Risk and capital management report

RISK AND CAPITAL MANAGEMENT REPORT

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OVERVIEW

FirstRand Limited (FirstRand or the Group) believes that effective risk management is of primary importance to its success and is a key component of the delivery of sustainable returns to shareholders. It is, therefore, deeply embedded in the Group's tactical and strategic decision making. The Group aligns its risk management approach to its strategy.

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.

Risk taking is an essential part of the Group's business and FirstRand explicitly recognises risk identification, assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates. Through its portfolio of leading franchises namely, FNB, RMB, WesBank and the newly-established investment management business, Ashburton Investments, FirstRand aims 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 create long-term value through sustainable earnings pools managed within acceptable earnings volatility parameters.

MANAGING THE RISK PROFILE

The Group's focus areas to manage its risk profile and optimise its portfolio, are:

Earnings resilience and balance sheet strength

- Strong earnings resilience through diversification, growth in client franchise businesses, improved margins and cost containment.
- Maintain balance sheet strength through:
  - an asset profile that reflects an appropriate balance between corporate and retail lending activities;
  - optimal retail asset mix; and
  - improved asset quality.
- A diversified and competitive deposit franchise.
- Maintain ROE.
- Fund the Group's activities in a sustainable, efficient and flexible manner, underpinned by strong counterparty relationships within prudential limits and requirements.
- Maintain the Group's strong capital position post-Basel III. Current targeted levels and ratios are summarised in the following table.

Capital adequacy position

%	CET1	Tier 1	Total
Regulatory minimum	4.5	6.0	9.5*
Target	9.5 – 11.0	11.0	12.0 – 13.5
Actual	**13.8**	**14.8**	**16.3**

* *The regulatory minimum excludes the bank-specific individual capital requirement (ICR).*

Risk governance

- Balance the Group's overall risk capacity with a bottom-up and consolidated view of the planned risk profile for each business, in line with the board risk appetite principles.
- Strong risk governance with multiple points of control consistently applied throughout the organisation.

TOP AND EMERGING RISKS

- Although the debt crisis in Europe has stabilised somewhat, concerns exist that the slowdown in emerging market economies, coupled with US quantitative easing tapering, pose a risk to growth prospects.
- South Africa currently runs a large current account deficit. This imbalance reflects the country's dependence on foreign capital inflows to fund growth. The dependence renders the economy vulnerable to adverse global or domestic economic developments that could affect foreign capital inflows, increasing the risks to growth and commodity prices.
- The tailwinds (commodity super cycle and foreign capital flows) that benefited the South African economy over the past few years are fading, putting pressure on an already weak exchange rate, and a higher inflation rate relative to domestic demand conditions.
- Consumers' disposable income will remain constrained resulting in continued pressure on the retail credit book performance and growth. This may also result in increased levels of non-performing loans (NPLs) including unsecured lending portfolios.
- Regulatory changes that are currently being planned for unsecured lending may affect business models and could result in a number of consequences across the industry.
- With global cybercrime increasing, renewed focus is being placed on protecting the Group against external and internal attacks.
- A changing and tougher regulatory landscape (Financial Intelligence Centre Act, Consumer Protection Act, Treating Customers Fairly, Basel III) with concomitant high compliance costs. This is further exacerbated by international requirements such as Foreign Account Tax Compliance Act and Office of Foreign Asset Control Sanctions, which do not form part of South African law, but which banks have to apply in order to maintain correspondent banking relationships and secure inward funding.

RECENT AND FUTURE REGULATORY CHANGES

The year under review was characterised not only by announcements relating to comprehensive future regulatory reforms but also by amended legislation, ongoing amendments and proposed enhancements to the banking, regulatory and supervisory framework.

Basel III

The most notable regulatory change was the implementation of the Basel III framework through the amended *Regulations relating to Banks* (the Basel III regulations), which became effective on 1 January 2013. The regulatory reforms in respect of the Basel III framework are mainly focused on banks capital and liquidity, and details on these can be found in the relevant sections of this report. The Group expects that, in order to ensure that the South African regulatory framework for banks remains aligned to internationally-agreed regulatory and supervisory standards, future amendments to banking legislation will continue. The Group will continue to actively and constructively support and participate in working and task groups.

Twin peaks

An important development in respect of the regulatory framework was a document issued for public comment in February 2013 by the Financial Regulatory Reform Steering Committee. This provides information on a wide-ranging set of reforms and proposals relating to, amongst others, the implementation of a twin peaks model of financial regulation in South Africa; details of which were initially published during February 2011 in a policy document, *A safer financial sector to serve South Africa better*. In a pure twin peaks model, prudential and market conduct regulation is undertaken by separate regulators. A dedicated prudential regulator performs the safety and soundness supervision function and a dedicated market conduct regulator performs the market and business conduct supervision function. It is expected that the financial regulation reforms will be implemented in two phases, along with the development of necessary legislation to enable the relevant regulators to deliver on revised mandates.

The design and implementation of a twin peaks model of financial regulation is a complex undertaking that requires considerable consultation and the Group will, as a key stakeholder, continue to foster close interaction and cooperation with the regulators.

Below is a high-level overview of strategic, operational and functional outcomes resulting from execution of strategy, and related risk management focus areas.

Outcomes	Risk management focus areas
Capital management	
• Basel III was successfully implemented on 1 January 2013. The final capital framework was released in October 2012 and the impact on the Group's CET1 capital ratio is positive given the add-back of certain disclosable reserves, most notably the share-based payment, available-for-sale and foreign currency translation reserves. • Tier 1 and Total capital ratios will be negatively impacted by 2019 as the existing Additional Tier 1 (AT1) and Tier 2 instruments do not meet the Basel III qualifying criteria. These instruments will be grandfathered from 2013 over ten years.	• The Group continues to focus on the most optimal capital mix following guidance from the South African Reserve Bank (SARB) on the loss absorbency requirements for capital instruments, as well as capacity for new issuance in the capital markets. • In addition, the Group will look at: – maintaining strong capital levels, with particular attention on the quality of capital; and – optimising the Group's risk-weighted assets (RWA) and capital mix during the transitional period of implementing Basel III.
Credit risk	
• Steady growth in retail advances attributable to affordable housing loans, card advances, personal loans, FNB Africa and vehicle and asset finance (locally and internationally). • Growth in corporate advances particularly in infrastructure finance (including renewable energy), resource finance (predominantly Africa), larger listed property funds and other structured lending transactions. • Mortgages continue to show improvement with the vintages at multi-year lows, although slow growth reflects continuing pressure in the property market vintages and arrear levels in vehicle and asset finance at consistently low and stable levels. • Impairments are at the bottom of the cycle and lower than the FirstRand impairment highway of roughly 100 – 110 bps, however, given the level of consumer indebtedness, further rate increases would negatively impact impairments. • Improvements in NPLs emanating from reductions in mortgages, driven by the low interest rate environment, which positively impacted customers ability to service debt, lower levels of new inflows into NPLs and ongoing focus on enhanced collection processes across the Group. • Credit tightening actions taken in the unsecured loans portfolios are expected to result in continued slower growth in these portfolios going forward.	• Monitoring credit concentration in industries affected by labour unrest. *Retail credit portfolio* • Continued focus on credit strategy and consumer affordability to capture appropriate levels of new business utilising credit capacity calculation and risk appetite drivers. • Refining origination scorecards to ensure optimal credit quality of new business in the unsecured lending portfolios as well as the other retail portfolios. • Ongoing focus on low risk business in the retail bank and banked clients is expected to improve the risk profile of the book further. *Commercial credit portfolio* • Credit strategy to capture appropriate levels of new business utilising credit capacity and more granular risk appetite drivers. • Further developing commercial lending skills and product offerings, especially across Africa and India, to strengthen advances growth in support of our global product ownership and African corridor strategies. *Wholesale credit portfolio* • Ensuring movements in facilities are in line with origination strategy, i.e. predominantly to better-rated counterparties, medium and low volatility industries and strong growth in the Africa portfolio.

Outcomes	Risk management focus areas
Counterparty credit risk	
• Successful implementation of the Basel III credit value adjustment (CVA), asset value correlation (AVC) and central clearing capital charges. • Improvement in the risk profile of the prime financing portfolio with the implementation of bespoke risk frameworks for each individual business line.	• Continued incorporation of the African businesses into the counterparty credit risk process. • Extracting gains through the optimal management of collateral. • Risk management of credit and funding fair value adjustments of derivatives.
Market risk	
Market risk in the trading book	
• Overall levels of market risk remained fairly low compared to prior periods, particularly following the strategic decision to cease outright proprietary trading activities. • Integration of the remaining equities businesses into Global Markets and the consolidation of market risk analysis across the division. • Incorporation of the African subsidiaries into the overall RMB market risk process.	• Continued improvements to the overall RMB market risk process, with a focus on producing risk analytics on an intra-day basis.
Interest rate risk in the banking book	
• During the year under review, the average repo rate dropped by 48 bps, resulting in a negative endowment impact, which was managed through hedges.	• Improving the quality and frequency of interest rate risk identification, management and analysis throughout the Group.
Equity investment risk	
• Regular portfolio churn with a number of realisations during the year. • Certain industries presented new investment opportunities for the Group. • Established Ashburton Investments, the Group's new investment management business.	• Basel III impact on the treatment of investments in financial entities and optimisation of these requirements.
Foreign exchange and translation risk in the banking book	
• Continued to strengthen principles for management of foreign exchange positions, funding and support from FirstRand to its foreign entities. • Net open forward positions in foreign exchange (NOFP) limits were set for each of the Group's foreign entities, together with a reporting and management framework and the foreign exchange market risk framework and limits.	• Management of foreign exchange assets and foreign exchange exposures on the balance sheets of the Group's foreign entities. • Continually assess and review the Group's foreign exchange exposure and enhance the quality and frequency of reporting.

