoveries, especially in the unsecured portfolios.

Wholesale portfolios

During the year under review the corporate portfolios were resilient, however the inflow of new NPLs increased mainly due to challenges in the commercial property finance sector. These exposures, accounted for on a fair value basis in RMB, are, however, well supported by collateral. This moderated the rise in fair value credit adjustments and resulted in lower coverage.

Credit assets

The following table provides a breakdown of FirstRand's credit assets by segment, including items not recognised in the balance sheet (comparatives in the sections below are provided for FRBH):

Credit assets by type and segment

R million	FirstRand[1] December 2010	FRBH[1] December 2009	FRBH[1] June 2010
Cash and short term funds	**25 576**	20 220	22 427
Money at call and short notice	**1 700**	1 888	2 009
Balances with central banks and guaranteed by central banks	**12 142**	11 573	11 513
Balances with other banks	**11 734**	6 759	8 905
Gross advances	**461 503**	426 826	441 723
FNB	**201 847**	196 136	199 113
– FNB Retail	**169 834**	166 295	168 660
– FNB Corporate[2]	**3 231**	3 144	2 132
– FNB Commercial[3]	**28 782**	26 697	28 321
WesBank	**95 359**	90 825	92 756
RMB	**137 794**	114 692	128 252
FNB Africa	**21 061**	18 582	19 646
Other	**5 442**	6 591	1 956
Derivatives	**51 052**	38 686	39 752
Debt investment securities (excluding non-recourse investments)	**96 289**	87 161	88 294
Accounts receivable	**5 598**	4 438	4 580
Loans due by holding company and fellow subsidiaries	**–**	859	1 628
Loans to Insurance Group	**–**	1 177	1 302
Reinsurance assets	**527**	–	524
Credit risk not recognised on the balance sheet	**83 485**	87 561	84 000
Guarantees	**21 168**	19 129	24 011
Acceptances	**291**	288	299
Letters of credit	**5 352**	5 776	5 541
Irrevocable commitments	**55 313**	60 962	52 809
Credit derivatives	**1 361**	1 406	1 340
Total	**724 030**	666 928	684 230

1 Effective 1 July 2010 FirstRand became the regulated bank controlling company. Prior to 1 July 2010 FRBH was the regulated bank controlling company. The December 2010 numbers included are therefore not comparable to December 2009 and June 2010.

2 Includes public sector.

3 Certain portfolios have been restated to reflect the current segmentation of the business.

Credit quality

Advances are considered past due where a specific payment date was not met or where regular instalments are required and such payments were not received. A loan payable on demand is classified as overdue where a demand for repayment was served but repayment was not made in accordance with the stipulated requirements. The following table provides an age analysis of exposures classified as past due as at 31 December 2010.

Age analysis of advances

	FirstRand[1]						
	December 2010						
			Past due but not impaired				
R million	**Neither past nor impaired**	**Renego-tiated but current**	**1 – 30 days**	**31 – 60 days**	**> 60 days**	**Impaired**	**Total**
Age analysis of advances							
FNB Retail	**147 906**	**634**	**5 370**	**2 537**	**1 156**	**12 231**	**169 834**
FNB Corporate	**3 226**	**–**	**–**	**–**	**–**	**5**	**3 231**
FNB Commercial	**26 589**	**–**	**188**	**35**	**33**	**1 937**	**28 782**
FNB	**177 721**	**634**	**5 558**	**2 572**	**1 189**	**14 173**	**201 847**
WesBank	**88 399**	**–**	**1 507**	**493**	**73**	**4 887**	**95 359**
FNB Africa	**19 558**	**–**	**675**	**258**	**204**	**366**	**21 061**
RMB[2]	**136 422**	**–**	**129**	**32**	**32**	**1 179**	**137 794**
Other	**5 443**	**–**	**(1)**	**(1)**	**–**	**1**	**5 442**
Total	**427 543**	**634**	**7 868**	**3 354**	**1 498**	**20 606**	**461 503**

1 Effective 1 July 2010 FirstRand became the regulated bank controlling company. Prior to 1 July 2010 FRBH was the regulated bank controlling company. The December 2010 numbers included are therefore not comparable to December 2009 and June 2010.

2 Impaired advances for RMB are net of cumulative credit fair value adjustments.

	FRBH[1]						
	June 2010						
			Past due but not impaired				
R million	Neither past nor impaired	Renego-tiated but current	1 – 30 days	31 – 60 days	> 60 days	Impaired	Total
Age analysis of advances							
FNB Retail	144 068	783	5 773	2 701	1 717	13 618	168 660
FNB Corporate	2 131	–	–	–	–	1	2 132
FNB Commercial	26 078	–	261	34	21	1 927	28 321
FNB	172 277	783	6 034	2 735	1 738	15 546	199 113
WesBank	85 316	–	1 577	647	118	5 098	92 756
FNB Africa	17 270	–	1 149	459	360	408	19 646
RMB[2]	127 357	1	31	17	6	840	128 252
Other	1 931	–	–	–	–	25	1 956
Total	404 151	784	8 791	3 858	2 222	21 917	441 723

1 Effective 1 July 2010 FirstRand became the regulated bank controlling company. Prior to 1 July 2010 FRBH was the regulated bank controlling company. The December 2010 numbers included are therefore not comparable to December 2009 and June 2010.

2 Impaired advances for RMB are net of cumulative credit fair value adjustments.

The classification of advances past due follows the standards set out in applicable accounting policies. A distinction is drawn between accounts past due for technical reasons (e.g. insufficient payments due to debit orders not having been updated for changes in interest rates) and normal arrears (i.e. accounts in arrears by one to three full repayments). The split provided in the tables above includes both types of arrear accounts. Total exposure to technical arrears included in this analysis was R4.3 billion (2009: R4.5 billion) and was primarily driven by retail exposures.

Renegotiated advances are advances where, due to the deterioration in a counterparty's financial condition, FRB granted a concession where the original terms and conditions of the facility were amended. The objective of such an amendment is to mitigate the risks where the current situation could result in the counterparty no longer being able to meet the terms and conditions originally agreed. As part of the risk management and workout approach, the Group enters into arrangements with clients where concessions are made on payment terms (e.g. a reduction in payments for a specified period of time, changes in the payment profile, or debt counselling payment plans). There are formally defined eligibility criteria appropriate for individual products to determine when clients are eligible for such arrangements. These accounts are monitored in a separate portfolio in each product segment and the performance is tracked for management and impairment purposes. Reclassification of NPLs into the renegotiated advances category is not allowed.

The renegotiated advances disclosed above include all loans renegotiated to date and for which the renegotiated terms have not yet expired. All of these advances are within the revised terms and conditions. These advances are considered as a separate category for purposes of impairments and are not considered with the Neither past due nor impaired category.

The renegotiated advances exclude any advances where the facility terms were extended or renewed as part of the ordinary course of business on terms and conditions equivalent to the current terms or conditions for new debt with similar risk.

Policy for impairment of financial assets

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

Assets carried at amortised cost

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event(s) has an adverse impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

i. significant difficulty of the issuer or debtor;

ii. a breach of contract, such as a default or delinquency in payments;

iii. it becomes probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;

iv. the disappearance of an active market for that financial asset because of financial difficulties; or

v. observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be allocated to the individual financial assets in the Group, including:

- adverse changes in the payment status of issuers or debtors in the Group; or
- national or local economic conditions that correlate with defaults on the assets in the Group.

FirstRand first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If FirstRand determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and performs a collective assessment for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the financial assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, FirstRand may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of FirstRand's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors).Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows of a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in FirstRand and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by FirstRand to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Analysis of movement in impairment of advances

	FirstRand		
R million	**December 2010**	December 2009	June 2010
Opening balance	**6 888**	7 206	7 206
Exchange rate difference	**(2)**	4	(3)
Amounts written off	**(3 167)**	(3 430)	(6 826)
Unwinding of discounted present value on NPLs	**(124)**	(155)	(258)
Reclassifications, transfers and acquisitions	**70**	30	241
Net new impairment created/(released)	**2 551**	3 385	6 528
Specific impairment	**6 216**	7 040	6 888
Portfolio impairment	**1 997**	2 528	2 084
Total impairments	**8 213**	9 568	8 972

Non-performing loans and impaired advances

Adequacy of impairments is assessed through the ongoing review of the quality of the credit exposures. Although credit management and workout processes are similar for amortised cost advances and fair value advances, the creation of impairments for these differs.

For amortised cost advances, impairments are recognised through the creation of an impairment reserve and an impairment charge in the income statement. For fair value advances, the credit valuation adjustment is charged to the income statement through trading income and recognised as a change to the carrying value of the asset.

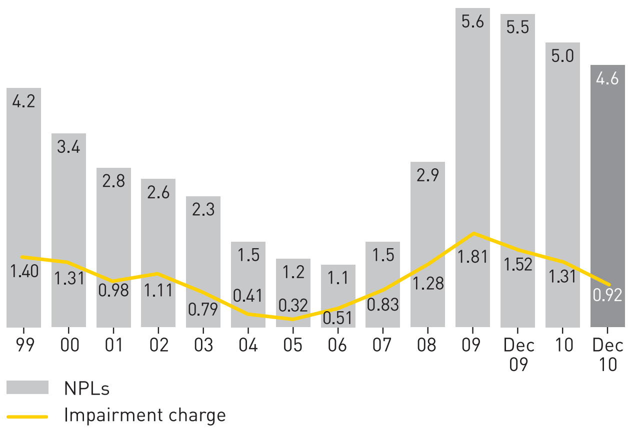
Specific impairments are created for non-performing advances for which objective evidence that an incurred loss event will have an adverse impact on the estimated future cash flows from the asset was identified. Potential recoveries from guarantees and collateral are incorporated into the calculation of the impairment figures.

All assets not individually impaired, as described, are included in portfolios with similar credit characteristics (homogeneous pools) and are collectively assessed. Portfolio impairments are created with reference to these performing advances based on historical patterns of losses in each part of the performing book. Points of consideration for this analysis are the level of arrears; arrears roll rates, PIT PDs, LGDs and the economic environment. Loans considered uncollectible are written off against the reserve for loan impairments. Subsequent recoveries against these facilities decrease the credit impairment charge in the income statement in the year of the recovery.

The graph below shows the history of the credit losses reflected by the impairment charge and NPLs percentages.

NPLs and impairment history

(%)



Impairment charges are reflected before insurance proceeds where applicable.

The tables below provide an analysis of NPLs by class, sector and geographical area respectively.

NPLs by class

	FirstRand					
	NPLs as a % of advances			NPLs		
%/R million	**Dec 10**	Dec 09[1]	Jun 10[1]	**Dec 10**	Dec 09[1]	Jun 10[1]
FNB	**7.02**	8.39	7.81	**14 173**	16 450	15 546
FNB Retail	**7.22**	9.00	8.00	**12 231**	14 643	13 618
FNB Corporate Banking	**0.18**	0.14	0.06	**5**	4	1
FNB Commercial	**6.73**	6.75	6.80	**1 937**	1 803	1 927
WesBank	**5.12**	5.33	5.50	**4 887**	4 836	5 098
RMB	**1.23**	1.05	0.86	**1 690**	1 200	1 126
FNB Africa	**1.74**	2.16	2.07	**366**	401	407
Other	**0.02**	3.55	1.43	**1**	234	28
Total NPL	**4.58**	5.48	5.00	**21 117**	23 121	22 205

The December 2009 and June 2010 numbers reflect FirstRand information.

NPLs by sector

	FirstRand					
	NPLs as a % of advances			NPLs		
%/R million	**Dec 10**	Dec 09[1]	Jun 10[1]	**Dec 10**	Dec 09[1]	Jun 10[1]
Agriculture	**2.90**	3.24	2.83	**390**	392	356
Banks and Financial Services	**0.04**	1.08	0.54	**28**	430	330
Building and Property Development	**9.57**	6.65	6.69	**2 056**	1 294	1 299
Government, Land Bank and public authorities	**0.42**	0.41	0.60	**73**	74	84
Individuals	**5.87**	7.09	6.64	**15 333**	17 759	16 954
Manufacturing and Commerce	**2.30**	2.56	2.41	**752**	824	793
Mining	**0.56**	1.25	0.97	**61**	125	91
Transport and Communication	**2.15**	2.02	2.44	**305**	284	335
Other	**8.71**	6.30	7.66	**2 119**	1 939	1 963
Total NPL	**4.58**	5.48	5.00	**21 117**	23 121	22 205

The December 2009 and June 2010 numbers reflect FirstRand information.

NPLs by geographical area

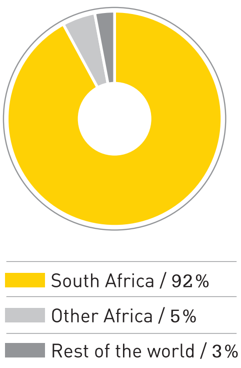
	FirstRand					
	NPLs as a % of advances			NPLs		
%/R million	**Dec 10**	Dec 09[1]	Jun 10[1]	**Dec 10**	Dec 09[1]	Jun 10[1]
South Africa	**4.81**	5.58	5.14	**20 360**	21 887	21 100
Other Africa	**1.89**	2.24	2.41	**456**	479	549
UK	**0.17**	0.50	0.36	**15**	41	26
South America	**60.17**	81.02	54.73	**210**	286	214
Australasia	**12.82**	44.26	23.15	**76**	428	316
Total NPL	**4.58**	5.48	5.00	**21 117**	23 121	22 205

The December 2009 and June 2010 numbers reflect FirstRand information.

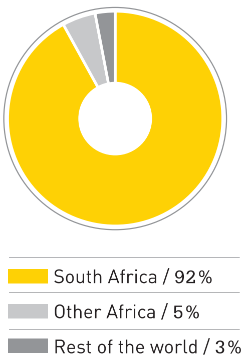
Geographic and industry concentration risk

Geographically, most of the Group's exposure originates in South Africa. The following charts provide the geographical and industry split of gross advances after deduction of interest in suspense.

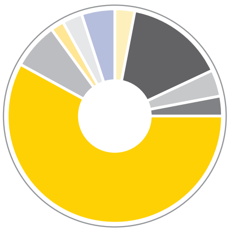
Geographic split by exposure as at 31 December 2010



Geographic split by exposure as at 31 December 2009

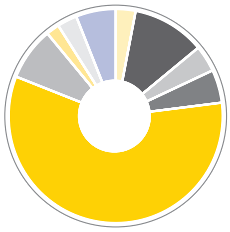


Industry split by exposure as at 31 December 2010



- Agriculture / 3%
- Bank and financial services / 14%
- Building and property development / 5%
- Government, Land Bank and public authorities / 4%
- Individuals / 57%
- Manufacturing and commerce / 7%
- Mining / 2%
- Transport and communication / 3%
- Other services / 5%

Industry split by exposure as at 31 December 2009



- Agriculture / 3%
- Bank and financial services / 9%
- Building and property development / 5%
- Government, Land Bank and public authorities / 4%
- Individuals / 59%
- Manufacturing and commerce / 8%
- Mining / 2%
- Transport and communication / 3%
- Other services / 7%

The Group seeks to establish a balanced portfolio profile and monitors concentrations in the credit portfolio closely. The following table provides a breakdown of credit exposure across geographies.

Concentration of significant credit exposure

	FirstRand[1]								
	December 2010								
R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	423 561	24 114	8 669	15	2 076	1 216	349	1 503	461 503
Derivatives	33 393	200	7 823	–	7 987	1 477	–	172	51 052
Debt securities	82 029	9 762	567	–	1 905	904	–	1 122	96 289
Guarantees, acceptances and letters of credit[2]	22 723	2 912	311	–	25	13	59	768	26 811
Irrevocable commitments[2]	50 791	3 446	793	–	187	22	–	74	55 313

1 Effective 1 July 2010 FirstRand became the regulated bank controlling company. Prior to 1 July 2010 FRBH was the regulated bank controlling company. The December 2010 numbers included are therefore not comparable to December 2009 and June 2010.

2 Significant exposures not recognised on the balance sheet.

R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
	FRBH[1]								
	December 2009								
Advances	391 914	21 405	8 179	983	2 086	370	353	1 536	426 826
Derivatives	26 128	242	6 551	5	4 654	991	1	114	38 686
Debt securities	69 247	9 026	609	–	6 873	986	–	420	87 161
Guarantees, acceptances and letters of credit[2]	22 858	2 324	–	–	–	–	–	11	25 193
Irrevocable commitments[2]	56 829	2 887	144	2	873	99	1	127	60 962

1 Effective 1 July 2010 FirstRand became the regulated bank controlling company. Prior to 1 July 2010 FRBH was the regulated bank controlling company. The December 2010 numbers included are therefore not comparable to December 2009 and June 2010.

2 Significant exposures not recognised on the balance sheet.

R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
	FRBH[1]								
	June 2010								
Advances	408 426	22 741	7 186	68	660	819	391	1 432	441 723
Derivatives	26 352	257	6 128	2	5 070	1 696	11	236	39 752
Debt securities	72 063	7 742	471	–	6 004	999	–	1 015	88 294
Guarantees, acceptances and letters of credit[2]	26 606	2 608	–	–	282	–	5	350	29 851
Irrevocable commitments[2]	48 339	3 195	78	–	1 149	38	–	10	52 809

1 Effective 1 July 2010 FirstRand became the regulated bank controlling company. Prior to 1 July 2010 FRBH was the regulated bank controlling company. The December 2010 numbers included are therefore not comparable to December 2009 and June 2010.

2 Significant exposures not recognised on the balance sheet.

The average advances for the period under review amounts to R470 219 million.

