FirstRand Bank Holdings

BASEL II PILLAR 3 DISCLOSURE

for the six months ended 31 December 2009

FirstRand Bank Holdings Limited

CONTENTS

INTRODUCTION

Regulation 43 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. Banks are also required on a semi-annual basis to disclose to the public the qualitative and quantitative information as described above. This disclosure requirement is commonly known as Pillar 3 of the Basel II Accord.

This is the Basel II Pillar 3 report of FirstRand Bank Holdings Limited ("FRBH"), which is referred to as "the Banking Group"' or "the Bank". This report complies with the risk disclosure requirements of Basel II Pillar 3. FRBH is a wholly owned subsidiary of FirstRand Limited ("FirstRand" or "the Group"). A simplified diagrammatic representation of the Group is set out on page 68 of this report. The Pillar 3 disclosures in this report have been internally verified by the Group's governance processes. The semi-annual disclosure is not subject to external verification, and as such, has not been audited.

Risk in FRBH is managed on a group basis with FirstRand Bank Limited ("FRB") as its major subsidiary. Some differences between the practices, approaches, processes and policies of FRBH and FRB exist and these are highlighted by a reference to the appropriate entity, where necessary.

FRBH, one of FirstRand's major subsidiaries, adheres to the same corporate governance principles, structures and policy framework as FirstRand. FRBH's primary business objective, like that of the Group, is the generation of sustainable profits. As an integrated financial services provider and through a portfolio of leading franchises, FRBH wants to be appropriately represented in all significant earnings pools across all chosen market and risk taking activities. This entails building revenue streams that are diverse, and creating long term value via sustainable earning pools with acceptable earnings volatility.

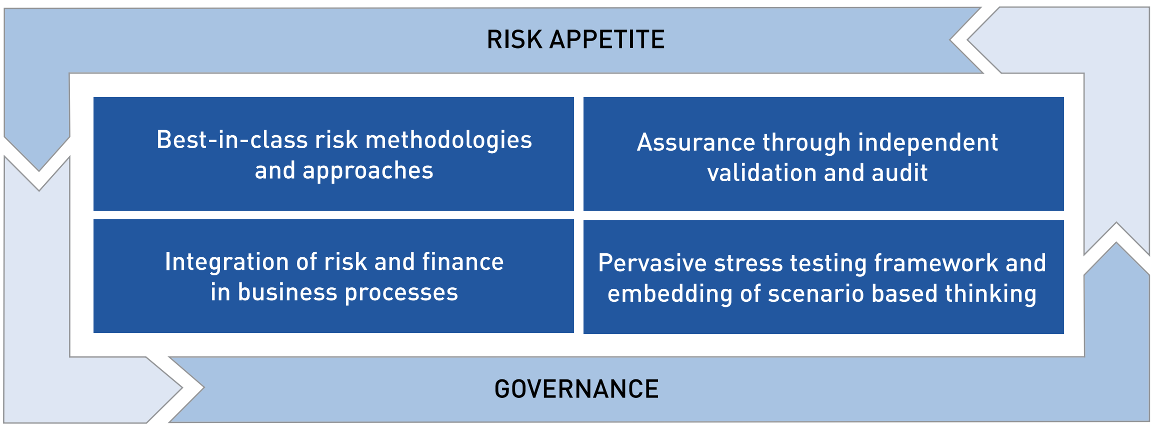
As an integrated financial services company, risk taking is an essential part of the Group's business and FirstRand thus explicitly recognises risk assessment, monitoring and management as core competencies and important differentiators in the competitive environment it operates in.

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.

As a company built on a strong and pervasive "owner-manager culture", the adherence to the validity, methodology and scope of risk management is deeply embedded in the Group's tactical and strategic decision making. Accordingly capital is seen as a scarce resource and the imperative to protect its reputation means that risk is considered in a holistic and integrated manner.

The recent economic crisis precipitated by the turmoil in the world's financial markets and the failure of financial institutions internationally has dramatically underscored the need for an integrated risk and capital management approach alongside the renewed emphasis on sustainable earnings. Consequently, the Banking Group has adopted a comprehensive approach to risk and capital management that comprises six core components, illustrated graphically in the chart below.

Components of FRBH'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 Banking Group's continuing efforts to improve its risk identification, assessment and management capabilities. The articulation of risk appetite is closely related to the level of earnings volatility the Banking Group is willing to accept, its target capitalisation level and the allocation of capital and risk capacity (see pages 6 and 12). Sound capital management practices are a core component of the Bank's business strategy and support the management of its businesses within risk appetite constraints.
- A strong governance structure and policy framework fosters the embedding of risk considerations in existing business processes and ensures that consistent standards exist across the Banking Group's operating units (see page 7).
- Best practice risk methodologies have been developed in and for the respective business areas. These have been modelled on existing and emerging best practice in the global financial services industry and are constantly reviewed, challenged and enhanced by deployed and central risk management teams (see page 17).
- An integrated approach to managing risk has been established to facilitate the pro-active exchange of information between individual risk areas and between risk and finance functions. In doing so, the organisation aims to eliminate any 'risk silo' thinking across different risk types and ensure an increasing integration of the traditionally separate domains of risk and finance (see page 10).
- The Banking 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. This will enable the Bank to draw on strong expertise in individual risk areas and the finance functions to ensure optimal decision making in pursuit of stable, growing and sustainable earnings (see page 11).
- Independent oversight, validation and audit functions ensure a high standard across methodological, operational and process components of the Bank's risk and capital management efforts. These functions independently review and challenge deployed and centralised risk, business and support functions and are directly responsible for providing board members with assurance that the Banking Group remains within its chosen risk appetite and adheres to the standards and practices set by the board (see page 11).

The remainder of this introductory section provides the Bank's perspective on the recent financial crisis as well as an overview of the major risks it is exposed to and the steps taken to strengthen risk management practices on the basis of lessons taken from the international financial markets. Each of the core components mentioned above is described in more detail in the main section of this report, alongside a detailed discussion of the risk profile for the banking operations.

Emerging from financial crisis

Supported by unprecedented policy stimulus and growing demand from emerging markets, the global economy is expanding again.

Nevertheless, the recent financial crisis changed the global economic environment significantly. Unemployment increased, government debt levels ballooned and policy rates are at historic lows. Consumers in the developed world are also deleveraging. These developments should keep growth from reaching the frothy levels experienced during the credit boom years.

The improvement in the real economy has reduced the systemic risks in the global financial system. Financial markets have rebounded, emerging market risks have eased, banks have raised capital and wholesale funding markets have reopened. The IMF warns, however, that complacency about banking system repair is still a concern as credit deterioration will continue to put pressure on banks' balance sheets.

Positive global growth and policy stimulus have pulled the South African economy out of its first recession in 17 years. Growth conditions are, however, expected to remain weak with private sector demand increasing at a pedestrian pace and the labour market forecast to remain under pressure. Credit demand should be low. Debt to disposable income levels are forecast to improve and savings rates may even increase.

The return to growth has been accompanied by signs that credit conditions (lending criteria) are easing and that the deterioration in credit quality has troughed.

The Bank has taken a number of steps to address the economic challenges and mitigate the negative impact of the financial and economic crisis. In addition, a number of regulatory enhancements to the regulatory framework are underway and the Banking Group is in discussion with the relevant regulatory bodies and industry forums to implement the necessary changes as required.

Major risk factors and recent developments

The Banking 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 financial risks, operational risks and strategic risks.

This section provides a brief summary of the major risk types as well as the changes in measurement and management approaches implemented over the period under review, as appropriate. Further information and an analysis of the respective risk profiles can be found in the detailed risk sections from page 17 onwards.

Credit risk

Credit risk, in terms of the potential impact on earnings and associated capital requirements, is the most significant risk type for the Bank.

The Banking Group remains focused on detailed analyses of the credit portfolio with respect to the organisation's credit risk appetite, which enables it to continuously align its efforts to rebalance the portfolio with its core macroeconomic outlook.

Changes to the determination of credit strategy and the origination process have been implemented. These are now the joint responsibility of the individual business areas and the central Balance Sheet Management ("BSM") function. These steps aim to ensure consistency across credit origination practices in the Bank as well as a granular implementation of and alignment with the Bank's credit risk appetite. In addition, centralised cross risk type management as part of the BSM function in the Chief Operating Officer ("COO") portfolio is intended to facilitate a consistent and integrated approach to managing credit, market and liquidity risk.

Further methodological refinements to credit scoring models across various business areas are in progress and sophisticated macroeconomic credit stress testing models have been implemented as part of the wider stress testing framework. These models are being embedded as vital components of strategic and tactical decision making processes and are already being used as inputs into the planning and budgeting process.

Counterparty credit risk

The sudden and unprecedented failure of several large international financial institutions has highlighted the importance of pro-active and resolute counterparty risk measurement practices. In response to these events, the Banking Group has strengthened the level of communication and cooperation between all risk functions that contribute to the assessment of this risk type so as to ensure that all relevant factors are taken into account for purposes of assessing and pricing this risk.

Market and equity investment risk

In line with improvements in measuring market risk internationally and in anticipation of forthcoming regulatory requirements, the Banking Group's efforts are focused on integrating market and credit risk considerations more closely. One example of this is the development and implementation of an internal model for measuring specific risk, i.e. the idiosyncratic credit risk component not commonly captured by traditional Value at Risk ("VaR") models.

Over the period under review, a number of steps have been taken to strengthen market risk controls. The most noteworthy of these are the implementation of absolute loss thresholds that supplement traditional VaR limits and the inclusion of a liquidity adjusted portfolio structure predicated on the assumption that positions that attract market risk can be separated into appropriate liquidity adjusted utilisation measure categories. The liquid trading book portfolio, measured on a 10 day Expected Tail Loss ("ETL") basis plus a specific risk measure, comprises positions that can be exited within a short period of time without undue price action under distressed liquidity conditions. The less liquid (or illiquid) portfolios are measured on at least a 90 day ETL basis and supplemented with a scenario set pertinent to the individual portfolio under consideration.

Changes to the equity investment risk measurement methodology are also planned to reflect an increased emphasis by business on the pro-active management of the investment portfolio through the economic cycle.

Liquidity risk

The international market turbulence, the recent developments in certain EU countries and ambitious fund raising by state owned enterprises and the South African government, led to an increase in the liquidity premium for term funding in South Africa.

Group Treasury proactively undertook several measures, starting in 2008 and continuing in 2009, to further strengthen and safeguard its liquidity position and increase liquidity buffers, including the adjustment of short term funding targets and an increased focus on balance sheet asset reduction. This ensures that the Group has a robust and strong balance sheet to fund future growth requirements. The broad diversity of its funding sources and its contingency planning processes resulted in a robust asset and liability profile with the funding profile similar to that of the year ended 30 June 2009. The Group's domestic retail, commercial, corporate and wealth businesses remain a valuable source of funding. In addition the Group has established funding platforms in Africa and London providing access to US and Asian markets to fund potential growth, in excess of in-country funding requirements.

Global reforms relating to liquidity risk management include the proposed introduction of a global minimum liquidity standard, which includes a 30-day liquidity coverage ratio as well as a longer term structural liquidity ratio ("the Net Stable Funding Ratio"). This proposal has not been finalised and remains open to comment and further quantitative impact studies. However, in its current form it could have a significant impact on the South African financial services industry given the specific structure of the domestic funding and savings markets.

The Banking Group continues to comply with the Basel Committee on Banking Supervision's *Principles for Sound Liquidity Risk Management and Supervision.* In addition, liquidity buffers have been increased substantially, and the portfolios of highly liquid securities in which these buffers have been placed continue to be the focus of pro-active management and close monitoring.

Interest rate risk in the banking book

Interest rate risk management practices have remained focused on putting in place and managing appropriate hedges to protect the Banking Group's income statement and balance sheet through the declining interest rate cycle. Over the reporting period, the Bank's exposure to interest rate risk remained within the limits imposed by the board as part of the Banking Group's risk appetite.

The Banking Group's interest rate risk management strategy is closely aligned with the stress testing framework over the reporting period, and rate movements have been successfully managed on the basis of the Bank's core planning scenario. Hedging decisions have also been supported by scenario and stress analyses, with a number of positions taken to mitigate potential tail risks in the interest rate cycle. Over the reporting period, the Banking Group experienced no disruptions in the domestic market with respect to its interest rate risk management efforts.

Operational risk

FRB received approval from the South African Reserve Bank ("SARB") to adopt the Advanced Measurement Approach ("AMA") for operational risk on a partial use basis from 1 January 2009. The Bank recognises the significance of operational risk and remains focused on improving the measurement, management and reporting of this risk across all its operations.

Sophisticated risk assessment approaches and statistical models are a part of this effort as is the ongoing review of controls and management frameworks to ensure their effectiveness. In support of the operational risk modelling approaches, the Bank seeks to capture and collate relevant internal and external operational risk loss data. During 2009 the Bank was accepted as a member of the Operational Riskdata Exchange Association ("ORX"), which greatly enhances its access to high quality loss event data and thus improves the sophistication and accuracy of the risk assessment models for operational risk.

Enterprise risk management

The Enterprise Risk Management ("ERM") functions provide central independent oversight and risk control as part of the Banking Group's risk governance structure. The mandate of the ERM function, reporting lines and the emphasis on assuring independent oversight through the staffing of non executive directors on all relevant risk and audit boards across the Banking Group are discussed further in the *Risk governance* section of this report (page 7).

Risk management: Income statement and balance sheet

The Banking Group considers risk management to be an integral part of the management of its balance sheet and income statement. To this end, risk adjusted versions of the income statement are considered regularly as part of the Banking Group's ongoing stress testing and scenario planning process, as well as in the evaluation of performance across the various businesses. The relevant governance and management processes are discussed in the detailed risk sections, as appropriate. (For example, the management of the balance sheet from a risk perspective is largely covered in the *Credit risk* section of this report, see page 18).

RISK APPETITE

The Banking Group's business as a financial intermediary is based on the identification, measurement, pricing, and ultimately the taking and management of risk. It does not aim to eliminate risk entirely but to assume it deliberately in a measured, calculated and controlled fashion pursuant to its business objectives.

The level of risk the Bank is willing to take on – its risk appetite – is determined by the Banking Group's board, which also assumes responsibility for ensuring that risks are adequately managed and controlled through its Risk, capital and compliance committee ("RCC") and its subcommittees, as described in the *Risk governance* section below.

The Banking Group's risk appetite framework sets out specific principles, objectives and measures that link diverse considerations such as strategy setting, risk considerations, target capitalisation levels and acceptable levels of earnings volatility. As each business 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 Banking Group's business philosophy and thus fall outside its risk appetite.

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

- the level of earnings volatility the Bank is willing to accept from certain risks that are core to its business; and
- the level of capitalisation it seeks to maintain.

These two metrics define the Bank's risk capacity and this expression of risk appetite is calibrated against broader financial targets such as the level of dividend coverage and acceptable levels of impairment rates. As a function of the business environment and stakeholders' expectations, and together with the primary risk appetite metrics, these provide firm boundaries for the organisation's chosen path of growth.

Thus, in setting the Banking Group's risk appetite, the Executive committee and the 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 Bank 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.

In practice, the Bank has increased its target capitalisation levels in response to the recent financial crisis and remains comfortably above these higher target ranges. Furthermore, earnings volatility thresholds have been refined for the Bank's major risk types and a number of changes to business practices were made to ensure that activities remain within its risk appetite.

These include:

- the credit origination strategy has been adjusted where portfolios had migrated outside the target risk profile (see *Credit risk* section, page 18);
- proprietary trading activities have been reduced in line with new earnings volatility targets (see *Market risk* section, page 48);
- additional liquidity buffers have been implemented and are managed conservatively in response to the financial crisis (see *Liquidity risk* section, page 54);
- as a key area of focus for the board, ongoing awareness and extensive education sessions on risk appetite are being held at all levels of the organisation; and
- risk appetite measures are included in all management reports across the businesses, as well as at board level, and significant efforts aimed at refining risk thresholds and extending management information in this regard are underway. The results of ongoing stress testing exercises are regularly reported, compared and discussed in light of the Banking Group's risk appetite targets and limits.

RISK GOVERNANCE

The Banking Group's board retains ultimate responsibility for ensuring that risks are adequately identified, measured, monitored and managed. The Bank believes that a culture focused on risk paired with an effective governance structure is a prerequisite for managing risk effectively.

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 Banking Group's operations:

1. Risk ownership – Risk taking is inherent in the individual businesses' activities and, as such, business management carries the primary responsibility for the risks in its business, in particular with respect to identifying and managing it appropriately.
2. Risk control – Business heads are supported in this by deployed risk management functions that are involved in all business decisions and that are represented at executive level across all franchises. These are overseen by an independent, central risk control function, namely 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 Bank. These are the internal audit functions at a business and at a Banking Group level and external auditors who are also present at relevant board committee meetings.

The risk management and governance structure explicitly recognises these lines of control and embeds these as a policy of the board. The following three sections discuss this risk management and governance framework and the associated committee structures in more detail.

Risk management framework

The risk management structure described above is set out in the Business Performance and Risk Management Framework ("BPRMF"), illustrated graphically in the chart below. As a policy of both the board and the Executive committee of FRBH, it delineates the roles and responsibilities of key stakeholders in business, support and control functions across the various franchises and the Banking Group.

As indicated previously, the BPRMF stipulates that the head of each business unit is responsible for managing risk in line with the BPRMF and other relevant frameworks of the Banking Group or divisional boards. Therefore, it emphasises the embedding of risk management as a core discipline and the requirement for giving explicit consideration to potential risks in all business decisions in line with the Banking Group's focus on ensuring the sustainability of earnings. Business ownership of risk and responsibility for risk management constitutes the first line of control applied across the Banking Group.

The heads of individual businesses are supported in this task by deployed risk management functions that participate in all business decisions. The heads of risk for the individual franchises have a direct reporting line to the Bank's Chief Risk Officer ("CRO"), but also retain a second reporting line to the head of the respective franchise. Deployed risk functions are thus partners of the business. They are represented on the respective franchises' executive committees and are involved in strategy setting and business decision making while remaining independent from a governance perspective with a primary focus on risk identification, measurement and control. The deployed risk management functions are overseen centrally by ERM and together form the second line of risk controls across the Bank.

ERM is headed by the Banking Group CRO who reports to the Chief Executive Officer ("CEO") and who is also a member of the Executive committee and plays an active role in the setting of the Bank's strategy. To ensure the independence of deployed risk management functions, the following also fall within the purview of the ERM function:

- agreeing deployed and divisional risk plans;
- reporting and escalating risk matters;
- reviewing skill placement at divisional level and below; and
- performance assessment and remuneration of risk personnel.

The third line of control is provided by the Group Internal Audit function ("GIA") – at the level of individual businesses and at a Banking Group level. GIA reports to the board through the FRBH Audit committee, and provides assurance on the implementation of risk frameworks and the integrity, accuracy and completeness of risk reports submitted to the individual boards and the Banking Group board's RCC.