Outcomes	Risk management focus areas
Funding and liquidity risk	
- The latest release of the Basel III liquidity coverage ratio has alleviated the requirement for the SARB committed liquidity facility due to a reduction in the outflow factors and an increase in available assets.	- The Basel III liquidity regime continues to be a focus area for the Group with emphasis on both funding and market liquidity risk management, and particular attention on the structural funding constraints of the South African market. - Optimising a risk-adjusted diversified funding profile in line with Basel III requirements for the liquidity coverage ratio (LCR), which measures short-term liquidity stress (effective from January 2015) and the net stable funding ratio (NSFR), which measures the stability of long-term structural funding (effective 1 January 2018).
Operational risk	
- Risk maturity assessments were conducted across the Group to identify key processes requiring improved levels of maturity in each division. - Progress with process mapping activities with an initial focus on end-to-end mapping of high risk processes and the identification of risks, controls and handover points. - Process-based risk and control identification and assessment methodology was rolled out. - Progress on automation of operational risk tools. - Approval of Group and divisional operational risk appetite enabling the Group and its divisions to measure and monitor operational risk profiles against approved operational risk appetite levels, and to set the boundaries for operational risk within which the business can achieve its strategic objectives.	- Integration and automation of the Group's operational risk management tools onto a single platform to enhance operational risk management processes. - Key themes identified during the risk maturity assessment initiative have resulted in the initiation and prioritisation of several projects across the Group which will address identified operational risks. - Roll-out of the process-based risk and control identification and assessment methodology. - Definition of operational risk appetite at Group and franchise levels.
Regulatory risk	
- The Basel III framework was implemented in the amended *Regulations relating to Banks*, which became effective on 1 January 2013. - Announcements by the authorities on the proposed implementation of a twin peaks model of financial regulation in South Africa.	- Continued support for the regulatory objectives and endorsement of improvements in risk management and governance practices, and cooperation with regulatory authorities.

BASEL PILLAR 3 DISCLOSURE

Regulation 43 of the revised Regulations of the Banks Act, 1990 (Act No. 94 of 1990), requires that a bank shall disclose in its annual financial statements and other disclosures to the public, reliable, relevant and timely qualitative and quantitative information that enables users of that information to make an accurate assessment of the bank's financial condition, including its capital adequacy, financial performance, business activities, risk profile and risk management practice. This disclosure requirement is commonly known as Pillar 3 of the Basel Accord. This is FirstRand's Basel Pillar 3 report and complies with the risk disclosure requirements of regulation 43 of the *Regulations relating to Banks*.

The COO and CFO's report provides a high level overview of the Group's financial condition, performance and risk profile for the year ended 30 June 2013.

FirstRand Limited is the listed holding company and regulated bank-controlling company. The wholly-owned subsidiaries of FirstRand are:

- FirstRand Bank Limited (the Bank or FRB);
- FirstRand EMA Holdings Limited (FREMA);
- FirstRand Investment Holdings Proprietary Limited (FRIHL), all of which are regulated; and
- Ashburton Investments Holdings Limited (Ashburton Investments).

Banking operations are included under the Bank, FREMA includes the banking operations in Africa, Ashburton Investments is the newly-established investment management business of FirstRand and all other activities are included under FRIHL. A simplified group structure can be found on page 433 of this annual integrated report.

Some differences exist between the practices, approaches, processes and policies of the Bank and its fellow wholly-owned subsidiaries and these are highlighted by a reference to the appropriate entity, where necessary. This report has been internally verified by the Group's governance processes in line with the Group's public disclosure policy. All information in this report is unaudited unless otherwise indicated.

IMPROVED DISCLOSURE

An assessment of the Group's Basel Pillar 3 disclosure in terms of the Financial Stability Board's (FSB) *Report of the Enhanced Disclosure Task Force* on risk disclosure of banks identified a number of recommendations which have been included in the Group's disclosure previously. The Group's risk disclosure has been improved in response to recommendations from regulators, investors, shareholders, the *Enhanced disclosure report* (not previously included) and other users of the Pillar 3 report, including disclosure of:

- top and emerging risks affecting the Group;
- the Group's risk culture and how procedures and strategies are applied to support the culture;
- the differences between statutory and regulatory consolidation;
- SARB's RWA calculation approaches per risk type applicable to FirstRand;
- additional information on the components of RWA calculations;
- exposure-weighted average risk weights for major credit risk portfolios;
- nominal amounts of exposure at default (EAD) and the RWA/EAD ratios for major credit risk portfolios;
- additional qualitative information regarding securitisations;
- description of the limitations of the use of the Value-at-Risk (VaR) methodology relevant to market risk;
- quantitative information for Africa subsidiaries using the standardised approach for market risk; and
- market risk factors relevant to the Group's market risk portfolio in addition to interest rates, foreign exchange, commodity and equity measures.

BASEL APPROACHES

The following approaches are adopted by the Group for the calculation of RWA.

Risk type	FirstRand Bank domestic operations	SARB approval date	Remaining FirstRand subsidiaries and FRB foreign operations	FRIHL entities
Credit risk	Advanced internal ratings-based (AIRB) approach	January 2008	Standardised approach	Not applicable
Counterparty credit risk	Standardised approach	May 2012	Current exposure method	Current exposure method
Market risk	Internal model approach	July 2007	Standardised approach	Standardised approach
Equity investment risk	Market-based approach: simple risk-weighted method	June 2011	Market-based approach: simple risk-weighted method	Market-based approach: simple risk-weighted method
Operational risk*	Advanced measurement approach (AMA)	January 2009	The standardised approach (TSA)	Basic indicator approach (BIA), TSA, AMA*
Other assets	Standardised approach	January 2008	Standardised approach	Standardised approach

* *All entities on AMA and TSA for operational risk were included in the approval for use of AMA and TSA from January 2009; some entities were moved to FRIHL with a subsequent legal entity restructure but remained on the same approaches. All other entities in FRIHL are on the BIA approach.*

BASIS OF CONSOLIDATION

Consolidation of all entities for accounting purposes is in accordance with International Financial Reporting Standards (IFRS) and for regulatory purposes in accordance with the requirements of Basel, the Banks Act and accompanying regulations. There are some differences in the manner in which entities are consolidated for accounting and regulatory purposes. The following table provides the basis on which the different types of entities are treated for regulatory purposes.

Regulatory consolidation treatment

Shareholding	Banking, security firm or financial entity	Insurance entity	Commercial entity
Between 10% and 20%	refer to threshold rules*.		Internal ratings-based approach risk weight up to maximum of 1250%.
Between 20% and 50%	Legal or *de facto* support: - proportionately consolidate. No other significant shareholder: - refer to threshold rules*.	Refer to threshold rules*.	Individual investment greater than 15% of CET1, AT1, Tier 2: - risk weight at 1250%. Individual investment up to 15% of CET1, AT1 and Tier 2: - risk weight at no less than 100%.
Greater than 50%	Entity conducting trading activities/ other bank, security firm or financial entity: - consolidate.		

* *As per regulation 38(5) of the Regulations relating to Banks.*

DEFINITIONS

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

Risk category reference	Risk components	Definition
Strategic and business risks	Includes strategic risk, business risk, volume and margin risk, reputational risk, and environmental, social and governance (ESG) risks.	Strategic risk is the risk to current or prospective earnings arising from inappropriate business decisions or the improper implementation of such decisions.
		Business risk is the risk to earnings and capital from potential changes in the business environment, client behaviour and technological progress. Business risk is often associated with volume and margin risk and relates to the Group's ability to generate sufficient levels of revenue to offset its costs.
		Reputational risk is the risk of reputational damage due to compliance failures, pending litigations, underperformance or negative media coverage.
		ESG risks focus on the environmental, social and governance issues which impact the Group's ability to successfully and sustainably implement business strategy.
Financial risks	Capital	The Group manages capital by allocating resources effectively in terms of its risk appetite and in a manner that maximises value for shareholders.
	Credit risk	The risk of loss due to the non-performance of a counterparty in respect of any financial or other obligation. For fair value portfolios, the definition of credit risk is expanded to include the risk of losses through fair value changes arising from changes in credit spreads. Credit risk also includes credit default risk, pre-settlement risk, country risk, concentration risk and securitisation risk.
	Securitisations	Securitisation is the structured process whereby loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities.
	Counterparty credit risk	The risk of a counterparty to a contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows.
	Market risk in the trading book	The risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates.
	Interest rate risk in the banking book	The sensitivity of a bank's financial position and earnings to unexpected, adverse movements in interest rates.