Basel II disclosure

Credit rating systems and processes used for Basel II

The Group uses the AIRB approach for the exposures of FRB and the Standardised Approach for all other legal entities in the Group for regulatory capital purposes. Due to the relatively smaller size of the subsidiaries and the scarcity of relevant data, the Group plans to continue using the Standardised Approach for the foreseeable future for these portfolios.

The following table provides a breakdown of credit exposure by type, segment and Basel II approach. The figures are based on IFRS accounting standards and differ from the exposure figures used for regulatory capital calculations, which reflect the recognition of permissible adjustments such as the netting of certain exposures.

Credit exposure by type, segment and Basel II approach for FirstRand

R million	2010	AIRB	Standardised Approach subsidiaries and branches	
		FRB (SA)	Regulated bank entities within FNB Africa	Offshore branches and other subsidiaries
Cash and short-term funds	**25 576**	21 806	2 098	1 672
Money at call and short notice	**1 700**	1 297	67	336
Balances with central banks and guaranteed by central banks	**12 142**	10 881	1 242	19
Balances with other banks	**11 734**	9 628	789	1 317
Gross advances	**461 503**	425 075	21 061	15 367
FNB	**201 847**	199 126	–	2 721
FNB Retail	**169 834**	167 113	–	2 721
FNB Corporate	**3 231**	3 231	–	–
FNB Commercial	**28 782**	28 782	–	–
WesBank	**95 359**	89 327	–	6 032
RMB	**137 794**	131 004	–	6 790
FNB Africa	**21 061**	–	21 061	–
Other	**5 442**	5 618	–	(176)
Derivatives	**51 052**	50 382	–	670
Debt investment securities	**96 289**	81 685	6 824	7 780
Accounts receivable	**5 598**	3 047	287	2 264
Loans due by holding company and fellow subsidiaries	**–**	16 202	2 248	(18 450)
Reinsurance assets	**527**	–	39	488
Credit risk not recognised on the balance sheet	**83 485**	75 651	5 720	2 114
Guarantees	**21 168**	18 640	2 030	498
Acceptances	**291**	291	–	–
Letters of credit	**5 352**	5 104	244	4
Irrevocable commitments	**55 313**	50 553	3 446	1 314
Credit derivatives	**1 361**	1 063	–	298
Total	**724 030**	673 848	38 277	11 905

For portfolios using the Standardised Approach, rating scales from Fitch Ratings, Moody's and Standard & Poor's are used. External ratings are not available for all jurisdictions and for certain parts of the portfolio other than corporate, bank and sovereign counterparties. Where applicable, the Group uses its internally developed mapping between FR grade and rating agency grade.

The following table provides the breakdown of exposures rated through the Standardised Approach in FNB Africa by risk bucket after taking risk mitigation into account:

FNB Africa exposures by risk bucket

Risk bucket	**Exposure R million**
0%	67
10%	–
20%	3 079
35%	7 893
50%	1 852
75%	2 504
100%	22 702
Specific impairments	180
Total	**38 277**

PD, EAD and LGD profiles

A summary of credit risk parameters as reported for regulatory capital purposes is shown below for each significant AIRB asset class. The parameters reflect through-the-cycle PDs and downturn LGDs. The scale used from 1–25 per the Basel II accord is for performing assets, with 1 being the lowest risk and NPL representing the defaulted exposures.

The graphs provide a summary of the EAD distribution by prescribed counterparty risk bands. The EAD weighted downturn LGD and the EAD weighted PD for the performing and total book are also shown. Comparative information for the prior year is provided in the charts.

Year-on-year trends will be impacted by the risk migration in the existing book (reflecting changes in the economic environment), quality of new business originated and any model recalibrations implemented during the course of the year.

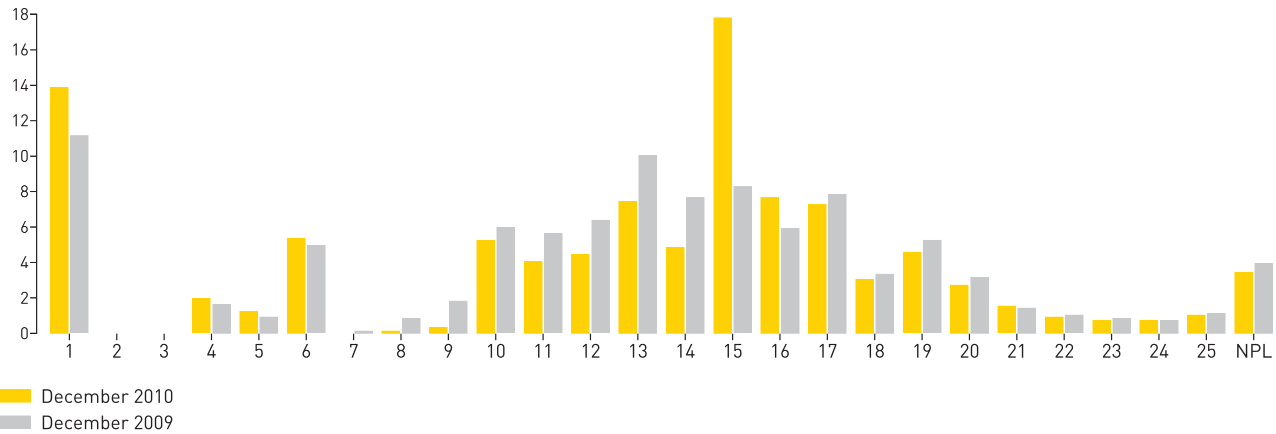
For the majority of the retail portfolios there was significant positive risk migration since December 2009. This was, however, negated by model recalibrations implemented during the financial year, incorporating relatively high defaults experienced in recent times.

Over the year under review, the performance of the credit portfolio was in line with that of the industry.

The risk profile reflects the revised credit origination strategy that selectively targets areas providing an appropriate risk/return profile in the current economic environment.

Risk profile for FirstRand Bank: EAD % distribution per Basel risk buckets

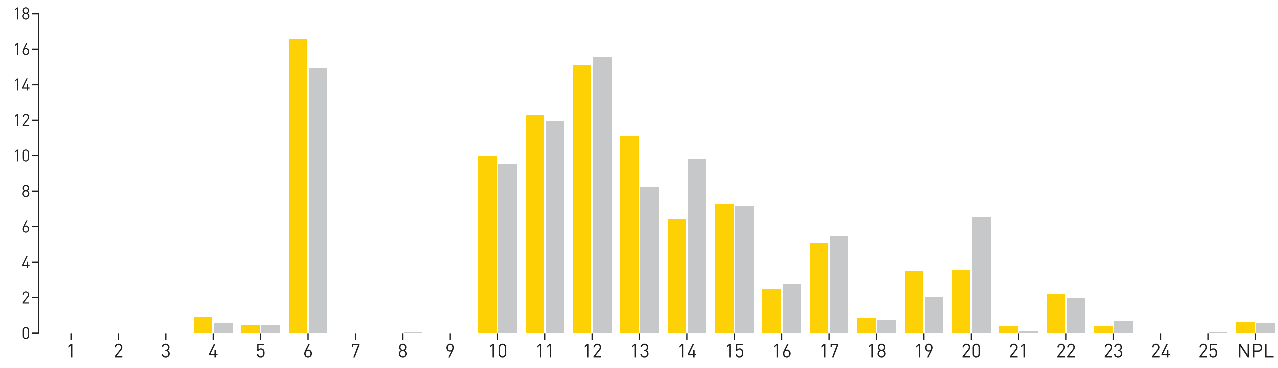
(EAD %)



EAD weighted performing PD%	2.63%	EAD weighted total book PD%	6.05%
EAD weighted performing LGD%	28.16%	EAD weighted total book LGD%	28.31%
Performing book EL/EAD	0.74%	Total book EL/EAD	1.71%

Risk profile for Corporate exposures: EAD % distribution per Basel risk buckets

(EAD %)

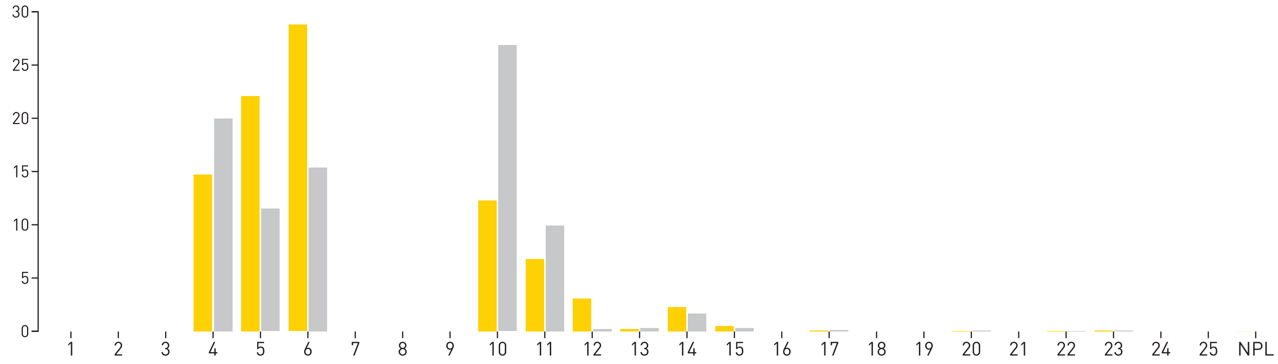


December 2010
December 2009

EAD weighted performing PD%	1.46%	EAD weighted total book PD%	2.31%
EAD weighted performing LGD%	36.65%	EAD weighted total book LGD%	36.69%
Performing book EL/EAD	0.53%	Total book EL/EAD	0.85%

Risk profile for Banks exposures: EAD % distribution per Basel risk buckets

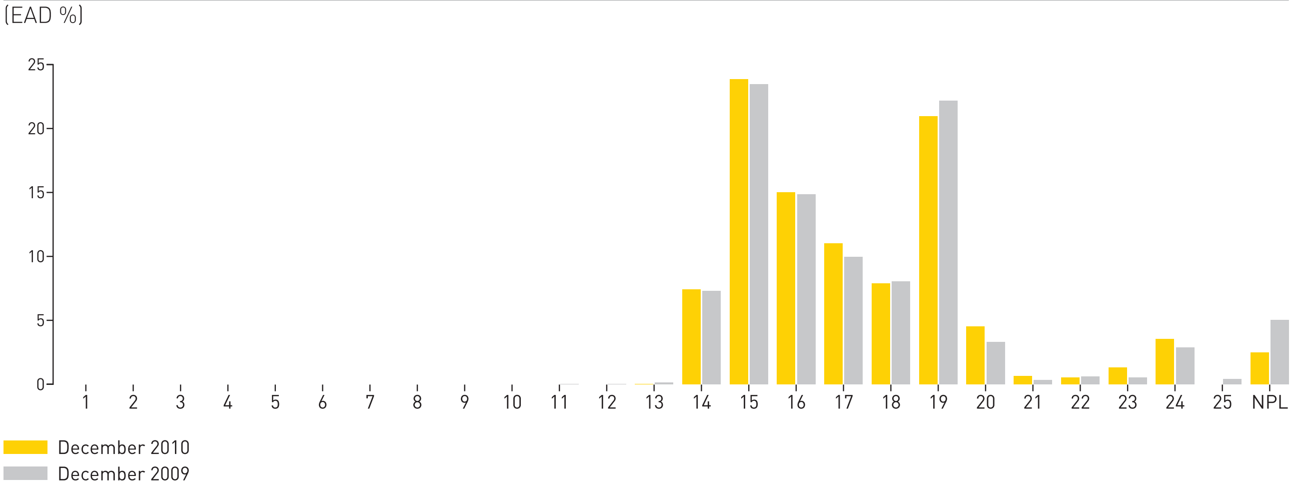
(EAD %)



December 2010
December 2009

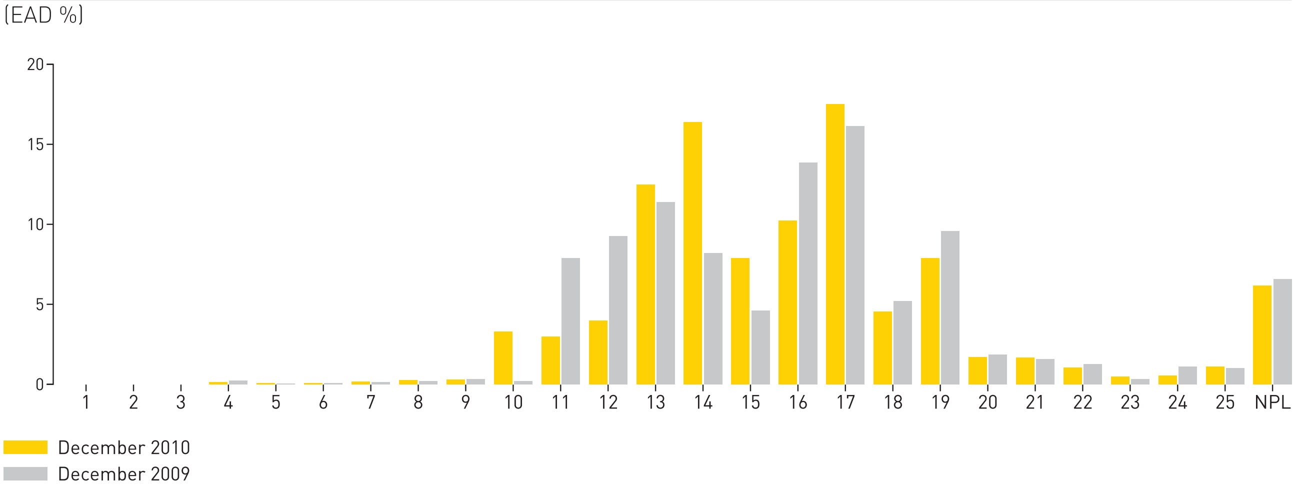
EAD weighted performing PD%	0.13%	EAD weighted total book PD%	0.13%
EAD weighted performing LGD%	31.94%	EAD weighted total book LGD%	31.94%
Performing book EL/EAD	0.04%	Total book EL/EAD	0.04%

Risk profile for SME corporate exposures: EAD % distribution per Basel risk buckets



EAD weighted performing PD%	4.57%	EAD weighted total book PD%	5.63%
EAD weighted performing LGD%	34.80%	EAD weighted total book LGD%	34.87%
Performing book EL/EAD	1.59%	Total book EL/EAD	1.96%

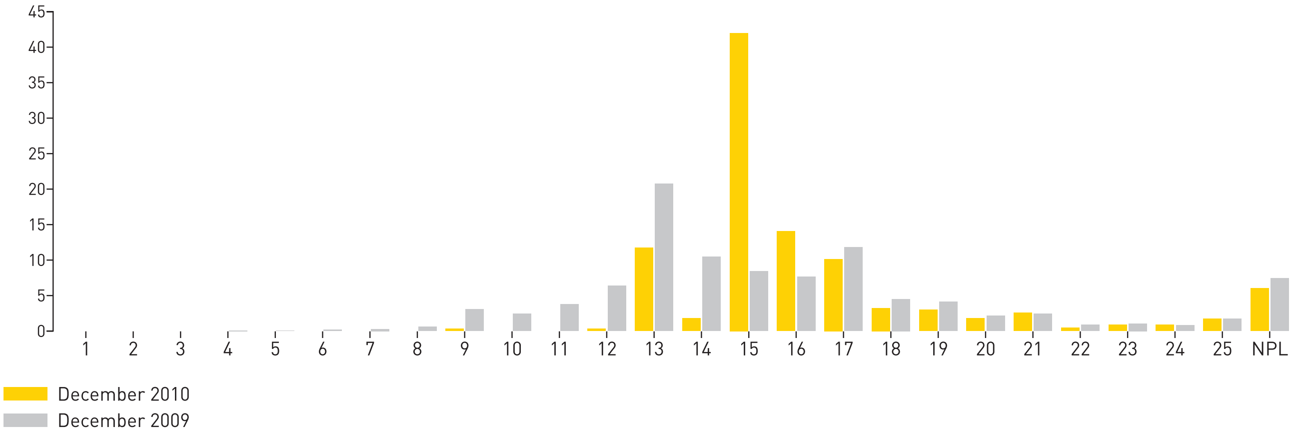
Risk profile for SME retail exposures: EAD % distribution per Basel risk buckets



EAD weighted performing PD%	2.85%	EAD weighted total book PD%	11.00%
EAD weighted performing LGD%	34.69%	EAD weighted total book LGD%	35.53%
Performing book EL/EAD	0.99%	Total book EL/EAD	3.91%

Risk profile for Retail mortgage exposures: EAD % distribution per Basel risk buckets

(EAD %)



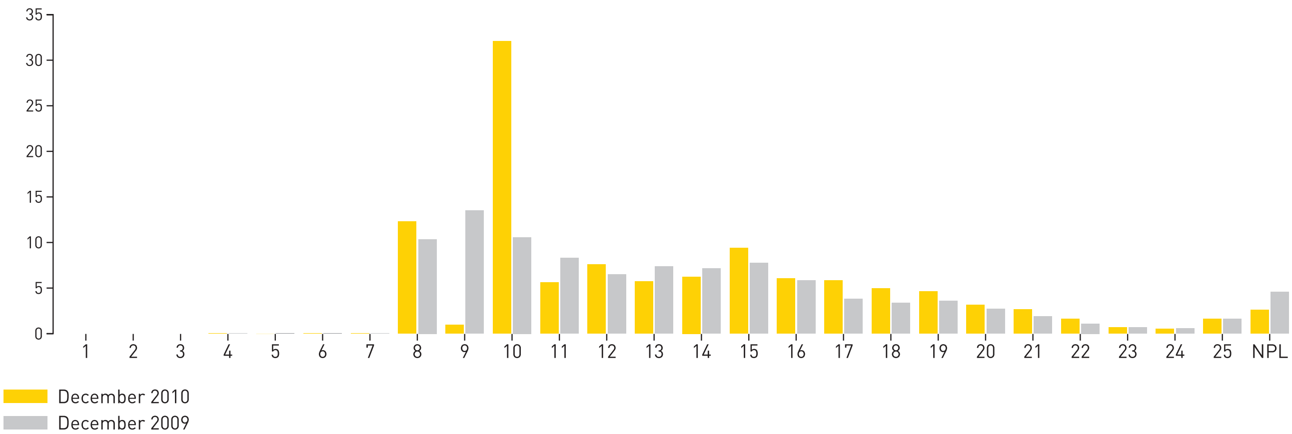
EAD weighted performing PD%	3.53%	EAD weighted total book PD%	11.87%
EAD weighted performing LGD%	13.24%	EAD weighted total book LGD%	13.74%
Performing book EL/EAD	0.47%	Total book EL/EAD	1.63%

The risk profile in the above chart appears to be deteriorating. This is not due to deterioration in credit quality, but in fact due to rating system recalibrations implemented in September 2010, which resulted in an increase in PDs due to the inclusion of the relatively high defaults experienced in recent times.