Lines of risk control in the Bank

First Line of Risk Controls

HEAD OF BUSINESS: PRIMARY RISK OWNER

Ensure that the entity acts in accordance with mandates approved by the board:

- Identify and quantify key risks to business under normal and stress conditions
- Specify and implement appropriate risk management processes
- Specify and implement early warning measures as well as associated reporting, management and escalation processes
- Implement risk control and mitigation strategies
- Implement corrective actions as required
- Report risk information to the Executive committee and the governance committee structure as appropriate through to the board
- Ensure all staff understand their responsibilities in relation to risk management

Second Line of Risk Controls

ENTERPRISE RISK MANAGEMENT ("ERM")

Provide independent oversight and monitoring across the Banking Group on behalf of the board and relevant committees:

- Take ownership of and maintain risk frameworks
- Challenge risk profile through reviews of risk assessments, evaluation of risk management processes and monitoring of exposures and corrective actions
- Report risk exposures and performance vis-à-vis management of risk exposures to relevant committees
- Maintain risk governance committee structures
- Ensure appropriate risk skills throughout the Group alongside an appropriate risk management culture for risk taking
- Perform risk measurement validation and maintain risk governance structures
- Manage regulatory relationships with respect to risk matters

DEPLOYED, SEGMENT AND DIVISIONAL RISK MANAGERS

Support business unit management in identifying and quantifying significant risks:

- 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 exposure and corrective actions are reported in an appropriate format and frequency
- Monitor appropriate implementation of corrective action
- Identify process flaws and risk management issues, initiate corrective action
- Ensure all risk management and loss containment activities are performed in a timely manner as agreed with ERM

Third Line of Risk Controls

INTERNAL AUDIT

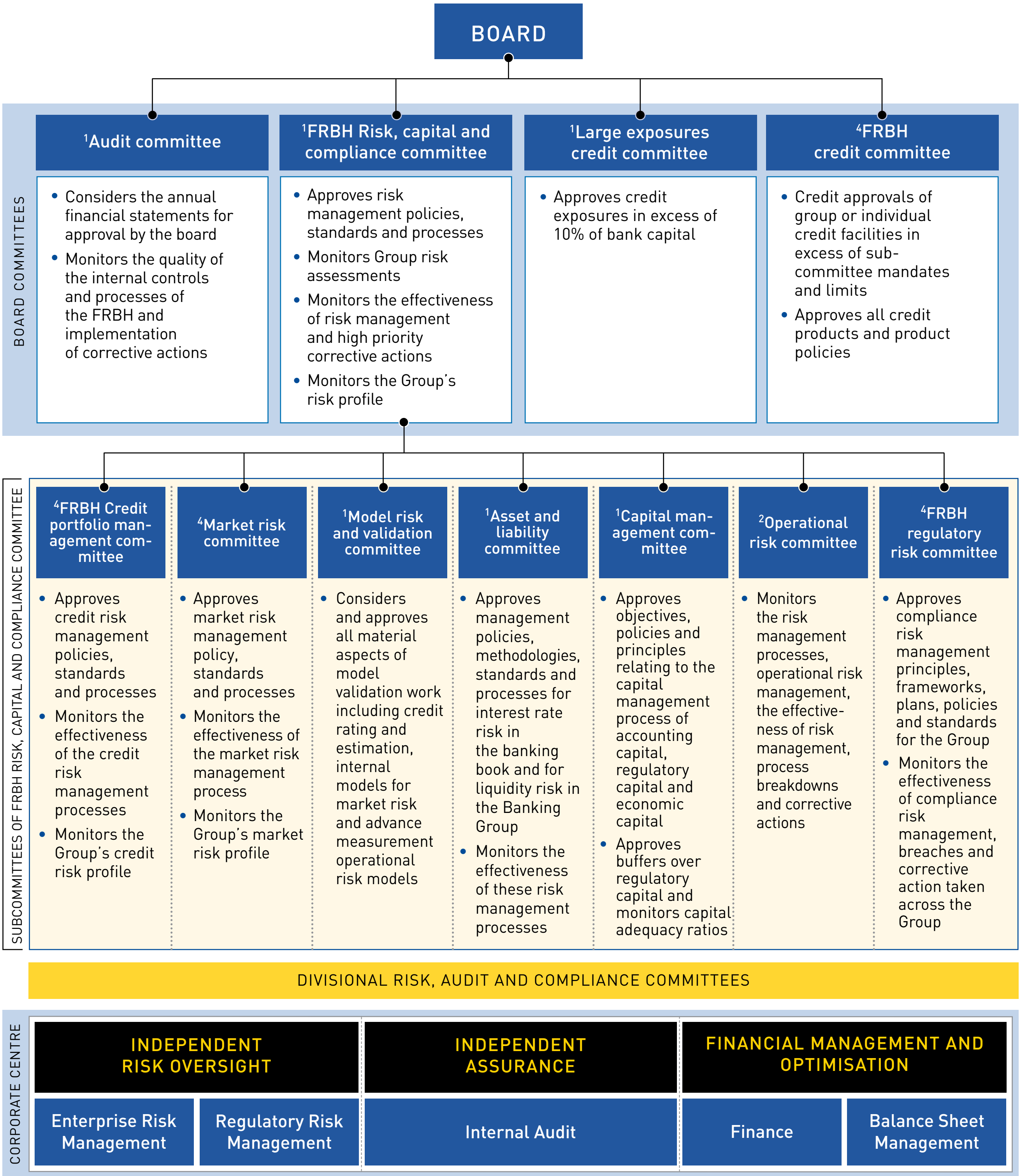
Provide independent assurance of the adequacy and effectiveness of risk management practices:

- Review risk assessment results of the business entities
- Assessment of compliance with the directives of the BPRMF
- Evaluation of the development and implementation of policies of the board of relevant committees
- Review of the integrity, accuracy and completeness of risk reports to the RCC and the board

Committee structure

In line with the Banking Group's corporate governance framework, the board retains ultimate responsibility for ensuring that risks are adequately identified, measured, managed and monitored across the banking operations. The board discharges its duty through relevant policies and frameworks as well as four board committees and their respective subcommittees, as illustrated graphically in the chart below.

Risk governance structure and committees



1 Denotes chairperson is a non executive board member.
2 Denotes chairperson is a non executive non board member.
3 Denotes chairperson is an executive board member.
4 Denotes chairperson is executive management. The FRBH Credit committee has non executive board representation.

The primary board committee overseeing risk matters in the Banking Group is the FRBH RCC. It has delegated responsibility for a number of specialist topics to various subcommittees, as outlined in the chart above. The role of the RCC and its subcommittees is described further with reference to the applicable governance structures and processes for a particular risk type in each of the major risk sections.

A number of the individual committees' members are non executives, further strengthening the Bank's central, independent risk oversight and control functions.

Additional risk, audit and compliance committees exist in each franchise, the governance structures of which generally align closely with that of the Bank as illustrated above. The Banking Group 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 Banking Group.

The FRBH Audit committee provides independent assurance on a range of topics and oversees the third line of controls across the banking operations, as set out in the BPRMF. In this task, it relies on the audit committees in the individual franchises as well as the FRBH Audit committee and the deployed audit functions. These audit committees, as well as the RCC, have non executive representation and representatives from the Banking Group's external auditors and the independent risk management functions attend all committee meetings.

In addition to the independent risk management and oversight functions, the board as well as the Executive committee rely on the Banking Group BSM function, which is tasked with supporting the implementation of Banking Group strategy across the portfolio from an operational perspective. As such, the Macro Portfolio Management ("MPM") team within BSM plays a vital role in defining the Bank's core macroeconomic view and associated risk scenarios, which are used for planning and stress testing purposes. The Credit Portfolio Management team plays an active role in the determination of suitable risk appetite constraints for individual credit portfolios and in the setting of credit strategy across the Bank to ensure that credit portfolios remain within their targeted risk profile. The Capital Management function within BSM retains responsibility for capital planning and it advises the board as well as the Executive committee on potential capital actions, dividend strategy and other capital management related topics.

Extensive, regular risk reporting and challenge of current practices

The governance model outlined in the preceding sections and the Banking Group's focus on embedding risk-oriented thinking in all its business processes are the basis for pro-actively identifying, managing and mitigating risks across the Bank. Deployed risk managers support the implementation of risk management policies and frameworks in the businesses and continuously evaluate the effectiveness of the relevant risk identification, monitoring and management processes. Reports on the effectiveness of these processes and controls are submitted to the RCC on at least a quarterly basis.

In order to ensure the integrity of the information presented, ERM challenges the practices, assumptions and results provided by the businesses and the deployed risk managers. As part of this reporting, challenge, debate and control process, ERM also 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.

Together with the review by the independent audit functions this ensures 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 management control over the Bank's risk position at all times.

INTEGRATION OF RISK AND FINANCE

A key lesson from the recent developments in the international financial markets is that failure to take a comprehensive and integrated view, not only across different risk types, but also across the traditionally separate domains of risk and finance, substantially increases the risk of financial underperformance or organisational failure.

The Banking Group considers the sustainability of its earnings as a core objective and key performance metric. The value of its franchises is ultimately driven by their financial strength and the Bank is thus adopting a management approach that seeks to balance independent franchises with strong central oversight aimed at ensuring optimal outcomes across the Banking Group.

This is necessary since the optimisation of each individual franchise's value does not necessarily ensure the maximisation of the Banking 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 Banking Group level, where appropriate.

The creation last year of the COO portfolio was a major step in this direction. The franchises are ultimately responsible for maximising risk adjusted returns on a sustainable basis, i.e. within the confines of the Bank's risk appetite. Centralised business functions within BSM such as MPM support these efforts by providing consistent assumptions and planning scenarios, modelling and forecasting methods and tools (such as detailed risk adjusted income statements) as well as a structured challenge and debate process that is integrated with the strategy setting and budgeting process for the Bank.

Through the centralisation of the integrated risk and finance view on the Bank's performance, as well as its budgets and plans, these functions also allow the Banking Group to target a more resilient earnings profile and to take actions that address residual risks that are not adequately offset once aggregated at Banking Group level. Such actions may be related to specific credit hedges, may involve macro economic hedges that seek to provide indirect mitigation of earnings at risk in certain businesses; or they may involve the procurement of insurance against other operational risks where this is judged to be economically sensible.

These central functions are also responsible for the management of the Bank's capital and liquidity position, which provide the final buffer against insufficient business performance under extremely severe economic conditions. For the purpose of determining the Bank's strategy with respect to capital management actions and the setting of its dividend policy, scenario analyses are employed extensively as supplements to budgets based on consistent planning assumptions and stress scenarios.

A disjointed view on risk and its interaction with more traditional accounting aspects of financial institutions' businesses (e.g. mark-to-market ("MTM") requirements) has been an important driver of the recent financial crisis. The practices instituted at the Bank are intended to ensure that capital and liquidity related decisions can be taken in a well coordinated and pro-active manner on the basis of a consistent, integrated view incorporating aspects of both finance and risk domains, should the need arise.

STRESS TESTING AND SCENARIO BASED PLANNING

The evaluation of business plans and strategic options at a Banking Group and business level as well as the choice of tactical steps towards implementing these plans is a process that is 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 as well as on the basis of unforeseen events is an integral part of the Bank's strategy setting process.

The Banking Group has implemented a comprehensive stress testing framework that formalises the application of scenario based thinking and stress analyses in its business processes. The design of this stress testing framework built on, and consolidated, practices that already existed in various businesses, as well as the established risk functions.

The most important reflection of these practices is the usage of stress analyses in the planning and budgeting process where all businesses are required to base their forecasts on a consistent set of planning assumptions.

The core scenario reflects the Bank'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 Banking Group level with respect to potential deviations from budget and the potential implications for earnings volatility. The framework also provides for the definition and execution of reverse stress tests to provide management and regulators with a structured view on potential developments that may threaten the stability of the institution.

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

As indicated in the preceding section, stress testing and scenario analyses have been integrated across the traditionally separate domains of risk and finance. They are an important tool for management decision making on a range of topics, including strategy setting and risk appetite considerations.

AUDIT

GIA provides independent assurance to the board through its Audit committee. The function is led by the Chief Audit Executive who reports to the Group's CEO while also retaining an independent functional reporting line to the Chairman of the FRBH Audit committee who is a non-executive member of the FRBH board.

The Chief Audit Executive has direct, unrestricted access to the CEO of the Banking Group, the executives in the respective franchises as well as all FirstRand functions, records, property and personnel.

With respect to risk and capital management, the GIA forms the third line of assurance and control across the organisation and oversees all processes related to financial risks and internal controls, financial reporting and the monitoring of the results of internal and external audit processes. It is responsible for ensuring that:

- risks are appropriately identified and managed;
- significant financial, managerial and operational information is accurate, reliable and timely;
- resources and assets are effectively and efficiently utilised and adequately protected;
- employees' actions are in compliance with policies, standards, procedures and applicable laws and regulations;
- significant legislative or regulatory issues impacting the organisation are recognised and addressed appropriately;
- the adequacy and effectiveness of the organisation's corporate governance, risk and control frameworks are assessed rigorously; and
- processes for controlling and managing its activities and associated risks are adequate.

GIA coordinates its efforts with the other control and monitoring functions – ERM, Regulatory Risk Management ("RRM") and external auditors. As indicated in the governance section, GIA representatives attend all Audit and RCC committee meetings across the Banking Group. In addition, GIA also attends various governance and management committees in order to remain informed about new developments in the business and to align its risk based audit approach accordingly.

The GIA team conducts audit work, or any other task, in accordance with the internal auditing standards set by the globally recognised Institute of Internal Auditing ("IIA"). This requires compliance with the *Standards for Professional Practice of Internal Auditing* ("SPPIA"), in particular, the codes of conduct and ethics that are promulgated from time to time by relevant professional bodies, and any other corporate governance initiatives.

To ensure a consistent standard of quality and detail, all audit reports are reviewed by the GIA Quality Assurance Department in addition to the respective audit committees in the business units. Internal audit practices and activities are also assessed independently by the external auditors on an annual basis, in line with the International Standards of Auditing, *ISA 610: Considering the Work of Internal Audit.* This standard requires that the external auditors assess GIA in order to determine the use that may be made of the work of internal audit in modifying the nature and timing, and in reducing the extent of external audit procedures.

CAPITAL MANAGEMENT

Allocating resources effectively (including capital and risk capacity), in terms of the Banking Group's risk appetite and in a manner that maximises value for shareholders, is a core competence and key focus area for the Bank and, as such, sound capital management practices form an important component of its overall business strategy.

FRBH is the regulated entity and includes all regulated subsidiaries.

Strategic overview

The Banking Group seeks to establish and manage a portfolio of businesses and risks that will deliver sustainable returns to its shareholders. In doing so, it targets a particular earnings profile that will allow it to generate these returns within appropriate levels of volatility.

Sustainability also refers to the businesses' 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. The Banking Group therefore maintains capitalisation ratios appropriate to safeguard its operations and the interests of its stakeholders. 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 of the Bank and the insurer 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 investors' expectations, targeted capital ratios, future business plans, plans for the issuance of additional capital instruments, the need for appropriate buffers in excess of minimum requirements, and considerations of rating agencies.

The efficacy of the Banking Group's capital allocation decisions and the efficiency of its capital structure are important determinants of its ability to generate returns for shareholders. The Bank seeks to hold limited excesses above the capital required to support its short term growth plans (including appropriate buffers for stresses and volatility).

The Bank's capital planning efforts ensure that the total capital adequacy and Tier 1 ratios remain within the approved ranges or above target levels across the economic and business cycle. The Bank is appropriately capitalised under a range of normal and severe scenarios, as well as under a range of stress events. FRBH has continued to meet its goal of operating at the upper end of its targeted capitalisation range. The actual Tier 1 ratio for FRBH is 12.19%. Similarly, FRB excluding subsidiaries and branches is operating above its Tier 1 target of 9.5%, at 10.55%.

The board approved capital plan for FRBH is reviewed as part of the Banking Group's Internal Capital Adequacy Assessment Process ("ICAAP"), with the stress testing framework being an extension of this process. These processes are under continuous review and refinement.

The Basel Committee on Banking Supervision ("BCBS") released a number of consultative papers during 2009. These papers focused on strengthening the resilience of the banking sector, enhancing the current Basel II framework, revising the market risk framework and providing guidance on liquidity risk measurement and monitoring. The BCBS is currently in the process of conducting a quantitative impact study to assess the impact on participating banks of the rules provided in these consultative papers. FRBH is participating in this process, and preliminary calculations show an impact on the Tier 1 and total capital adequacy ratios of FRBH. However, both FRB and FRBH are expected to remain above the current regulatory minimum and within the targeted range. The proposed changes will be incorporated in the continuous capital planning for FRBH.

Dividends

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. In the prevailing uncertain environment, the Banking Group would prefer to maintain capital ratios at the upper end of the band.

Six months under review

FRBH has continued to focus on its Tier 1 ratio during the past six months. This ratio has fallen slightly to 12.19% which is still comfortably ahead of the internal target of 10%. Similarly, FRB is operating above its Tier 1 target of 9.5%, at 10.55%. During the period credit risk weighted assets ("RWA") increased primarily as a result of credit risk recalibrations despite a decline in advances. In the capital ratios, this increase was largely offset by the strong internal capital generation during the period.

The targeted capital levels as well as the current ratios as at 31 December 2009 are summarised in the table below.

Capital adequacy position

	FRBH			FRB*			
%	Actual	Actual**	Target	Actual	Actual**	Target	Regulatory minimum
Capital adequacy ratio	14.34	14.83	12.0 – 13.5	12.83	13.38	11.5 – 13.0	9.50#
Tier 1 ratio	12.19	12.68	10.00	10.55	11.09	9.50	7.00

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

*** Including unappropriated profits of R1 616 million and R1 713 million for FRB and FRBH, respectively.*

 # The regulatory minimum excludes the bank specific (Pillar 2b) add on.

The following table shows the composition of regulatory capital (financial resources) and capital ratios of FRBH, while the subsequent table provides a breakdown of RWA.

Composition of qualifying capital and capital ratios of FRBH

	FRBH					
	At 31 December				At 30 June	
R million	**2009**	%	2008	%	2009	%
Tier 1						
Ordinary share capital and premium	**5 750**		5 672		5 671	
Non controlling interest	**1 668**		1 930		1 514	
Non redeemable non cumulative preference shares	**3 100**		3 100		3 100	
Reserves	**34 218**		32 536		32 626	
Less: Total impairments	**(2 563)**		(3 230)		(2 299)	
Excess of expected loss over eligible provisions (50%)	**(292)**		(1 055)		(325)	
First loss credit enhancement in respect of securitisation structures (50%)	**(221)**		(262)		(260)	
Goodwill and other impairments	**(2 050)**		(1 913)		(1 714)	
Total Tier 1 Capital	**42 173**	**12.2**	40 008	11.1	40 612	12.3
Tier 2						
Upper Tier 2 instruments	**1 068**		1 068		1 068	
Tier 2 subordinated debt instruments	**6 633**		6 911		6 642	
Other reserves	**176**		160		193	
Less: Total impairments	**(431)**		(1 317)		(493)	
Excess of expected loss over eligible provisions (50%)	**(292)**		(1 055)		(325)	
First loss credit enhancement in respect of securitisation structures (50%)	**(221)**		(262)		(260)	
Other impairments	**82**		–		92	
Total Tier 2 Capital	**7 446**	**2.2**	6 822	1.9	7 410	2.2
Total qualifying capital and reserves	**49 619**	**14.3**	46 830	13.0	48 022	14.6

RWA by risk type of FRBH

	FRBH		
	At 31 December		At 30 June
R million	**2009**	2008	2009
Credit risk	**252 557**	245 336	241 447
Operational risk	**47 579**	61 696	47 125
Market risk	**12 437**	12 689	13 246
Equity investment risk	**18 781**	24 624	13 649
Other risk	**14 695**	16 840	14 037
Total risk weighted assets	**346 049**	361 185	329 504

The following table shows the composition of regulatory capital (financial resources) and capital ratios for FRB*, while the subsequent table provides a breakdown of RWA.