Risk category reference	Risk components	Definition
Financial risks	Equity investment risk	The risk of an adverse change in the fair value of an investment in a company, fund or any other financial instrument, whether listed, unlisted or bespoke.
	Foreign exchange and translation risk in the banking book	Foreign exchange risk is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank is exposed to currency risk in its NOFP and foreign investments. Translation risk is the risk associated with banks that deal in foreign currencies or hold foreign assets. The greater the proportion of asset, liability and equity classes denominated in a foreign currency, the greater the translation risk.
	Funding and liquidity risk	Funding liquidity risk is the risk that a bank will not be able to meet current and future cash flow and collateral requirements (expected and unexpected) without negatively affecting its reputation, daily operations and/or financial position. Market liquidity risk is the risk that market disruptions or lack of market liquidity will cause the bank to be unable (or able, but with difficulty) to trade in specific markets without affecting market prices significantly.
Operational risks	Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes fraud and criminal activity (internal and external), project risk, legal risk, business continuity, information and IT risk, process and human resources risk. Strategic, business and reputational risks are excluded from the definition.
	Regulatory risk	The risk of statutory or regulatory sanction and material financial loss or reputational damage as a result of failure to comply with any applicable laws, regulations or supervisory requirements.

RISK APPETITE AND FINANCIAL RESOURCE MANAGEMENT

The Group's risk appetite and financial resource management process frames all organisational decision making and is fully integrated with the Group's strategic objectives. The Group's risk appetite is not equal to its absolute risk capacity. When setting risk appetite, the Group takes into consideration the following:

- growth expectations;
- operating environment;
- targeted return profile, capital levels, liquidity position and credit rating; and
- acceptable volatility in earnings through different economic cycles.

Risk capacity is quantified in terms of:

- level, growth, volatility and mix of earnings;
- regulatory capital requirements; and
- level of liquidity buffers and diversification of funding sources.

The financial resource management process sets minimum targets for these resources. Business and strategic decisions and the setting of risk appetite are aligned to these targets to ensure they are met during a normal cyclical downturn. Therefore, at a business unit level, strategy and execution are managed through the availability and price of financial resources, earnings volatility limits and required hurdle rates.

The Group's balance sheet and return targets are outlined in the table below.

Balance sheet and return targets

Description	Target
Targeted capital adequacy ratio (CAR)	12% to 13.5%
ROE	18% to 22%
Liquidity coverage ratio	60%
Credit rating	Sovereign rating

RISK APPETITE

When setting risk appetite, the Group considers the requirements of key stakeholders, namely, regulators, debt holders (including depositors) and shareholders. Business units are ultimately tasked with the generation of sustainable returns within risk appetite limits. These limits act as a constraint on the assumption of increasing risk in the pursuit of profits – both quantum and type. The financial resource management process would, for example, prevent a marginal increase in return in exchange for disproportionately more volatile earnings. Certain types of risk, such as reputational, fall outside risk appetite.

The board has established risk appetite principles against which business is measured. These include:

- not excessively gearing the balance sheet;
- off-balance sheet exposure should be limited relative to own capital and funding base;
- ensure true risk transfer, avoid accounting or regulatory arbitrage;
- sources of income should be widely diversified across business entities, products, market segments, investments, financial and commodity markets and regions;
- the potential impact of severe downturn and stress conditions must be identified, measured, quantified, understood and contained in accordance with capital preservation and earnings volatility parameters;
- limit concentration in higher risk asset classes;
- diversify sources of funding;
- hold sufficient buffers for capital and liquidity purposes; and
- contain losses arising from operational process breakdowns.

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

The board assumes responsibility for ensuring that risks are adequately managed and controlled through the risk, capital management and compliance (RCC) committee and subcommittees, as described in the *Risk governance* section.

Risk appetite measures and stress and scenario results are included in risk and management reports across the businesses and at board level and are continually refined.

SCENARIO PLANNING

The Group offers value to its shareholders by undertaking to deliver sustainable earnings within a desired risk profile. The ability to deliver this profile is regularly evaluated with stress and scenario planning. The value of the franchises is ultimately supported by the Group's financial strength, quality of its earnings and a management approach that seeks to deliver the desired risk and return profile.

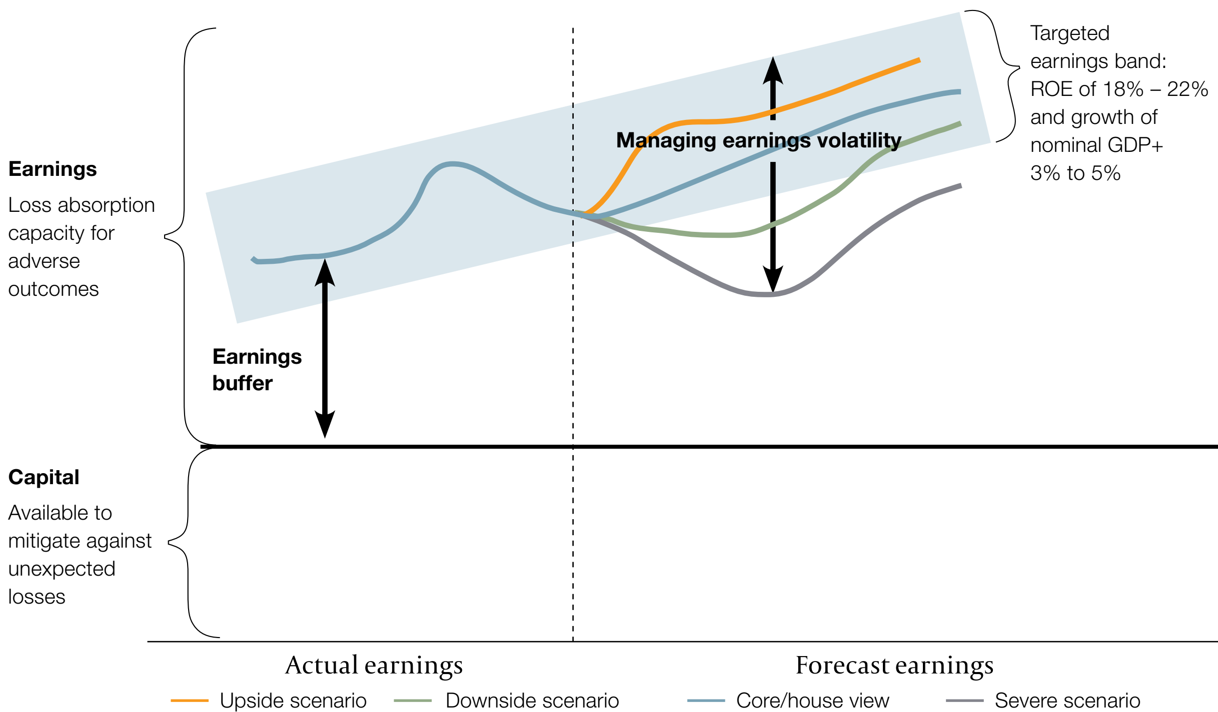
Shifts in the macro environment are critical to any strategic adjustments. FirstRand manages its business based on the Group's house view which is used for budgeting, forecasting and credit origination strategies. The house view focuses on the key macroeconomic variables that impact the balance sheet and income statement. The macro outlook is reviewed on a monthly basis and spans a three-year forecast horizon. The business plan

for the next three years is included in the budget and forecasting process. Scenario planning is then used to assess whether the desired profile can be delivered and whether the business stays within the constraints it has set itself. The scenarios are based on changing macroeconomic variables, plausible event risks and regulatory and competitive changes.

The Group employs a comprehensive, consistent and integrated approach to stress testing and scenario planning. The impact of risk scenarios on the business is evaluated and the need for adjustment to origination is considered and appropriate actions are taken. More severe scenarios are run less frequently but are critical to inform the buffers, capital and liquidity planning, validate existing quantitative risk models and understanding required management action.

The following chart illustrates the strategy to manage earnings volatility through the cycle.

Managing earnings volatility through the cycle



FINANCIAL RESOURCE MANAGEMENT

The strategy, risk and financial resource management processes described above influence the capital and funding plans of the Group. The capital position provides the final buffer against adverse business performance under extremely severe economic conditions. Thorough analysis and understanding of value drivers, markets and macro environment will also affect the portfolio optimisation decision and the price and allocation of financial resources.

To be successful in the process of allocating financial resources, a common understanding of the implications for the balance sheet and income statement is needed.

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

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

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

ICAAP outlines the process to ensure the Group achieves its capital management objectives.