Both prior and subsequent to September 2010, the risk profile improved and PDs decreased consistently, due to positive risk migration, with the lower interest rate environment positively impacting the existing portfolio. In addition, stricter lending criteria resulted in higher quality new business being written. Monthly trend analyses from December 2009 to December 2010 show a once off increase in PDs in September 2010, due to the recalibrations, thereafter a consistent decrease due to the positive risk migration.

Risk profile for Retail revolving credit exposures: EAD % distribution per Basel risk buckets

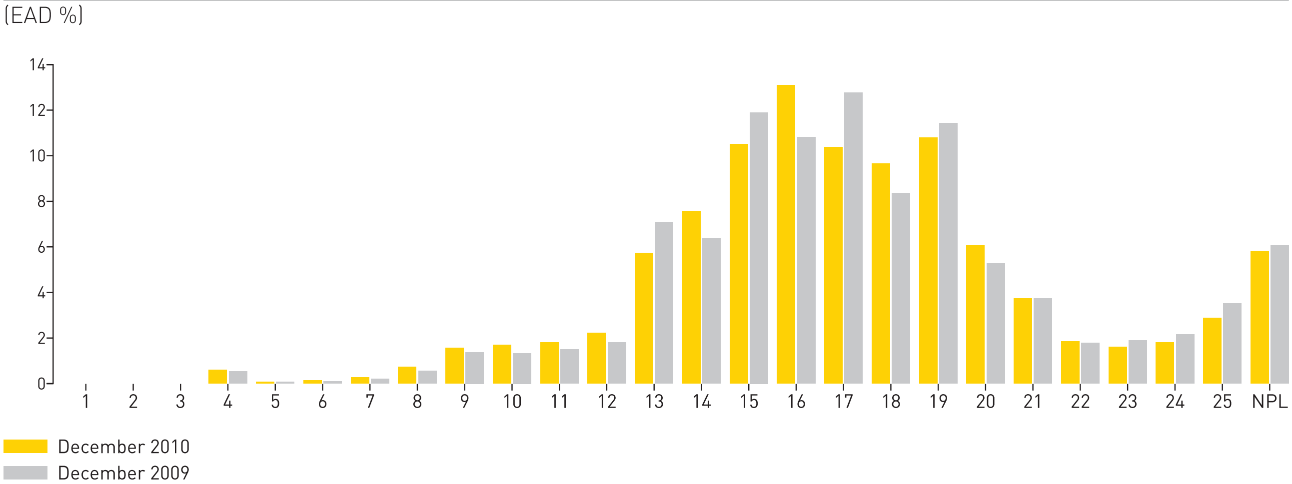
(EAD %)



EAD weighted performing PD%	3.13%	EAD weighted total book PD%	5.46%
EAD weighted performing LGD%	70.72%	EAD weighted total book LGD%	71.01%
Performing book EL/EAD	2.21%	Total book EL/EAD	3.88%

Once again, the risk profile in the above chart appears to be deteriorating. As with retail mortgages, this can be attributed to the recalibrations incorporating the higher defaults experienced in more recent times, implemented in October 2010. With the exception of this once-off increase in PDs, PDs decreased consistently from December 2009 to December 2010 reflecting the effect of the lower interest rate environment.

Risk profile for Retail other exposures: EAD % distribution per Basel risk buckets



EAD weighted performing PD%	6.75%	EAD weighted total book PD%	13.01%
EAD weighted performing LGD%	33.15%	EAD weighted total book LGD%	33.84%
Performing book EL/EAD	2.24%	Total book EL/EAD	4.40%

A significant proportion of the Retail other asset class is made up of vehicle and asset finance which is secured by the underlying asset. As such, the LGD is lower than what would be expected in unsecured other retail portfolios. The risk profile in the above chart is improving – this is due to positive risk migration, resulting from the low interest rate environment positively impacting the portfolio. The recalibration for vehicle and asset finance has not yet been implemented, which is why the effect seen within Retail mortgages and Retail revolving credit exposures is not mirrored within this asset class. The recalibration will be implemented in early 2011, when the once off increase in PDs is likely to be observed.

Maturity breakdown

Maturity is defined as the average term to contractual cash flows weighted by the size of each of the cash flows.

Maturity parameters, calculated for each account or exposure, are used as an input in the AIRB regulatory capital calculation for the wholesale portfolios. These are aggregated on an asset class basis for review and reporting purposes. The longer the maturity of a deal, the greater the uncertainty, and all else equal the larger the regulatory capital requirement.

Maturity breakdown of AIRB asset classes within the wholesale credit portfolio is disclosed in the graph below.

Maturity breakdown per wholesale AIRB asset class as at 31 December 2010

Actual vs. expected loss analysis

To provide a meaningful assessment of the effectiveness of the internal ratings based models, expected loss is compared against losses actually experienced during the year. This is performed for all significant AIRB asset classes.

Expected loss here refers to regulatory expected loss. This provides a one year forward looking view, based on information available at the beginning of the year.

The risk parameters include:

- PDs, which are calibrated to long run default experience to avoid regulatory models being skewed to a specific part of the credit cycle;
- LGDs, which are calibrated to select downturn periods to reflect depressed asset prices during economic downturns; and
- EADs.

Actual losses experienced during the year consist of both the level of specific impairments at the start of the year 1 January 2010 and the net specific impairment charge recorded through the income statement for the year ended 31 December 2010 as determined by IFRS. The calculation is based on the assumption that the specific provisions raised are a fair estimate of what final losses on defaulted exposures would be, although the length of the workout period creates uncertainty in this assumption.

The measure of actual losses includes specific provisions raised for exposures which defaulted during the year, but which did not exist at 31 December 2010. These exposures are not reflected in the expected loss value described below.

The table below provides the comparison of actual loss to regulatory expected loss for each significant AIRB asset class of FRB. With PD models used for regulatory capital purposes being calibrated to long run default experience, it would be expected that actual losses are larger than regulatory expected losses during the top of the credit cycle and lower than expected losses during the bottom of the credit cycle, as is evident from the table below.

Actual vs. expected loss per portfolio segment for FRB

	31 December 2010	
R million	Expected loss	Actual loss
Corporate (corporate, banks and sovereigns)	785	135
SME (SME corporate and SME retail)	1 267	1 134
Residential mortgages	3 230	3 956
Qualifying revolving retail	1 559	1 489
Other retail	826	1 454
WesBank	2 763	3 434
Total	10 431	11 602

The composition used above differs slightly from that used in the remainder of this section, due to impairment charges being available on business entity level as apposed to AIRB asset class level.

It should also be noted that the regulatory expected loss shown above is based on the regulatory capital models that were applied as at 31 December 2010. The models currently applied have since incorporated the subsequent increase in defaults and resulted in an increase in expected losses. A restatement of the above comparison using the capital models currently applied would result in a closer alignment of actual vs. expected losses.

This comparison is supplemented with more detailed analysis below, comparing actual and expected outcomes for each of the risk parameters (PD, LGD and EAD) over the year under review.

Expected values are based on regulatory capital models applied as at 31 December 2009. For PDs, this is applied to the total performing book as at 31 December 2009. For LGDs and EADs, it is applied to all facilities that defaulted over the next twelve months.

Actual values are based on actual outcomes over the year January 2010 to December 2010. It should be noted that due to the length of the workout period, there is uncertainty in the measure provided for actual LGDs as facilities that default during the year would only have had between 1 and 12 months to recover to date – depending on when the default event occurred.

The EAD estimated to actual ratio is derived as the ratio of nominal expected exposure at default (for all accounts that defaulted during the January 2010 – December 2010 time period) to the actual nominal exposure at default for the same accounts. A ratio above 100% indicates an overestimation.

Risk parameters used to determine regulatory expected loss for FRB

	December 2010				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate	1.63	1.75	34.20	0.01	100.00
Banks	0.15	–	n/a	n/a	n/a
SME Corporate	3.99	3.81	35.90	23.86	104.33
SME Retail	3.31	4.05	43.11	13.82	107.33
Residential Mortgages	3.36	3.72	16.04	11.20	103.13
Qualifying Revolving Retail	2.64	2.74	65.68	67.32	124.78
Other Retail	6.26	6.60	33.72	35.69	105.36
Total	2.98	3.21	30.41	16.24	104.52

No bank defaults were experienced during the year under review; hence actual LGDs and EADs are not applicable. PDs used for regulatory capital purposes are based on long run experience and would be anticipated to under-predict actual defaults at the top of the credit cycle and over-estimate actual defaults at the bottom of the credit cycle. The analysis is based on the regulatory capital models that were applied at 31 December 2009. The models currently being applied have since incorporated further defaults experienced during the latter part of the recent economic downturn and resulted in an increase in expected losses. A restatement of the above comparison using the capital models currently applied would result in a closer alignment of actual and expected PDs.

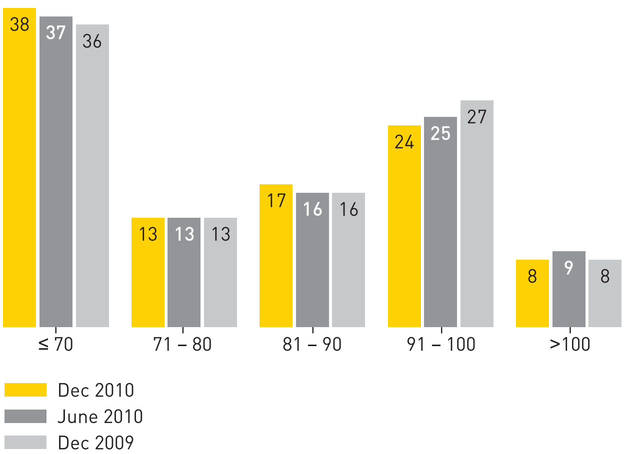
Selected risk analyses

This section provides further information on selected risk analyses of the credit portfolios of FRB.

The graphs below provide the balance-to-value distribution for residential mortgages over time as well as the aging of the residential mortgage portfolios. The recent focus on the loan-to-value ratios for new business resulted in a slight improvement in the balance to original value.

Residential mortgages balance-to-value – original value

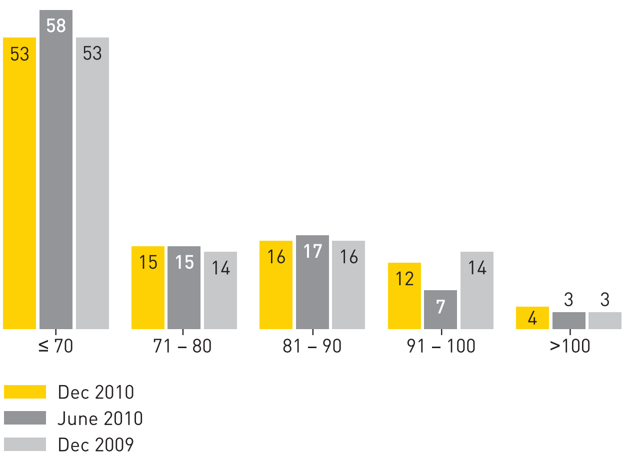
As % of total book (%)



The balance-to-market value shows a significant proportion of the book in the lower risk categories.

Residential mortgages balance-to-value – market value

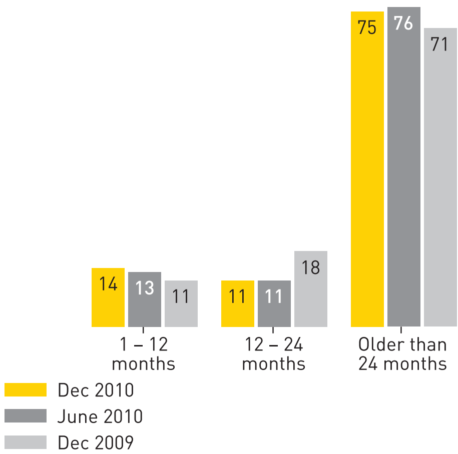
As % of total book (%)



The low levels of new business are evident in the age distribution shown in the graph below:

Residential mortgages age distribution

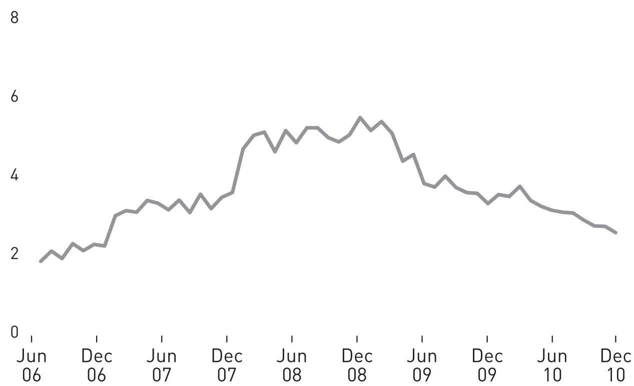
As % of total book (%)



The following graph provides the arrears in the FNB HomeLoans portfolio. It includes arrears where more than one full payment is in arrears expressed as a percentage of the total advances balance.

FNB HomeLoans arrears

(%)

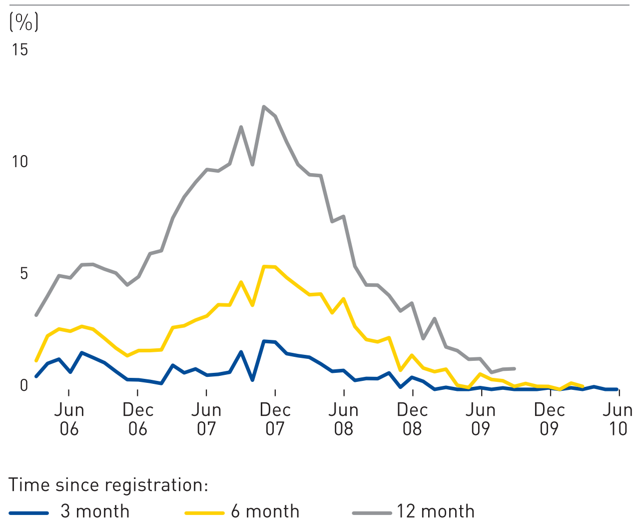


FNB HomeLoans arrears continue on a downward trend. Similar trends are also observed in the WesBank and Credit Card portfolios.

The following graphs provide vintage analyses for FNB HomeLoans and WesBank retail, respectively. Vintage graphs provide the default experience three, six and twelve months after each origination date. It indicates the impact of origination strategies and the macro environment.

For FNB HomeLoans, the three, six and twelve month cumulative vintage analyses illustrate a marked improvement in the quality of business written since mid-2008, despite further deterioration in macro conditions. The more recent decreases in the default experience reflect a combination of the credit origination strategies and the improved environment.

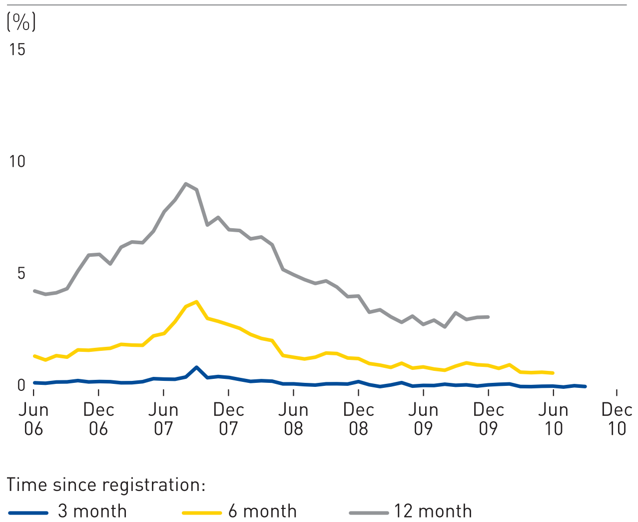
FNB HomeLoans vintage analysis



The Group's South African repossessed properties decreased from R513 million (1 564 properties) at 30 June 2010 to R450 million (1 387 properties) at 31 December 2010.

The WesBank retail six and twelve month cumulative vintage analyses continue to reflect a noticeable improvement in the quality of business written since mid-2007 and the more benign macro environment.

WesBank retail vintage analysis



In the asset finance business, repossession and stock holding levels continued to decline relative to the comparative period. The gradually reducing trend is likely to continue into the future, as the economic environment improves.