Composition of qualifying capital and capital ratios of FRB

	FRB*					
R million	At 31 December				At 30 June	
	2009	**%**	2008	%	2009	%
Tier 1						
Ordinary share capital and share premium	**10 969**		10 294		10 821	
Non redeemable non cumulative preference shares	**3 000**		3 000		3 000	
Reserves	**18 976**		18 123		17 682	
Less: Total impairments	**(1 828)**		(1 741)		(1 782)	
Excess of expected loss over eligible provisions (50%)	**(292)**		(1 055)		(325)	
First loss credit enhancements in respect of securitisation structures (50%)	**–**		(13)		–	
Qualifying capital in branches	**(1 330)**		–		(1 297)	
Goodwill and other impairments	**(206)**		(673)		(160)	
Total Tier 1 Capital	**31 117**	**10.5**	29 676	9.9	29 721	10.7
Tier 2						
Upper Tier 2 instruments	**1 068**		1 068		1 068	
Tier 2 subordinated debt instruments	**5 893**		6 055		5 872	
Less: Total impairments	**(210)**		(1 068)		(234)	
Excess of expected loss over eligible provisions (50%)	**(292)**		(1 055)		(325)	
First loss credit enhancement in respect of securitisation structures (50%)	**–**		(13)		–	
Other impairments	**82**		–		91	
Total Tier 2 Capital	**6 751**	**2.3**	6 055	2.0	6 706	2.4
Total qualifying capital and reserves	**37 868**	**12.8**	35 731	11.9	36 427	13.1

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

RWA by risk type of FRB

	FRB*		
	At 31 December		At 30 June
R million	**2009**	2008	2009
Credit risk	**219 493**	211 196	205 472
Operational risk	**35 522**	47 435	35 000
Market risk	**8 251**	6 272	7 809
Equity investment risk	**18 120**	20 609	17 469
Other risk	**13 660**	14 513	12 071
Total risk weighted assets	**295 046**	300 025	277 821

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

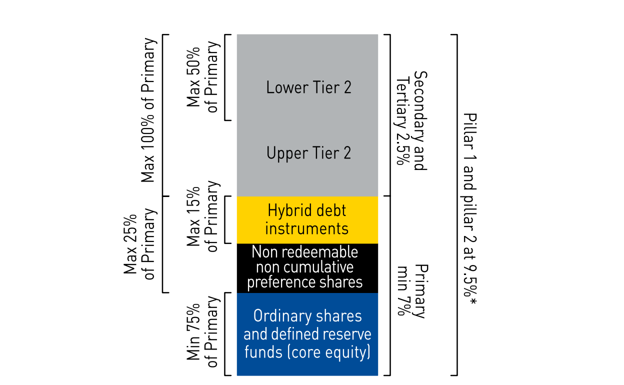
Risk weighted assets for each risk type are calculated as follows.

RWA calculation approach for each risk type

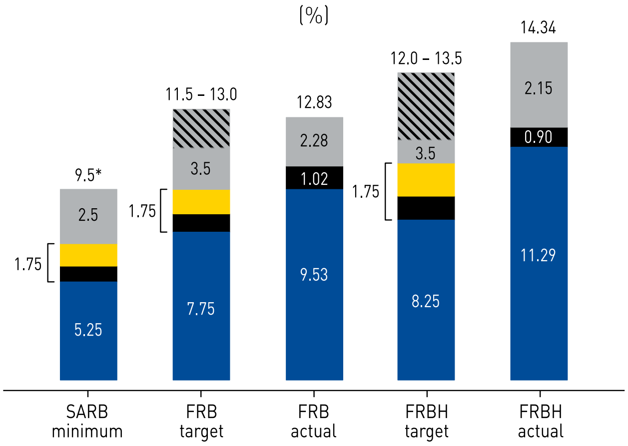
Risk type	FRB	Other regulated entities (FRBH)
Credit risk	Advanced Internal Ratings Based approach ("AIRB")	Standardised approach
Operational risk*	AMA	Domestic operations: AMA Offshore operations: Standardised approach
Market risk	Internal model approach	Standardised approach

* *Approval for the application of the AMA was given by the SARB from 1 January 2009.*

Minimum capital adequacy



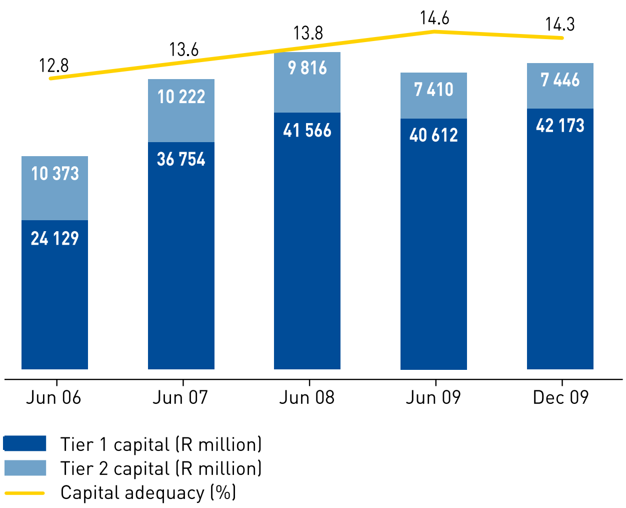
Capital adequacy as at December 2009



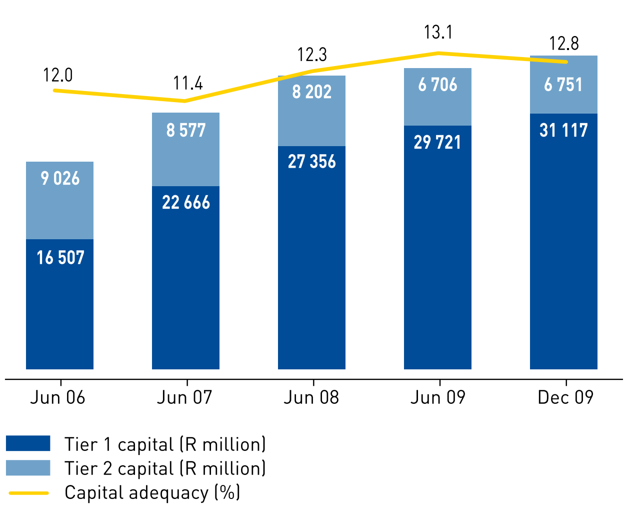
* *Excludes the Bank specific (Pillar 2b) add-on.*

The graphs below depict the current capital adequacy position of FRBH* and FRB*.

FRBH regulatory capital position



FRB regulatory capital position



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

The risk weighted assets and capital adequacy position of FRBH and its subsidiaries are set out in the table below.

RWA and Capital adequacy position for FRBH and its subsidiaries

	At 31 December			At 30 June
	2009	**2009**	2008	2009
	Risk weighted assets R million	**Total capital adequacy %**	Total capital adequacy %	Total capital adequacy %
Basel II				
FirstRand Bank Holdings Limited*	**346 049**	**14.34**	12.97	14.57
FirstRand Bank Limited (South Africa)	**295 046**	**12.83**	11.91	13.11
FirstRand Bank UK (London branch)	**4 356**	**14.64**	18.53	21.35
FirstRand India	**83**	**266.22**	–	157.15
FirstRand (Ireland) PLC	**6 903**	**22.69**	18.31	18.15
RMB Australia Holdings Limited	**5 885**	**18.07**	15.78	19.53
Basel I**				
FNB (Botswana) Limited	**6 232**	**17.26**	15.90	19.05
FNB (Lesotho) Limited	**220**	**18.51**	16.10	19.08
FNB (Moçambique) S.A.	**522**	**16.96**	18.08	17.43
FNB (Namibia) Limited	**9 144**	**19.70**	19.62	20.31
FNB (Swaziland) Limited	**1 239**	**22.11**	23.26	24.69
FNB (Zambia) Limited	**119**	**71.27**	–	168

* *Note: FRBH successfully implemented Basel II at the beginning of January 2008. The registered banks in FRBH 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 Pillar 2b add on). The FNB Africa subsidiaries currently report under Basel I. These entities also report under Basel II and are included on this basis for the consolidated position of FRBH.*

Economic capital

In addition to the regulatory capital requirements discussed in the previous section, the Bank also calculates its economic capital requirements on the basis of a number of internally developed models. It defines economic capital as the level of capital it must hold, commensurate to its risk profile under severe stress conditions to give 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 that it would continue to operate as a going concern.

Regular reviews of the economic capital position are carried out across the businesses, and the Banking Group remains well capitalised in the current environment, with levels of Tier 1 capital (available financial resources) exceeding the level of economic capital required. Furthermore, it uses the allocation of capital as a steering tool and as one expression of risk capacity used for performance measurement purposes. To this end, and considering the need for achieving an adequate return on all capital held by the Bank, capital is allocated to business units as the maximum of the following, including a buffer, namely:

- regulatory capital;
- economic capital; and
- net asset value (shareholder funds)

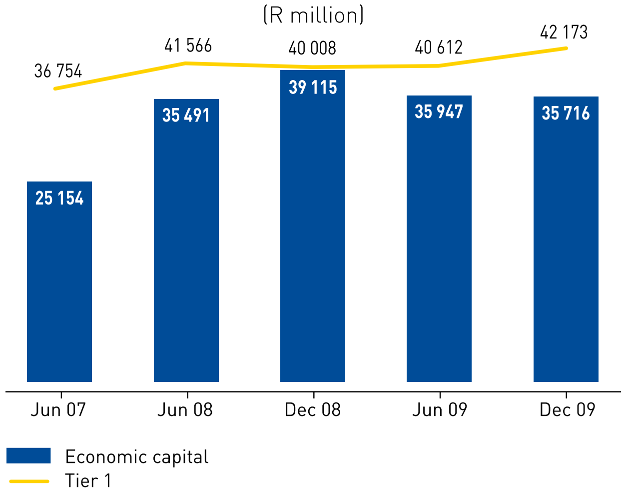
The ICAAP assists in the attribution of capital in proportion to the risks inherent in the respective business units with reference to both normal economic circumstances and times of potential stress, which may lead to the realisation of risks not previously considered. This process is also supported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

The allocation methodology for economic capital is broadly based on the approaches set out as part of the AIRB component of Basel II, with the exception of credit risk, which is considered at a product level. A number of assumptions are necessarily made in the attribution and allocation methodologies. These are reviewed periodically and any changes will have a direct impact on business unit level measures, such as economic profit or net income after capital charges ("NIACC"). The economic capital framework incorporates aspects of the portfolio's composition in its calibration and reflects the effects of risk concentrations (e.g. large exposures and industry concentrations) and diversification benefits. The Banking 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.

The graph below provides an overview of the evolution of economic capital requirements and Tier 1 capital as at 31 December 2009 for FRBH:

Economic capital

(R million)



RISK METHODOLOGIES

As indicated in the introduction to this report, the Banking Group considers the development and embedding of risk assessment and management methodologies and models as a requirement for effective risk management practices that can support the Bank in attaining its strategic objectives.

The following sections provide a detailed description of the approaches, methodologies, models and processes used in the identification and management of each major risk. Each section also describes the applicable governance and policy framework and provides an analysis of the respective portfolios and the Banking Group's risk profile with respect to the type of risk under consideration.

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.

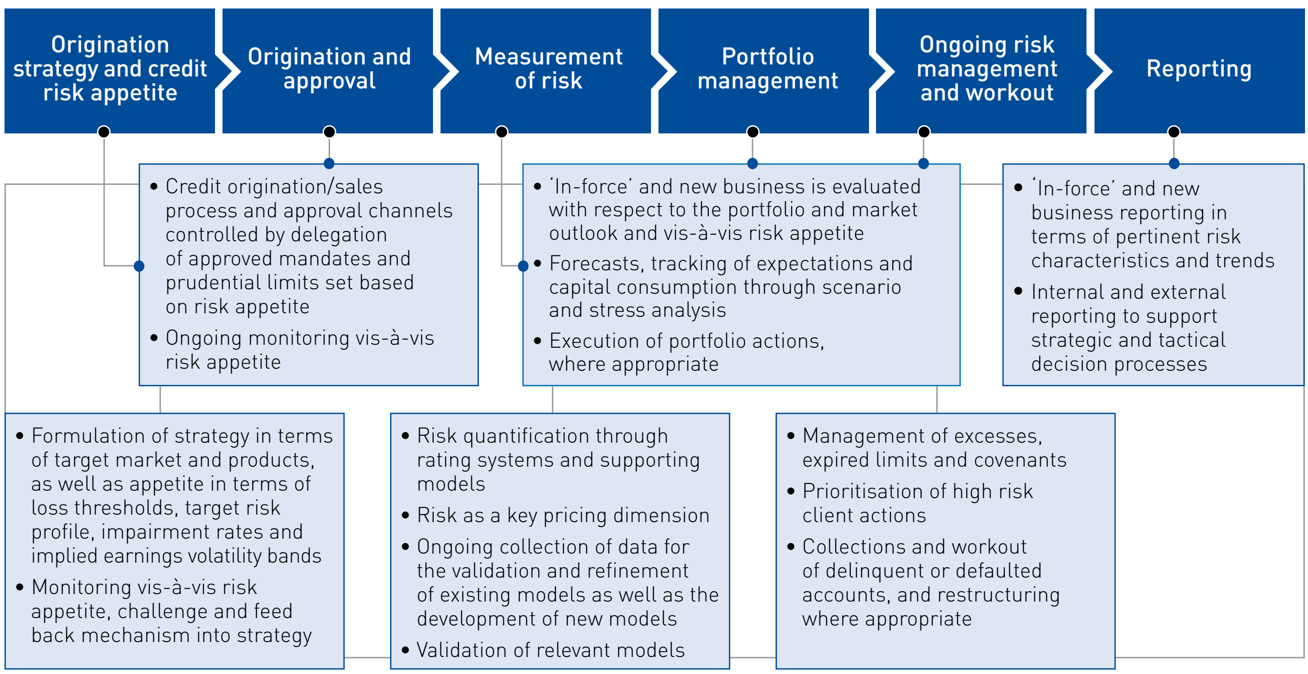
Introduction and objectives

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

1. Risk control: Appropriate limits need to be placed on the assumption of credit risk and steps have to be taken to ensure the accuracy of credit risk assessments and reports. Deployed and central credit risk management teams fulfil this task.
2. Management: Credit risk needs to be taken within the constraints of the Banking Group's risk appetite framework and the credit portfolio is managed at an aggregate level to optimise the Banking Group's exposure to this risk. The business units and the deployed risk functions, overseen by the central ERM function and relevant board committees, as well as the Credit Portfolio Management ("CPM") team in the BSM function fulfil this role.

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

Scope of credit risk management and identification practices



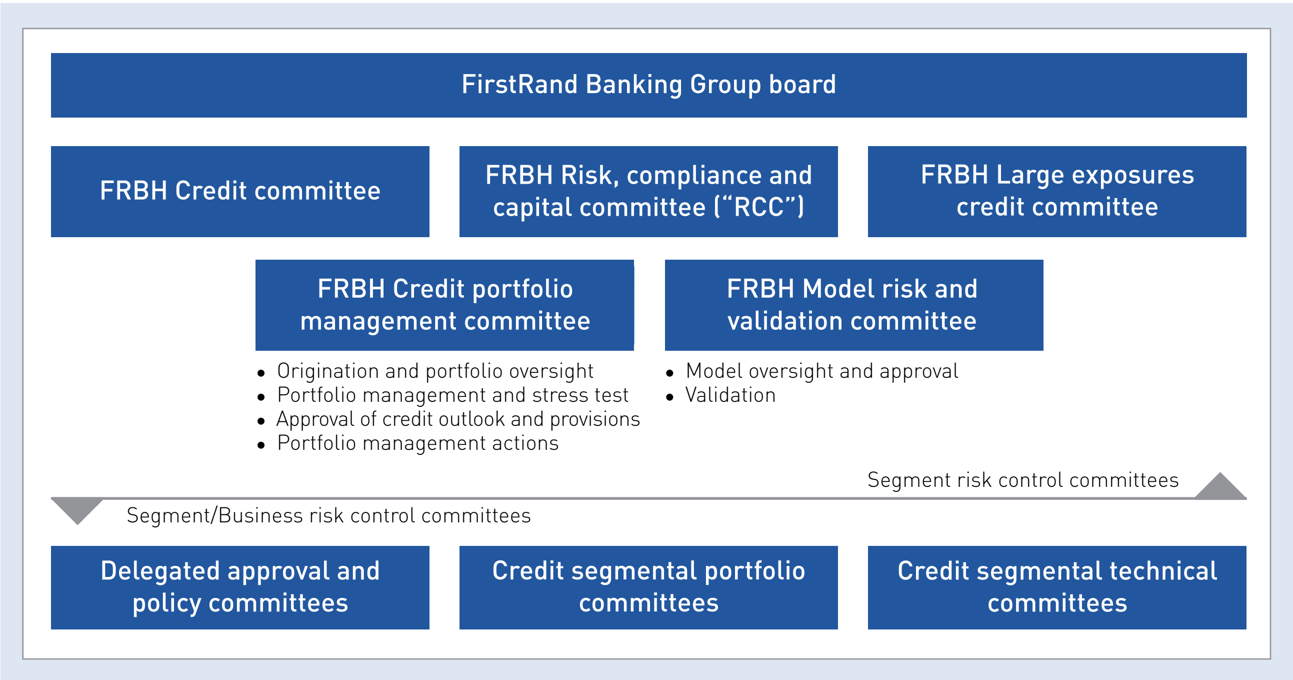
Organisational structure and governance

As described in the *Risk governance* section (page 7) the ultimate responsibility for the identification and adequate management of risks rests with the board, which has delegated its responsibility for overseeing credit risk to the RCC, its respective subcommittees and the boards of the Banking Group's subsidiaries. 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, the CRMF is a policy of the board and integrates with the BPRMF (see page 7). As the primary risk governance body in the Bank, the RCC regularly receives and reviews reports on the adequacy and robustness of credit risk identification, management and control processes, as well as reports on the current and projected credit risk profile across the various businesses.

Two credit focused board committees, the Banking Group credit committee and the Large Exposures Credit committee as well as two subcommittees of the RCC, the FirstRand Banking Group Credit portfolio risk committee and the Model risk and validation committee, support the RCC in this task. This is illustrated graphically in the chart below.

Credit risk governance structure and committees



The Credit portfolio risk committee ("Credit Exco") is responsible for the management of the credit risk profile at a strategic level through the review of reports and the execution of specific actions on:

- the macro economic outlook generally, and the forecasts of credit conditions specifically;
- the credit risk profile and the performance of the credit portfolio, in particular with respect to the appropriate level of impairment charges;
- new business origination with reference to the Bank's credit risk appetite and suitable adjustments on the basis of the macro cycle;
- scenario and sensitivity analyses, stress tests and credit economic capital; and
- credit concentrations.

The Model risk and validation committee fulfils a supervisory role with respect to credit risk measurement systems such as the Bank's rating models. It regularly reviews, challenges and approves reports on the design and operation of these systems and it retains ownership of the Banking Group's model development and validation frameworks.

As indicated in the *Risk governance* section (page 7), three primary lines of risk control have been established across the Bank's operations. Deployed and central risk management functions are the second tier of this control structure.

The Banking Group Credit Risk Management ("GCRM") function in ERM provides independent oversight of the credit risk management practices in the deployed risk management functions in the businesses and of the CPM function in BSM. It is the owner of the CRMF and related policies and monitors the implementation of credit risk related frameworks. In addition, its responsibilities include:

- monitoring of the credit components of the Banking Group's risk appetite framework;
- monitoring of the Bank's credit risk profile and reporting thereof;
- review of all credit rating systems and the independent re-validation of material credit rating systems;
- management of the 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. Their responsibilities specifically include:

- formulation of credit strategy and assessment of business level credit risk appetite (together with CPM and within the constraints of the Bank's overall credit risk appetite, see below);
- maintaining and monitoring implementation of methodologies, policies, procedures and credit risk management standards;
- independent 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.

The CPM function in BSM, on the other hand, is responsible for management of the statement of financial position with respect to credit risk and thus fulfils both an operational and a central coordination role. Its mandate includes:

- the formulation of the macro economic and credit outlook used for planning and stress testing purposes;
- the quantification and allocation of credit economic capital, including the credit risk assessment employed for the ICAAP and the assessment of appropriate capital buffers;
- active participation in the formulation of credit and origination strategies, in particular with a view to the implementation and management of the Bank's credit risk appetite across the business units;
- credit risk related stress testing, scenario analysis and portfolio modelling;
- assessment of impairments, its analysis, forecasting and reporting;
- the coordination of the Bank's securitisation process as well as the design and initiation of structured credit transactions aimed at optimising the credit risk profile and the statement of financial position; and
- credit risk reporting to stakeholders such as the Credit Exco.

Credit risk assessment: Calculation of internal ratings and rating process

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

Credit risk models are employed widely in a number of areas such as the assessment of capital requirements, pricing, impairment calculations and the 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. FRB has been granted regulatory approval for the use of its internal models under the AIRB approach. The remaining FRBH subsidiaries are utilising the Standardised Approach for regulatory reporting purposes under the Basel II framework, even though the same or similar models are applied for the internal assessment of the three primary credit risk components, as outlined in the following sections.