In order to achieve this objective the Group needs to:

- ensure that at least the minimum amount of regulatory capital is held at all times for the SARB to allow the Group to conduct business;
- hold sufficient capital that will instil confidence in the Group's ongoing solvency and status as a creditworthy counterparty for all stakeholders;
- allocate capital to businesses based on an understanding of the risk and reward drivers of the income streams and to ensure that appropriate returns are earned on capital deployed;
- ensure that the buffer over the minimum regulatory capital requirement is sufficient to cater for income and capital volatility and economic risk which may manifest through business disruption, regulatory intervention or credit downgrades, where applicable;
- consider the returns on a risk-adjusted basis to assess business performance; and
- ensure that FirstRand's capital adequacy ratios and other limits remain within approved thresholds during different economic and business cycles.

The optimal level and composition of capital is determined after taking into account business units' organic growth plans as well as investor expectations, targeted capital ratios, future business plans, plans for the issuance of additional capital instruments, appropriate buffers in excess of minimum requirements, rating agencies considerations, proposed regulatory changes and risk appetite of management and board.

Additionally, this requires that the Group develops and maintains a capital plan that incorporates, among others, the following:

- anticipated capital utilisation;
- planned issuance of capital instruments;
- stress tests and scenario analysis;
- appropriation of profits and dividend payments;
- desired level of capital, inclusive of a buffer;
- expansion and strategic initiatives; and
- general contingency plan for dealing with divergences and unexpected events.

ICAAP is an integral tool in meeting the above capital management objectives and is key to the Group's risk and capital management processes. ICAAP allows and facilitates:

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

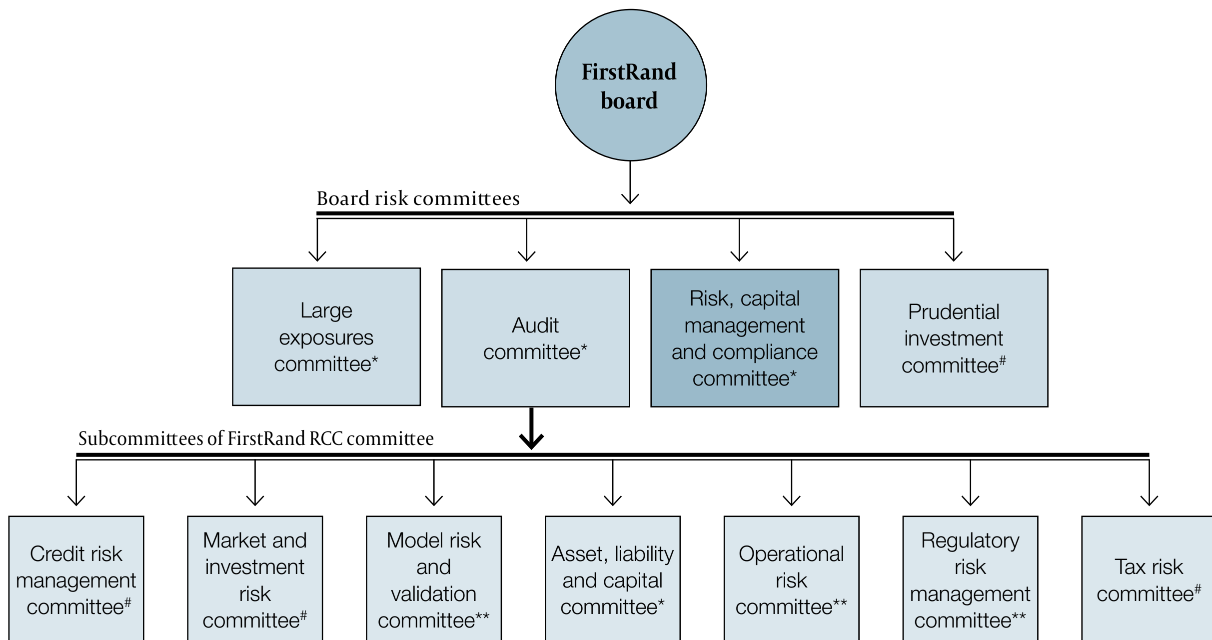
RISK GOVERNANCE

The Group believes that effective risk management is based on effective governance structures and policy frameworks as well as a risk-focused culture. Strong governance structures and policy frameworks foster the embedding of risk considerations in existing business processes and ensure that consistent standards exist across the Group. In line with the Group's corporate governance framework, the board retains ultimate responsibility for providing strategic direction and ensuring that risks are adequately identified, measured, monitored, managed and reported on.

RISK GOVERNANCE STRUCTURE

The risk management structure is set out in the Group's business performance and risk management framework (BPRMF). As a policy of both the board and exco, it delineates the roles and responsibilities of key stakeholders in business, support and control functions across the various franchises and the Group.

Risk governance structure



* *Chairperson is an independent non-executive board member.*
** *Chairperson is an external member.*
\# *Chairperson is a member of senior executive management. The credit risk management committee has non-executive board representation.*

The primary board committee overseeing risk matters across the Group is the FirstRand RCC committee. It has delegated responsibility for a number of specialist topics to various subcommittees. The RCC committee submits its reports and findings to the board and highlights control issues to the audit committee. The responsibilities of the board risk committees and the subcommittees of the RCC committee are included in the following tables. Further detail on the roles and responsibilities of the RCC committee and its subcommittees relating to each particular risk type is provided in the major risk sections of this report.

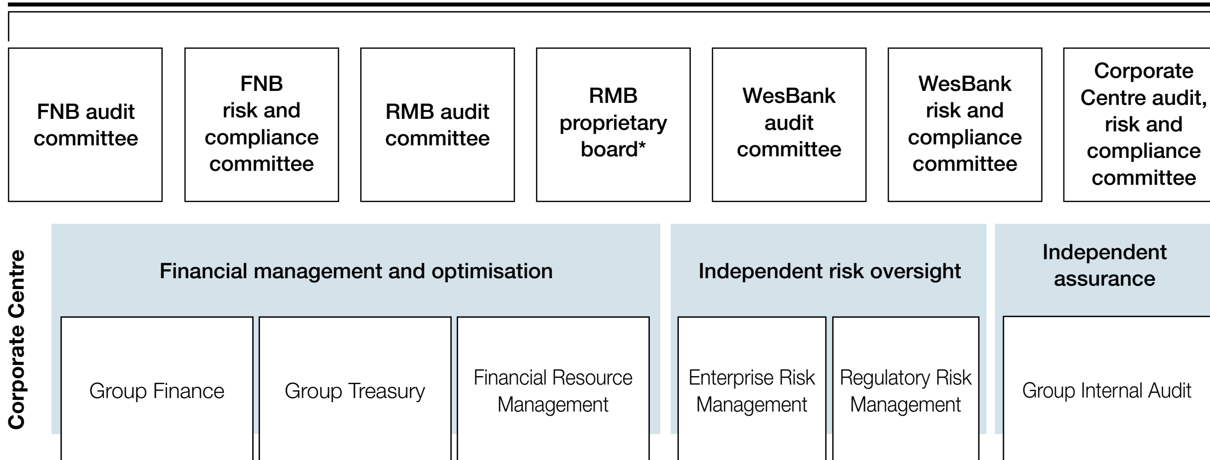
Responsibilities of the board risk committees

Committee	Responsibility
Large exposures committee (LEC)	• approves credit exposures in excess of 10% of the Group's capital; and • delegates the mandate for the approval of group and individual facilities to the FirstRand wholesale credit, commercial credit and retail credit committees, as appropriate.
Audit committee	• assists the board with its duties relating to the safeguarding of assets, operation of adequate systems and controls, assessment of going concern status and ensuring that relevant compliance and risk management processes are in place; • reviews work performed by the external auditors and internal audit function; and • considers financial information and integrated reports which are provided to shareholders and other stakeholders for approval by the board.
Risk, capital management and compliance (RCC) committee	• approves risk management policies, standards and processes; • monitors Group risk assessments; • monitors effectiveness of risk management and high priority corrective actions; • monitors Group's risk profile; • initiates corrective action, if required; • monitors compliance with the *Regulations relating to Banks*; and • approves regulatory capital models, risk and capital targets, limits and thresholds.
Prudential investment committee (PIC)	• ensures investment exposures comply with FirstRand's prudential investment guidelines.