9. SECURITISATIONS AND CONDUITS

Key developments and focus

In October 2010, FirstRand sought and received approval from the SARB to repurchase all outstanding auto loan assets from Nitro Securitisation 3 (Pty) Limited ("Nitro 3"). A detailed description of this action is provided on page 52. The R2 billion synthetic auto loan securitisation, Procul (Pty) Ltd ("Procul"), matured in August 2010 (see page 52). There were a number of rating actions on several classes of Fresco 2 notes and Ikhaya 1 and 2 during the period under review. These are discussed in more detail on page 52.

Introduction and objectives

The Group uses securitisation transactions as a tool to achieve one or more of the following objectives:

- enhance FRB's liquidity position through the diversification of funding sources;
- match the cash flow profile of assets and liabilities;
- reduce credit risk exposure;
- reduce capital requirements; or
- manage credit concentration risk.

From an accounting perspective, traditional securitisations are treated as sales transactions. At inception, the assets are sold to a special purpose vehicle at carrying value and no gains or losses are recognised. The securitisation entities are subsequently consolidated into FRB for financial reporting purposes. For synthetic securitisations, the credit derivatives used in the transaction are recognised at fair value, with any fair value adjustments reported in profit or loss.

Traditional and synthetic securitisations

The following tables show the traditional and synthetic securitisations currently in place as well as the rating distribution of any exposures retained by the Group. Whilst national scale ratings have been used in this table, global scale equivalent ratings are used for internal risk management purposes. All assets in these vehicles were originated by FRB and in each of these transactions FRB acted as originator, servicer and swap counterparty.

Securitisation transactions (unaudited)

R million	Asset type	Year initiated	Expected close	Rating agency	Assets securitised
Traditional securitisations					14 784
Nitro 2	Retail: Auto loans	2006	2010	Moody's	5 000
Nitro 3	Retail: Auto loans	2007	2011	Moody's and Fitch	5 000
Ikhaya 1	Retail: Mortgages	2007	2011	Fitch	1 900
Ikhaya 2	Retail: Mortgages	2007	2012	Fitch	2 884
Synthetic securitisations					22 000
Procul	Retail: Auto loans	2002	2010	Fitch	2 000
Fresco II	Corporate receivables	2007	2013	Fitch	20 000
Total					36 784

Rating distribution of retained securitisation exposure (unaudited)

R million	AAA (zaf)	AA+ (zaf)	AA (zaf)	A+ (zaf)
Conduits				
At 31 Dec 2010	**6**	**–**	**5**	**–**
At 31 Dec 2009	**15**	**–**	**9**	**–**
At 30 June 2010	15	–	10	–
Fixed Income Fund				
At 31 Dec 2010	**17 840**	**–**	**–**	**–**
At 31 Dec 2009	**18 124**	**–**	**180**	**52**
At 30 June 2010	17 991	–	180	53

It should be noted that while national scale ratings have been used in the information above, global scale equivalent ratings are used for internal risk management purposes.

	Assets outstanding			Notes outstanding			Retained exposure		
	Dec 2010	Dec 2009	June 2010	**Dec 2010**	Dec 2009	June 2010	**Dec 2010**	Dec 2009	June 2010
	2 962	4 972	3 907	**2 918**	5 780	4 276	**262**	341	254
	–	489	–	**–**	838	–	**–**	28	–
	–	1 151	736	**–**	1 555	1 129	**–**	54	39
	1 232	1 377	1 317	**1 232**	1 432	1 321	**79**	100	87
	1 731	1 955	1 854	**1 687**	1 955	1 826	**183**	160	128
	20 000	22 000	22 000	**20 000**	22 000	22 000	**18 263**	19 183	19 138
	–	2 000	2 000	**0**	2 000	2 000	**0**	1 010	875
	20 000	20 000	20 000	**20 000**	20 000	20 000	**18 263**	18 173	18 263
	22 962	26 972	25 907	**22 918**	27 780	26 276	**18 525**	19 525	19 392

	A (zaf)	BBB+ (zaf)	BBB (zaf)	BBB– (zaf)	BB+ (zaf)	Not rated	Total
	4	**–**	**45**	**–**	**–**	**203**	**262**
	4	**29**	**–**	**–**	**–**	**285**	**341**
	4	15	–	–	–	210	254
	–	**–**	**–**	**180**	**53**	**190**	**18 263**
	–	**–**	**–**	**–**	**–**	**827**	**19 183**
	–	–	–	–	–	914	19 138

Rating actions by Fitch Ratings

Fresco 2, which is incorporated under South Africa law, is a partially-funded synthetic securitisation of a portfolio of South African and international wholesale credit exposures held on FRB's balance sheet. At closing on 17 July 2007, Fresco 2 entered into a credit default swap ("CDS") with FRB whereby Fresco 2, as the protection seller, purchased the credit risk portfolio from FRB.

In May 2009, following a change in its methodology for rating emerging market corporate collateralised debt obligations ("CDOs"), Fitch Ratings placed all of the notes issued by Fresco 2 on rating watch negative.

On the 12th of November 2010, Fitch announced that it had downgraded 9 tranches of Fresco 2. These downgrades were a result of Fitch's revision of their rating criteria/methodology and were not a reflection of any deterioration in the credit quality of the underlying corporate assets of Fresco 2 or FRB.

Fitch Ratings downgraded Fresco 2 Class A to G tranches and assigned Loss Severity ("LS") Ratings to seven tranches.

The rating actions were as follows:

- Class A1: Downgraded to 'AA– (zaf)' from 'AAA (zaf)', remains on Rating Watch Negative ("RWN");
- Class A2: Downgraded to 'AA– (zaf)' from 'AAA (zaf)', remains on RWN;
- Class B1: Downgraded to 'BB (zaf)' from 'AA (zaf)'; Outlook Stable; assigned 'LS-4';
- Class B2: Downgraded to 'BB (zaf)' from 'AA (zaf)'; Outlook Stable; assigned 'LS-4';
- Class C: Downgraded to 'B+ (zaf)' from 'A+ (zaf)'; Outlook Stable; assigned 'LS-4';
- Class D: Downgraded to 'B (zaf)' from 'A– (zaf)'; Outlook Stable; assigned 'LS-5';
- Class E: Downgraded to 'B (zaf)' from 'BBB (zaf)'; Outlook Stable; assigned 'LS-5';
- Class F: Downgraded to 'B (zaf)' from 'BBB– (zaf)'; Outlook Stable; assigned 'LS-5'; and
- Class G: Downgraded to 'B– (zaf)' from 'BB (zaf)'; Outlook Stable; assigned 'LS-5'.

Since closing, the transaction's performance has been within expectation and there has only been one credit event. The settlement of the credit event did not result in a write-down of any notes as the excess spread captured by the structure was sufficient to absorb the losses.

Exercise of clean up-call option for Nitro 3

Nitro 3 was launched on 17 May 2007 with a size of R5 billion and 11.2% subordination below the Aaa.za rated notes. The subordinated loan of R100 million and the Class D notes (from April 2008) were held by the originator (FRB). By August 2010, notes to the value of R920.1 million were outstanding, representing some 18% of the outstanding principal amount of the notes on issue date. Due to lower levels of prepayments as a result of the credit crisis, Nitro 3 was left with insufficient cash to redeem notes at the next interest payment date.

Consequently FRB sought and obtained approval from the SARB in September 2010 to repurchase the Nitro 3 assets, for a market-related consideration. The repurchase took place on the 12th of October 2010, proceeds of which were utilised for early redemption of the outstanding Nitro 3 notes. This brought to a successful close the third securitisation of instalment sale agreements originated by WesBank. The objective of the Group to obtain matched term funding at a time when its retail asset book was growing rapidly, was achieved. The structure proved resilient despite the recent difficulties experienced in the retail consumer environment.

Investors in Nitro 3 were able to, without suffering any losses, realise their investments earlier than the legal maturity.

Maturity of Procul

Procul, launched in June 2002, was a R2 billion synthetic securitisation of retail instalment sale automotive loans originated and managed by WesBank. Using a CDS, the transaction provided protection to WesBank on the auto loans up to the value of the portfolio amount. The transaction performed as expected up to its maturity on 31 of August 2010. The transaction and investors suffered no losses and all noteholders were repaid in full.

Outlook changes on SA residential mortgage-backed securities ("RMBS") transactions

During August 2010, 10 South African RMBS transactions rated by Fitch Ratings, among them Ikhaya 1 and 2, were placed on Rating Watch Negative as a result of Fitch's revision of their rating methodology.

Conduit programmes and fixed income funds

The Group's conduit programmes are debt capital market vehicles, which provide investment-grade corporate South African counterparties with a source of funding alternative to traditional bank funding. It also provides institutional investors with highly-rated short-term alternative investments. The fixed income fund is a call loan bond fund, which offers overnight borrowers and lenders an alternative to traditional overnight bank lending products on a matched basis.

All the assets originated for the conduit programmes are rigorously evaluated as part of the ordinary credit approval process applicable to any other corporate exposure held by the Group.

The following tables show the programmes currently in place, the ratings distribution of the underlying assets, and the role played by FRB in each of these programmes. All of these capital market vehicles continue to perform in line with expectations.

Conduits and fixed income funds

Transaction					Non recourse investments			Credit enhancement provided		
R million	Underlying assets	Year initiated	Rating agency	Programme size	**Dec 2010**	Dec 2009	June 2010	**Dec 2010**	Dec 2009	June 2010
Conduits										
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**7 160**	7 117	**7 373**	**–**	–	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**5 413**	5 797	**5 772**	**638**	805	758
Total				30 000	**12 573**	12 914	**13 145**	**638**	805	758
Fixed income fund										
iNkotha	Overnight corporate loans	2006	Fitch	10 000	**2 233**	**3 763**	**2 164**	**–**	–	–
Total				10 000	**2 233**	3 763	**2 164**	**–**	–	–

Rating distribution of conduits and fixed income funds

R million	F1+ (zaf)	AAA (zaf)	AA+ (zaf)	AA (zaf)	AA–(zaf)	A+ (zaf)	A (zaf)	A–(zaf)	Total
Conduits									
At 31 Dec 2010	–	**1 096**	**338**	**2 448**	**4 361**	**1 680**	**1 945**	**705**	**12 574**
At 31 Dec 2009	–	1 400	327	1 230	4 883	1 586	2 720	768	12 914
At 30 June 2010	–	1 436	633	1 487	4 682	1 480	2 592	835	13 145
Fixed Income Fund									
At 31 Dec 2010	–	**–**	**–**	**878**	**413**	**244**	**409**	**289**	**2 233**
At 31 Dec 2009	–	1 142	–	–	2 076	–	202	343	3 763
At 30 June 2010	–	656	–	–	1 195	–	116	197	2 164

FRB's role in the conduits and the fixed income fund

Transaction	Originator	Investor	Servicer	Liquidity provider	Credit enhancement provider	Swap counterpart
iNdwa			√	√		√
iNkotha			√			
iVuzi			√	√	√	√

All the above programmes continue to perform in line with expectations.

Liquidity facilities

The table below provides an overview of the liquidity facilities issued by FRB.

Liquidity facilities

		Exposure		
R million	Transaction type	**Dec 2010**	Dec 2009	June 2010
Own Transactions		**9 800**	10 902	10 442
iNdwa	Conduit	**5 611**	5 790	5 898
iVuzi	Conduit	**4 189**	5 112	4 544
Third Party Transactions	Securitisations	**1 674**	1 601	1 577
Total		**11 474**	12 503	12 019

It is important to note that from an accounting perspective, upon consolidation the underlying assets in the entities not recognised on the balance sheet are reconsolidated back onto FRB's balance sheet.

All liquidity facilities granted to the transactions in the table above rank senior in terms of payment priority in the event of a drawdown. Economic capital is allocated to the liquidity facility extended to iNdwa and iVuzi as if the underlying assets were held by FRB. The conduit programmes are consolidated into FRBL for financial reporting purposes.

Additional information

The following table provides the securitisation exposures retained or purchased as well as their associated IRB capital requirements per risk band.

Retained or purchased securitisation exposure and the associated regulatory capital charges

	Exposure			IRB capital			Capital deduction		
R million	**Dec 2010**	Dec 2009	June 2010	**Dec 2010**	Dec 2009	June 2010	**Dec 2010**	Dec 2009	June 2010
Risk weighted bands									
= <10%	**17 840**	17 840	17 840	**139**	122	122	**–**	–	–
>10% = <20%	**11 474**	12 527	12 042	**85**	87	88	**–**	–	–
>20% = <50%	**11**	180	180	**–**	6	6	**–**	–	–
>50% = <100%	**4**	1 067	931	**–**	64	66	**–**	–	–
>100% = <650%	**863**	834	773	**302**	216	198	**–**	–	–
1 250%/deduction	**445**	442	414	**–**	–	–	**445**	442	414
Total	**30 637**	32 890	32 180	**526**	495	480	**445**	442	414

The table below provides a summary of the deductions arising from securitisation exposures.

Deductions arising from securitisation exposures

R million	Corporate receivables	Retail mortgages	Retail: instalment sales an leasing	Total
Traditional	–	203	–	203
Synthetic	243	–	–	243
Total	243	203	–	445

The Group did not securitise any exposures that were impaired or past due at the time of securitisation. None of the securitisations transactions are subject to the early amortisation treatment.

10. COUNTERPARTY CREDIT RISK

Key developments and focus

During the six months under review, focus remained on ongoing improvements of the Group's monitoring of the interaction of risk factors in the counterparty risk domain. In-depth reviews of the business, clients and processes continued in all the trading areas. A dedicated "cross-over risk" function supplements business risk processes through ongoing detailed reviews of portfolios and market and credit risk interactions. Portfolio quality remained within targeted parameters. The focus over the next six months will remain on ongoing improvements of quantification and modelling of "look through" risk of these portfolios, as well as aligning internal processes with the requirements of the new Basel III requirements for Central Counterparties risk and capital assessment.

Introduction and objectives

Counterparty credit risk is concerned with a counterparty's ability to satisfy its obligations under a contract that has a positive economic value to a bank at time of settlement. 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 bank or the client.

Counterparty credit risk is a risk taken mainly in the Group's trading and client execution business and the objective of counterparty credit risk management is to ensure that risk is only taken within specified limits in line with the Group's risk appetite framework as mandated by the Board.

Organisational structure and governance

Counterparty credit risk is managed on the basis of the principles, approaches, policies and processes set out in the Credit Risk Management Framework for Wholesale Credit Exposure.

In this respect, counterparty credit risk governance aligns closely with the Group's credit risk governance framework, with mandates and responsibilities cascading from the Board through the RCC committee to the respective sub-committees as well as deployed and central risk management functions. Refer to the *Risk management framework and governance* section, (page 9), and the *credit risk governance* section (page 23) for more details.

Assessment and management

Quantification of risk exposure

The measurement of counterparty credit risk aligns closely with credit risk measurement practices and is focused on establishing appropriate limits at counterparty level.

To this end, appropriate quantification methodologies of potential future exposure over the life of a product, even under distressed market conditions, are developed by a combined credit and market risk team and submitted to technical risk committees for approval.

Individual counterparty risk limit applications are prepared using the approved risk quantification methodologies and assessed and approved at the relevant credit committees, with appropriate executive and non-executive representation.

All counterparty credit risk limits are subject to annual review and counterparty exposures are monitored by the respective risk functions on a daily basis. Overall counterparty risk limits are allocated across a number of products and desk level reports are used to ensure sufficient limit availability prior to executing additional trades with a counterparty.

Business and risk management functions share the following responsibilities in this process:

- quantification of exposure and risk as well as management of facility utilisation within approved credit limits;
- ongoing monitoring of counterparty creditworthiness to ensure early identification of high risk exposures and predetermined facility reviews at certain intervals;
- collateral management;
- management of high risk (watch list) exposures;
- collections and workout process management for defaulted assets; and
- credit risk reporting.

Limit breaches are dealt with in accordance with the approved Excess Mandate. Significant limit breaches necessitate reporting to the head of the business unit, the head of risk for the respective business unit and the RMB risk and compliance function. Any remedial actions are agreed amongst these parties and failure to remedy such a breach is reported to the RMB Risk and Performance Measurement meeting and Compliance and operational risk committee, the ERM function and the RCC committee.

As part of the ongoing process of understanding the drivers of counterparty credit risk, regular analysis is carried out on over the counter derivative and securities financing portfolios on a "look-through" basis. This portfolio review process seeks to identify concentrations, the hypothetical impact of stress scenarios, and to better understand the interaction of underlying market risk factors and credit exposure. The benefits gained are a clearer insight into potential collateral, earnings and capital volatility, and potentially unduly risky trading behaviour by counterparts.

Advanced monitoring of the creditworthiness of developed market counterparty banks is conducted through the real time analysis of listed securities issued by or referencing these banks.

Counterparty credit risk mitigation

Where appropriate, various instruments are used to mitigate the potential exposure to various counterparties. These include financial or other collateral in line with common credit risk practices, as well as netting agreements, guarantees and credit derivatives.

The Group uses International Swaps and Derivatives Association and International Securities Market Association agreements for the purpose of netting derivative transactions and repurchase transactions respectively. These master agreements as well as associated Credit Support Annexes ("CSA") set out internationally accepted valuation and default covenants, which are evaluated and applied on a daily basis, including daily margin calls based on the approved CSA thresholds.

For regulatory purposes, the net exposure figures are employed in capital calculations, whilst for accounting purposes netting is only applied where a legal right to setoff and the intention to settle on a netted basis exist.

Discussion of the risk profile

The following table provides an overview of the counterparty credit risk arising from derivative and structured finance transactions of FirstRand.