Probability of default ("PD")

The probability of default 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; and
- Event-driven: the Bank has 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 for the Bank).

The Bank applies this definition of default consistently across all credit portfolios as well as in the recognition of non performing loans for accounting purposes.

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

Mapping of FR grades to rating agency scales

FR rating	Mid point 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 and Poor's.*

A FirstRand ("FR") rating of 1 denotes the lowest PD, and an FR rating of 100 the highest. External ratings have also been mapped to the master rating scale for reporting purposes and these mappings are reviewed and updated on a regular basis.

In line with international best practice, the Banking Group distinguishes between point-in-time ("PIT") and through-the-cycle ("TTC") measures of PD. PIT PDs reflect default expectations in the current economic environment and thus tend to be more volatile than TTC PD measures which reflect long term, average default expectations over the course of the economic cycle. Both measures are used for the management of the business and the exposure to credit risk. For example, PIT PDs are typically used in the calculation of impairments for accounting purposes whereas TTC PDs are an input to economic and regulatory capital calculations, providing for a more stable assessment of capital requirements through the business cycle.

Exposure at default ("EAD")

The exposure at default of a particular facility is defined as the expected exposure the Bank may have to a counterparty through the facility, should the counterparty default over the next year. It reflects commitments made and facilities granted by the Bank that have not been paid out and that may be drawn over the time period under consideration (exposures not recognised in the statement of financial position). 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 Banking Group. These have been developed internally and are calibrated to the Bank's historical default experience.

Loss given default ("LGD")

Loss given default is the third major credit risk component estimated by the Bank on the basis of its internal models. It is defined as the economic loss the Bank is expected to suffer on a particular facility upon default of the counterparty, and it is typically expressed as a percentage of exposure outstanding at the time of default.

In most portfolios, the LGD is strongly dependent on the type, quality, and level of subordination and value of collateral held by the Bank compared to the size of the overall exposure as well as 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 for the assessment of LGD across various portfolios, which have been developed internally and whose outputs are calibrated to reflect both the Bank's internal loss experience, where available, as well as external benchmarks, where appropriate.

Typically, a distinction is made between the long run expected LGD and a LGD 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 by the Banking Group.

Rating process

The Bank employs a consistent rating process across the various businesses, differentiated by the type of counterparty and thus the type of model employed for rating purposes. For example, retail portfolios are segmented into homogeneous pools in an automated process based on statistical models of customer behaviour, data gathered from customer applications, a client's delinquency status and other client or product specific parameters. Based on the Bank's internal product level data, probabilities of default are then estimated (and continuously updated) for each pool.

A combination of external models, such as Moody's RiskCalc, and internally developed models are used in the commercial and corporate portfolios, where clients are typically scored on the basis of their financial strength and PDs are estimated based on historical internal default data. For larger counter-parties in the corporate portfolios, as well as for complex bespoke transactions, detailed individual assessments are carried out within a framework that combines qualitative and quantitative analyses with the output of internally developed statistical models, which have been calibrated to the Bank's internal and external data, covering more than ten years.

The following table summarises the processes and approaches employed and it provides an overview of the types of exposures within each of the Banking Group's portfolios.

Credit portfolios and rating process

Portfolio and type of exposures	Description of rating system
Large corporate portfolios **(Wholesale: First National Bank ("FNB") Corporate, BSM 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 ten years. The qualitative analysis is based on the methodology followed by international rating agencies. • The rating assessment is reviewed by the FRBH 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, BSM 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 FRBH 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 FRBH 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 **Small and medium enterprise ("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. • Probabilities of default 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:** • Counterparties are scored using Moody's RiskCalc, the output of which has been calibrated to internal historical default data. • 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. • Portfolio level credit conversion factors ("CCF") are estimated on the basis of the Bank'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.	The default definition applied in the rating systems is aligned to the requirements of Basel II. **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. • Probabilities of default are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools. • No overrides of the PDs 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 credit managers' 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).
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)**	

Model validation

The Bank's rating models are recalibrated and independently validated on an annual basis to ensure their validity, efficacy and accuracy. The rating models used across the credit portfolios incorporate an appropriate degree of conservatism, which has been achieved through the prudent choice of model parameters and the inclusion of downturn periods such as 2001 and 2007/2008 in their calibration.

The independent validation of the Bank's rating systems is carried out by GCRM in ERM. It is responsible for the review of all rating systems and a comprehensive revalidation of all material rating systems on an annual basis. An actuarial auditing team in GIA carries out additional reviews of the rating systems as well as sample revalidations. The results of these analyses are reported to the Model risk and validation committee. 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 the processes followed and the data used to construct and parameterise 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 the 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 that the model development teams have to adhere to.

Credit risk management

The management of individual credit exposures and the credit portfolio as a whole is a core competence of the Bank with commensurate responsibilities shared across business and risk teams as well as deployed and central functions. The individual businesses seek to optimise the risk/return profile of their respective credit portfolios and control their risk exposure through the processes and within the risk appetite constraints set out by the Bank.

Central risk control functions provide the appropriate oversight of this management process and the CPM team in BSM seeks to optimise the overall credit portfolio so as to ensure that diversification effects are duly reflected when evaluating the risk profile against risk appetite constraints and managing the portfolio against these limits.

The primary components of the management process are thus shared and consist of control mechanisms, risk mitigation strategies, approaches to managing credit risk concentrations and a consistent framework for the monitoring of weak and high risk exposures.

Control mechanisms

As indicated in the *Credit risk governance* section, risk control is exercised primarily by deployed and central risk management functions. GCRM, as part of the ERM function, is the ultimate owner of credit risk relevant frameworks and policies and provides oversight of their implementation by the deployed risk management personnel.

Additionally, it facilitates credit risk control through the production of relevant reports for the board, senior management and the regulator. A third component of its mandate is the independent validation of credit risk rating systems across the Bank. As indicated in the preceding section, the team seeks to ensure that credit rating systems are appropriately conservative and that their calibration is sufficiently reflective of periods of economic downturn. An actuarial team in GIA carries out additional reviews and pertinent documentation is ultimately submitted to the Model risk and validation committee for approval.

Mitigation

Since the taking and managing of credit risk is a core component of the Bank'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 Banking Group's risk appetite.

In addition, various instruments are used to reduce the Bank's 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 typically depends on the portfolio, product or customer segment, for example:

- mortgage and instalment sale finance are secured by the assets financed;
- personal loans, overdrafts and credit card exposures are generally unsecured or secured by guarantees and suretyships;
- FNB Commercial credit facilities tend to be 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 typically 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 Bank employs strict policies governing the valuation and management of collateral across all business areas. Collateral is managed internally so as to ensure that the Bank retains title 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 re-valued by physical inspections in the event of default and at the start of the workout process.

Management of concentration risk

Concentration risk is managed in the respective credit portfolios with aggregate monitoring taking place at Banking Group level through the GCRM and CPM functions in ERM and BSM respectively.

In the wholesale credit portfolio, concentrations are managed primarily through single name limits for large exposures as well as the evaluation of country and industry concentrations. The assessment of credit concentrations and their potential impact on this portfolio is based on a sophisticated, simulation based portfolio model. The Banking Group also uses securitisation structures and credit derivatives to manage concentration risk, as discussed in the governance section with respect to the CPM function's mandate.

In commercial portfolios, the Bank is focused on maintaining an appropriate balance of exposures across industries with a view to mitigating residual risks at a Banking Group level, where appropriate and economically feasible. Due to the inherent diversification of retail portfolios, credit risk concentrations in these segments are largely driven by the reliance on a small number of collateral types. These concentrations are monitored and managed in the respective business segments (e.g. exposure to geographical areas and 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 are maintained alongside specific and detailed action plans for each client. These are actively monitored and updated on at least a monthly basis through the respective credit committees in the business area. The Bank seeks to reduce or mitigate its exposure to such clients through the restructuring of facilities where appropriate, through the use of credit derivatives, and ultimately, through an efficient workout and the realisation of collateral value in the event of default.

In retail credit portfolios, weak exposures are monitored on a (homogeneous) portfolio basis. Certain weak exposures are restructured to increase the projected realised value for the Bank. Additionally, the Banking Group typically reduces or removes undrawn facilities in areas such as HomeLoans and Credit Cards, or requires further 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.

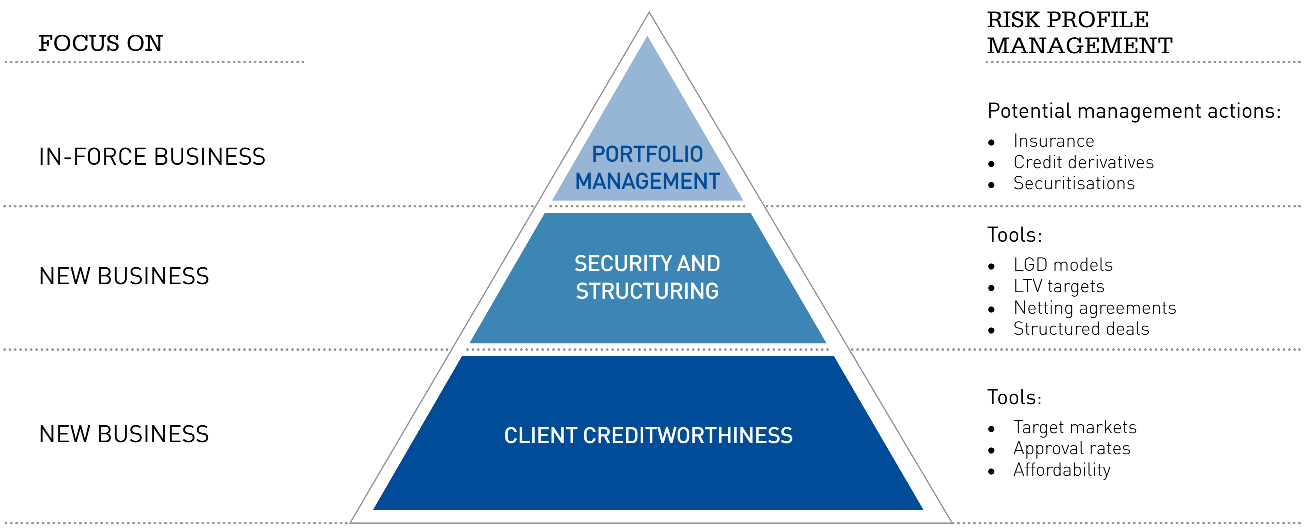
Reports on the overall quality of the portfolio are monitored closely at a business unit as well as at a Banking Group level. As indicated previously, the CPM team in BSM is actively involved in the determination of credit strategy and required changes thereto, so as to ensure that the credit portfolio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

Use of credit risk measures

The Bank uses credit risk measures in a large number of business processes, including pricing, the setting of impairments, in determining capitalisation levels, and in determining overall business strategy, risk appetite and the choice of appropriate return targets.

As the largest risk type in terms of regulatory and economic capital requirements, credit is a particularly prominent component of the Bank's risk appetite framework. Credit risk tools and measures are used extensively in the determination of its current credit risk profile as well as its credit risk appetite (see chart overleaf).

Use of credit measures



Management of the credit portfolio is also heavily reliant on the credit risk measures discussed in the preceding sections. In this context, PD, EAD and LGD are inputs into the portfolio and Banking Group level credit risk assessment where they are combined with estimates of correlations between individual counterparties and industries to reflect diversification benefits across the Bank's portfolio of credit risks.

Expected loss ("EL"), the product of the primary risk metrics PD, EAD and LGD, is a forward looking measure of portfolio or transaction risk. It is used for a variety of purposes across the business alongside the other risk measures. The following table describes the usage of risk concepts and metrics 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). Rating is an important consideration in this process and risk related limits on the composition of the portfolio are used to ensure compliance with the Bank'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 FRBH Credit risk committee, the Wholesale credit technical committee and the board RCC.	See Wholesale. Reports are also submitted to the Retail and SME Credit risk technical committee and the board RCC.
Provisioning	PD and LGD estimates are used extensively in the assessment of impairments and thus in the calculation of provisions.	PIT, long run LGD and roll rates are used in the derivation of specific, portfolios and IBNR provisions.
Regulatory and economic capital allocation	The primary credit risk metrics 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 metrics 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 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 (NIACC).
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 obligator risk. The risk parameters are also used in the Banking 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 Bank's portfolio.	See Wholesale. Extensive analyses of portfolio and risk movements are carried out on a monthly basis, which are used in portfolio management and credit strategy decisions.
Determination of portfolio and client acquisition strategy	Credit portfolio strategy is driven by the Bank's assessment of overall portfolio credit risk, which is based on a portfolio model driven by the primary risk metrics. In this context, acquisition and overall strategy set in terms of appropriate limits so as to ensure that the credit portfolio remains 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 management and compensation	The primary risk metrics are key parameters for the calculation of deal pricing and they 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 metrics.	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.

Discussion of the credit portfolio

The Banking Group's current credit strategy remains aligned to the macroeconomic view of a slow economic recovery and potential volatilities introduced from the global recovery phase. The Bank expects that credit demand will increase in accordance with general consumer expenditure growth, but moderate when compared with the previous economic cycle.

The Banking Group is looking to carefully ease some credit criteria in line with its risk appetite and the expectation of appropriate risk return. Within the current economic environment, areas of opportunity, however, remain limited.

The positive impact of the interest rate reductions during 2008 and 2009 have been reflected in the reduced levels of new non performing loans and credit impairments in most retail credit portfolios. Interest rate increases are not expected in the short term; however, job losses incurred during 2009 are only expected to reverse markedly during 2011. This will result in a slower recovery in the real disposable income of consumers. Improvements in consumers' balance sheets are expected to transpire slowly over the 2010 calendar year. Cognisance should be taken of the impact of this on consumer spending and the effect on the other market sectors. As expected, the SME market remains vulnerable until consumer spending growth momentum returns. The large corporate market is still vulnerable for the same reason, but the expectation is that this market will follow the recovery in the global corporate environment.

Retail credit portfolios

The retail credit portfolios showed an improvement during the six months under review. Interest rate reductions during 2008 and 2009 have resulted in a reduction in the new non performing loans and consequentially a reduction of credit impairment charges in most of the retail portfolios. Despite a reduction in new non performing loans, non performing loan balances are significantly impacted by increasing debt counselling cases.

Wholesale portfolios

For the period under review, the wholesale environment continues to show resilience to the economic downturn, with exception of small business portfolios, which are highly correlated with the retail market. Recent increases in the non performing loan balances and impairment charges relate primarily to the FNB Commercial mid corporate and develop-ment finance portfolios.

Credit assets

The following table provides a breakdown of the Banking Group's credit assets by segment, including items not recognised in the statement of financial position.

Credit assets by type and segment

R million	Dec 2009	Dec 2008	Jun 2009
Short term funds	**20 220**	29 046	21 678
– Money at call and short notice	**1 888**	1 959	1 414
– Balances with central banks and guaranteed by central banks	**11 573**	12 753	12 559
– Balances with other banks	**6 759**	14 334	7 705
Gross advances	**426 826**	441 632	429 777
FNB	**196 136**	202 302	204 370
– FNB Retail	**166 295**	164 873	166 094
– FNB Corporate*	**3 160**	12 050	11 414
– FNB Commercial	**26 681**	25 379	26 862
WesBank	**90 825**	96 091	92 328
RMB	**114 692**	125 206	112 895
FNB Africa	**18 582**	17 304	17 519
Other	**6 591**	729	2 665
Derivatives	**38 686**	81 526	60 213
Investment securities (excluding non recourse investments)	**87 161**	77 531	79 127
Accounts receivable	**4 438**	5 145	4 333
Loans due by holding company and fellow subsidiaries	**859**	371	333
Loans to Insurance Group	**1 177**	1 997	1 868
Credit risk not recognised on the statement of financial position	**87 561**	74 414	84 105
Guarantees	**19 129**	18 268	19 011
Acceptances	**288**	451	279
Letters of credit	**5 776**	6 231	5 576
Irrevocable commitments	**60 962**	46 580	57 786
Underwriting exposures	**–**	200	2
Credit derivatives	**1 406**	2 684	1 451
Total	**667 928**	711 662	681 434

* *Includes public sector.*

Gross advances net of interest in suspense ("ISP")

R million	Dec 2009	Dec 2008	Jun 2009
Advances – Sector analysis			
Agriculture	**12 099**	12 286	11 877
Bank and financial services	**39 697**	55 372	42 592
Building and property development	**19 443**	17 048	18 420
Government, Land Bank and public authorities	**18 004**	17 526	20 825
Individuals	**250 597**	250 878	248 807
Manufacturing and commerce	**32 203**	38 343	35 915
Mining	**9 969**	11 136	9 457
Transport and communication	**14 035**	13 348	13 012
Other services	**30 779**	25 695	28 872
Gross advances after ISP	**426 826**	441 632	429 777
Add back: ISP	**2 109**	1 797	1 896
Gross advances before ISP	**428 935**	443 429	431 673

R million	Dec 2009	Dec 2008	Jun 2009
Advances – Geographic analysis			
South Africa	**391 914**	406 387	393 763
Other Africa	**21 405**	21 818	20 965
UK	**8 179**	4 894	10 381
Ireland	**983**	118	381
Europe	**2 086**	5 446	2 205
North America	**370**	290	320
South America	**353**	1 034	445
Australasia	**967**	1 393	1 157
Other	**569**	252	160
Gross advances after ISP	**426 826**	441 632	429 777
Add back: ISP	**2 109**	1 797	1 896
Gross advances before ISP	**428 935**	443 429	431 673

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 Bank 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 becoming 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 Banking Group, including:

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

The Bank 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 the Bank 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 asset's 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, the Bank 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 the Bank'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 in 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 the Bank 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 the Bank 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

R million	Dec 2009	Dec 2008	Jun 2009
Opening balance	**7 204**	4 918	4 918
Exchange rate difference	**–**	(17)	(6)
Amounts written off	**(3 430)**	(2 536)	(5 843)
Unwinding of discounted present value on non performing loans	**(155)**	(118)	(413)
Reclassifications	**29**	(47)	27
Net new impairment created/released	**3 390**	3 899	8 521
Acquisitions	**–**	3	–
Specific provision (closing balance)	**7 038**	6 102	7 204
Portfolio provision (closing balance)	**2 527**	2 518	2 386
Total provisions (closing balance)	**9 565**	8 620	9 590

Non performing loans ("NPLs") and impaired advances

The bank assesses the adequacy of impairments through the ongoing review of the quality of the credit exposures. Although credit management and workout processes are similar for amortised cost advances and for fair value advances, the creation of impairments for these differs.

For amortised cost advances, impairments are recognised through the creation of an impairment reserve through 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 has been 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 tables below provide an analysis of non performing loans by class, sector and geographical area respectively.