Responsibilities of the subcommittees of the RCC committee

Committee	Responsibility
Credit risk management committee	• approves credit risk management and risk appetite policies; • independent analysis, evaluation and ongoing oversight of credit portfolio quality and performance relative to credit risk appetite thresholds; • monitors quality of the in-force business and new business origination, and underlying assets in the securitisation process; • monitors scenario and sensitivity analysis, stress tests, credit economic capital utilisation, credit pricing and credit concentrations; • ensures uniform interpretation of credit regulatory requirements and acceptable standards of credit reporting; and • reviews credit economic conditions outlook as described in the Group's house view and ensures that business units align credit origination strategies accordingly.
Market and investment risk committee (MIRC)	• approves market and investment risk management policies, standards and processes; • monitors the effectiveness of market and investment risk management processes; • monitors the market and investment risk profile; and • approves market and investment risk-related limits.
Model risk and validation committee (MRVC)	• considers and recommends the approval of all material aspects of model validation work including credit ratings and estimations, internal models for market risk and advanced measurement operational risk models for the calculation of regulatory capital.
Asset, liability and capital committee (ALCCO)	• approves and monitors effectiveness of management policies, assumptions, limits and processes for liquidity and funding risk, capital risk and market risk in the banking book (interest rate risk in the banking book, foreign exchange and translation risk); • monitors the management of funding of the Group's balance sheet; • provides governance and oversight of the level and composition of capital, and considers the supply and demand of capital across the Group; • approves buffers over regulatory capital minimum requirements and monitors capital adequacy ratios; and • approves frameworks and policies relating to internal funds transfer pricing (FTP) for the Group.
Operational risk committee (ORC)	• provides governance, oversight and coordination of relevant operational risk management practices and initiates corrective action where required; • reviews and recommends the operational risk appetite for approval to the RCC committee; and • approves the operational risk management framework (ORMF) and all its subframeworks used in the management of operational risk in the specialist areas including fraud risk, legal risk, business resilience, information governance, information technology and physical security.
Regulatory risk management (RRM) committee	• approves regulatory risk management principles, frameworks, plans, policies and standards; and • monitors the effectiveness of regulatory risk management across the Group and initiates corrective action where required.
Tax risk committee	• monitors tax management processes, effectiveness of tax management processes and corrective actions.

Franchise risk governance structure



* *The RMB proprietary board is the risk and regulatory committee for RMB.*

Additional risk, audit and compliance committees exist in each franchise; the governance structures of which align closely with that of the Group, as illustrated in the previous chart. The board committees are staffed by members of the respective committees of the individual franchise boards so as to ensure a common understanding of the challenges business faces and how these are addressed across the Group.

RISK GOVERNANCE FRAMEWORK

Effective risk management also requires multiple points of control or safeguards that should be consistently applied at various levels throughout the organisation. There are three primary lines of control across the Group's operations, which are explicitly recognised in the BPRMF:

- first line of risk control – risk ownership;
- second line of risk control – risk control; and
- third line of risk control – independent assurance.

In the first line, risk ownership, risk taking is inherent in the individual businesses' activities. Business management carries the primary responsibility for the risks in its business, in particular identifying and managing risk appropriately. Business owners, the board and exco are supported in these responsibilities by Group Treasury and Financial Resource Management (FRM) in the Corporate Centre.

In the second line, risk control, business heads are supported by deployed divisional and segment risk management functions that are involved in all business decisions and are represented at an executive level across all franchises. Franchise heads of risk have a direct reporting line to the Group chief risk officer (CRO) and the relevant franchise CEO. Franchise and segment risk managers are responsible for risk identification, measurement and control. Divisional and segment risk management activities are overseen by the independent, central risk control functions, Enterprise Risk Management (ERM) and RRM. ERM is headed by the Group CRO who is a member of exco and provides independent oversight and monitoring across the Group on behalf of the board and relevant committees.

In the third line, Group Internal Audit (GIA) and external advisors provide independent and objective assurance to the board, Audit committee and regulators. The assurance is provided on the overall adequacy and effectiveness of governance, risk management and control within the Group as established by the first (management oversight) and second (management of risk) lines of control. GIA is headed by the chief audit executive (CAE) and reports to the board through the audit committee chairman. The CAE has direct, unrestricted access to the Group CEO and executives, and respective subsidiaries as well as to all FirstRand business unit functions, records, property and personnel.

GIA conducts work in accordance with international internal audit standards and practices and its activities are assessed annually by the external auditors.

The responsibilities of different areas in the three lines of risk control model are outlined in the following diagram.

Responsibilities in the lines of risk control

First line	Second line	Third line
Heads of business - act in accordance with mandates approved by the board or its delegated authority; - identify, quantify and monitor key risks to business under normal and stress conditions; - implement strategy within approved risk appetite; - design business and risk management processes that will ensure that risks are appropriately managed; - specify and implement early warning measures, associated reporting, management and escalation processes through governance structures; - implement risk mitigation strategies; - implement timeous corrective actions and loss control measures as required; and - ensure staff understand responsibilities in relation to risk management. **Financial Resource Management** - provides an integrated approach to financial resource management; - optimises the Group's portfolio to deliver sustainable returns within an acceptable level of risk; and - performs scenario analysis and stress testing. **Group Treasury** - manages the Group's capital, liquidity, funding, interest rate risk in the banking book and foreign exchange mismatch.	**Deployed risk management** - ensures that risk policies and tools are implemented and adhered to; - approves the design of business and risk management processes that will ensure that risks are appropriately managed; - identifies process flaws and risk management issues and initiates and monitors implementation of corrective action; and - compiles, analyses and escalates risk reports on performance, risk exposures and corrective actions, through governance structures in appropriate format and frequency. **Enterprise Risk Management** - maintains risk frameworks and governance structures; - develops and communicates risk management strategy and challenges risk profiles; - reports risk exposures and performance to management and governance structures; - ensures appropriate risk skills and risk management culture for risk taking; - performs risk measurement validation; and - manages regulatory relationships with respect to risk matters. **Regulatory Risk Management** - monitors that business practices, policies, frameworks and approaches are consistent with applicable laws.	**Group Internal Audit** GIA determines whether the Group's processes and controls are adequate to ensure: - risks are appropriately identified, quantified and controlled by approved business and risk procedures; if not, initiate corrective action; - management and financial information systems incorporate sound controls; - financial reports, accounting records and operating information is accurate, valid, complete, reliable and timeous; - employees execute duties in compliance with policies, standards, applicable laws and regulations; - resources are acquired economically, used efficiently and effectively; and - adequate processes are implemented to ensure protection of assets.

Combined assurance

Formal enterprise-wide governance structures for enhancing the practice of combined assurance at Group and subsidiary levels are overseen by the audit committee. The primary objective of the Group and assurance forums is for the assurance providers to work together with management to deliver the right assurance in the right areas by people with the best skills and experience as cost effectively as possible. The assurance providers in this model include GIA, senior management, ERM, RRM and external auditors. The combined outcome of independent oversight, validation and audit tasks performed by the assurance providers ensure a high standard across methodological, operational and process components of the Group's risk and capital management processes.

The outcomes of the combined assurance work indicate greater efficiency of the assurance processes through the elimination of duplication, more focused risk-based assurance against key control areas and heightened awareness of emerging issues resulting in the implementation of appropriate preventative and corrective action plans.

Regular risk reporting and challenge of current practices

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

ERM, together with the independent review by GIA, ensure that all pertinent risk information is accurately captured, evaluated and escalated appropriately and timeously. This enables the board and its designated committees to retain effective management control over the Group's risk position at all times.

RISK CULTURE

The Group and its investors, debt holders and regulators recognise that effective risk management requires the maintenance of a proper risk culture, in addition to appropriate risk governance structures, policy frameworks and effective risk and capital methodologies.

Culture, the net result of how the organisation lives its values, is a strong driver of behaviour. Understanding and managing cultural attitudes towards risk and cultural attitudes that create risk, receive significant attention in the Group. ERM, in conjunction with people and culture risk specialists in the Group's Ethics Office, collaborate closely to identify and manage risk culture.

The Group believes its risk culture is influenced by the interaction of the following:

- competent and ethical leadership in setting the strategy, risk appetite and a positive attitude towards appropriate risk practices;
- robust risk governance structures to ensure risk policy frameworks are implemented, and that appropriate committee memberships and structures exist;
- best practice risk and capital methodologies for the appropriate identification, measurement, monitoring, management and reporting of risk and allocation of capital;
- accurate assessment of the broader organisational culture which determines business ethics practices and supports or detracts from risk goals; and
- a people risk profile that provides a balance between skills and ethical values and the appropriate allocation of resources and accountability for performance.

The Group has established four parameters as the dominant drivers impacting the risk rating of its culture, outlined in the following table.

Risk culture parameters

Parameters	Activities
Leadership living good values	ensure that leaders set the appropriate tone in terms of responsible business conduct.
Setting risk goals	ensure risk management goals are set and properly communicated throughout the organisation; ensure that ethics and accountability to risk management parameters are not overshadowed efficiency, innovation and profit messages; avoid expediency/quick fix mentalities which may create medium- to long-term risk; and create space for subordinates to challenge superiors.
Providing resources	ensure risk management goals are attainable by adequately resourcing risk management functions; apply fit and proper tests for key risk roles; ensure comprehensive culture and people risk data is obtained from the Group culture and people risk assessment specialists within the Ethics Office; combat overloading of human and systems infrastructure; and combat unhealthy internal competition over scarce resources.
Aligning measurement and rewards	ensure risk metrics are incorporated into measurements and the way business rewards performance.

RISK AND CAPITAL METHODOLOGIES

Best practice risk and capital management methodologies have been developed in and for the relevant business areas. The detailed sections provide in-depth descriptions 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 risk profile with respect to the type of risk under consideration and the capital position.