Composition of counterparty credit risk exposure of FirstRand

R million	**Dec 2010**	Dec 2009	June 2010
Gross positive fair value	**120 741**	114 202	90 367
Netting benefits	**(58 066)**	(46 593)	(36 693)
Netted current credit exposure before mitigation	**62 675**	67 609	53 674
Collateral value	**(52 220)**	(53 707)	(43 701)
Netted potential future exposure	**14 613**	13 036	14 511
Exposure at default	**25 068**	26 938	24 484

FirstRand employs credit derivatives primarily for the purposes of protecting its own positions and for hedging its credit portfolio, as indicated in the following table.

Credit derivatives exposure of FirstRand

	December 2010			
R million	**Credit default swaps**	**Total return swaps**	**Other**	**Total**
Own credit portfolio				
– protection bought	**922**	**–**	**–**	**922**
– protection sold	**2 253**	**–**	**–**	**2 253**
Intermediation activities				
– protection bought	**–**	**–**	**–**	**–**
– protection sold	**–**	**–**	**–**	**–**

	December 2009			
R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	2 129	–	5 170	7 299
– protection sold	135	–	–	135
Intermediation activities				–
– protection bought	–	–	–	–
– protection sold	970	–	–	970

R million	June 2010 Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	2 681	–	3 661	6 342
– protection sold	2 594	–	–	2 594
Intermediation activities				
– protection bought	–	–	–	–
– protection sold	–	–	–	–

11. MARKET RISK IN THE TRADING BOOK

Key developments and focus

Operational improvements to the market risk process, such as hardware and software upgrades have been implemented. These have resulted in increased processing and reporting efficiencies throughout the market risk management domain. The Group is now focusing on updating its market risk stress data set in line with the new regulatory requirements released by the BCBS in July 2009, entitled "Revisions to the Basel II market risk framework". Furthermore, the Group is focusing on further integrating its global operations, specifically the African and Indian operations, into the overall market risk management process.

Introduction and objectives

Market risk exists in all trading, banking and investment portfolios but for the purpose of this report, it is considered as a risk specific to trading portfolios. Substantially all market risk in the Group is taken and managed by RMB. The relevant businesses within RMB function as the centre of expertise with respect to all trading and market risk related activities and seek to take on, manage and contain market risk within guidelines set out as part of the risk appetite.

Non-trading interest rate risk in the banking book is managed by Group Treasury and is disclosed as part of the interest rate in the banking book section of this report.

Organisational structure and governance

In terms of the market risk framework, a subframework of the BPRMF, responsibility for determining the appetite for market risk vests with the Board, which also retains independent oversight of the market risk related activities through the RCC committee and its market and investment risk sub-committee ("MIRC").

Separate governance forums, such as the RMB Proprietary Board, take responsibility for allocating these mandates further whilst deployed and central risk management functions provide independent control and oversight of the overall market risk process.

Assessment and management

Quantification of risk exposures

Market risk exposures are primarily measured and managed using an expected tail loss ("ETL") measure and ETL limits. The ETL measure used by RMB is a liquidity adjusted historical simulation measure assessing the average loss beyond a selected percentile. RMB's ETL is based on a confidence interval of 99% and applicable holding periods. During the year holding periods used in the calculation were increased and are now based on an assessment of distressed liquidity of portfolios. As a consequence, holding periods ranging between 10 to 90 days are used. Historical data sets are chosen to incorporate periods of market stress.

Value at Risk ("VaR") calculations over holding periods of 1 day and 10 days are used as an additional tool in the assessment of market risk. VaR triggers and absolute loss thresholds are used to highlight positions to be reviewed by management.

Risk concentrations in the market risk environment are controlled by means of appropriate ETL sublimits for individual asset classes and the maximum allowable exposure for each business unit. In addition to the general market risk limits described above, limits covering obligor specific risk were introduced and utilisation against these limits is monitored continuously (based on the regulatory building block approach).

Stress testing

Stress testing provides an indication of potential losses that could occur under extreme market conditions. The ETL assessment provides a view of risk exposures under stress conditions.

Additional stress testing, to supplement the ETL assessment, is conducted using historical market downturn scenarios and includes the use of historical, hypothetical and Monte Carlo type simulations. The calibrations of the stress tests are reviewed from time to time to ensure that the results are indicative of possible market moves under distressed market conditions. Stress and scenario analyses are reported to and considered regularly by the individual executive committees and the boards.

Back testing

Back testing is performed in order to verify the predictive ability of the VaR calculations and ensure ongoing appropriateness of the model. The regulatory standard for back testing is to measure daily profits and losses against daily VaR at the 99th percentile. The number of breaches over a period of 250 trading days is calculated, and, should the number exceed that which is considered appropriate, the model will be reassessed for appropriateness.

Regulatory and economic capital for market risk

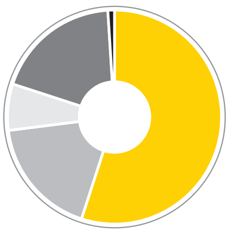
The internal VaR model for general market risk was approved by the regulator for local trading units and is consistent with the methodologies as stipulated under the Basel II framework. For all international legal entities, the standardised approach is used for regulatory market risk capital purposes.

Economic capital for market risk is calculated using liquidity adjusted ETL plus an assessment of specific risk.

Discussion of the trading book market risk profile

The following chart shows the distribution of exposures per asset class across the Group's trading activities at 31 December 2010 based on the ETL methodology.

Composition of ETL exposure of FirstRand



VaR and ETL analysis by risk type

The tables below reflect the VaR over a 10 day holding period and the liquidity adjusted ETL at a 99% confidence level for trading book activities. Results for 31 December reflect that the VaR and ETL utilisations were within risk appetite with the interest rate component of risk being the most dominant over the period under review.

10 day 99% VaR analysis by instrument of FirstRand

	December 2010				Dec 2009	June 2010
R million	Min[1]	Max[1]	Ave	Period end	Period end[2]	Period end
Risk type						
Equities	39.7	97.3	66.7	63.3	314.6	66.4
Interest rates	59.8	106.5	76.6	80.9	249.1	53.3
Foreign exchange	13.9	47.0	21.1	19.6	82.4	9.0
Commodities	7.0	81.5	41.2	76.2	25.5	7.1
Traded credit	–	5.4	2.6	4.9	0.1	0.1
Diversification effect	–	–	–	(134.9)	(158.8)	(52.9)
Diversified total	70.4	156.9	120.1	110.0	512.9	83.0

Distressed ETL analysis by instruments of FirstRand

	December 2010				Dec 2009	June 2010
R million	Min[1]	Max[1]	Ave	Period end	Period end[2]	Period end
Risk type						
Equities	98.4	231.9	152.7	114.4	430.2	160.4
Interest rates	96.3	425.8	262.0	339.3	483.8	119.1
Foreign exchange	28.3	105.2	42.2	40.8	115.8	20.2
Commodities	15.0	126.9	67.6	115.7	38.4	11.1
Traded credit	1.8	8.0	4.5	7.3	1.4	1.6
Diversification effect				(404.7)	(192.6)	(105.4)
Diversified total	149.9	316.7	240.4	212.7	877.0	207.0

Notes:

1. *The maxima and minima VaR and ETL figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table.*
2. *The ETL and VaR measures as at 31 December 2010 and 30 June 2010 are not directly comparable to those reported in December 2009 due to changes in the diversification methodology, as well as the introduction of liquidity adjusted ETL measures and the exclusion of banking book exposures managed by Group Treasury as these are reported under the banking book interest rate risk section. The diversified 90 day ETL measure for the equity investment book subject to market price risk as at 31 December 2010 is R588 million (interest rates: R2.1 million, equities: R518 million, foreign exchange: R239 million).*

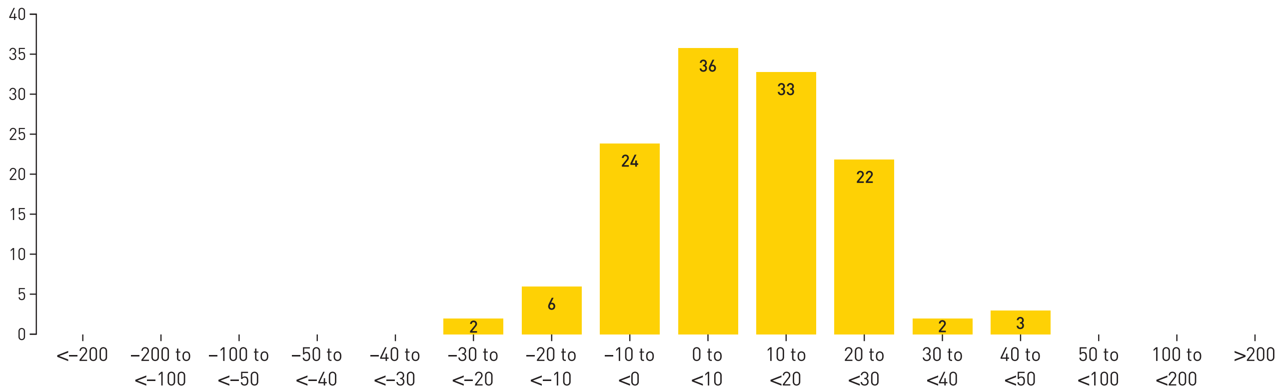
The diversified 1 day 99% VaR as at 31 December 2010 is R46 million (interest rates: R30.8 million, equities: R34.8 million, foreign exchange: R6.9 million, commodities: R21.6 million, traded credit: R0.01 million).

Distribution of daily trading earnings from trading units

The histogram below shows the daily revenue for the trading units for the period under review.

Distribution of daily earnings of FirstRand

(Frequency: days in a period)

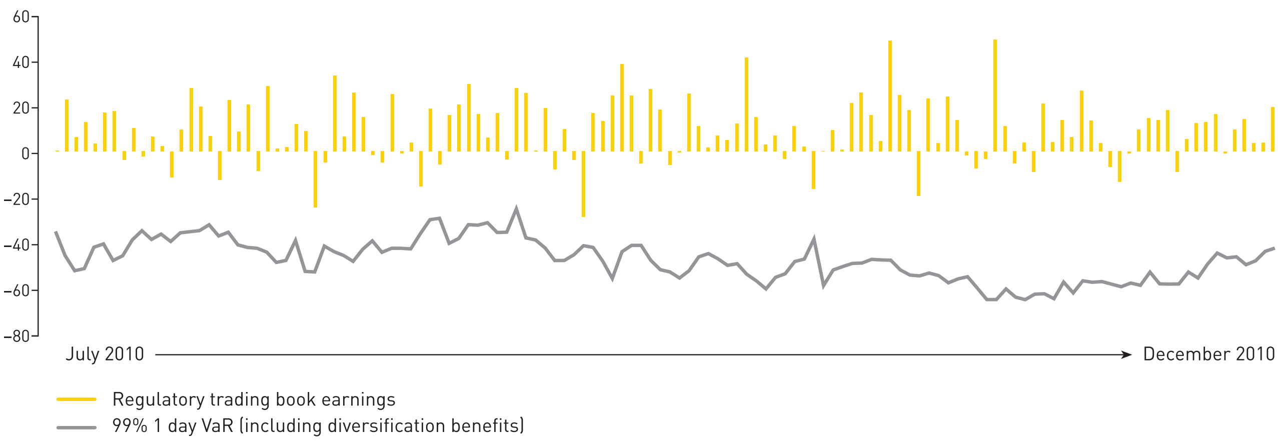


Back testing: daily regulatory trading book earnings and VaR

The Group tracks its daily local earnings profile as illustrated in the chart below. Exposures were contained within risk limits during the trading period and the earnings profile is skewed towards profitability.

Back testing: daily regulatory trading book earnings versus 1 day 99% VaR

(R million)



Over the period under review there were no instances of actual trading losses exceeding the corresponding VaR estimate. This implies that the Group's model provided reasonably accurate quantification of market risk.

FirstRand International

FirstRand Ireland plc ("FRIE") and FirstRand India hold the most material exposure to market risk amongst the international subsidiaries. The same approach is employed for the measurement and management of market risk as in the local portfolio. Market risk exposures in FRIE have decreased substantially predominantly due to derisking coupled with the decision to wind down the operation. During the period under review, market risk was contained within acceptable limits.

FNB Africa subsidiaries

FNB Namibia and FNB Botswana are the only African subsidiaries with notable exposure to market risk. Market risk is measured and managed in line with the Group's market risk framework. During the period under review, market risk was contained within acceptable limits and was effectively managed by the Group across its African subsidiaries.

12. EQUITY INVESTMENT RISK

Key developments and focus

Investment portfolio valuations generally held up well against the backdrop of the macroeconomic growth slowdown and other external pressures. Impairments were raised on selected assets, but overall unrealised profit of the portfolio was still resilient. An enhanced investment risk management framework was developed during the period under review. This framework included refinements on risk appetite quantification, investment valuation as well as stress testing. Focus in the next six months will be to implement all elements of this new enhanced framework.

Introduction and objectives

Portfolio investments in equity instruments are primarily undertaken in RMB, but certain equity investments have been made by WesBank and a small residual portfolio is reported and managed by the Corporate Centre. Positions in unlisted investments in RMB are taken mainly through its Private Equity, Resources and Investment Banking divisions, while listed investments are primarily made through the Equity trading division.

Organisational structure and governance

The responsibility for determining equity investment risk appetite vests with the Board. The following structures have been established in order to assess and manage equity investment risk:

- The Prudential Investment Committee ("Investment committee") chaired by the RMB Chief Investment Officer and its delegated sub-committees are responsible for the approval of all portfolio investment transactions in equity, quasi-equity or quasi-debt instruments.
- Where the structure of the investments also incorporate significant components of senior debt, approval authority will also rest with the respective credit committees and the Board's Large exposures approval committee, as appropriate.
- The RCC committee and MIRC are responsible for the oversight of investment risk measurement and management across the Group.
- The RMB CRO, in consultation with the FirstRand CRO and with support from the deployed and central risk management functions, provides independent oversight and reporting of all investment activities in RMB to the RMB Proprietary Board, as well as MIRC. WesBank's executive management monitors and manages its investments through the financial reporting process.

Assessment and management

Management of exposures

The equity investment risk portfolio 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 under-standing of the target company's business, risks, challenges, competitors, management team and unique advantage or value proposition is developed.

For each transaction, an appropriate structure is put in place which aligns the interests of all parties involved through the use of incentives and constraints for management and the selling party. Where appropriate, the Group seeks to take a number of seats on the company's Board and maintains close oversight through monitoring of the company's operations.

The investment thesis, results of the due diligence process, and investment structure are challenged at the Investment committee before final approval is granted. In addition, normal semi-annual reviews are carried out and crucial parts of these reviews, such as valuation estimates, are independently peer-reviewed.

Recording of exposures – accounting policies

IAS 39 requires equity investments to be classified as:

- financial assets at fair value through profit and loss; or
- available-for-sale financial assets.

The consolidated financial statements include the assets, liabilities and results of operations of all equity investments in which the Group, directly or indirectly, has the power to exercise control over the operations for its own benefit.

Equity investments in associates and joint ventures are included in the consolidated financial statements using the equity accounting method. Associates are entities where the Group holds an equity interest of between 20% and 50%, or over which it has the ability to exercise significant influence, but does not control. Joint ventures are entities in which the Group has joint control over the economic activity of the joint venture through a contractual agreement.

Measurement of risk exposures

Risk exposures are measured as the potential loss under stress conditions. A series of standardised stress tests are used to assess potential losses under current market conditions, adverse market conditions, as well as severe stress/event risk.

The Group targets an investment portfolio profile which is diversified along a number of pertinent dimensions, such as geography, industry, investment stage and vintage (i.e. annual replacements of realisations).

Stress testing

Economic and regulatory capital calculations are complemented with regular stress tests of market values, and underlying drivers of valuation, e.g. company earnings, valuation multiples and assessments of stress resulting from portfolio concentrations.

Regulatory and economic capital

The Basel II simple risk weight (300% or 400%) approach or Standardised approach is used for the quantification of regulatory capital.

For economic capital purposes an approach using market value shocks to the underlying investments is utilised to assess economic capital requirements for unlisted investments after taking any unrealised profits not taken to book into account.

Where price discovery is reliable, the risk of listed equity investments is measured based on a 90-day ETL calculated using RMB's Internal Market Risk Model. The ETL risk measure is supplemented by a measure of the specific (idiosyncratic) risk of the individual securities per specific risk measurement methodology.

Discussion of the risk profile

The listed equity portfolio benefited from the global equity market rally as well as domestic corporate action during the period under review.

The Group continues to rebuild its private equity portfolio after recent large realisations. Some segments of the portfolio have come under pressure given the current macroeconomic environment and impairments were raised in selected instances. Overall unrealised profits for the portfolio remain resilient.

The deal pipeline remains strong with the team working on a number of new opportunities as well as potential realisations of transactions already in the portfolio.

Listed investment exposures of R1 825 million (30 June 2010: R1 376 million) were included in the equity investment risk ETL process. The ETL on these exposure amounted to R695 million at 31 December 2010 (30 June 2010: R575 million). The estimated sensitivity of the remaining investment balances (i.e. those not subject to the equity investment risk ETL process) to a 10% movement in market value is an impact of R943 million on investment fair values.

RMB continues to prudently manage its Dealstream portfolio, but no significant new impairments where necessary. The Dealstream portfolio was taken over in terms of Dealstream's futures clearing agreement and applicable JSE rules when Dealstream, a former clearing client, was placed into default in 2008. RMB continues to hold and manage these exposures as part of its legacy portfolio to realise value over the longer term.

The cumulative gains realised from the sale of positions held in the Group's banking book during the current year amounted to R129 million.

The following table provides information relating to equity investments in the banking book of those entities regulated as banks within the Group.