Non performing loans by class

	NPL as % of advances			Non performing loans ("NPL")		
%/R million	**Dec 09**	Dec 08	Jun 09	**Dec 09**	Dec 08	Jun 09
FNB	**8.39**	6.61	8.70	**16 451**	13 367	17 770
FNB Retail	**8.81**	7.46	9.67	**14 644**	12 302	16 063
FNB Corporate Banking	**0.13**	1.20	0.74	**4**	145	84
FNB Commercial	**6.76**	3.63	6.04	**1 803**	920	1 623
WesBank	**5.32**	3.45	4.98	**4 836**	3 312	4 600
RMB	**1.05**	1.17	1.04	**1 200**	1 459	1 177
FNB Africa	**2.16**	2.24	2.45	**401**	388	430
Other	**3.5**	12.76	9.34	**231**	93	249
Total NPL	**5.42**	4.22	5.64	**23 119**	18 619	24 226

Non performing loans by sector

	NPL as % of advances			Non performing loans ("NPL")		
%/R million	**Dec 09**	Dec 08	June 09	**Dec 09**	Dec 08	June 09
Agriculture	**3.24**	4.57	3.48	**392**	561	413
Banks and Financial Services	**1.08**	0.19	0.95	**430**	103	406
Building and Property Development	**6.66**	3.70	5.61	**1 294**	631	1 034
Government, Land Bank and public authorities	**0.41**	0.27	0.36	**74**	48	75
Individuals	**7.09**	6.11	7.71	**17 759**	15 331	19 179
Manufacturing and Commerce	**2.55**	1.54	2.95	**822**	591	1 061
Mining	**1.25**	0.42	1.41	**125**	47	133
Transport and Communication	**2.02**	1.51	1.87	**284**	201	243
Other	**6.30**	4.30	5.83	**1 939**	1 106	1 682
Total NPL	**5.42**	4.22	5.64	**23 119**	18 619	24 226

Non performing loans by geographical area

	NPL as % of advances			Non performing loans ("NPL")		
%/R million	**Dec 09**	Dec 08	June 09	**Dec 09**	Dec 08	June 09
South Africa	**5.58**	4.17	5.82	**21 885**	16 958	22 933
Other Africa	**2.24**	1.78	2.45	**479**	389	513
UK	**0.50**	0.61	0.36	**41**	30	37
Ireland	**–**	–	–	**–**	–	–
Europe	**–**	3.27	4.54	**–**	178	100
North America	**–**	–	–	**–**	–	–
South America	**81.02**	44.68	67.42	**286**	462	300
Australasia	**44.26**	43.22	29.65	**428**	602	343
Other	**–**	–	–	**–**	–	–
Total NPL	**5.42**	4.22	5.64	**23 119**	18 619	24 226

Specific provisions by geographical area

	(Balance sheet)		
R million	**Dec 2009**	Dec 2008	June 2009
South Africa	**6 452**	5 580	6 770
Other Africa	**271**	182	218
UK	**27**	27	28
Ireland	**–**	–	–
Europe	**–**	–	–
North America	**–**	–	–
South America	**–**	18	–
Australasia	**286**	295	188
Other	**2**	–	–
Total specific provision	**7 038**	6 102	7 204

Risk concentrations

The Bank 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.

	December 2009								
Concentration risk of significant credit exposures R million	**South Africa**	**Other Africa**	**United Kingdom**	**Ireland**	**Other Europe**	**North America**	**South America**	**Other**	**Total**
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*	**22 858**	**2 324**	**–**	**–**	**–**	**–**	**–**	**11**	**25 193**
Irrevocable commitments*	**56 829**	**2 887**	**144**	**2**	**873**	**99**	**1**	**127**	**60 962**

The average advances for the period under review **305 672**

	December 2008								
Concentration risk of significant credit exposures R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	406 235	21 745	4 993	–	5 375	182	1 042	2 060	441 632
Derivatives	49 938	440	15 925	7	13 042	1 601	–	573	81 526
Debt securities	61 114	7 803	–	7 664	–	720	205	25	77 531
Guarantees, acceptances and letters of credit*	20 345	1 583	–	–	–	–	–	3 022	24 950
Irrevocable commitments*	43 829	2 529	29	–	–	34	–	159	46 580

	June 2009								
Concentration risk of significant credit exposures R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	393 763	20 965	10 381	381	2 205	320	445	1 317	429 777
Derivatives	37 203	278	12 591	2	8 184	1 874	4	77	60 213
Debt securities	64 081	8 731	357	–	5 005	789	–	164	79 127
Guarantees, acceptances and letters of credit*	22 698	2 153	–	–	–	–	–	15	24 866
Irrevocable commitments*	54 139	3 046	255	13	80	119	8	126	57 786

* *Significant off balance sheet credit exposures.*

Credit rating systems and processes used for Basel II

The Banking Group is utilising the AIRB approach for the exposures of FRB and the Standardised Approach for all other legal entities in the Banking Group for the purpose of calculating regulatory capital requirements. Due to the small size of the subsidiaries and the scarcity of relevant data, the Bank 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, Basel II approach and the Banking Group segment. The figures given here are based on International Financial Reporting Standards ("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.

Exposure by type, segment and Basel II approaches

			Standardised Approach subsidiaries	
R million	**2009**	FirstRand Bank (AIRB)	Regulated bank entities within FNB Africa	London Branch and other subsidiaries
Short term funds	**20 220**	16 949	1 744	1 527
– Money at call and short notice	**1 888**	1 403	389	96
– Balances with central banks and guaranteed by central banks	**11 573**	10 628	942	3
– Balances with other banks	**6 759**	4 918	413	1 428
Gross advances	**426 826**	387 437	18 582	20 807
FNB	**196 136**	191 053	–	5 083
– FNB Retail	**166 295**	161 582	–	4 713
– FNB Corporate	**3 160**	2 790	–	370
– FNB Commercial	**26 681**	26 681	–	–
WesBank	**90 825**	83 664	–	7 161
RMB	**114 692**	108 155	–	6 537
FNB Africa	**18 582**	–	18 582	–
Other	**6 591**	4 565	–	2 026
Derivatives	**38 686**	37 882	53	751
Debt investment securities	**87 161**	72 596	9 026	5 539
Accounts receivable	**4 438**	2 449	308	1 681
Loans due by holding company and fellow subsidiaries	**859**	14 261	1 806	(15 208)
Loans to Insurance Group	**1 177**	976	–	201
Credit risk not recognised on the balance sheet	**87 561**	80 199	4 862	2 500
Guarantees	**19 129**	17 197	1 877	55
Acceptances	**288**	288	–	–
Letters of credit	**5 776**	5 679	98	(1)
Irrevocable commitments	**60 962**	56 015	2 887	2 060
Underwriting	**–**	–	–	–
Credit derivatives	**1 406**	1 020	–	386
Total	**667 928**	612 749	36 381	17 798

For portfolios using the Standardised Approach, the agency 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 Bank 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%	389
10%	–
20%	2 868
35%	6 837
50%	1 059
75%	2 049
100%	22 991
Specific impairments	188
Total	**36 381**

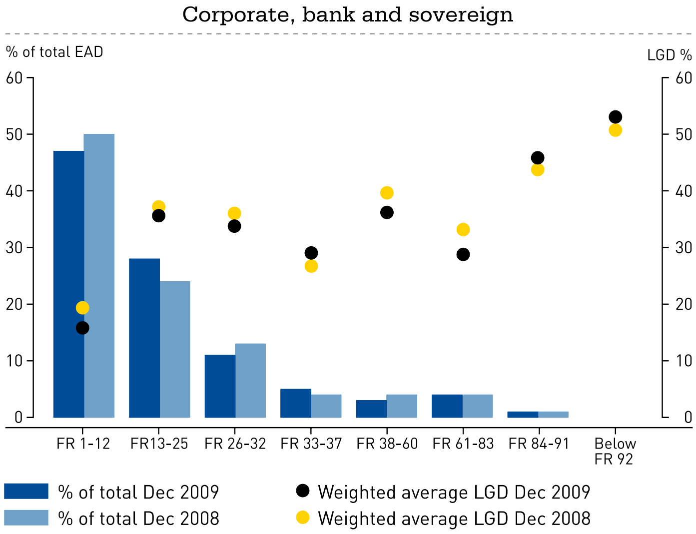
PD, EAD and LGD profiles

The following graphs provide a summary of the EAD distribution by Banking Group segment, bucketed by FR grade. They also show the EAD weighted downturn LGD and the EAD weighted PD. The associated capital requirements are given in the corresponding tables provided below each graph. Comparative information for the prior period has also been provided in the charts and in the tables.

Over the period under review, the performance of the credit portfolio has been in line with that of the industry.

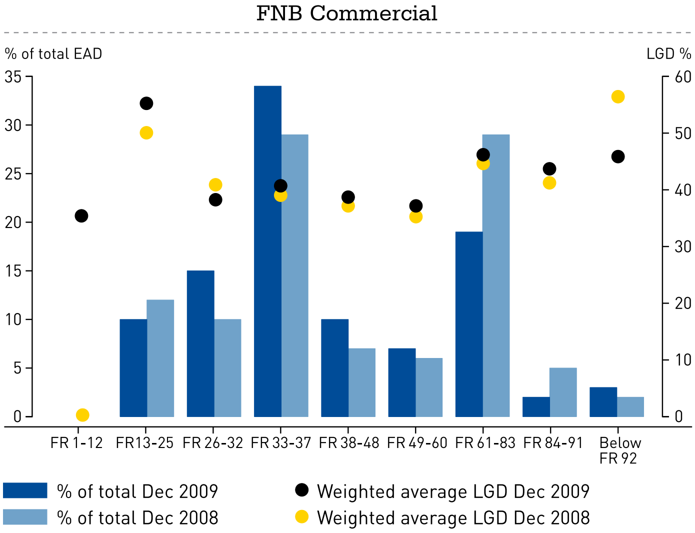
Capital requirements as given by Risk Weighted Assets ("RWA"), have evolved in line with movements in the primary risk parameters, notably shifts in LGD. This is a reflection of the Banking Group's revised credit strategy that selectively targets areas that provide an appropriate risk and return profile in the current economic environment.

Risk profile for corporate, bank and sovereign exposures



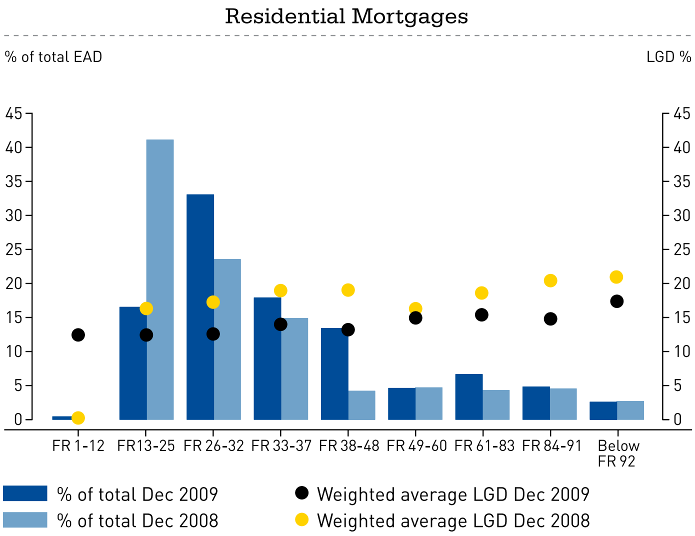
Measure	FR 1-12	FR 13-25	FR 26-32	FR 33-37	FR 38-60	FR 61-83	FR 84-91	Below FR 92
Weighted average PD Dec 2009	0.02%	0.29%	0.89%	1.35%	2.80%	6.34%	15.95%	50.91%
Weighted average PD Dec 2008	0.03%	0.29%	0.88%	1.35%	2.80%	5.91%	16.41%	49.81%
Capital % Dec 2009	0.53%	3.77%	6.23%	6.16%	9.75%	9.87%	22.60%	15.16%
Capital % Dec 2008	0.60%	3.75%	6.51%	6.13%	10.92%	11.07%	20.43%	14.34%

Risk profile for FNB Commercial exposures



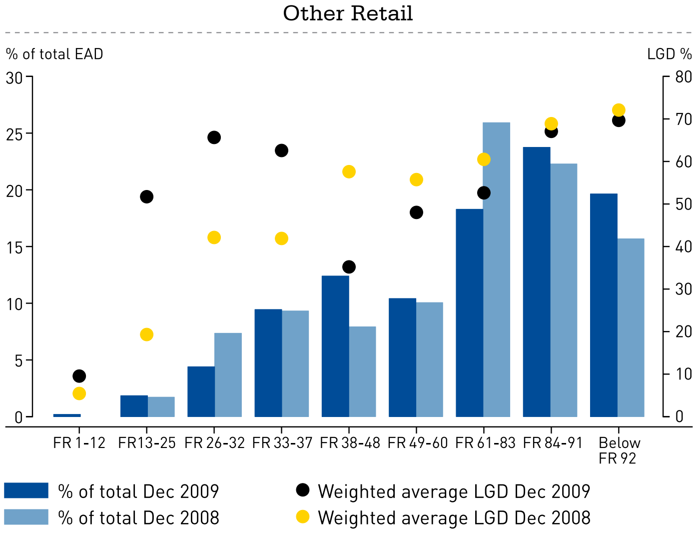
Measure	FR 1-12	FR 13-25	FR 26-32	FR 33-37	FR 38-60	FR 61-83	FR 84-91	Below FR 92
Weighted average PD Dec 2009	0.00%	0.35%	0.85%	1.53%	2.51%	3.63%	5.14%	13.51%
Weighted average PD Dec 2008	0.00%	0.30%	0.87%	1.43%	2.47%	3.74%	4.87%	12.77%
Capital % Dec 2009	0.00%	3.27%	4.32%	6.61%	7.16%	8.04%	11.77%	11.59%
Capital % Dec 2008	0.00%	2.50%	5.30%	5.99%	7.40%	6.99%	12.28%	15.20%

Risk profile for residential mortgage exposures



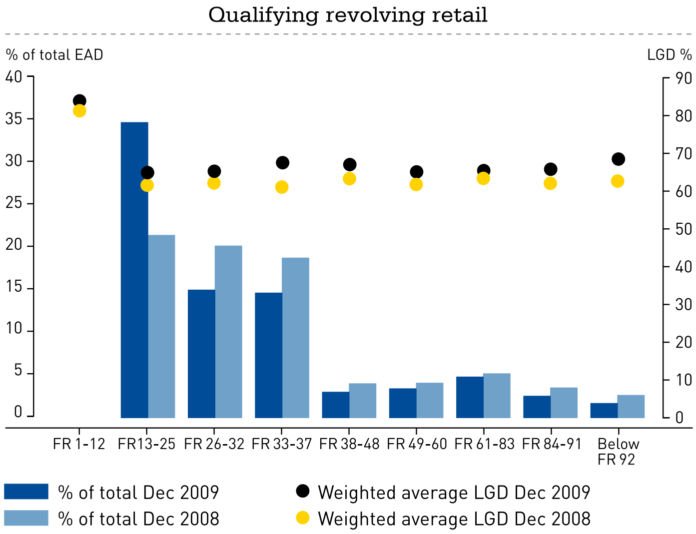
Measure	FR 1-12	FR 13-25	FR 26-32	FR 33-37	FR 38-60	FR 61-83	FR 84-91	Below FR 92
Weighted average PD Dec 2009	0.07%	0.31%	0.71%	1.48%	2.51%	3.58%	5.91%	12.85%
Weighted average PD Dec 2008	0.00%	0.32%	0.80%	1.54%	2.50%	3.81%	6.27%	16.48%
Capital % Dec 2009	0.21%	0.67%	1.23%	2.19%	2.78%	4.11%	5.20%	6.79%
Capital % Dec 2008	0.00%	0.91%	1.74%	2.99%	4.14%	4.08%	6.41%	10.31%

Risk profile for other retail exposures



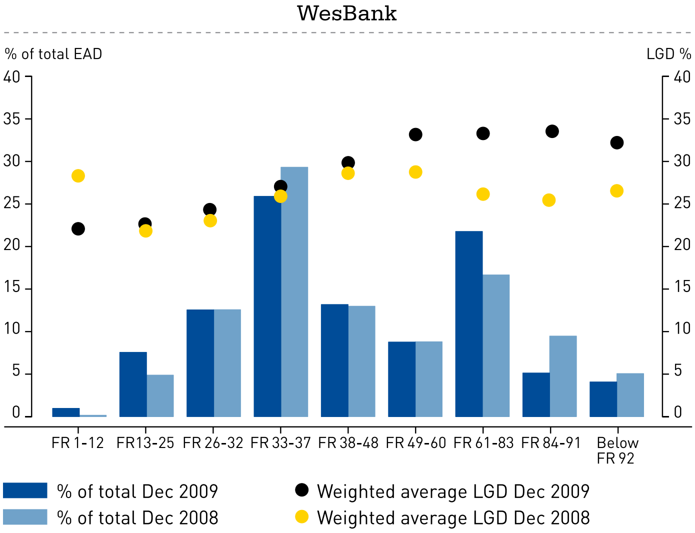
Measure	FR 1-12	FR 13-25	FR 26-32	FR 33-37	FR 38-60	FR 61-83	FR 84-91	Below FR 92
Weighted average PD Dec 2009	0.04%	0.39%	0.82%	1.60%	2.74%	3.64%	6.21%	15.38%
Weighted average PD Dec 2008	0.03%	0.37%	0.88%	1.46%	2.61%	3.69%	5.42%	14.97%
Capital % Dec 2009	0.10%	3.16%	5.83%	7.14%	4.58%	6.58%	7.77%	12.98%
Capital % Dec 2008	0.06%	1.25%	3.77%	4.72%	7.41%	7.60%	8.75%	13.20%

Risk profile for qualifying revolving retail exposures



Measure	FR 1-12	FR 13-25	FR 26-32	FR 33-37	FR 38-60	FR 61-83	FR 84-91	Below FR 92
Weighted average PD Dec 2009	0.08%	0.23%	0.84%	1.49%	2.55%	3.57%	6.08%	13.23%
Weighted average PD Dec 2008	0.06%	0.44%	0.79%	1.57%	2.54%	3.49%	6.14%	14.19%
Capital % Dec 2009	0.39%	0.76%	4.27%	5.90%	6.12%	9.07%	9.62%	14.10%
Capital % Dec 2008	0.29%	1.21%	2.79%	4.69%	5.52%	8.48%	9.90%	13.78%

Risk profile for WesBank exposures



Measure	FR 1-12	FR 13-25	FR 26-32	FR 33-37	FR 38-60	FR 61-83	FR 84-91	Below FR 92
Weighted average PD Dec 2009	0.05%	0.30%	0.83%	1.58%	2.55%	3.62%	5.54%	13.96%
Weighted average PD Dec 2008	0.06%	0.39%	0.84%	1.53%	2.55%	3.62%	6.36%	15.35%
Capital % Dec 2009	0.26%	1.14%	2.29%	3.30%	4.26%	4.81%	4.99%	6.53%
Capital % Dec 2008	0.49%	1.39%	2.22%	3.15%	4.00%	4.16%	4.71%	5.45%

The following table provides the portfolio weighted average performing PD and LGD per Basel II asset class (TTC PDs and downturn LGDs):

Portfolio weighted avearage performing PD and LGD per Basel II asset class

	Weighted average performing PD 31 Dec 2009	Weighted average performing PD 31 Dec 2008	**Weighted average LGD 31 Dec 2009**	Weighted average LGD 31 Dec 2008
Corporate, bank and sovereign	**0.83%**	0.80%	**25.77%**	31.76%
SME exposures	**3.56%**	3.66%	**41.94%**	43.15%
Residential mortgages	**3.25%**	3.26%	**13.40%**	17.40%
Qualifying revolving retail	**2.69%**	3.54%	**65.04%**	62.03%
Other retail	**15.12%**	13.05%	**58.20%**	59.67%
WesBank	**4. 85%**	6.09%	**29.22%**	26.07%

The performing PD is measured through the cycle. The LGD used is the downturn LGD.

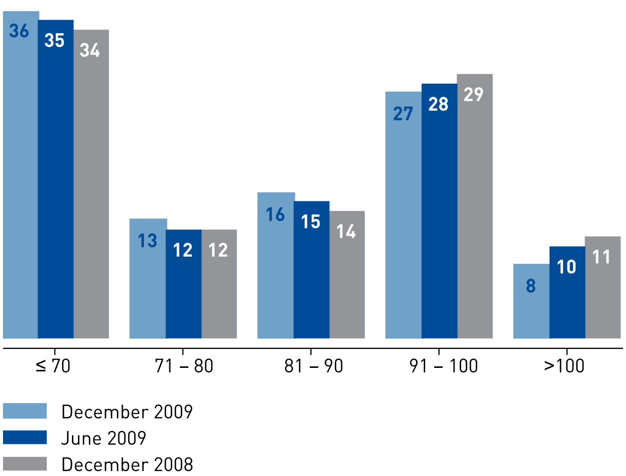
Selected risk analyses

This section provides further information on selected risk analysis that impacts the credit portfolios.