STRATEGIC AND BUSINESS RISK

INTRODUCTION AND OBJECTIVES

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

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

In an environment of continued weakness in the South African economy and the risks imposed by the weak global economy, FirstRand continues to focus on cost containment whilst pursuing growth opportunities both locally and in selected African markets.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

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

Business unit and Group executive management, as well as Group Treasury, FRM and ERM review the external environment, industry trends, potential emerging risk factors, competitor actions and regulatory changes as part of strategic planning. Through this review, as well as regular scenario planning and stress-testing exercises, the risk to earnings and level of potential business risks faced are assessed. Reports on the results of these exercises are discussed at various business, risk and board committees and are ultimately taken into account in the setting of risk appetite and in potential revisions to existing strategic plans.

ASSESSMENT AND MANAGEMENT

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

Volume and margin risk

Volume and margin risk is part of strategic planning and is regularly assessed through the Group's management and governance processes, and ICAAP. Volume and margin risk could result in a situation where the operating income of the Group is insufficient to absorb the variability in income and operating costs.

Reputational risk

As a financial services provider, the Group's business is one inherently built on trust and close relationships with its clients. Reputational risk can arise from environmental, social and governance issues or as a consequence of financial or operational risk events.

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

Environmental, social and governance risk management

FirstRand has formal governance processes for managing ESG risks affecting the Group's ability to successfully implement business strategy. These processes involve the generation of ESG management reports at Group and franchise level, which detail ESG performance on a quarterly basis.

Each franchise defines tolerances for its principal ESG risks and action plans for addressing these in line with particular circumstances and risk appetite. Tolerances and mitigating actions are defined at Group and franchise level, and progress in respect of these is tracked through existing risk reporting structures. Provision is made for the escalation of significant ESG issues to the board via exco, RCC and audit committees.

The impact and likelihood of these risks are evaluated taking into account measures for management, mitigation and avoidance.

Equator Principles and environmental and social risk analysis (ESRA)

FirstRand embraces sustainable development practices in project finance transactions by integrating social and environmental management principles into its decision making. FirstRand implements its commitment to promote environmental and social management and sustainability by:

- defining requirements for environmental and social risk assessment, and monitoring approved transactions;
- developing and communicating environmental and social performance standards that clients will be expected to meet within an acceptable time frame; and
- defining environmental and social roles and responsibilities for both FirstRand and its clients.

FirstRand became an Equator Principles (EP) finance institution in July 2009. Within FirstRand, the application of EP forms part of ESRA and is a specific credit risk management framework for determining, assessing and managing environmental and social risk in selected transactions. During 2012/2013, the EP Association and its member financial institutions conducted a strategic review and increased the scope of transactions to which EP applies. Approved and effective from June 2013, this new revised standard (EP III) will be implemented by December 2013 for all products within the new scope of EP.

The key changes to EP are an increase in the scope of transaction types included from merely project finance-related transactions to transactions specified in the following table:

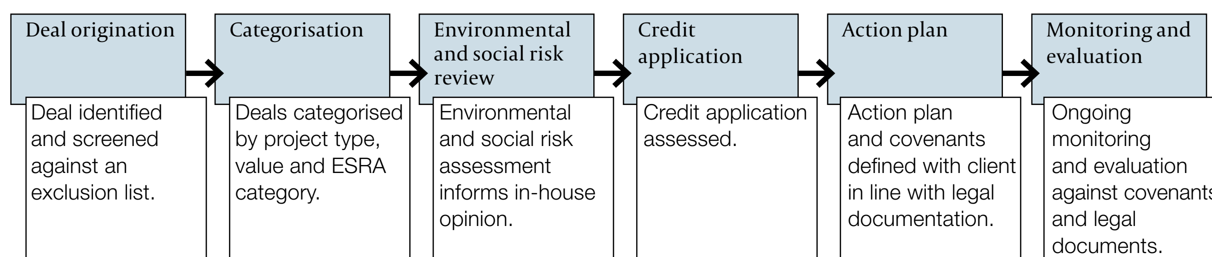
ESRA transaction type

Transaction type	Threshold amount after which an ESRA review is triggered
Project finance transactions	Total project capital costs at or above USD10 million: EP review.
Project finance advisory	Total project capital costs at or above USD10 million: EP review.
Project finance transactions	All category A (high risk) and B (medium risk) transactions with a total project capital cost of less than USD10 million: in-house ESRA review.
Corporate loans	No threshold applied, all corporate loans: in-house ESRA review.
Corporate loans – project related	Total aggregate loan amount is at least USD100 million of which the member banks individual commitment (before syndication or sell down) is at least USD50 million and loan tenor is at least two years: EP review.
Bridge loans (subject to EP)	Bridge loans with a tenor of less than two years that are intended to be refinanced by project finance (at or above USD10 million): EP review.
Equity investment deals	No threshold applied, all equity investment deals: in-house ESRA review.
Affected commercial loans (inclusive of property finance)	No threshold applied, all property finance or property securitised loans: in-house ESRA review. Commercial loans (non-property related) – total facility amount above R7.5 million: in-house ESRA review.

ESRA review process

Each of the Group's operating franchises have formalised credit and compliance processes for the implementation of ESRA, with oversight provided by franchise social and ethics committees, risk and compliance officers, and credit committees throughout the Group. At a Group level, oversight is provided by RRM and divisional social and ethics committees. Total ESRA performance statistics related to all relevant transaction types will be formally reported from July 2013 onwards. The ESRA review process is illustrated in the following chart.

ESRA review process



2013 Equator Principles performance

The Group measures EP performance in line with the International Finance Corporation (IFC) performance standards as either Category A (high risk), Category B (medium risk) or Category C (low to no risk), per the definitions set out below.

Definition of EP performance categories

IFC/equator category	Risks/impacts
Category A (high risk)	Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented. Issues relating to these risks may lead to work stoppages, legal authorisations being withdrawn and reputational damage. Examples could include projects involving the physical displacement of the natural environment or communities.
Category B (medium risk)	Projects with potential limited adverse social or environmental impacts that are few in number, generally site specific, largely reversible and readily addressed through mitigation measures. Issues relating to these risks may lead to fines, penalties or legal non-compliance and reputational damage. Examples could include increased use of energy or increased atmospheric emissions.
Category C (low risk)	Projects with minimal or no social or environmental impacts.

EP transactions

	2013		2012	
EP category	**Projects screened for the first time during the year**	**Projects that reached financial close during the year**	Projects screened for the first time during the year	Project that reached financial close during the year
A (high risk)	**9**	**3**	2	1
B (medium risk)	**5**	**4**	9	8
C (low risk)	**12**	**14**	6	7
Total*	**26**	**21**	17	16

* *Excludes project finance advisory transactions.*

The projects screened are the structured EP-defined project finance deals, which were reviewed by an in-house environmental and social risk specialist. All category A and B transactions were subjected to independent EP review to establish environmental and social risks of the project for the first time during the reporting period. Financial close is assumed when all conditions precedent to initial drawing of the debt have been satisfied or waived. EP reporting is externally assured for public disclosure by an independent third party as per requirements set out by the EP Association.

Analysis of EP transactions

The number of EP transactions screened per industry category and region during the year is provided in the following tables.

EP project finance transactions screened per industry category

	2013						
Transaction categories*	**Mining****	**Infrastructure**	**Power***	**Renewable energy***	**Retail**	**Other#**	**Total**
A (high risk)	**7**	**1**	**–**	**–**	**–**	**1**	**9**
B (medium risk)	**–**	**–**	**1**	**4**	**–**	**–**	**5**
C (low risk)	**–**	**–**	**–**	**–**	**9**	**3**	**12**
Total	**7**	**1**	**1**	**4**	**9**	**4**	**26**

* *The power and renewable energy category was split in two categories from 2013. No EP project finance transactions in the oil and gas industry category were screened during the year.*
** *Two mining transactions were based in the Americas region and the balance of the transactions in Africa.*
# *Transactions in the other category are deals related to large commercial property developments.*

	2012*						
Transaction categories	Mining	Infrastructure	Power and renewable energy	Oil and gas	Retail	Other**	Total
A (high risk)	1	1	–	–	–	–	2
B (medium risk)	–	1	7	1	–	–	9
C (low risk)	–	1	–	–	–	5	6
Total	1	3	7	1	–	5	17

* *All transactions were southern Africa-based projects.*
** *Transactions in the other category are deals related to large commercial property developments.*

The following additional EP project finance advisory transactions were screened during the year and included in disclosures from the current year.

EP project finance advisory transactions screened per industry category

	2013			
Transaction categories*	**Mining**	**Power**	**Renewables**	**Total****
A (high risk)	**2**	**–**	**–**	**2**
B (medium risk)	**–**	**1**	**4**	**5**
C (low risk)	**–**	**–**	**–**	**–**
Total	**2**	**1**	**4**	**7**

* *No EP project finance advisory transactions in the infrastructure, retail, oil and gas, and other industry categories were screened during the year.*
** *All transactions were based in Africa.*

The following table provides the number of EP transactions per EP category for the year.