Investment valuations and associated economic capital requirements

	FirstRand[1]		
	December 2010		
R million	**Publicly quoted investments**	**Privately held**	**Total**
Carrying value disclosed in the balance sheet	**2 237**	**9 792**	**12 029**
Fair value[2]	**2 263**	**12 226**	**14 489**
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement[3]	**296**	**62**	**359**
Latent revaluation gains not recognised in the balance sheet[3]	**26**	**2 434**	**2 460**
Capital requirement	**356**	**1 308**	**1 664**

	FRBH[1]		
	December 2009		
R million	Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	3 306	4 267	7 573
Fair value[2]	3 306	8 080	11 386
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement[3]	929	142	1 071
Latent revaluation gains not recognised in the balance sheet[3]	–	3 813	3 813
Capital requirement	742	973	1 715

1 *Effective 1 July 2010, FirstRand became the regulated bank controlling company. Prior to 1 July 2010, FRBH was the regulated bank controlling company. The December 2010 figures are therefore not comparable to December 2009 and June 2009 figures.*

2 *Fair values of publicly quoted investments were not considered to be materially different from the quoted market prices.*

3 *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*

	June 2010		
R million	Publicly quoted	Privately held	Total
Carrying value disclosed in the balance sheet	2 415	4 106	6 521
Fair value[2]	2 415	6 708	9 123
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement[3]	769	93	862
Latent revaluation gains not recognised in the balance sheet[3]	–	2 602	2 602
Capital requirement	534	1 009	1 543

1 *Effective 1 July 2010, FirstRand became the regulated bank controlling company. Prior to 1 July 2010, FRBH was the regulated bank controlling company. The December 2010 figures are therefore not comparable to December 2009 and June 2009 figures.*

2 *Fair values of publicly quoted investments based on their values in use exceeded the quoted market prices by R72 million.*

3 *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*

13. FOREIGN EXCHANGE AND TRANSLATION RISK IN THE BANKING BOOK

Key developments and focus

As an authorised dealer in foreign exchange, the Group has a restriction on the gross amount of foreign currency holdings and other foreign exposure it may hold, which is capped at 25 per cent of its local liabilities. Furthermore, banking regulations regarding the net open forward position in foreign exchange ("NOFP") limits the net open overnight position to no more than 10 per cent of net qualifying capital. The two aspects (gross macro foreign exposure limit and the NOFP) overlay each other and ensure a complimentary prudential approach to foreign currency risk management. In addition to the regulatory prudential limit on foreign exposure, the Board has set internal limits on FirstRand's total foreign currency exposure, within the regulatory limit and allowing opportunity for expansion and growth. The internal limits and utilisation are continuously monitored and reviewed when necessary.

The Group's NOFP position is also well within the regulatory limits of approximately $500 million. Senior management has also implemented an internal prudential limit, again well below the regulatory limit but large enough to cater for the hedging, settlement and execution positions of the business units. Group Treasury is the clearer of all currency positions in FirstRand and manages foreign currency related risks and is, therefore, tasked with the responsibility for both the prudential limits on foreign exposure and the overnight open positions.

Introduction and objectives

Foreign exchange risk arises from placement, lending and investing activities in a currency other than the presentation currency, foreign currency funding, from facilitating client foreign exchange transactions and from authorised trading and hedging activities in a currency other than the presentation currency. The objective of foreign exchange risk management is to ensure that currency mismatches are managed within the risk appetite for such risk and to ensure that it is overseen and governed in keeping with the risk governance structures.

Translation risk is the risk to the Rand based South African reported earnings brought about by fluctuations in the exchange rate when applied to the value, earnings and assets of foreign operations. Translation risk is, at present, seen as an unavoidable risk consequent of having offshore operations. It is not an actively hedged risk in its own right in terms of Group policy.

Organisational structure and governance

Foreign exchange risk is results from the activities of all the franchises, but management and consolidation of all these positions occur at present in one of two business units. Client flow is consolidated under and managed by RMB FICC. Foreign currency funding, foreign exposure and currency mismatch are consolidated under and managed by Group Treasury.

Market risk, foreign exposure and mismatch limits are approved by the Board and the primary governance body is the RCC committee. Trading risk is overseen by MIRC, a sub-committee of the RCC committee, and mismatch risk is governed through the FirstRand Asset and liability management committee ("ALCO") process and its International ALCO sub-committee. In addition to the committee structures, business units charged with frontline management of the risks have deployed risk managers within their units who assess the risks on an ongoing basis.

Assessment and management

Group Treasury and RMB's FICC manage the mismatch and open positions on a daily basis within limits. Any breaches are reported through the risk management structures and remediation is monitored by both the deployed risk manager and ERM.

Discussion of risk profile

Over the past year no significant foreign exchange positions have been run apart from the translation risk in strategic foreign investments and mismatches have been contained well within regulatory limits at all times. The NOFP internal management limit was recently adjusted upwards to cater for increased (unhedged) currency risk related to foreign investment positions held directly by the Bank and to cater for increased buffers and trading positions for RMB divisions. In addition, the macro foreign exposure of the Group remained far below both regulatory and board limits and there is significant headroom for expansion into foreign assets.

14. FUNDING AND LIQUIDITY RISK

Key developments and focus

During the period under review, a number of additional measures were taken to further protect the Group against negative stress events:

- New Basel rules for liquidity are anticipated to have a significant impact on the bank if implemented in its current state. Implementation of the proposed rules has been postponed until 2015/18 as detailed below.
- Group Treasury have already begun positioning the balance sheet to mitigate against this. Local Regulators have been allowed some discretion under the Basel III proposals. The discretion to be applied by the SARB is still under review.
- Liquidity buffers have been enhanced, both in terms of quantum and nature of the assets in the portfolio, which is now predominantly comprised of government treasury bills, stocks and debentures.
- Emerging effects of proposed new legislation, such as Basel III proposals received attention. The Group has been closely engaged with regulatory authorities both locally and internationally in order to gauge the effect on it and the markets in which it operates. The Basel III proposals for liquidity involve two ratios, the Liquidity Coverage Ratio which will enter an observation period commencing January 2012 with compliance required from January 2015; and the Net Stable Funding Ratio, also observed from January 2012 but only in force from January 2018.
- The international balance sheet has also been carefully managed, with liquidity buffers placed in European Central Bank stocks considered to be safe havens even under stress conditions.
- Liquidity conditions in sub-Saharan subsidiaries remain under close scrutiny.

Overall the Group has not experienced untoward pressure in any of the jurisdictions it operates in during the period under review.

Introduction and objectives

The Group applies a comprehensive definition of liquidity risk and distinguishes two types of liquidity risk:

- funding liquidity risk is the risk that a bank will not be able to effectively meet current and future cash flow and collateral requirements without negatively affecting the normal course of business, financial position or reputation; and
- market liquidity risk is the risk that market disruptions or lack of market liquidity will cause the bank to be unable (or able, but with difficulty) to trade in specific markets without affecting market prices significantly.

The Group's principal liquidity risk management objective is to optimally fund itself under normal and stressed conditions.

Organisational structure and governance

Liquidity risk management is governed by the Liquidity Risk Management Framework ("LRMF"), which provides relevant standards in accordance with regulatory requirements and international best practices. As an ancillary framework to the BPRMF, the LRMF is approved by the Board and sets out consistent and comprehensive guidelines for outlining the standards, principles, policies and procedures to be implemented throughout FirstRand to effectively identify, measure, report and manage liquidity risk.

The Board retains ultimate responsibility for the effective management of liquidity risk. The Board has delegated its responsibility for the assessment and management of this risk to the RCC committee, which in turn delegated this task to FirstRand ALCO. FirstRand ALCO's primary responsibility is the assessment, control and management of both liquidity and interest rate risk for FRB, FNB Africa and international subsidiaries and branches, either directly or indirectly, through providing guidance, management principles and oversight to the ALM functions and ALCOs in these subsidiaries and branches.

FirstRand Bank Limited

Liquidity risk for FRB (RMB, FNB and WesBank) is centrally managed by a dedicated liquidity risk management team in Group Treasury. It is this central function's responsibility to ensure that the liquidity risk management framework is implemented appropriately. ERM provides governance and independent oversight of the central liquidity management team's approaches, models and practices.

The Group's liquidity position, exposures and auxiliary information are reported bimonthly to the Funding executive committee. In addition, management aspects of the liquidity position are reported to and debated by Group Treasury. The liquidity risk management and risk control teams in Group Treasury and ERM also provide regular reports to FirstRand

ALCO, which is the designated governance and risk management forum for liquidity risk.

FNB Africa

Individual ALCOs have been established in each of the FNB African businesses that manage liquidity risk on a decentralised basis in line with the principles under delegated mandates from the respective boards. Reports from these committees are presented to FirstRand ALCO on a regular basis and the management and control of liquidity risk in the subsidiaries follow the guidance and principles that have been set out and approved by FirstRand ALCO.

International subsidiaries

Similarly, liquidity risk for international subsidiaries is managed on a decentralised basis in line with the Group's LRMF. Each international subsidiary and branch reports into International ALCO, which is a sub-committee of FirstRand ALCO and meets on quarterly basis to review and discuss region specific issues and challenges for liquidity and interest rate risk.

Dispensation was granted by the Financial Services Authority ("FSA") for a waiver on a "Wholefirm Liquidity Modification application" basis where the FSA considers local risk reporting and compliance of the parent bank sufficient to waive FSA requirements for the London branch.

Assessment and management

As indicated in the preceding section, liquidity risk for FRB is managed centrally by a team in Group Treasury. The Group explicitly acknowledges liquidity risk as a consequential risk that may be caused by other risks as demonstrated by the reduction in liquidity in many international markets as a consequence of the recent credit crisis. The Group is, therefore, focused on continuously monitoring and analysing the potential impact of other risks and events on the funding and liquidity position of the organisation.

Measurement and assessment

The following are the primary tools and techniques employed for the assessment of liquidity risk:

Liquidity mismatch analyses

The purpose of these analyses is to anticipate the mismatch between payment profiles of balance sheet items under normal, stressed and contractual conditions. Three forecasting models for this purpose have been developed:

- *Business as usual model:* Forecasting the liquidity situation on an ongoing basis. This model provides an estimate of the funds required to be raise under routine circumstances, taking into account behavioural assumptions around the optionality inherent in some products.
- *Contractual maturity model:* This model provides a forecast of the liquidity position based on the assumption that assets and liabilities will be liquidated at the contracted date.
- *Stress test and event model:* This model provides forecasts of the potential outflow of liquidity under extraordinary circumstances such as times of economic stress or event related adverse impacts on the Group's reputation.

For each of these categories, multiple key risk indicators are defined that highlight potential risks within defined thresholds that distinguish two levels of severity for each indicator. Monitored on a daily and monthly basis, the key risk indicators may trigger immediate action where required. Their current status and relevant trends are reported to the FirstRand ALCO and RCC committee on a monthly and a quarterly basis, respectively.

Stress testing and scenario analysis

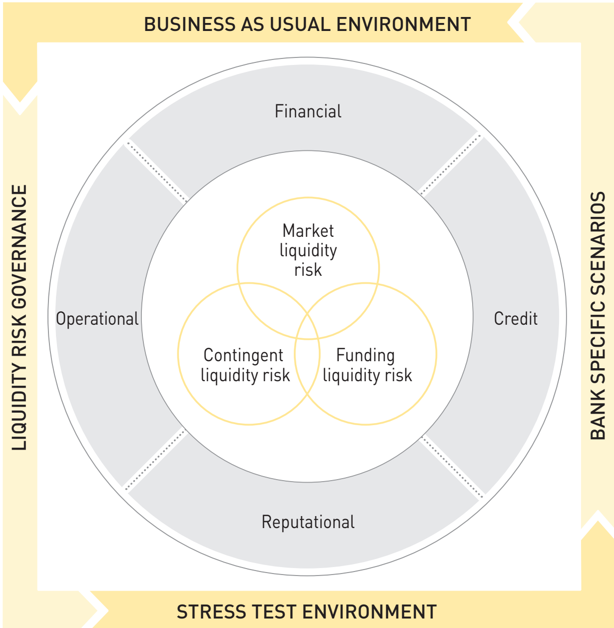
Regular and rigorous stress tests are conducted on the funding profile and liquidity position as part of the overall stress testing framework with a focus on:

- quantifying the potential exposure to future liquidity stresses;
- analysing the possible impact of economic and event risks on cash flows, liquidity, profitability and solvency position; and
- proactively evaluating the potential secondary and tertiary effects of other risks on the Group.

Effective liquidity risk management

Effective liquidity risk management begins with the establishment of a comprehensive and strong internal governance process for identifying, measuring and controlling liquidity risk exposure. The liquidity risk management infrastructure naturally considers business as usual, bank specific scenarios and stress test environments. The liquidity risk management process considers not only market and funding risks, but how risks are interconnected and can "compound" in ways that create elevated levels of risk and potential exposure. Measures of liquidity risk must be based on both structural condition and prospective cash flow measures.

Liquidity risk governance



The approach to liquidity risk management distinguishes between structural, daily and contingency liquidity risk, and various approaches are employed in the assessment and management of these on a daily, weekly and monthly basis as illustrated in the chart below.

Aspects of liquidity risk management

MANAGEMENT OF LIQUIDITY RISK		
Structural LRM	**Daily LRM**	**Contingency LRM**
The risk that structural, long term on and off balance sheet exposures cannot be funded timeously or at reasonable cost.	Ensuring that intraday and day-to-day anticipated and unforeseen payment obligations can be met by maintaining a sustainable balance between liquidity inflows and outflows.	Maintaining a number of contingency funding sources to draw upon in times of economic stress.
• liquidity risk tolerance; • liquidity strategy; • ensuring substantial diversification over different funding sources; • assessing the impact of future funding and liquidity needs taking into account expected liquidity shortfalls or excesses; • setting the approach to managing liquidity in different currencies and from one country to another; • ensuring adequate liquidity ratios; • ensuring an adequate structural liquidity gap; and • maintaining a funds transfer pricing methodology and processes.	• managing intraday liquidity positions; • managing the daily payment queue; • monitoring the net funding requirements; • forecasting cash flows; • perform short term cash flow analysis for all currencies individually and in aggregate; • management of intragroup liquidity; • managing Central Bank clearing; • managing the net daily cash positions; • managing and maintaining market access; and • managing and maintaining collateral.	• managing early warning and key risk indicators; • performing stress testing including sensitivity analysis and scenario testing; • maintaining the product behaviour and optionality assumptions; • ensuring that an adequate and diversified portfolio of liquid assets and buffers are in place; and • maintaining the contingency funding plan.

Liquidity contingency funding planning

The formal contingency funding plan sets out policies and procedures as a blueprint for handling a potential liquidity crisis. Addressing both temporary and long range liquidity disruptions, it is a comprehensive framework that is tightly integrated with ongoing analyses, stress tests, key risk indicators and early warning systems, as described above. It is reviewed, updated and debated on a regular basis and structured to provide for reliable but flexible administrative structures, realistic action plans and ongoing communication with key external stakeholders and across all levels of the Group.

Liquidity risk management cycle

These management activities are part of the liquidity risk management cycle, which is illustrated in the chart below.

The target liquidity risk profile is determined by the risk appetite framework. It is compared to the current risk profile as set out in the LRMF and evaluated under a range of scenarios and business conditions, including economic and event stresses. These analyses in turn inform the size of liquidity buffers held in excess of statutory requirements. Liquidity buffers are actively managed, high quality, highly liquid assets that are available as protection against unexpected events or market disruptions.

As an outcome of these analyses, the current funding profile is adjusted through a range of short, medium and long-term actions to ensure that the Group remains within its chosen risk profile. The cost of these actions is then transferred to the business units through the internal matched maturity funds transfer pricing mechanism. It should be noted in this context that financial transactions using special purpose vehicles are treated as part of the balance sheet and are considered in the liquidity risk management cycle and thus managed consistently and conservatively across the Group.

Regulatory developments

The recent global financial crisis is expected to result in increased political and regulatory pressure on banking systems worldwide. Some of these pressures are likely to materialise in South Africa, particularly given its G20 membership. For example, the SARB is expected to implement the BCBS proposals on capital and liquidity (the so-called "Basel III" proposals).

Discussion of the risk profile

Contractual discounted cash flow analysis

The following table represents the contractual discounted cash flows of assets, liabilities and equity for the Group. Relying solely on the contractual liquidity mismatch when assessing a bank's maturity analysis would overstate risk, since this represents an absolute worst case assessment of cash flows at maturity.

Due to South Africa's structural liquidity position, banks tend to have a particularly pronounced negative (contractual) gap in the shorter term as more short-term obligations than short-term assets tend to mature.

In addition, therefore, to the analysis shown in the table above, the Group carries out an adjusted liquidity mismatch analysis, which estimates the size of the asset and liability mismatch under normal business conditions. This analysis is also used as a framework to manage this mismatch on an ongoing basis.

Contractual discounted cash flow analysis for FirstRand

	FirstRand[1]			
	December 2010			
		Term to maturity		
R million	**Carrying amount**	**Call – 3 months**	**3 – 12 months**	**>12 months**
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	**695 809**	**255 649**	**58 672**	**381 488**
Total equity and liabilities	**695 809**	**466 041**	**82 253**	**147 515**
Net liquidity gap	**–**	**(210 392)**	**(23 581)**	**233 973**
Cumulative liquidity gap	**–**	**(210 392)**	**(233 973)**	**–**

	FRBH[1]			
	December 2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	>12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	620 788	233 115	60 528	327 145
Total equity and liabilities	620 788	421 336	86 915	112 537
Net liquidity gap	–	(188 221)	(26 387)	214 608
Cumulative liquidity gap	–	(188 221)	(214 608)	–

	FRBH[1]			
	June 2010			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	>12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	638 818	223 439	67 789	347 590
Total equity and liabilities	638 818	419 094	93 687	126 037
Net liquidity gap	–	(195 655)	(25 898)	221 553
Cumulative liquidity gap	–	(195 655)	(221 553)	–

1 Effective 1 July 2010, FirstRand became the regulated bank controlling company. Prior to 1 July 2010, FRBH was the regulated bank controlling company. The December 2010 FirstRand figures are not comparable to the December 2009 and June 2010 FRBH figures.