The graphs below provide the balance to value distribution for the residential mortgages over time as well as the aging of the residential mortgages 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

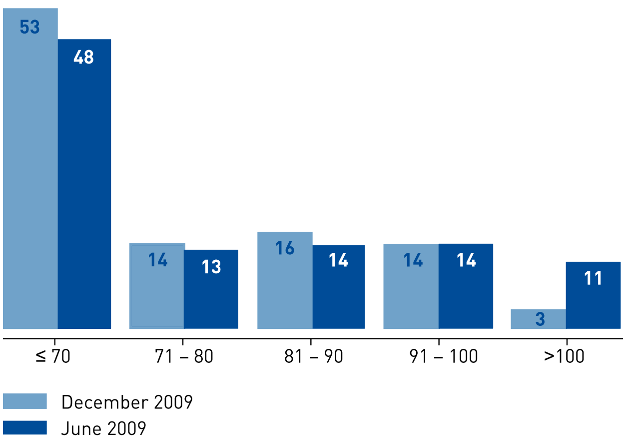
(%)



The balance to market value shows a significant proportion of the book in the lower risk category of below 70%.

Residential mortgages balance to market value

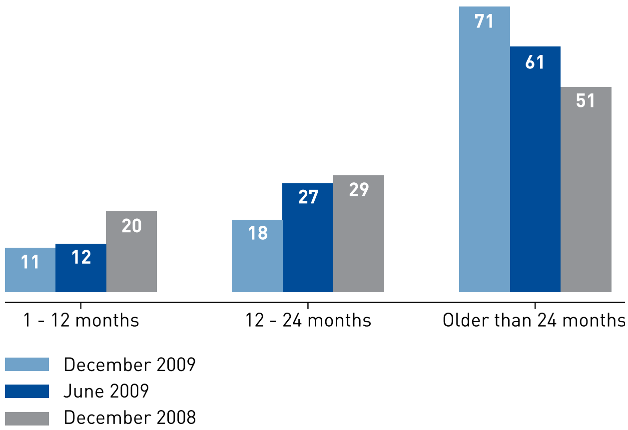
(%)



The improvement in the residential mortgages age distribution is a direct result of the reduction in new loans written during the 2008/2009 year due to the credit and pricing policies followed.

Residential mortgages age distribution

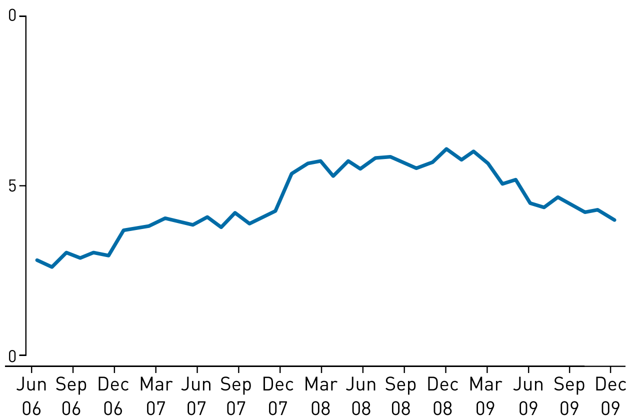
(%)



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

(%)



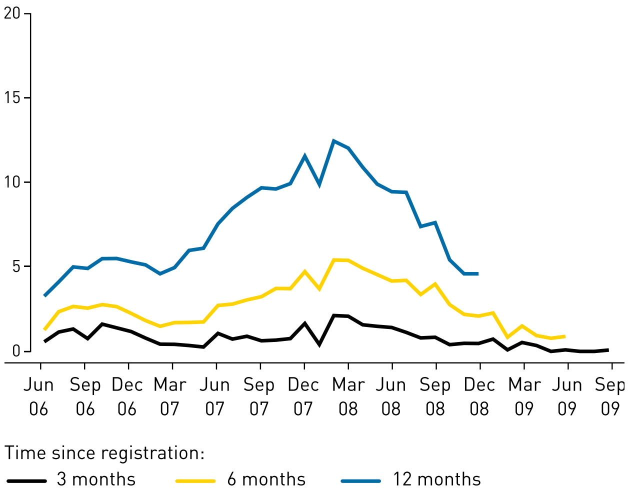
FNB HomeLoans arrears are showing a decreasing trend in the recent months. Similar trends are also observed in the WesBank and credit card portfolios.

The following graphs provide the vintage analysis for FNB HomeLoans and WesBank Retail respectively. Vintage graphs provide the default experience three, six and 12 months after each origination date. It indicates the impact of credit tightening and the market environment.

For FNB HomeLoans, the three, six and 12 month cumulative vintage analysis shows a marked improvement in the quality of business written since mid 2008 notwithstanding further deterioration in the market. The more recent decreases in the default experience are a combination of the credit tightening and the market conditions.

HomeLoans vintage analysis

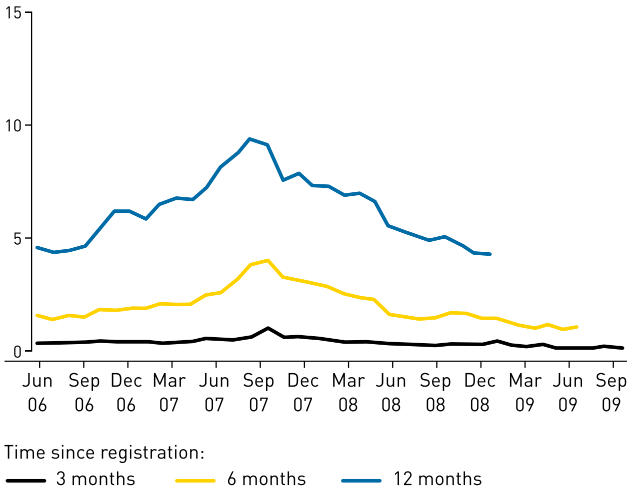
(%)



The WesBank retail six and 12 month cumulative vintage analysis continues to show a noticeable improvement in the quality of business written since mid 2007 as well as reflecting the lower interest rate environment experienced lately.

WesBank retail vintage analysis

(%)



In the asset finance business, repossession and stock holding levels continue to decline over the previous comparative period, the reducing trend (although gradual) is likely to continue into the future as the economic environment eases.

The Banking Group's South African repossessed properties increased from R178 million (670 properties) at 30 June 2009 to R413 million (1 135 properties) at 31 December 2009.

Securitisations and conduits

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

- enhancing the liquidity position through the diversification of funding sources;
- matching of the cash flow profile of assets and liabilities;
- reduction of statement of financial position credit risk;
- reduction of capital requirements; and
- management of credit concentration risk.

From an accounting perspective, traditional securitisations are treated as sales transactions. At inception, the assets are sold to the special purpose vehicle at carrying value and no gains or losses are recognised. Subsequently, the securitisation entities are consolidated into FRBH 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 Bank. 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 the Bank acted as originator, servicer as well as swap counterparty.

Securitisation transactions

Transaction	Asset type	Year initiated	Expected close	Rating agency	Assets securitised	Assets outstanding	
R million						**As at 31 Dec 2009**	As at 31 Dec 2008
Traditional securitisations					16 784	**4 972**	7 578
Nitro 1	Retail: Auto loans	2006	2009	Moody's	2 000	**–**	320
Nitro 2	Retail: Auto loans	2006	2010	Moody's	5 000	**489**	1 282
Nitro 3	Retail: Auto loans	2007	2011	Moody's and Fitch	5 000	**1 151**	2 294
Ikhaya 1	Retail mortgages	2007	2011	Fitch	1 900	**1 377**	1 522
Ikhaya 2	Retail mortgages	2007	2012	Fitch	2 884	**1 955**	2 160
Synthetic securitisations					22 000	**22 000**	22 000
Procul	Retail: Auto loans	2002	2010	Fitch	2 000	**2 000**	2 000
Fresco II	Corporate receivables	2007	2013	Fitch	20 000	**20 000**	20 000
Total					38 784	**26 972**	29 578

Rating distribution of retained securitisation exposures

R million	AAA(zaf)	AA(zaf)	A+(zaf)	A(zaf)	BBB+(zaf)	BBB(zaf)
Traditional						
At 31 Dec 2009	15	8	–	4	29	–
At 31 Dec 2008	15	8	–	4	39	4
At 30 June 2009	56	1	–	–	-	–
Synthetic						
At 31 Dec 2009	18 124	180	52	–	–	–
At 31 Dec 2008	18 126	182	52	–	–	–
At 30 June 2009	18 083	189	52	4	–	–

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.

Downgrades of South African structured finance ratings by Moody's

On 20 July 2009, Moody's downgraded all Aaa- and Aa1-rated notes of South African asset backed securities, residential mortgage asset backed securities, commercial mortgage backed securities and repackaged securities to Aa2. This was as a result of Moody's downgrading South Africa's local currency ceiling for bonds and deposits to Aa2 from Aaa. This action aligned the global scale structured finance ratings with the revised ceiling. The rating action affected notes in the following FRB transactions:

- Nitro Securitisation 1 (Pty) Limited (Classes A14 and A15 downgraded to Aa2)
- Nitro International Securitisation 1 Plc (Classes A downgraded to Aa2)
- Nitro Securitisation 2 (Pty) Limited (Classes A12, A13, A14 and A15 downgraded to Aa2)
- Nitro International Securitisation 2 Plc (Classes A downgraded to Aa2)
- Nitro Securitisation 3 (Pty) Limited (Classes A9, A10, A11, A12, A13, A14 and A15 downgraded to Aa2)

Notably, Moody's did point out that the action was not prompted by concerns on the performance of the underlying portfolios.

	Notes outstanding			Retained exposure		
As at 30 Jun 2009	**As at 31 Dec 2009**	As at 31 Dec 2008	As at 30 Jun 2009	**As at 31 Dec 2009**	As at 31 Dec 2008	As at 30 Jun 2009
6 206	**5 780**	8 596	7 261	**341**	361	351
181	**–**	392	245	**–**	8	5
847	**838**	1 651	1 216	**28**	32	24
1 688	**1 555**	2 759	2 095	**54**	96	73
1 439	**1 432**	1 596	1 592	**100**	82	93
2 051	**1 955**	2 198	2 113	**160**	143	156
22 000	**22 000**	22 000	22 000	**19 183**	19 190	19 182
2 000	**2 000**	2 000	2 000	**1 010**	1 015	1 009
20 000	**20 000**	20 000	20 000	**18 173**	18 175	18 173
28 206	**27 780**	30 596	29 261	**19 525**	19 551	19 533

BBB-(zaf)	BB+(zaf)	BB(zaf)	Not rated	Total
–	–	–	285	341
–	–	–	291	361
–	–	–	294	351
–	–	–	827	19 183
–	–	–	830	19,190
–	29	2	823	19,182

Nitro Securitisation 1 (Pty) Limited – Exercise of Clean-up call

Nitro Securitisation 1 (Pty) Limited ("Nitro 1") was launched on 28 March 2006 with a value of R2 billion and a 7% subordination below the Aaa rated notes. FRB, the originator, held the subordinated loan of R20 million and the Class D notes from March 2008. There was an excess spread of 2%. By 14 September 2009, R186.5 million of notes was outstanding, which represented less than 10% of the original principal amount. On 14 September, the next interest payment date, Nitro 1 redeemed the total outstanding balance by exercising the clean-up call option as outlined in Clause 7.3 of the Offering Circular. This brought to a successful close the first securitisation of instalment sale agreements originated by WesBank. The objective of the Bank to obtain matched term funding at a time when its retail asset book was growing rapidly, was achieved. The structure of the securitisation proved to be robust, even during the recent stressed consumer environment.

All the other transactions continue to perform in line with expectations.

Conduit programmes and fixed income funds

The Bank's conduit programmes are debt capital market vehicles, which provide investment grade corporate South African counterparties with an alternative funding source to traditional bank funding. These also provide 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 Bank.

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

Conduits and fixed income funds

Transaction	Underlying assets	Year initiated	Rating agency	Programme size	Non recourse investments			Credit enhancement provided		
R million					**As at 31 Dec 2009**	As at 31 Dec 2008	As at 30 Jun 2009	**As at 31 Dec 2009**	As at 31 Dec 2009	As at 30 Jun 2009
Conduits										
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**7 117**	10 810	7 287	**–**	–	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**5 797**	5 083	5 017	**805**	680	679
Total					**12 914**	15 893	12 304	**805**	680	679
Fixed income fund										
iNkotha	Overnight corporate loans	2006	Fitch	10 000	**3 763**	5 631	3 623	**–**	–	–
Total					**3 763**	5 631	3 623	**–**	–	–

Rating distribution of conduits and fixed income funds

	F1+(zaf)	AAA(zaf)	AA+(zaf)	AA(zaf)	AA-(zaf)	A+(zaf)	A(zaf)	A-(zaf)	Total
Conduits									
At 31 Dec 2009	**–**	**1 400**	**327**	**1 230**	**4 883**	**1 586**	**2 720**	**768**	**12 914**
At 31 Dec 2008	1 488	1 985	379	2 637	5 951	2 321	1 060	72	15 893
At 30 June 2009	–	1 552	341	2 076	4 640	2 259	1 020	416	12 304
Fixed income fund									
At 31 Dec 2009	**–**	**1 142**	**–**	**–**	**2 076**	**–**	**202**	**343**	**3 763**
At 31 Dec 2008	–	1 708	–	–	3 107	–	302	514	5 631
At 30 June 2009	–	1 209	–	–	1 107	–	1 002	305	3 623

The Bank's role in the conduits and the fixed income fund

Transaction	Originator	Investor	Servicer	Liquidity provider	Credit enhance-ment 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 the Banking Group.

**Liquidity facilities as at 31 December*

		Exposure		
		At 31 Dec 2009	At 31 Dec 2008	At 30 June 2009
Transaction	Transaction type	**R million**	R million	R million
Own transactions		**10 902**	12 154	9 540
iNdwa	Conduit	**5 790**	8 024	5 653
iVuzi	Conduit	**5 112**	4 130	3 887
Third party transactions	Securitisations	**1 601**	2 332	2 160
Total		**12 503**	14 486	11 700

* *It is important to note that from an accounting perspective, upon consolidation, the underlying assets in the entities not recognised in the statement of financial position are reconsolidated back into the Banking Group's statement of financial position.*

All liquidity facilities in the transactions given in the table below 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 the Bank to reflect the risk that these assets may have to be brought onto the balance sheet in a stress scenario. The conduit programmes are consolidated into FRBH 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

Risk weight bands	Exposure			Internal ratings based capital			Capital deduction		
R million	**As at 31 Dec 2009**	As at 31 Dec 2008	As at 30 June 2009	**As at 31 Dec 2009**	As at 31 Dec 2008	As at 30 June 2009	**As at 31 Dec 2009**	As at 31 Dec 2008	As at 30 June 2009
=<10%	**17 840**	17 840	17 840	**122**	122	122		–	–
>10% =<20%	**12 527**	14 510	11 724	**87**	122	92		–	–
>20% =<50%	**180**	235	233	**6**	9	9		–	–
>50% =<100%	**1 067**	1 019	1 013	**64**	57	57		–	–
>100% =<650%	**834**	722	711	**216**	134	152		–	–
1 250%/Deduction	**442**	523	519	**–**	–	–	**442**	519	523
Total	**32 890**	34 849	32 040	**494**	444	432	**442**	519	523

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 & leasing	Total
Traditional	–	232	110	342
Synthetic	100	–	–	100
Total	100	232	110	442

The Bank has not securitised any exposures that were impaired or past due at the time of securitisation. None of the securitisation transactions are subject to the early amortisation treatment.

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.

Introduction and objectives

Counterparty credit risk is closely related to credit risk in that it is concerned with a counterparty's ability to satisfy its obligations under a contract that has a positive economic value to the Bank at time of settlement. It differs from 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.

It is a risk commonly taken in the Banking Group's trading operations and the objective of counterparty credit risk management is thus to ensure that risk is only taken within specified limits in line with the Bank'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. This framework is a subcomponent of the Banking Group's CRMF, which is ancillary to the BPRMF, as discussed in the preceding section on *Credit risk* (see page 18).

In this respect, counterparty credit risk governance aligns closely with the Bank's credit risk governance framework, with mandates and responsibilities cascading from the board, through the RCC to the respective subcommittees as well as deployed and central risk management functions. Refer to the *Risk governance section*, page 7, and the *Credit risk governance* section, page 19, for more details.

Counterparty credit risk assessment and management

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, counterparty risk limit applications are assessed and approved individually, based on a comprehensive analysis of potential exposure, including exposure under distressed conditions. A credit specialist, in conjunction with the market risk team, typically carries out this analysis and submits a recommendation to the appropriate credit committee for discussion and potential approval.

These recommendations are then discussed and tabled for approval 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 typically 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.

Limited 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 have to be agreed amongst these parties and failure to remedy such breaches are reported to the RMB Finance, risk and capital committee, the ERM function and the Banking Group's RCC.

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 Banking Group utilises International Swaps and Derivatives Association ("ISDA") and International Securities Market Association ("ISMA") 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 FRB.

Composition of counterparty credit risk exposure

R million	**31 Dec 2009**	31 Dec 2008	30 June 2009
Gross positive fair value	**114 202**	123 222	134 055
Netting benefits	**46 593**	73 042	60 864
Netted current credit exposure before mitigation	**67 609**	50 180	73 130
Collateral value	**53 707**	21 578	54 513
Exposure at default	**26 938**	53 144	34 945

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

Exposure to credit derivatives at 31 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**

Exposure to credit derivatives at 31 December 2008

R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	2 257	–	5 966	8 223
– protection sold	–	–	–	–
Intermediation activities				
– protection bought	–	–	250	250
– protection sold	970	–	–	970

Exposure to credit derivatives at 30 June 2009

R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	2 264	–	5 694	7 958
– protection sold	–	–	–	–
Intermediation activities				
– protection bought	–	–	–	–
– protection sold	970	–	–	970

MARKET RISK

Market risk is the risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates.

Introduction and objectives

Market risk exists in all trading, banking and investment portfolios, but for the purpose of this report, is considered as a risk specific to trading portfolios. Substantially all market risk in the Banking Group is taken and managed by RMB. The relevant businesses within the RMB, acts as the Bank's 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 Bank's risk appetite.

Risks related to market factors and rate movements in credit and investment portfolios are managed as part of the credit, counterparty credit and equity investment risk management processes.

Organisational structure and governance

Market risk is taken and managed on the basis of the Market Risk Framework, which is a subframework of the BPRMF. It sets out a governance structure consistent with the overall risk management approach of the Banking Group as well as applicable lines of accountability, reporting procedures and policies.

Responsibility for determining the Bank's appetite for market risk vests with the board, which also retains independent oversight of the market risk related activities through the RCC and its Market and investment risk subcommittee. Separate governance forums, such as the RMB Proprietary board, take responsibility for allocating these mandates further while deployed and central risk management functions provide independent control of the overall market risk process. Refer to the governance chart on page 9.

Market risk assessment and management

Market risk exposures are assessed and managed against limits calculated on the basis of liquidity adjusted distressed ETL measures. Additional soft liquidity adjusted VaR triggers are used to highlight positions that need to be reviewed by management.

The recent crisis has clearly demonstrated the need to move beyond simplistic VaR measures and, most importantly, to incorporate the risks inherent in potentially illiquid positions. The basis for the liquidity adjusted ETL limits is thus a scenario set pertinent to the individual structure or transaction under consideration. As indicated in the preceding section, both sets of limits are approved by the RMB Proprietary board and the RCC.

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

In summary, the assessment and management process can be described as follows:

- exposures are quantified daily and monitored against the respective limits as described above by the business unit and central risk management functions;
- the causes of any limit breaches are investigated immediately and relevant reports are escalated to the respective business and risk heads as well as the independent risk control functions and board committees with corrective action, as appropriate;
- risk management also tracks and reports daily P&L movements and their attribution to individual risk factors to ensure that all risk exposure is appropriately identified and risk measures appropriately calibrated; and
- absolute loss thresholds have been introduced to ensure an automatic, staggered de-risking of positions in the event of trading losses exceeding predetermined thresholds.

Market risk assessment practices have also been aligned with the Banking Group's stress testing framework and regular portfolio wide analyses are conducted on the basis of systemic stresses representative of illiquid conditions and heightened volatility characteristic of historical market downturn scenarios. A distressed ETL measure for the whole portfolio is calculated based on a full re-valuation on the basis of pertinent risk factor movements.