Category of EP transactions

	2013	
Number of EP transactions screened	**Hosted in non-OECD* countries**	**Hosted in OECD* countries**
A (high risk)**	**7**	**2**
B (medium risk)**	**5**	**–**
C (low risk)	**12**	**–**
Total	**24**	**2**

* *Organisation for economic cooperation and development (OECD).*
** *All of the category A (high risk) and category B (medium risk) transactions were subject to independent EP review during the year.*

ESRA process going forward

FirstRand is currently in the fifth year of implementation of ESRA processes. Continued focus will be given to both awareness training and effective implementation of the ESRA process.

Areas of focus in the new financial year include the planned implementation of the new categorisation tool, which will assist in the accuracy of future reporting of all ESRA transactions, and the implementation of additional disclosure to comply with the EP III reporting requirements in the 2014 EP report.

Please visit www.firstrand.co.za/sustainability/pages/default.aspx for more detail on EP and ESRA processes, and the 2013 FirstRand EP report.

Scan with your smart device's QR code reader to access more information on EP and ESRA on the Group's website.

CAPITAL MANAGEMENT

INTRODUCTION AND OBJECTIVES (AUDITED)

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

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

- targeted capital ratios;
- future business plans;
- issuance of additional capital instruments;
- appropriate buffers in excess of minimum requirements;
- rating agencies' considerations;
- investor expectations;
- proposed regulatory changes; and
- risk appetite of management and board.

Allocating resources effectively, including capital and risk capacity, in terms of the risk appetite targets and in a manner that maximises value for shareholders is a core competence and key focus area. Sound capital management practices, therefore, form an important component of its overall business strategy.

The effectiveness of capital allocation decisions and the efficiency of its capital structure are important determinants of the ability to generate returns for shareholders. The Group seeks to hold limited excesses above the capital required to support its medium-term growth plans (including appropriate buffers for stresses and volatility) and future regulatory changes.

The total capital plan includes a dividend policy, which is set to ensure sustainable dividend cover based on sustainable normalised earnings. The plan also takes into account volatile earnings brought on by fair value accounting, anticipated earnings yield on capital employed, organic growth requirements and a safety margin for unexpected fluctuations in business plans.

CAPITAL ADEQUACY AND PLANNING

Year under review

The capital planning process ensures that the total capital adequacy and CET1 ratios remain within approved ranges or above target levels across economic and business cycles. The Group is appropriately capitalised under normal and severe scenarios as well as a range of stress events.

The board-approved capital plan is reviewed annually as part of the Group's ICAAP, with the stress-testing framework an extension of the process. ICAAP assists in the attribution of capital in proportion to the risks inherent in the respective businesses with reference to normal economic circumstances and times of potential stress, which may lead to the realisation of risks not previously considered. These processes are under continuous review and refinement, and continue to inform the targeted buffer over the minimum capital requirement.

Regular reviews of economic capital are carried out and the Group remains well capitalised in the current environment, with levels of Tier 1 capital exceeding the level of economic capital required. The Group aims to back all economic risk with Tier 1 capital, which offers the greatest capacity to absorb losses.

Throughout the year under review, the Group operated above its targeted capitalisation range, reporting a total capital adequacy ratio of 16.3% and a solid CET1 ratio of 13.8% at 30 June 2013. The Group continues to follow a conservative approach to capital levels and prefers to maintain capital ratios at the upper end of its targeted capitalisation range, particularly given the current macro conditions, ongoing regulatory developments and African expansion initiatives.

The targeted capital levels as well as the ratios at 30 June 2013 are summarised in the following table.

Capital adequacy position

%	CET1	Tier 1	Total
Regulatory minimum	4.5	6.0	9.5*
Target	9.5 – 11.0	11.0	12.0 – 13.5
Actual	**13.8**	**14.8**	**16.3**

* *The regulatory minimum excludes the bank-specific ICR.*

Basel III

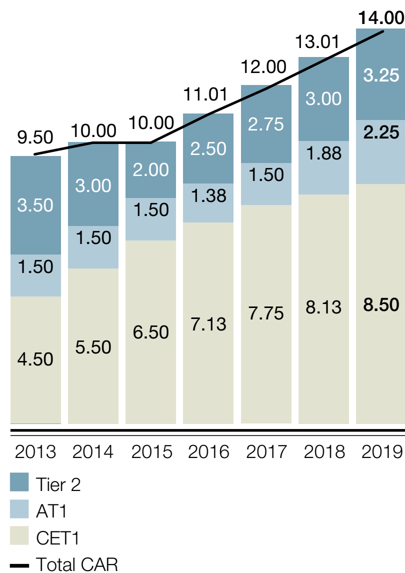
Basel III was successfully implemented on 1 January 2013 and the impact on the Group's CET1 ratio is positive. However, the Tier 1 and Total capital ratios will decline from 1 January 2013 to 2019, as the current AT1 and Tier 2 instruments do not meet the Basel III qualifying criteria. These instruments will

be grandfathered from 2013 over a ten-year period. The internal target levels will be reassessed during the transitional period of Basel III.

Given the transitional period to comply with the final capital framework, the Group remains focused on meeting the end state CET1 requirement, while looking at ways to optimise the overall capital mix. The following graph shows the minimum capital requirements (excluding the bank-specific ICR) during the transitional period until 2019.

Minimum capital requirements

(%)



The Group continues to participate in the SARB's biannual quantitative impact studies to assess the effect of Basel III on capital adequacy ratios, as well as to monitor the impact of leverage for the industry. The simple, transparent non-risk based leverage ratio is calibrated to act as a credible supplementary measure to the risk-based capital requirements. The Group's current leverage ratio of 8.2% continues to comfortably exceed the SARB's minimum requirement of 4%.

Supply of capital – Tier 1

Tier 1 capitalisation ratios benefited from stronger internal capital generation through earnings and the add-back of certain disclosable reserves (i.e. share-based payment, available-for-sale and foreign currency translation) under Basel III. All profits were appropriated at 30 June 2013.

Supply of capital – Tier 2

During the year under review, FirstRand replaced the FRB06 and FRB07 subordinated debt instruments with a Basel III instrument that references a resolution regime. The FRB11 bond meets the Basel III entry criteria and will be included for grandfathering from 1 January 2013 with full recognition envisaged once the resolution regime is implemented in South Africa. The Group continues to focus on the most optimal capital mix and awaits final guidance from the SARB on the loss absorbency requirements for capital instruments.

Demand for capital

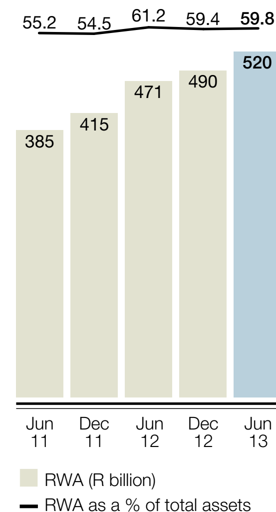
Basel III is the primary driver for the movement in RWA. The following changes impacted the overall movement in RWA:

- credit risk increased due to additional capital requirements for counterparty credit risk i.e. CVA and AVC. The SARB, however, has allowed for a delayed implementation of CVA for local and ZAR counterparties until 1 January 2014;
- previously impaired first loss securitisation exposures are risk weighted at 1250%;
- previously impaired deferred tax assets relating to temporary differences are risk weighted at 250%; and
- previously impaired investment in financial, banking and insurance entities are risk weighted at 250%. These exposures are included under other assets RWA.

Operational risk also increased in line with the six-monthly recalibration of risk scenarios, while credit risk RWA increased primarily due to organic growth.

The following graph shows the increase in the demand for capital, taking into account regulatory changes over time.

FirstRand RWA history



Capital adequacy

The following table shows the composition of regulatory capital for the Group.

Composition of qualifying capital

	FirstRand			
	2013		2012	
R million	Basel III	%	Basel 2.5	%
Ordinary share capital and share premium*	**5 452**		5 271	
Retained earnings*	**60 786**		53 267	
Accumulated other comprehensive income and reserves**	**5 947**		–	
Non-controlling interests‡	**1 347**		2 767	
Less: total regulatory deductions	**(1 663)**		(3 419)	
Excess of expected loss over eligible provisions#	**(135)**		(400)	
First loss credit enhancements in respect of securitisation structures†	**–**		(508)	
Goodwill and intangibles	**(1 169)**		(1 743)	
Other deductions	**(359)**		(768)	
Total CET1 capital	**71 869**	**13.8**	57 886	12.3
Total AT1 capital	**5 343**		4 119	
NCNR preference share capital	**4 067**		4 519	
Instruments recognised as AT1 capital issued by subsidiaries to third parties‡	**1 276**		–	
Less: total regulatory deductions	**–**		(400)	
Total Tier 1 capital	**77 212**	**14.8**	62 005	13.2
Instruments recognised as Tier 2 capital issued by subsidiaries to third parties‡	**7 237**		8 018	
Other reserves	**241**		215	
Less: total regulatory deductions	**–**		(908)	
Excess of expected loss over eligible provisions#	**–**		(400)	
First loss credit enhancements in respect of securitisation structures†	**–**		(508)	
Total Tier 2 capital	**7 478**	**1.5**	7 325	1.5
Total qualifying capital and reserves	**84 690**	**16.3**	69 330	14.7

* *Audited.*
** *Disclosable reserves not qualifying under Basel 2.5: available-for-sale, share-based payment, foreign currency translation and other.*
# *Previously impaired 50:50 under Tier 1 and Tier 2. 100% impairment in CET1 under Basel III.*
† *Previously impaired 50:50 under Tier 1 and Tier 2. Risk weighted at 1250% under Basel III.*
‡ *Subject to the Basel rules in regulation 38(16) of Regulations relating to Banks.*

The following table provides a detailed breakdown of the RWA numbers and capital requirement per current SARB regulations for each risk type of the Group.