Contractual discounted cash flow analysis for FRB

	December 2010			
		Term to maturity		
R million	**Carrying amount**	**Call – 3 months**	**3 – 12 months**	**>12 months**
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	**623 183**	**234 851**	**54 200**	**334 133**
Total equity and liabilities	**623 183**	**430 094**	**73 642**	**119 448**
Net liquidity gap	**–**	**(195 243)**	**(19 442)**	**214 685**
Cumulative liquidity gap	**–**	**(195 243)**	**(214 685)**	**–**

	December 2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	>12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	553 556	201 240	52 925	299 391
Total equity and liabilities	553 556	379 723	87 604	86 229
Net liquidity gap	–	(178 483)	(34 679)	213 162
Cumulative liquidity gap	–	(178 483)	(213 162)	–

	June 2010			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	>12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	576 386	196 980	65 642	313 764
Total equity and liabilities	576 386	385 394	88 673	102 319
Net liquidity gap	–	(188 414)	(23 031)	211 445
Cumulative liquidity gap	–	(188 414)	(211 445)	–

As illustrated in the table above the negative contractual liquidity short-term gap has deteriorated slightly in the short end on a cumulative basis during the period under review due to muted asset growth in the banking sector. Management continue to focus on building up stress funding buffers both locally and offshore and growing stable and long-term funding.

15. INTEREST RATE RISK IN THE BANKING BOOK

Key developments and focus

FirstRand manages interest rate risk arising out of the banking book (defined as the assets and liabilities where interest income and expense is recognised on an accrual basis) on an active basis. Term assets and liabilities are hedged out in the derivative market and consequently the primary risk remains that of the "endowment" effect on low and non-earning net liabilities. The effect gives rise to risk of lower margins during rate decline cycles. If left unhedged, asset earning rates decline and liabilities do not move down by an equivalent amount as they are already either at or close to zero rate (e.g. Capital).

Hedging of the endowment effect is performed in a number of ways:

- Structural alignment of the balance sheet (e.g. fixed rate assets provide some protection, i.e. natural hedging).
- Derivative instruments hedging (receive fixed – pay float interest rate swaps also achieves protection against downward rate cycles).
- Income protection is also managed holistically. The interest rate cycle and the credit cycle are to some extent countercyclical from an earning perspective, albeit subject to leads and lags. The two cycles are managed together as a further natural hedge of the cycle. This is particularly appropriate where market conditions limit the extent to which derivative hedges may be performed economically.

The interest rate cycle can be difficult to predict at times. This is further exacerbated by the market view mirroring the Group view. Due to the lack of secondary and derivative markets, sub-Saharan African subsidiaries' interest rate risk is managed predominantly using balance sheet structure.

Introduction and objectives

This risk is identified and categorised in the following components:

- interest rate repricing risk arises from the differences in timing between repricing of assets, liabilities and off-balance sheet positions;
- yield curve risk arises when unanticipated changes in the shape of the yield curve adversely affects the income or underlying economic value;
- basis risk arises from an imperfect correlation in the adjustment of the rates earned and paid on different instruments with similar repricing characteristics; and
- optionality is the right, but not the obligation, of the holder to alter the cash flow of the underlying position, which may adversely affect the Group's position as the counter-party to such a transaction.

The assumption and management of interest rate risk can be an important source of profitability and shareholder value, but excessive interest rate risk positions may pose a significant threat to the Group's earnings and capital base. Effective interest rate risk management practices that contain the interest rate risk exposure within prudent levels, as stipulated by the risk appetite, are essential to the safety and soundness of the enterprise. To this end, various board and internal limits exist which limit both current and long-term risk taken. Where practical, the internal measures also include fair value limits of the banking book instruments that can be fair valued.

The objective of interest rate risk management is, therefore, to protect the financial position and earnings level from potential adverse effects arising from exposure to various components of interest rate risk as described above.

Organisational structure and governance

The control and management of interest rate risk is governed by the Framework for the Management of IRRBB, which is an ancillary framework to the BPRMF. Due to regulatory requirements and the structure of the Group, different management approaches, reports and lines of responsibility exist across the various parts of the Group, as discussed below.

All IRRBB related activities are overseen and reported to the through FirstRand ALCO, a sub-committee of the RCC committee, as illustrated in the governance structure on page 11. The FirstRand ALCO is also responsible for the allocation of sublimits on the basis of mandates given by the RCC committee and it approves proposed remedial action for any limit breaches, as appropriate.

Whilst the margin and performance management aspects of interest rate risk management fall within the purview of the respective businesses and the central Group Treasury function, ERM provides central oversight and control across the activities of the deployed risk management functions and Group Treasury.

Interest rate risk, unlike credit risk, can only be sensibly assessed and managed at an aggregate level. The net interest rate risk profile of the domestic banking book (i.e. FRB, excluding RMB) is centrally managed by BSM and Group Treasury.

RMB has a delegated mandate from FirstRand ALCO for the management of its interest rate risk (under the market risk framework) as well as for ensuring that the limits of the Group's risk appetite are observed. Interest rate risk management of both Group Treasury and RMB is overseen and controlled by a team in the central ERM function.

Individual ALCOs exist in each of the FNB Africa subsidiaries for the purpose of interest rate risk monitoring and management. Relevant reports are submitted by the subsidiaries to FirstRand ALCO on a monthly basis. International subsidiaries and branches are overseen by the International ALCO, a sub-committee of FirstRand ALCO, which provides central oversight and monitoring reflective of each region's specific issues and requirements.

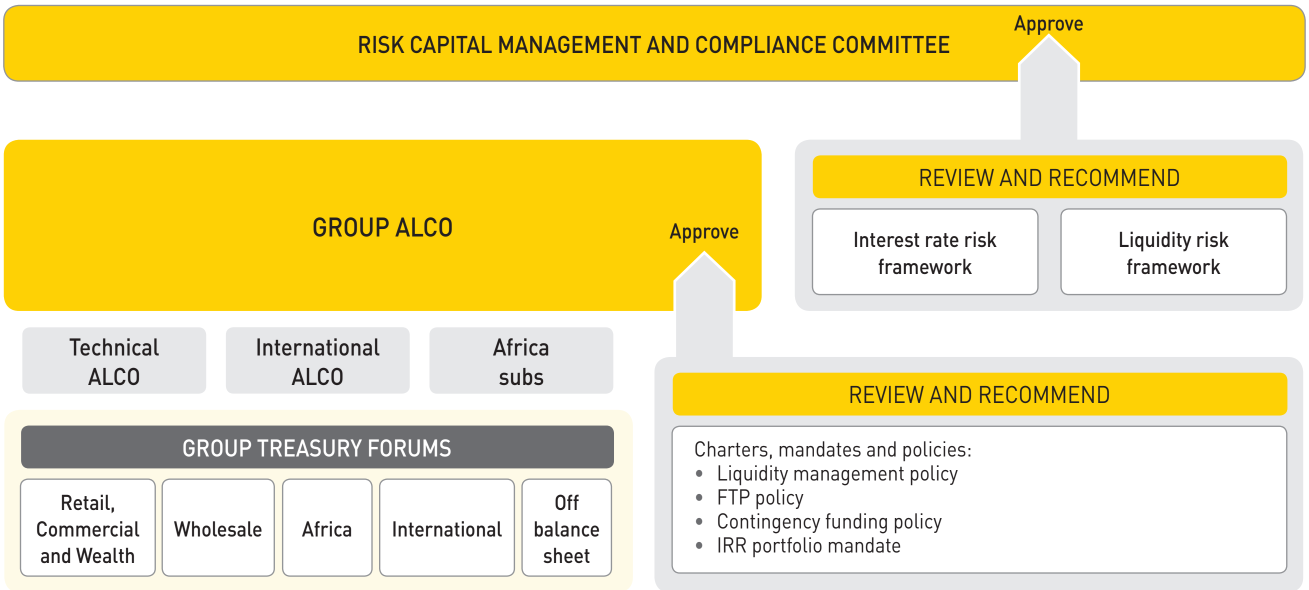
Assessment and management

A number of measurement techniques to quantify interest rate risk as defined above, are employed focusing both on the potential risk earnings as well as the potential impact on overall economic value.

In line with industry practice the pertinent analysis includes parallel rate shocks, yield curve twists, complex stress tests and static repricing gap analysis. Results from these analyses are reported to FirstRand ALCO for review on a monthly basis. Additionally, daily mark-to-market positions of the main risk portfolios are monitored daily and all risk measures are managed within defined risk appetite levels.

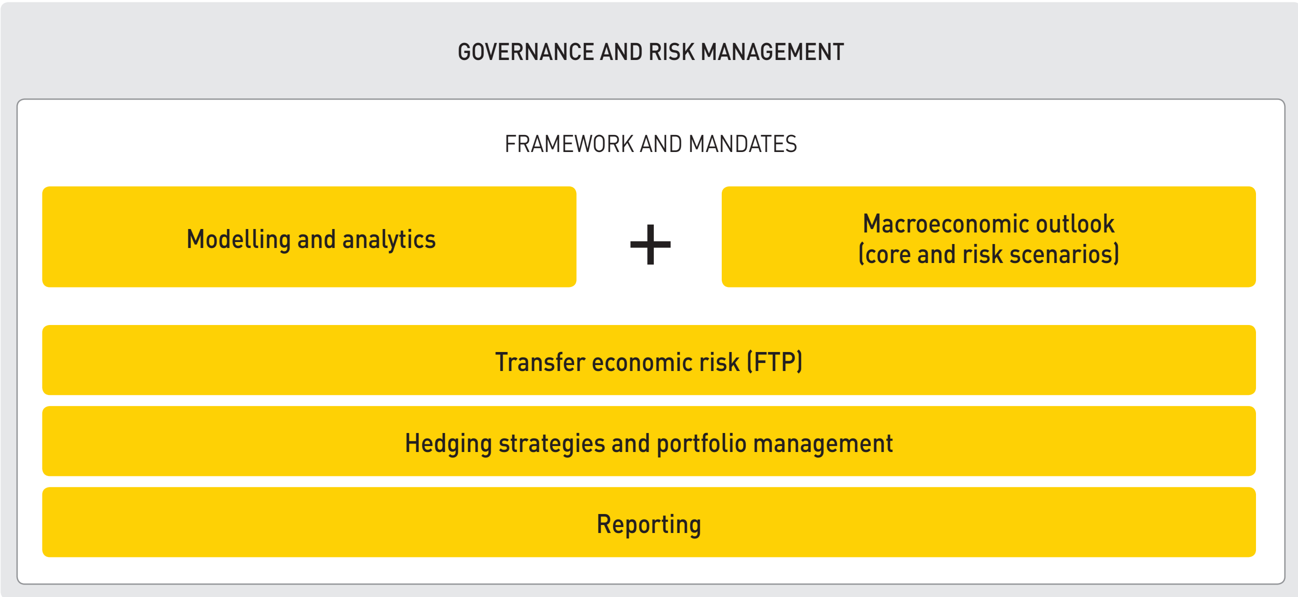
The management and governance of interest rate risk is delegated by the Board to RCC committee, which in turn delegates the responsibility to ALCO, Group Treasury, RMB and the regional ALCOs as illustrated in the following chart.

Interest rate risk management and governance structure



The Group's activities around the management and assessment of interest rate risk are summarised in the following chart.

Interest rate risk management and assessment



The risk profile is adjusted by changing the composition of the Group's liquid asset portfolio or through derivative transactions where possible based on the interest rate outlook as well as its view on potential other risk factors that may impact its balance sheet. In this respect, it is important to highlight that interest rate risk can, in the Group's view, only be effectively managed if it is understood in the context of other risks and how the interaction may adversely impact its financial position and, ultimately, its interest rate risk profile.

In addition to measuring and hedging risk at an aggregate (net position) level, individual, large and complex transactions may be hedged at a micro level where appropriate. Management of the interest rate risk profile is carried out within the limits approved by the ALCOs. The Investment committee oversees these activities for the domestic banking operations, challenges and debates the macroeconomic view and proposed portfolio actions as well as existing and proposed management strategies from a business perspective.

As indicated in the section covering liquidity risk, the costs of the portfolio level risk management actions are transferred through the internal funds transfer pricing mechanisms and contribute to a suitable measurement of risk adjusted performance across the various businesses.

Cash flow hedge accounting is applied for derivatives used in the hedging strategies for the banking book. Where hedges do not qualify for this treatment, mismatches may arise due to timing differences in the recognition of income from the fair valued hedges and the underlying exposures, which would be accounted for on an accrual basis.

Assumptions relating to loan repayments and behaviour of core deposits

Modelling assumptions are made that affect both the determination of interest rate risk incurred in the banking book and the hedging activity that takes place in mitigation of the exposures. These include:

- all banking book assets, liabilities and derivative instruments are placed in gap intervals based on their repricing characteristics;
- instruments which have no explicit contractual repricing or maturity dates are placed in gap intervals according to management's judgement and analysis, based on the most likely repricing behaviour;
- new volume points are assigned to balances as and when they mature in order to maintain balance sheet size and mix;
- derivatives hedges that mature are not replaced;
- presettlement expectations are factored into the volume and term of hedges for fixed rate lending activities; and
- interest rate risk modelling extends over a 5 year time horizon, of which the first 12 month period is disclosed. Similarly, several interest rate shocks and scenarios are modelled, with disclosure of the sensitivity to a 200 basis point parallel shift in the yield curve (and assuming no new management action to mitigate the impact).

Assumptions are made with respect to the repricing characteristics of instruments that have no explicit contractual repricing or maturity dates:

- non maturity deposits and transmission account balances ("NMD's") do not have specific maturities as individual depositors can freely withdraw or place funds. Interest rates associated with these products are administered by the bank, but are not indexed to market rates. NMD's are assumed to reprice overnight since the administered rate can change at any time at the bank's discretion; and
- prime linked products are assumed to reprice immediately whenever the Repo rate changes.

Discussion of the risk profile

The natural position of the banking book is asset sensitive, since interest earning assets tend to reprice faster than interest paying liabilities in response to interest rate changes. This results in a natural exposure of net interest income ("NII") to declining interest rates, which represents the largest component of interest rate risk. The Group seeks to use hedges against this exposure, wherever economically feasible. These hedges tend to be predominantly interest rate swaps (receive fixed, pay floating).

The change to the interest rate gap shown in the tables below can be ascribed to this maturing profile of the hedges compared to the period six months ago. The hedges were primarily put in place prior to the commencement of the 2010 financial year.

Repricing schedules for FirstRand banking book

	December 2010				
	Term to repricing				
R million	<3 months	>3 but ≤6 months	>6 but ≤12 months	>12 months	Non rate sensitive
FirstRand Bank Limited					
Net repricing gap	26 398	(13 065)	(7 646)	9 968	(15 656)
Cumulative repricing gap	26 398	13 333	5 687	15 656	–
African subsidiaries					
Net repricing gap	5 506	(869)	(708)	567	(4 496)
Cumulative repricing gap	5 506	4 638	3 930	4 496	–
Total cumulative repricing gap	**31 904**	**17 971**	**9 617**	**20 152**	**–**

	December 2009				
	Term to repricing				
R million	<3 months	>3 but ≤6 months	>6 but ≤12 months	>12 months	Non rate sensitive
FirstRand Bank Limited					
Net repricing gap	12 967	(12 731)	10 433	6 297	(16 966)
Cumulative repricing gap	12 967	236	10 668	16 965	–
African subsidiaries					
Net repricing gap	4 979	(1 044)	(1 121)	822	(3 637)
Cumulative repricing gap	4 979	3 935	2 814	3 637	–
Total cumulative repricing gap	17 946	4 171	13 482	20 602	–

	June 2010				
	Term to repricing				
R million	<3 months	>3 but ≤6 months	>6 but ≤12 months	>12 months	Non rate sensitive
FirstRand Bank Limited					
Net repricing gap	(14 385)	11 987	15 999	2 085	(15 686)
Cumulative repricing gap	(14 385)	(2 398)	13 601	15 686	–
African subsidiaries					
Net repricing gap	5 608	(960)	(1 141)	693	(4 200)
Cumulative repricing gap	5 608	4 648	3 507	4 200	–
Total cumulative repricing gap	(8 777)	2 250	17 108	19 886	–

This repricing gap analysis excludes the banking books of RMB and the international balance sheet, both of which are separately managed on an ETL and VaR basis.

Sensitivity analysis

NII sensitivity decreased by R121 million compared to the previous period. The sensitivity is subject to approved internal board limits. Utilisation of the risk limit was well within permitted exposures at the end of the period and during the period under review. Assuming no management action in response to interest rate movements, a hypothetical immediate and sustained parallel decrease of 200 basis points in all interest rates would result in a reduction in projected 12 month NII of R1 142 million. A similar increase would result in an increase in projected 12 month net interest income of R1 211 million.

Sensitivity of FirstRand projected NII

	December 2010		
	Change in projected 12 month NII		
R million	**FRB**	**African subsidiaries**	**FirstRand[1]**
Downward 200 bps	**(1 004)**	**(138)**	**(1 142)**
Upward 200 bps	**1 073**	**138**	**1 211**

	December 2009		
	Change in projected 12 month NII		
R million	FRB	African subsidiaries	FRBH[1]
Downward 200 bps	(1 155)	(108)	(1 263)
Upward 200 bps	1 171	108	1 279

	June 2010		
	Change in projected 12 month NII		
R million	FRB	African subsidiaries	FRBH[1]
Downward 200 bps	(789)	(124)	(913)
Upward 200 bps	798	124	922

1 Effective 1 July 2010, FirstRand became the regulated bank controlling company. Prior to 1 July 2010, FRBH was the regulated bank controlling company. The December 2010 FirstRand figures are not comparable to the December 2009 and June 2010 FRBH figures.