In addition to the distressed ETL and VaR methodologies, the Bank supplements its measurement techniques with defined stress tests and scenario analyses across all material risk factors. The calibrations of the stress tests are reviewed from time to time to ensure that they 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.

Consistent regulatory and business management approaches

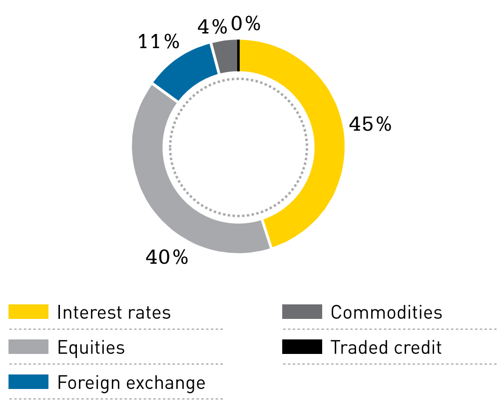
The Banking Group has approval from the SARB to measure regulatory general market risk capital under the internal model approach, as stipulated in the Basel II framework, for the domestic trading book. As such, the market risk assessment and management practices described above are consistent with the methodology used for the management of business on a day to day basis.

For all international legal entities, the Standardised Approach is used for regulatory market risk capital purposes although the internal model based approach on distressed ETL is used for internal economic capital measurement and business management.

Discussion of the market risk profile and analysis of the trading book

The Banking Group is active in all principal traded markets and thus seeks to maintain a balance of exposure to individual risk factors in line with its core view and planning outlook. The following pie chart shows the distribution of exposures per asset class across the Bank's trading activities at 31 December 2009 based on the distressed ETL methodology.

Composition of ETL exposure



Value-at-risk analysis

The VaR risk measure estimates the potential loss over a 10 day holding period at a 99% confidence level. The scenario set used in the calculation of these figures comprises of the most recent 250 days, as required for regulatory capital measurement purposes under the internal model based approach. The following table provides the aggregate risk exposure per asset class across different trading activities.

VaR analysis by instrument

	31 December 2009				31 Dec 2008	30 Jun 2009
R million	Min	Max	Ave	Period end	Period end	Period end
Risk type						
Equities	**251.7**	**539.2**	**362.6**	**314.6**	333.5	287.4
Interest rates	**217.6**	**493.5**	**344.3**	**249.1**	104.1	158.0
Foreign exchange	**25.9**	**277.5**	**115.7**	**82.4**	58.6	117.7
Commodities	**19.6**	**62.0**	**33.6**	**25.5**	58.0	71.2
Traded credit	**0.1**	**0.6**	**0.2**	**0.1**	15.1	8.4
Diversification				**(158.8)**	(196.9)	(263.7)
Total				**512.9**	372.4	379.0

VaR calculations are validated on a daily basis through a comparison of 1 day VaR figures (at the 99% confidence level) to actual trading profits or losses for the particular day.

Market risk stress analysis (distressed ETL)

The portfolio is also re-valued over a set of 500 scenarios, of which 250 represent a distressed market period. The following table provides a summary of distressed ETL figures by asset class, based on a 10 day liquidity horizon over a 99% confidence level.

Distressed ETL analysis by instrument

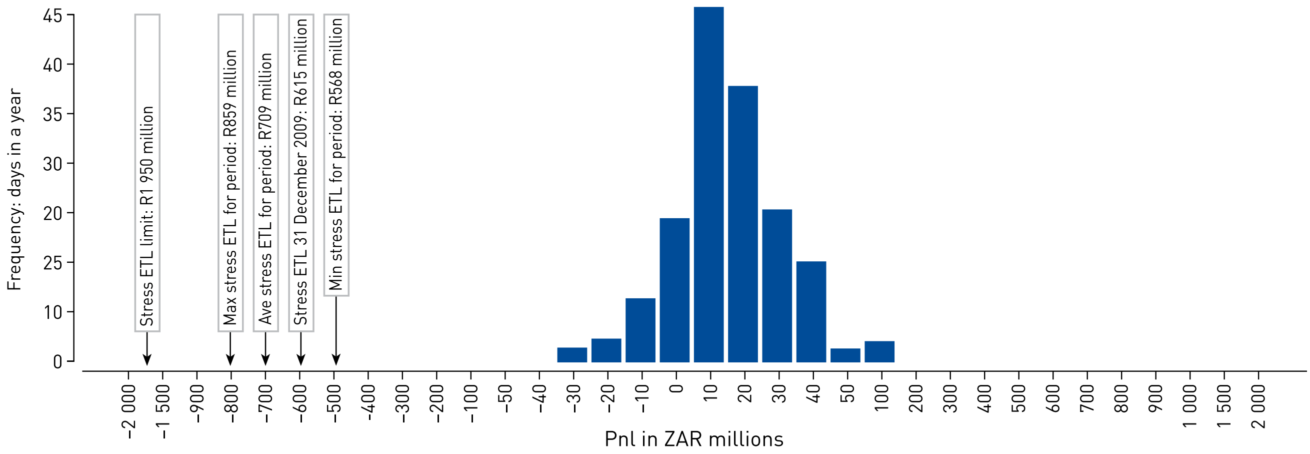
	31 December 2009				31 Dec 2008	30 Jun 2009
R million	Min	Max	Ave	Period end	Period end	Period end
Risk type						
Equities	**364.8**	**550.2**	**453.4**	**430.2**	516.7	431.8
Interest rates	**425.7**	**746.8**	**578.8**	**483.8**	226.8	525.2
Foreign exchange	**88.9**	**422.2**	**168.0**	**115.8**	93.0	169.7
Commodities	**29.6**	**92.8**	**52.5**	**38.4**	88.1	108.9
Traded credit	**0.9**	**2.7**	**2.0**	**1.4**	15.0	15.0
Diversification				**(192.6)**	(348.6)	(457.3)
Total				**877.0**	591.0	793.3

VAR and ETL measures for the current period are not directly comparable to those reported in prior periods due to changes in the diversification methodology, as well as the introduction of 90 day VaR/ETL measures (as opposed to 10 day measures) for illiquid portfolios.

Daily earnings at risk

The Bank tracks its daily earnings profile from trading activities as illustrated graphically in the chart below. In the period under review the Bank experienced heightened income volatility resulting from more volatile market conditions. Exposures have, however, been contained within risk limits during the trading period and the earnings profile has been skewed towards profitability.

Distribution of trading income for the year ended 31 December 2009 for local divisions

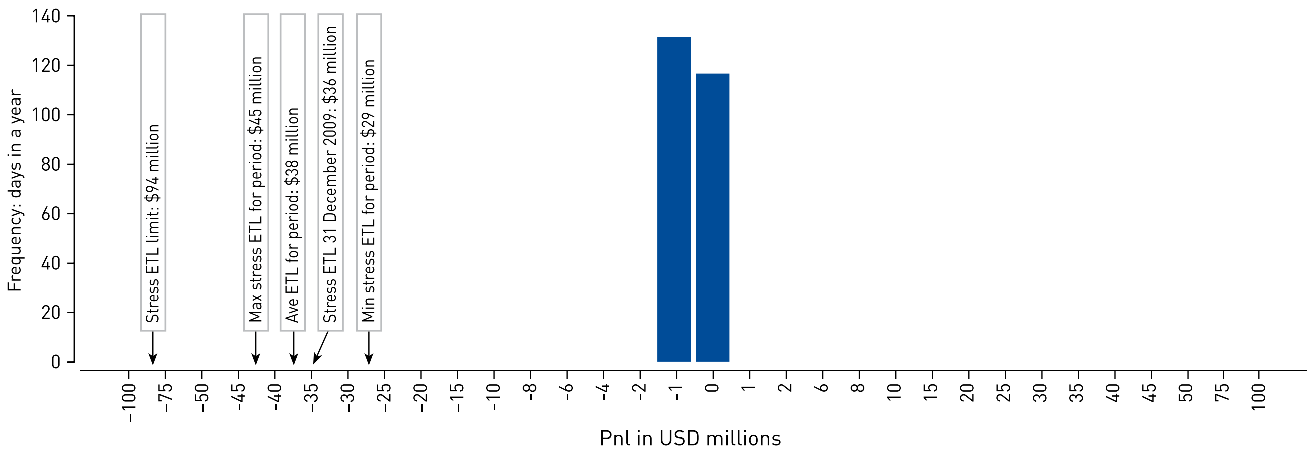


FirstRand International

FirstRand Ireland plc ("FRIE") holds the most material exposure to market risk amongst the international subsidiaries. The same distressed ETL and VaR methodologies are employed for the measurement and management of risk as in the South African portfolio. FRIE utilises additional stress scenarios and market risk monitoring processes specific to its portfolio. The market risk limits for each business area are set by the FRIE board.

The distribution of trading income provided in the chart below reflects a reduced level of volatility compared to the previous reporting period, which resulted from the de-risking of the offshore trading book.

Distribution of trading income for the year ended 30 June 2009 for offshore divisions



FNB Africa subsidiaries

FNB Namibia and FNB Botswana hold the most material exposure to market risk in the African subsidiaries. Both employ stress test methodology to estimate the potential maximum losses expected in their portfolios. Their respective market risk positions are monitored by a designated, independent risk manager within RMB. During the period under review, market risk has been contained within acceptable limits and has been managed effectively by the Banking Group across its African subsidiaries. Refer to page 59 of the *Interest rate risk in the banking book* section for qualitative risk disclosure.

EQUITY INVESTMENT RISK

Equity investment risk generally denotes the risk associated with the acquisition (complete or partial) of an ownership interest in a listed or unlisted company, with the intention of holding the investment over the longer term, and the potential adverse change in value of this investment.

Introduction and objectives

Equity investments can be a substantial source of value for shareholders as part of a balanced portfolio of risks as set out in the Bank's overall risk appetite statement. The objective of equity investment risk management is thus the identification, assessment, monitoring and management of risks associated with the Bank's investments so as to ensure that the aggregate risk to its earnings remains within acceptable limits.

During the latter part of 2008, RMB placed Dealstream, a clearing client, into default and took over its portfolio under its futures clearing agreement and applicable JSE rules. Due to market liquidity constraints and the relative size of the holdings, three large investments in the portfolio, namely Vox Telecom Limited, Simmer & Jack Mines Limited and Control Instruments Limited were retained. These are now managed as part of RMB Private equity with a view to realising value over the longer term, and therefore fall within the purview of the risk management framework set out in the following sections.

Organisational structure and governance

The primary responsibility for the assessment and management of equity investment risk vests with the board and its designated subcommittees. Approval authority for taking equity investment risk has been delegated to the respective business unit investment committees, e.g. the RMB Investment committee under a delegated mandate from the board and the RCC. As the structure of the Bank's investments may also incorporate significant components of debt, approval authority also rests with the respective credit committees and the board's Large exposures credit committee, as appropriate.

Equity investment risk assessment and management

Equity investment risk is assessed primarily in terms of regulatory and economic capital requirements as well as scenario analyses of potential event risks and associated write downs in value.

For the assessment of economic capital requirements, an approach similar to that employed for Basel II purposes is utilised – i.e. applying a risk weighting of 300% and 400% to the exposure for listed and unlisted investments, respectively. For unlisted investments that are equity accounted, a conservative offset is employed should the carrying value fall below the market value by a specified margin.

Where price discovery is possible for listed positions, an ETL under distressed market conditions is calculated on a standalone basis and used for economic capital purposes, subject to a floor of 20% of market value. Similarly, in the case of investments in funds, the modelling of economic capital requirements is based on a look through where this is feasible, where the individual exposure represents less than 5% of the fund's total value, and where RMB did not provide the seed capital for the fund. The distressed ETL figure used for economic capital purposes is supplemented by a specific risk add on of 12% in line with Basel II requirements. Funds for which frequently updated asset prices are not available are classified as unlisted investments and assessed as indicated above.

The Bank holds additional capital buffers against the potential of adverse revaluations of its investment portfolios, which are calculated on the basis of scenario and stress analyses. These analyses have been integrated with the Banking Group's overall stress testing framework (see page 12). For example, stress tests are carried out simulating the staggered write down of the three largest investment exposures to determine the largest potential marginal impact on existing capital requirements, which in turn is used to determine the appropriate level of buffers held.

The 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 in which the Bank develops a thorough understanding of the target company's business, risks, challenges, competitors, management team and unique advantage or value proposition.

For each transaction an appropriate structure is put in place that aligns the interests of all parties involved through the use of incentives and constraints for management and the selling party. The Bank typically seeks to take a number of seats on the respective company's board and maintains close oversight through the ongoing monitoring of the company's operations. In addition, normal semi annual reviews are carried out and crucial parts of these reviews such as valuation estimates are independently peer reviewed.

To reduce and manage risk within acceptable constraints, the Banking Group targets a diversified investment portfolio profile along a number of pertinent dimensions such as geography, industry, investment stage and vintage (i.e. annual replacements of realisations).

Discussion of the equity investment risk profile

As indicated in a preceding section, RMB took over significant positions in Vox Telecom Limited, Simmer and Jack Mines Limited and Control Instruments Limited, which are now managed as part of RMB's private equity portfolio. These holdings are monitored on a daily basis as part of the Bank's market risk monitoring process. Capital requirements for these positions are, however, calculated on the basis of the equity investment risk framework, reflecting the Bank's long term exit strategy.

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

Investment valuations and associated economic capital requirements as at 31 December 2009

R million	Publicly quoted	Privately held	Total
Carrying value disclosed in balance sheet	**3 306**	**4 267**	**7 573**
Fair value*	**3 306**	**8 080**	**11 386**
Total unrealised gains recognised directly in the balance sheet through equity instead of the income statement**	**929**	**142**	**1 071**
Latent revaluation gains not recognised in the balance sheet**	**–**	**3 813**	**3 813**
Economic capital held	**742**	**973**	**1 715**

** Fair values of publicly quoted investments were not considered to be materially different from the quoted prices.*
*** These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*

Investment valuations and associated economic capital requirements as at 31 December 2008

R million	Publicly quoted	Privately held	Total
Carrying value disclosed in balance sheet	2 210	6 452	8 662
Fair value*	1 836	6 896	8 732
Total unrealised gains recognised directly in the balance sheet through equity instead of the income statement**	702	92	794
Latent revaluation gains not recognised in the balance sheet**	(374)	444	70
Economic capital held	500	1 470	1 970

** Fair values for listed private equity associates based on their values in use exceeded the quoted market prices by R511 million.*
*** These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*

Investment valuations and associated economic capital requirements as at 30 June 2009

R million	Publicly quoted	Privately held	Total
Carrying value disclosed in balance sheet	2 179	4 861	7 040
Fair value*	2 179	7 958	10 137
Total unrealised gains recognised directly in the balance sheet through equity instead of the income statement**	666	132	798
Latent revaluation gains not recognised in the balance sheet**	–	3 097	3 097
Economic capital held	474	1 176	1 650

** Fair values for listed private equity associates based on their values in use exceeded the quoted market prices by R511 million.*
*** These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*

LIQUIDITY RISK

Liquidity risk is the risk that the 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.

Introduction and objectives

The Banking Group applies a comprehensive definition of liquidity risk and further distinguishes two types of liquidity that may pose a risk, namely:

1. Funding liquidity, which relates to the risk that the Bank will be unable to meet current and/or future cash flow or collateral requirements without adversely affecting the normal course of business, its financial position or its reputation; and
2. Market liquidity, which relates to the risk that the Bank may be unable to trade in specific markets or that it may only be able to do so with difficulty due to market disruptions or a lack of market liquidity.

The principal objective of the Bank's liquidity risk management efforts is to optimally fund the Banking Group under normal and stressed conditions.

Organisational structure and governance

Liquidity risk management efforts are 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 with respect to the following:

- governance (strategy as well as control and oversight of liquidity risk);
- principles for the management of liquidity risk;
- systems for measuring, monitoring and reporting liquidity exposures and risks as well as disclosure requirements and policies; and
- contingency funding plans.

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 a subcommittee of the RCC, the FRBH Asset and liability management committee ("FRBH ALCO"). FRBH ALCO's primary responsibility is the assessment, control and management of both liquidity and interest rate risk for FRB, FNB Africa and international subsidiaries or branches, either directly or indirectly through providing guidance, management principles and oversight to the asset and liability management 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 the BSM function. It is this central function's responsibility to ensure that the liquidity risk management framework is implemented appropriately, i.e. that suitable measurement and management tools are in place to control liquidity risk and to support relevant decision processes at the Banking Group level. 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 bi-monthly to the Funding executive committee. In addition, management aspects of the Banking Group's liquidity position are reported to and debated at FRBH ALCO. The liquidity risk management and risk control teams in BSM and ERM also provide regular reports to FRBH 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 Africa businesses that manage liquidity risk on a decentralised basis in line with the Banking Group's principles under delegated mandates from their respective boards. Reports from these committees are presented to FRBH ALCO on a regular basis and the management and control of liquidity risk in the subsidiaries follows the guidance and principles that have been set out and approved by FRBH ALCO.

International subsidiaries

Similarly, liquidity risk for international subsidiaries is managed on a decentralised basis in line with the Banking Group's LRMF. Each of the international subsidiaries and branches reports into the International ALCO, which is a subcommittee of FRBH ALCO and meets on a monthly basis to review and discuss region specific issues and challenges for liquidity and interest rate risk.

Liquidity risk assessment and management

As indicated in the preceding section, liquidity risk for FRB is managed centrally by a team in BSM. The Banking 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 credit crisis. The Banking Group is 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 statement of financial position items under normal, stressed and contractual conditions. The Bank has developed three forecasting models for this purpose:

1. *Business as usual model:* Forecasting the Bank's liquidity situation on an ongoing basis. This model provides an estimate of the funds the Banking Group is required to raise under routine circumstances, taking into account behavioural assumptions around the optionality inherent in some products on the statement of financial position.
2. *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.
3. *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 Bank's reputation.

Early warning systems and key risk indicators ("KRI")

As indicated above, liquidity risk is considered to be a consequential risk that may be driven by a number of variables unrelated to the structural composition of the statement of financial position and may thus not be easily quantified and summarised. Therefore, the Bank employs an early warning system composed of a number of key metrics and indicators to assess potential risks to its liquidity position. The indicators monitored in this regard can be grouped broadly as follows:

- diversification (term, source, product);
- exposures not recognised on the statement of financial position;
- available funding resources;
- performance measurement;
- reputation (risks and events);
- regulatory requirements;
- asset quality; and
- other risks/events.

For each of these categories, multiple KRIs 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 KRIs may trigger immediate action where required. Their current status and relevant trends are reported to the FRBH ALCO and RCC on a monthly and a quarterly basis, respectively.

Stress testing and scenario analysis

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

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

Management

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**
• 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 • Maintaining a funds transfer pricing methodology and process	• 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 • Managing and maintaining collateral	• Managing early warning and KRIs • 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 • Maintaining the Contingency funding plan

Structural liquidity risk management

Structural liquidity risk denotes the risk that structural, long term on and off statement of financial position exposures cannot be funded timeously or at reasonable cost. Risk management in this area therefore seeks to maintain an appropriately balanced asset and liability structure to avoid undue pressure on current or future sources of liquidity. The liquidity management team is responsible for determining the Banking Group's liquidity strategy and for establishing its liquidity risk tolerance, subject to approval by FRBH ALCO and the board. In doing so, the team retains responsibility for maintaining adequately diversified sources of funding in terms of instrument type, term, geography, counterparty and currency.

Daily liquidity risk management

The team is responsible for 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. This also includes responsibility for the management of daily payment queues, Central Bank clearing systems as well as the maintenance of collateral and the statutory liquid asset inventory.

Contingency liquidity risk management

The Bank seeks to maintain a number of contingency funding sources that it is able to draw upon in times of economic stress. To this end, the liquidity risk management team carries out stress analyses to determine the possible impact of various scenarios on the Bank's cash flows, liquidity, profitability and solvency position on a regular basis. The team also maintains and monitors early warning systems and KRIs, which it reports on to the funding EXCOs and FRBH ALCO, as appropriate.