The NII sensitivity analysis excludes the banking books of RMB and the international balance sheet, both of which are managed separately on a fair value basis.

16. OPERATIONAL RISK

Key developments and focus

FirstRand applies the Advanced Measurement Approach for operational risk under the Basel II framework for the Group's domestic operations. Offshore subsidiaries and operations utilise the Standardised Approach for operational risk. Effective 1 July 2010, FirstRand replaced FRBH as the regulated bank controlling company. For operational risk capital calculation purposes all previous unregulated domestic and offshore entities now part of FRIHL utilise the Basic Indicator Approach.

During the period under review management's focus on improving process efficiencies and lowering operational losses contributed to lower operational losses compared to the previous period. The risk relating to external criminal fraud remains high. Specialist fraud combating units continue to focus on reducing the risk of fraud related losses. The Group's control environment continues to receive heightened attention through a business process review project.

During the period under review all operational risk frameworks, policies and methodologies were reviewed, standardised and updated in line with the business environment.

Introduction and objectives

The Group has approval from the SARB to apply the AMA for operational risk on a partial use basis from 1 January 2009. This achievement highlights the sound operational risk governance practices across the Group's operations, which are aimed at ensuring the proper identification of all operational risks, mitigation where appropriate and management as part of the business operations.

Unlike other major risk types, operational risk is not assumed deliberately in pursuit of a commensurate return. It exists, to a varying degree, in all organisational activities. Major sources of this risk include:

- fraud;
- recruitment, training and retention of talent;
- operational process reliability;
- information technology and security;
- outsourcing of operations;
- dependence on key suppliers;
- implementation of strategic change;
- integration of acquisitions;
- human error;
- customer service quality; and
- regulatory compliance.

Organisational structure and governance

Operational risk is managed on the basis of the policies, standards, approaches and procedures set out in the Operational Risk Management Framework ("ORMF"), a subframework of the BPRMF, which is a policy of both the Board and Executive committee.

The FirstRand Board has delegated its responsibility for the adequate identification and management of operational risk to the RCC committee which in turn delegated this task to the Operational risk committee ("ORC"), a sub-committee of the RCC committee. The ORC provides governance, supervision, oversight, and coordination of relevant risk processes as set out in the framework. To ensure appropriate visibility at board level, the ORC includes two non-executive committee members, one of which is a member of the FirstRand Board. Other members include the divisional heads of risk, divisional heads of operational risk and senior personnel of the central ERM function.

As is the case with other risk types, ERM provides independent supervision over the business implementation of the respective frameworks and policies. Apart from operational risk governance, these teams also oversee business continuity, legal risk, information risk services, and forensic services as these are integral to the operational risk management process.

Assessment and management

Operational risk assessment approaches and tools

In line with international best practice, a variety of tools and approaches and management of operational risk is employed. The most pertinent of these are illustrated in the chart below.

Operational risk tools and approaches

OPERATIONAL RISK TOOLS AND APPROACHES		
Risk control self assessments	**Key risk indicators ("KRI")**	**Audit findings**
• Integrated in the business and risk management processes. • Assist risk managers in identifying key risk areas and assess the effectiveness of existing controls. • Other risk self assessments include business continuity self assessments, risk effectiveness reports for IT ("RERIT") and physical security self assessments.	• In place across all businesses as an early warning measure. • Highlight areas of increasing potential exposure to operational risk. • KRI reports are included in regular management reports to support ongoing risk identification and mitigation by the business.	• GIA acts as the third line of risk controls across the organisation. • Verify whether controls in place are appropriate to mitigating risks associated with key and supporting processes. • The number of findings issued and audit findings not resolved before the due date are tracked, monitored and reported on through the risk committee structures.
Internal loss data	**External loss data**	**Incident and issue reporting**
Loss data reporting and analyses are used by risk managers to understand: • the root causes of loss incidents; and • where corrective action should be taken to mitigate losses.	External loss data bases are used to: • derive lessons from other organisations and loss events; and • inform quantitative operational risk assessments through risk scenario analyses.	A a well defined and embedded process for the reporting of incidents and potential issues is in place to: • ensure that operational risk losses can be managed and potentially mitigated; and • facilitate a feedback of any lessons learned into the organisation's operational risk management practices.

Operational risk is recognised as a consequential risk that cannot be avoided or mitigated entirely. Accordingly, frequent operational risk events resulting in small losses are expected as part of business operations (e.g. fraud) and are budgeted for appropriately. The businesses seek to minimise these through continuously monitoring and improving relevant business and control practices and processes. Operational risk events resulting in substantial losses occur much less frequently and the Group seeks to minimise the incidence and contain the severity within its risk appetite limits.

Basel II – Advanced Measurement Approach

As is the case for other risk types, regulatory and economic capital requirements are established to provide a buffer against very rare and severe loss events. FirstRand began applying the AMA under the Basel II framework from 1 January 2009 for the Group's domestic operations. Offshore subsidiaries and operations continue to utilise the Standardised Approach for operational risk, as was the case for all domestic operations until the end of 2008. All previous unregulated entities now part of FRIHL utilise the Basic Indicator Approach.

The AMA allows the Group to use a sophisticated, statistical model for the calculation of capital requirements, which enables more granular and more accurate, risk based estimates of the capital requirements of all the business lines. A number of operational risk scenarios (covering key risks that, although low in probability, may result in severe losses) and internal loss data are the inputs into this model. Scenarios were derived through an extensive analysis of the Group's operational risks in consultation with business and risk experts from the respective business lines. All scenarios were subsequently cross referenced to external loss data, internal losses, the control environment and other pertinent information about relevant risk exposures. To ensure the ongoing accuracy of the capital assessment, all scenarios are reviewed, supplemented or updated semi annually, as appropriate.

The modelled operational risk scenarios are combined with modelled loss data in a simulation engine to derive the annual, aggregate distribution of potential operational risk losses. Regulatory capital requirements are then calculated (for the Group and each franchise) as the potential loss at the 99.9th percentile of the aggregate loss distribution, excluding the effects of insurance, expected loss and potential diversification effects.

Using the AMA capital model, capital requirements are calculated for each franchise on a FirstRand level. In order to then allocate capital to FRB the gross income ratio of FRB to FirstRand is calculated. This income ratio is then applied to FirstRand capital to split FRB specific capital requirements out of the originally calculated Group capital. This split of capital between legal entities is required for regulatory reporting and internal performance measurement.

The loss data used for this purpose is collected for all seven Basel II event types across various internal business lines. Data collection is the responsibility of the respective business units and is overseen by the central risk control function.

Business practices evolve continuously and the operational risk control environment is therefore constantly changing as a reflection of the underlying risk profile. The assessment of the operational risk profile and associated capital requirements takes the following into account:

- changes in the risk profile, as measured by various risk measurement tools;
- material effects of expansion into new markets, new or substantially changed activities as well as the closure of existing operations;
- changes in the control environment – the organisation targets a continuous improvement in the control environment, but deterioration is also possible due to, for example, unforeseen increases in transaction volumes; and
- changes in the external environment, which drives certain types of operational risk.

Management processes

As indicated in a preceding section, the ERM function also oversees a number of areas closely related to or integrated with the operational risk management processes. These are described in the following subsections.

Business continuity management

Business continuity management ("BCM") is focused on ensuring that the Group's operations are resilient to the risk of severe disruptions caused by internal failures or external events. The organisation carries out regular reviews of BCM practices, and any disruptions or incidents are regularly reported to a number of relevant risk committees. Over the reporting period, all areas remained at an acceptable status of readiness.

Legal risk

The organisation is counterparty to a large number of contractual agreements and is, therefore, at risk of loss due to deficient contractual arrangements, due to legal liability (civil and criminal) that may be incurred by its inability to enforce its rights or by its failure to address and remedy concerns about proposed changes in applicable law (existing law is covered by compliance risk, managed by RRM).

This risk is managed on the basis of the Legal Risk Management Framework, which prescribes activities such as the monitoring of new legislation, creation of awareness, identification of significant legal risk, as well as the monitoring and managing of the potential impact of these risks. The organisation strives to maintain appropriate procedures, processes and policies that enable it to comply with applicable regulation and that minimise any potential exposure to legal risk. During the year under review there were no significant incidents related to legal risk.

Information risk

The Group's clients entrust it with highly sensitive information and the Group accepts its fiduciary duty to safeguard this information in the course of its business activities. Information risk is the risk of adverse business impacts, including the loss of reputation caused by a failure of data confidentiality, integrity and availability controls and is therefore a key area of ongoing focus.

The organisation's Information Technology Governance and Information Security Framework ("IT framework") is a customisation of ISACA's Control Objectives for Information and related Technology ("COBIT®") framework and the Information Security Forum's Standard of Good Practice for the Group. The IT framework is approved by the Technology and Information Management Risk committee, a sub-committee of the ORC and applies to all operations within FirstRand.

The IT framework clearly defines the objectives for managing information risk, outlines the processes that need to be embedded, managed and monitored across the organisation and it also sets out a measurement framework for information risk across FirstRand.

The Information risk team in ERM is tasked with ensuring compliance to the principles set out in the IT framework by developing appropriate policies and validating the implementation in the respective functions across the Group.

Like many other large organisations, a number of new and changing threats across the evolving IT landscape are constantly faced. The risk monitoring and management structures are designed to enable it to adapt and evolve its risk management strategy with the continuously changing IT environment.

Fraud and security risks

The Group is committed to creating an environment that safeguards its customers, staff and assets through policies, frameworks and actions. To this end, it distributes and communicates its ethics policy to existing staff members on a quarterly basis. The ethics policy reiterates commitment to a stance of 'zero tolerance' towards crime. Executive management throughout the Group is committed to living the values of "zero tolerance" and enforcing them stringently.

The organisation utilises a deployed fraud risk management model that requires businesses to institute processes and controls specific and appropriate to its operations within the constraints of a consistent governance framework that is overseen centrally by ERM.

17. REGULATORY RISK

Key developments and focus

Apart from developments internationally, the local regulatory landscape has, once again, proved to be dynamic with many changes and enhancements being proposed. These emanate, in the main, from international standard setting bodies responding to the lessons learned from the global financial and economic crisis. South African banking regulation, as an example, is based on international standards and best practice and is constantly being enhanced in line with the BCBS's reform programme and its ongoing work to strengthen the resilience of banks and the global banking system. FirstRand is supportive of these objectives and endorses improvements in risk management and governance practices as an active participant in the new regulatory landscape. The same approach is also applied in respect of the Group's cooperation with other regulatory authorities and much 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 our global business activities.

Introduction and objectives

RRM is an integral part of managing the risks inherent in the business of banking. Non-compliance may potentially have serious consequences, which could lead to both civil and criminal liability, including penalties, claims for loss and damages or restrictions imposed by regulatory bodies. The Group therefore aims to foster a compliance culture in its operations that contributes to the overall objective of prudent regulatory compliance and risk management.

The objective of the compliance and regulatory risk management function is to ensure that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws and that any regulatory risks are identified and managed proactively.

It is of paramount importance to ensure compliance with the requirements of the Banks Act 94 of 1990 ("the Act") and the Regulations thereto, and to ensure that all non-compliance risks identified in this context are addressed and managed in accordance with the regulations and the Act and in line with international best practice.

To achieve this, all staff must be aware of compliance requirements, have a high level of understanding of the regulatory framework applicable to the Group, and they must be aware of the potential regulatory risks to which it is exposed. Ethical behaviour is both a keystone and an important contributor to the success of the entire compliance process. The Group expects all its staff members to maintain standards of honesty, integrity and fair dealing and to act with due skill, care and diligence.

Organisational structure and governance

While the responsibility for ensuring compliance with all relevant laws, internal policies, regulations and supervisory requirements rests with the Board, the role of monitoring, assessing and reporting the level of compliance is delegated by the Board to the Head of RRM. The RRM function carries out its duties in terms of Regulation 49 of the Banks Act, and its mandate is set out in the Compliance Risk Management Framework, a subpolicy of the BPRMF.

Governance oversight of regulatory risk management is done by a number of committees such as the RRM committee, the RCC committee and the FirstRand Audit committee, which receive detailed reports on the level of compliance and instances of material non-compliance from RRM on a regular basis.

The RRM function retains an independent reporting line to the CEO as well as to the Board through its designated committees.

In addition to the centralised RRM function, each of the operating franchises have appointed compliance officers responsible for implementing and monitoring compliance policies and procedures related to their respective franchises.

Assessment and management

The RRM function and its Board mandate prescribe a "zero tolerance" approach to compliance breaches. To achieve this, RRM has implemented appropriate structures, policies, processes and procedures to identify regulatory risks, monitor the management thereof and report on the level of compliance risk management to both the Board and the Registrar of Banks. These include:

- risk identification through documenting which laws, regulations and supervisory requirements are applicable to FirstRand;
- risk measurement through the development of risk management plans;
- risk monitoring and review of remedial actions;
- risk reporting; and
- providing advice on compliance related matters.

In support of the Compliance Risk Management Framework, a compliance manual was approved which assists the businesses in addressing all material compliance risks.

Although independent of other risk management and governance functions, the RRM function works closely with GIA, ERM, external audit, internal and external legal advisors and the Company secretary's office to ensure the effective functioning of the compliance processes.

New group structure

FIRSTRAND

The listed holding company

100% – FirstRand Bank Limited

Banking

100%	First National Bank[1]
	Rand Merchant Bank[1]
	WesBank[1]
	FirstRand Bank India[2]
	FirstRand Bank London[2]
	FirstRand Bank Dubai[3]
	FirstRand Bank Shanghai[3]
	FirstRand Bank Nigeria[3]
	FirstRand Bank Angola[3]

100% – FirstRand EMA Holdings Limited ("FREMA")

Emerging markets

100%	FNB Lesotho
59%	FNB Namibia
100%	FNB Swaziland
70%	FNB Botswana
90%	FNB Moçambique
100%	FNB Zambia
47%	OUTsurance[4]
100%	FirstRand International – Mauritius

100% – FirstRand Investment Holdings (Pty) Limited ("FRIHL")

Other activities[5]

96%	RMB Private Equity Holdings
93%	RMB Private Equity
100%	RMB Stockbroking Operations
100%	FirstRand International Wealth Management
40%	Eris Property Group
50%	RMB Morgan Stanley
75%	Rentworks
33%	Tracker
100%	FirstRand International – Guernsey
100%	FNB Insurance Brokers
100%	Barnard Jacobs Mellet Holdings Limited[6]

FirstRand unbundled its 100% shareholding in Momentum Group Limited effective 30 November 2010.

1 Division.
2 Branch.
3 Representative office.
4 Effective shareholding in FRSTIH. FirstRand announced on 15 December 2010 that it will be disposing of its interest in FRSTIH to RMB Holdings Limited.
5 For segmental analysis purposes entities included in FRIHL are reported within the respective franchise results.
6 On 15 December FNB announced that all the conditions precedent for the purchase of Barnard Jacobs Mellet Holdings Limited had been met. The accounting effective date, however, is 3 January 2011.

Structure shows effective consolidated shareholding.

ABBREVIATIONS

AIRB	Advanced internal ratings based approach
ALCO	Asset and liability management committee
AMA	Advance Measurement Approach
BCBS	The Basel Committee on Banking Supervision
BCM	Business continuity management
BPRMF	Business Performance and Risk Management Framework
BSM	Balance Sheet Management
CEO	Chief Executive Officer
CCF	Credit conversion factors
COO	Chief Operating Officer
CRMF	Credit Risk Management Framework
CRO	Chief Risk Officer
CSA	Credit Support Annexes
EAD	Exposure at default
EL	Expected loss
ERM	Enterprise Risk Management
ETL	Expected tail loss
FICC	Fixed income currency and commodities
FNB	First National Bank
FRB	FirstRand Bank Limited
FRBH	FirstRand Bank Holdings Limited
FREMA	FirstRand EMA Holdings Limited
FRIE	FirstRand Ireland plc
FSR	FirstRand Limited
FTP	Funds transfer pricing
GIA	Group Internal Audit function
GCRM	Group credit risk management
ICAAP	Internal Capital Adequacy Assessment Process
IBNR	Incurred but not reported
IFRS	International Financial Reporting Standards
IRRBB	Interest rate risk in the banking book
IT framework	Information Technology Governance and Information Security framework
KRI	Key risk indicators
LGD	Loss given default
LIP	Loss Identification Period
LRMF	Liquidity Risk Management Framework
LTV	Loan to value
MMMFTP	Marginal matched maturity funds transfer pricing
NII	Net interest income

NPL	Non-performing loans
ORC	Operational risk committee
ORMF	Operational Risk Management Framework
ORX	Operational Riskdata Exchange Association
PD	Probability of default
PFE	Potential future exposure
PGN	Professional Guidance Note
PIT	Point-in-time
RCC	Risk, Capital Management and Compliance committee
RCSA	Risk and control self assessments
RERIT	Risk effectiveness reports for IT
RMB	Rand Merchant Bank
RRM	Regulatory risk management
RWA	Risk weighted assets
S&P	Standard and Poor's
SARB	South African Reserve Bank
SME	Small and medium enterprise
SPPIA	Standards for Professional Practice of Internal Auditing
TTC	Through-the-cycle
VaR	Value-at-risk