Liquidity contingency funding planning

The Bank's 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, KRIs 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 as well as ongoing communication with key external stakeholders and across all levels of the Banking Group.

Liquidity risk management cycle

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

Liquidity risk management lifecycle

The target liquidity risk profile is determined by the Bank's 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 as described variously in the preceding points. 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 longer term actions to ensure that the Bank remains within its chosen risk profile. The cost of these actions is then passed on to the businesses through the internal matched maturity funds transfer pricing mechanism. It should be noted in this context that financial transactions utilising special purpose vehicles are treated as if they are on balance sheet and are considered in the liquidity risk management cycle and thus managed consistently and conservatively across the Banking Group.

Contractual discounted cash flow analysis

The following table represents the contractual discounted cash flows of assets, liabilities and equity for the Banking 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.

Therefore, in addition to the analysis shown in the table above, the Banking 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 FRBH

	31 December 2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	Over 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	–	(188 222)	(26 387)	214 608
Cumulative liquidity gap	–	(188 222)	(214 608)	–

	30 June 2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	Over 12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	634 398	246 868	56 040	331 490
Total equity and liabilities	634 398	437 349	86 551	110 498
Net liquidity gap	–	(190 481)	(30 511)	220 992
Cumulative liquidity gap	–	(190 481)	(220 992)	–

Contractual discounted cash flow analysis for FRB

	31 December 2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	Over 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)	–

Contractual discounted cash flow analysis for FRB

	31 December 2008			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	Over 12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	607 766	194 838	83 938	328 990
Total equity and liabilities	607 766	374 383	95 034	138 349
Net liquidity gap	–	(179 545)	(11 096)	190 641
Cumulative liquidity gap	–	(179 545)	(190 641)	–

	30 June 2009			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	Over 12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	564 847	223 103	43 410	298 334
Total equity and liabilities	564 847	399 301	81 801	83 745
Net liquidity gap	–	(176 198)	(38 391)	214 589
Cumulative liquidity gap	–	(176 198)	(214 589)	–

As illustrated in the table above, the negative contractual liquidity short term gap has remained relatively unchanged on a cumulative basis during the period under review. This is a consequence of the following market conditions and management actions:

- the Bank has undertaken efforts to grow stable and long term funding during the period under review;
- the Bank has built up stress funding buffers both locally and offshore during the period under review;
- the international buffer is placed in European Treasury Bills;
- the international balance sheet has been de-risked; and
- asset growth in the banking sector has been muted over the period under review.

INTEREST RATE RISK IN THE BANKING BOOK

Interest rate risk in the banking book ("IRRBB") is defined as the sensitivity of the balance sheet and income statement to unexpected, adverse movements in interest rates.

The Bank identifies and categorises this risk further in the following components:

- repricing risk arises from the differences in timing between repricing of assets, liabilities and derivatives;
- yield curve risk arises when unanticipated changes in the shape of the yield curve adversely affect the Bank's 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 Bank's position as the counterparty to such a transaction.

Introduction and objectives

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 Bank's earnings and capital base. Effective interest rate risk management practices that contain the Banking Group's interest rate risk exposure within prudent levels, as stipulated by its risk appetite, is essential to the safety and soundness of the enterprise.

The objective of interest rate risk management is therefore to protect the balance sheet and income statement 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 Banking Group, different management approaches, reports and lines of responsibility exist across the various parts of the Bank, as discussed below.

All IRRBB related activities are overseen and reported to the board through FRBH ALCO, a subcommittee of the RCC, as illustrated on page 9. FRBH ALCO is also responsible for the allocation of sublimits on the basis of mandates given by the RCC, 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 BSM function, ERM provides central oversight and control across the activities of the deployed risk management functions and BSM.

Interest rate risk, unlike credit risk, can only be sensibly assessed and managed at an aggregate level. Therefore, the net interest rate risk profile of the domestic banking book (i.e. FRB, excluding RMB) is centrally managed by the MPM team in BSM. In this respect, BSM is responsible for ensuring that adequate processes and controls are in place to quantify and manage the interest rate risk position by ensuring that the framework and relevant regulations are adhered to.

RMB has a delegated mandate from FRBH ALCO for the management of its interest rate risk (under the market risk framework) as well as for ensuring that the limits of the Banking Group's risk appetite are observed. The interest rate risk management efforts of both BSM and RMB are 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 FRBH ALCO on a monthly basis. International subsidiaries and branches are overseen by the International ALCO, a subcommittee of FRBH ALCO, which provides central oversight and monitoring reflective of each region's specific issues and requirements.

IRRBB assessment and management

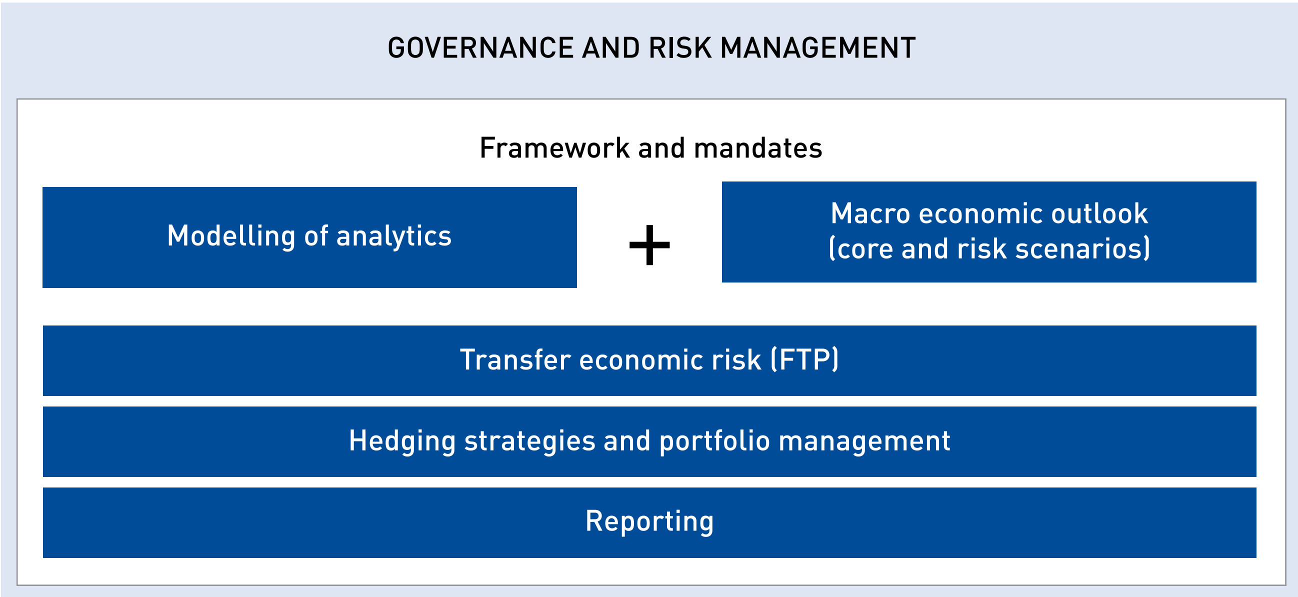
The Banking Group employs a number of measurement techniques to quantify interest rate risk as defined above, focusing both on the potential risk earnings as well as the potential impact on overall economic value.

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

The management of interest rate risk has been delegated by FRBH ALCO to BSM, RMB and the regional ALCOs as described above.

The Banking Group's activities around the assessment and management of interest rate risk have been summarised graphically in the chart.

Components of the interest rate risk management approach



As alluded to previously, the interest rate profile is modelled and analysed at an aggregate level, in line with the principles and standards set out in the respective risk framework. The risk profile is typically adjusted by changing the composition of the Banking Group's liquid asset portfolio or through derivative transactions where possible based on the Banking Group's 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 Bank's view, only be effectively managed if it is understood in the context of other risks and how their interaction may impact its balance sheet 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 ("Invesco") 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 these 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.

The Banking Group applies cash flow hedge accounting for derivates used in the aforementioned 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.

Discussion of the interest rate risk profile

The natural position of the Banking Group's 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 Bank's largest component of interest rate risk. The Bank seeks to employ 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 schedule for the FRBH banking book

	At 31 December 2009				
	Term to repricing				
R million	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 12 months	After 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	13 483	20 602	–

Note: 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.

	At 30 June 2009				
	Term to repricing				
R million	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 12 months	After 12 months	Non rate sensitive
FirstRand Bank Limited					
Net repricing gap	2 401	14 100	(527)	127	(16 101)
Cumulative repricing gap	2 401	16 501	15 974	16 101	–
African subsidiaries					
Net repricing gap	2 693	212	479	1 393	(3 819)
Cumulative repricing gap	2 693	2 905	2 425	3 819	–
Total cumulative repricing gap	5 094	19 406	18 399	19 920	–

Note: 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.

Net interest income sensitivity has increased slightly in rand terms 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 year end and throughout the year. 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 263 million. A similar increase would result in an increase in projected 12 month net interest income of R1 279 million.

Sensitivity of FRBH projected NII

	At 31 December 2009		
	FRB	African subsidiaries	FRBH
R million	Change in projected 12 month NII	Change in projected 12 month NII	Change in projected 12 month NII
Downward 200 bps	**(1 155)**	**(108)**	**(1 263)**
Upward 200 bps	**1 171**	**108**	**1 279**

	At 30 June 2009		
	FRB	African subsidiaries	FRBH
R million	Change in projected 12 month NII	Change in projected 12 month NII	Change in projected 12 month NII
Downward 200 bps	(1 111)	(74)	(1 185)
Upward 200 bps	1 123	74	1 197

Note: 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.

OPERATIONAL RISK

Operational risk denotes the risk of loss resulting from inadequate or failed internal processes, controls and systems, human factors or from external events.

Introduction and objectives

Over the reporting period FRB obtained approval from the SARB to adopt 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 Bank's operations, which are aimed at ensuring the proper identification of all operational risks, their mitigation where appropriate and their 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;
- regulatory compliance;
- recruitment;
- training and retention of talent;
- operational process reliability;
- information technology security;
- outsourcing of operations;
- dependence on key suppliers;
- implementation of strategic change;
- integration of acquisitions;
- human error;
- customer service quality;
- regulatory compliance; and
- social and environmental impacts.

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 board has delegated its responsibility for the adequate identification and management of operational risk to the Operational risk committee ("ORC"), a subcommittee of the RCC. The ORC provides governance, supervision, oversight, and coordination of relevant risk processes as set out in the framework. To ensure appropriate visibility at a board level, the ORC includes two non executives, one of which is a member of the board. Other members include the divisional heads of 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.

Operational risk assessment and management

In line with international best practice, the Banking Group employs a variety of approaches and tools in the assessment of operational risk. The most pertinent of these are:

- KRI – KRIs have been put in place across all businesses as an early warning measure to highlight areas of increasing potential exposure to operational risk. KRI reports are included in regular management reports to support ongoing risk identification and mitigation efforts by the business;
- self assessments – risk and control self assessments ("RCSA") are integrated in the business and risk management processes to assist risk managers in identifying key risk areas and to 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;
- audit findings – GIA acts as the third line of risk controls across the organisation and audit findings are used to verify whether controls put in place by the businesses are acceptable in mitigating the risks associated with their key and supporting processes. The number of findings issued, as well as audit findings that have not been resolved before the due date, are tracked, monitored and reported on through the risk committee structures;
- internal loss data – loss data reporting and analyses are used by risk managers to understand the root causes of loss incidents and to understand where corrective action should be taken to mitigate losses;
- external data – external loss data bases are used to derive lessons from other organisations and loss events and to inform quantitative operational risk assessments through risk scenario analyses; and
- incident and issue reporting – 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 to facilitate a feedback of any lessons learned into the organisation's operational risk management practices.

The Banking Group recognises that operational risk is a consequential risk that it cannot avoid or mitigate 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. Operational risk events resulting in substantial losses occur much less frequently and the Bank seeks to minimise their incidence and contain their severity within its risk appetite limits.

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. FRB began applying the AMA under the Basel II framework from 1 January 2009 for the Bank's domestic operations. Other subsidiaries and offshore operations continue to utilise the Standardised Approach for operational risk, as was the case for all domestic operations until the beginning of this year.

The AMA allows the Bank to employ a sophisticated, statistical model based approach for the estimation of capital requirements, which enables more granular and more accurate estimates of the capital requirements associated with the operational risks in each business. A number of operational risk scenarios covering key risks that, although low in probability, may result in severe losses are the basis for this model. These scenarios were derived through an extensive analysis of the Bank's operations in consultation with business experts from the respective areas. All scenarios were subsequently cross referenced to external loss data, internal losses, the control environment and other pertinent information about relevant business processes. To ensure the ongoing efficacy of the capital assessment, all scenarios are reviewed, supplemented or updated semi annually, as appropriate.

The internal loss scenarios are combined with loss data in a simulation engine to derive the distribution of potential operational risk losses. Regulatory and economic capital requirements are then calculated as the potential loss at the 99.9% confidence level, excluding the effects of insurance and potential diversification effects.

The loss data used for this purpose is collected for all seven Basel II event types across various 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 risk profile parameters, such as applicable loss estimates, which are evaluated continuously;
- 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.

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 Banking 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 reported regularly to a number of relevant risk committees so that they can be integrated with future BCM efforts. 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).

The Banking Group manages this risk on the basis of its 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 period under review there were no significant incidents related to legal risk.

Information risk

The Banking Group's clients entrust it with highly sensitive information and the Banking Group accepts its fiduciary duty to safeguard this information in the course of its business activities. Information risk, i.e. the risk of adverse business impacts, including the loss of reputation caused by a failure of data confidentiality, integrity and availability controls 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 Banking Group. The IT framework is approved by the Technology and Information Management Risk committee ("TIMCO"), a subcommittee of the ORC and applies to all operations within the Banking Group.

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 the Banking Group.

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 their implementation in the respective functions across the Banking Group.

Like many other large organisations, the Bank constantly faces a number of new and changing threats across the evolving IT landscape. 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 Bank 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 the Bank's commitment to a stance of "zero tolerance" towards crime. Executive management throughout the Banking 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 their operations within the constraints of a consistent governance framework that is overseen centrally by ERM.

STRATEGIC AND BUSINESS RISK

Strategic risk denotes the risk to current or prospective earnings arising from adverse business decisions or the improper implementation of such decisions. Business risk denotes the risk to earnings and capital due to potential changes in the business environment, client behaviour and technological progress. It is often termed volume and margin risk and relates to the Bank's ability to generate sufficient levels of revenue to offset its costs.

Introduction and objectives

The risk of choosing of an inappropriate strategy or failing to execute the chosen strategy appropriately is inherent in all business endeavours. The Bank's objective is to minimise this risk in the normal course of business.

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

Organisational structure and governance

The development and execution of business level strategy is the responsibility of the individual business areas, subject to approval by the board, which sets the Bank's overall strategy and ensures that strategic objectives set at a business level are consistent with its overall strategy. This includes the approval of any subsequent material changes to strategic plans, acquisitions, significant equity investments and new strategic alliances.

Business unit and executive management, as well as the central BSM and ERM functions, 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 through regular scenario planning and stress testing exercises, the Banking Group assesses the risk to its earnings and thus the level of potential business risk it faces. Reports on the results of such 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.

Strategic and business risk assessment and management

Strategic risk, as defined above, 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 the Bank's earnings on the other hand can be assessed, and this forms an explicit part of its risk appetite and ICAAP (including the regulatory ICAAP).

Business risk is a residual risk (to the extent that its impact is not captured by other risk types) and is assessed regularly as part of the ICAAP. It is managed strategically at a Banking Group level through the development, review and updating of the strategic plan in light of the organisation's evolving view of the business environment.

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

As a financial services provider, the Banking Group's business is one that is inherently built on trust and close relationships with its clients. Safeguarding the Banking Group's reputation is therefore of paramount importance to ensure its continued prosperity and is thus 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 Banking Group's reputation is built on the way in which it conducts its business and protects its reputation by managing and controlling these risks across its operations. It thus 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, which are a component of the planning and strategy setting processes. As indicated in the introduction of this report, the Banking Group aims to establish a risk and earnings profile within the constraints of its risk appetite and thus seeks to limit potential stress losses from credit, market, liquidity and operational risks that may otherwise introduce undesirable volatility in its financial results and adversely affect its reputation.

REGULATORY RISK

Regulatory risk denotes the risk of legal or regulatory sanction and material financial loss or reputational damage as a result of a failure by the Banking Group or any part thereof to comply with any applicable laws, regulations or supervisory requirements.

Introduction and objectives

Regulatory risk management 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 Banking Group therefore aims to establish a compliance culture in its operations that contributes to the overall objective of prudent regulatory compliance and risk management.

The objective of the Bank's compliance and regulatory risk management efforts is thus to ensure that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws and that any risks to compliance can be identified and managed pro-actively prior to incurring a potential liability.

It is of paramount importance to ensure compliance with the requirements of the Banks Act 94 of 1990 (as amended) and the Regulations thereto, and to ensure that all non compliance risks identified in this context are addressed and managed in accordance with these rules and regulations and are 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 Bank, 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. Therefore the Bank 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 status 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 their mandate is set out in the Compliance Risk Management Framework, a subpolicy of the BPRMF.

Supervision of regulatory risk is provided and managed by a number of committees such as the Regulatory risk committee, the RCC and the FRBH Audit committee, which receive detailed reports on the status 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 divisions have appointed compliance officers responsible for implementing and monitoring compliance polices and procedures related to their respective divisions.

Regulatory risk 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 status 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 FRBH;
- 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 has been drafted which also fulfils the function of assisting 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.

FIRSTRAND

The listed holding company

100% FirstRand Bank Holdings Limited – Banking

- 100% » FirstRand Bank
  - First National Bank[1]
  - Rand Merchant Bank[1]
  - WesBank[1]
  - FNB India[2]
  - FirstRand Bank London[3]
- 100% » FNB Lesotho
- 59% » FNB Namibia[7]
- 100% » FNB Swaziland
- 70% » FNB Botswana
- 90% » FNB Moçambique
- 47% » OUTsurance[4]
- 100% » FNB Insurance Brokers
- 100% » FirstRand International
  - – Ireland
  - – Mauritius
  - – Australia
- 100% » eBucks

100% FirstRand Investment Holdings (Proprietary) Limited ("FRIHL") – Unregulated[5]

- 97% » RMB Private Equity Holdings
- 92% » RMB Private Equity
- 100% » RMB Stockbroking[6]
- 100% » FirstRand International Wealth Management
- 40% » Eris Property Holdings
- 50% » RMB Morgan Stanley
- 50% » Rentworks
- 33% » Tracker

100% Momentum Group Limited – Insurance & Asset Management

- 100% » Momentum Insurance[1]
  - FNB Insurance[1]
- 85% » Advantage Asset Managers
- 100% » Momentum Medical Scheme Administrators
- 100% » AdviceAtWork
- 100% » RMB Asset Management
- 100% » Momentum Africa
- 50% » Momentum Short Term Insurance
- 35% » Momentum Life Assurance Namibia

1 Division
2 Branch
3 Representative office
4 Effective shareholding in FirstRand Short Term Insurance Holdings Limited
5 For segmental analysis purposes entities included in FRIH are reported as part of Banking Group Supersegment within the respetive franchise results
6 Regulated by the JSE
7 Includes 51% of Momentum Life Assurance Namibia

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
CPM	Capital portfolio management
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
FRIE	FirstRand Ireland plc
FTP	Funds transfer pricing
GIA	Group Internal Audit function
GCRM	Banking group credit risk managment
ICAAP	Internal Capital Adequacy Assessment Process
IBNR	Incurred but not reported
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditing
Invesco	Investment committee
IRRBB	Interest rate risk in the banking book
IT framework	Information Technology Governance and Information Security framework
ISDA	International Swaps and Derivative Association
ISMA	International Securities Market Association
ISP	Interest in suspense
KRI	Key risk indicators
LGD	Loss given default
LRMF	Liquidity Risk Management Framework

LTV	Loan to value
MMMFTP	Marginal matched maturity funds transfer pricing
MPM	Macro Portfolio Management
MTM	Mark-to-market
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 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
UK	United Kingdom
US	United States
VaR	Value at risk