RWA and capital requirements

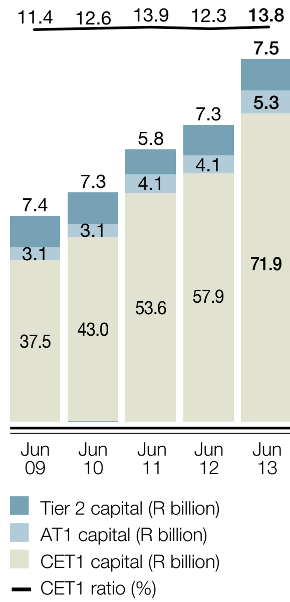
	FirstRand				
	June 2013				June 2012
	RWA				
R million	Advanced approach	Standardised approach	Total	Capital requirement#	RWA
Credit risk	**295 315**	**62 818**	**358 133**	**34 022**	317 849
– Corporate, banks and sovereigns	**126 357**	**12 574**	**138 931**	**13 198**	117 561
– Small and medium enterprises (SMEs)	**37 664**	**16 578**	**54 242**	**5 153**	45 493
– Residential mortgages	**48 579**	**4 647**	**53 226**	**5 056**	55 932
– Qualifying revolving retail	**18 382**	**199**	**18 581**	**1 765**	12 661
– Other retail	**59 691**	**10 076**	**69 767**	**6 628**	63 710
– Securitisation exposure	**4 642**	**–**	**4 642**	**441**	9 588
– Other	**–**	**18 744**	**18 744**	**1 781**	12 904
Counterparty credit risk†	**2 548**	**–**	**2 548**	**242**	–
Total credit risk	**297 863**	**62 818**	**360 681**	**34 264**	317 849
Operational risk*	**65 887**	**17 332**	**83 219**	**7 906**	72 963
Market risk	**7 855**	**1 930**	**9 785**	**930**	15 868
Equity investment risk	**38 190**	**–**	**38 190**	**3 628**	40 640
Other assets**	**–**	**28 085**	**28 085**	**2 668**	24 148
Total RWA	**409 795**	**110 165**	**519 960**	**49 396**	471 468

* *Exposures subject to BIA are included under the standardised approach.*
** *Other assets include the investment in financial, banking and insurance entities.*
# *Capital requirement calculated at 9.5% of RWA.*
† *Excluding default risk. Balance for 2012 included in credit risk.*

Historical overview of capital adequacy

The following graph provides a historical overview of the capital adequacy for FirstRand.

Capital adequacy – FirstRand



Capital adequacy position for FirstRand and its subsidiaries/foreign branches

The registered banking subsidiaries of FirstRand must comply with the SARB regulations and those of the respective in-country regulators, with primary focus placed on Tier 1 capital and Total capital adequacy ratios. Based on the outcome of detailed stress testing, each entity targets a capital level in excess of the regulatory minimum. Adequate controls and processes are in place to ensure that each entity is adequately capitalised to meet local regulatory requirements. Capital generated by subsidiaries/branches in excess of targeted levels is returned to FirstRand, usually in the form of dividends/return of profits. During the year under review, no restrictions were experienced on the repayment of such dividends or capital to the Group.

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

RWA and capital adequacy positions for FirstRand and its subsidiaries/foreign branches

	For the year ended 30 June			
	2013			2012
	RWA R million	Tier 1 %	Total capital adequacy %	Total capital adequacy %
Basel III*				
FirstRand	**519 960**	**14.8**	**16.3**	14.7
FirstRand Bank South Africa	**398 519**	**13.3**	**14.9**	14.6
FirstRand Bank London	**13 002**	**11.2**	**11.3**	18.0
FirstRand Bank India	**1 374**	**35.1**	**36.0**	30.4
RMB Australia	**10 341**	**11.5**	**11.5**	14.2
FNB Namibia**	**15 910**	**12.7**	**16.2**	17.6
Basel I**				
FNB Botswana	**12 216**	**14.9**	**17.4**	16.6
FNB Lesotho	**527**	**13.5**	**18.1**	17.4
FNB Mozambique	**1 569**	**12.1**	**12.7**	11.9
FNB Swaziland	**1 701**	**26.9**	**28.1**	29.4
FNB Zambia	**1 735**	**17.6**	**26.6**	18.0
FNB Tanzania	**157**	**26.7**	**26.7**	77.8
RMB Nigeria#	**147**	**>100**	**>100**	

* *Ratios for the current period based on Basel III rules, 2012 ratios based on Basel 2.5.*
** *Ratios based on local rules.*
\# *Opened offices on 7 February 2013.*

The following disclosure templates, as required by *SARB Directive 8 of 2013* as part of the Pillar 3 disclosure for the year ended 30 June 2013, is available on www.firstrand.co.za/investorcentre/pages/capitaldisclosures.aspx:

- composition of capital;
- reconciliation of audited financial statements and regulatory qualifying capital and reserves; and
- main features of qualifying capital instruments.

Scan with your smart device's QR code reader to access additional capital disclosures on the Group's website.

CREDIT RISK

INTRODUCTION AND OBJECTIVES (AUDITED)

Credit risk is defined as the risk of loss due to the non-performance of a counterparty in respect of any financial or performance obligation. For fair value portfolios, the definition of credit risk is expanded to include the risk of losses through fair value changes arising from changes in credit spreads. Credit risk also includes credit default risk, pre-settlement risk, country risk, concentration risk and securitisation risk.

The goal of credit risk management is to maximise the Group's risk-adjusted return, i.e. net income after cost of capital (NIACC), within acceptable levels of earnings volatility by maintaining credit risk exposure within acceptable parameters.

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

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

Credit risk management across the Group is split into three distinct portfolios: retail, commercial and wholesale. These portfolios are aligned to customer profiles. As advances are split over the three Group franchises, default risk is allocated to the income-receiving portfolio.

Based on the Group's risk-reward appetite for credit risk, as measured on a ROE, NIACC and volatility of earnings basis, credit risk is managed on principles such as appropriate levels of capital and pricing for risk on an individual and portfolio basis. The scope of credit risk identification and management practices across the Group therefore spans the credit value chain including credit origination strategy, risk appetite, risk quantification and measurement, collection and recovery of delinquent accounts.

Credit risk is managed through comprehensive policies and processes that ensure adequate identification, measurement, monitoring and control and reporting of credit risk exposure. Objectives are to ensure a sound credit risk management environment with appropriate credit granting, administration, measurement and monitoring through the implementation of adequate risk management controls.

Retail credit

Secured products in retail credit in FNB include mortgage finance with property as security for the loan and pension-backed loans with a portion of a pension fund as security to purchase or improve a property. Secured retail credit at WesBank is mainly instalment sale agreements for motor vehicle financing.

Unsecured products in both FNB and WesBank include:

- personal loans ranging from small short-term loans to larger loans with repayment terms of up to 60 months;
- revolving overdraft facilities linked to transactional demand deposit accounts; and
- credit cards with revolving credit limits and either straight or budget period repayment facilities.

Commercial credit

The commercial credit portfolio strategy is focused on tailoring credit products for commercial customers. FNB (primary relationship owner) and WesBank (vehicle and asset-based finance (VAF)) both provide products, which include:

- revolving overdraft facilities linked to transactional demand deposit accounts;
- traditional VAF and fleet petrol cards;
- dealer funding solutions to selected vehicle dealerships secured by trade stock;
- guarantees and letters of credit to assist in facilitation of transactions;
- forward exchange contracts and interest rate swaps;
- secured term loans;
- property finance includes owner-occupied and multi-tenanted properties as well as finance for residential developments secured by the properties;
- leveraged finance provides specialised business financing to fund, amongst others, business acquisitions, management buy-outs, management buy-ins, BEE transactions and balance sheet re-structuring; and
- working capital facilities secured against debtors books and selective invoice discounting.

Wholesale credit

Wholesale credit offered by RMB to large corporate multi-banked customers includes the following products:

- all inclusive financing packages for investment banking clients;
- funding of corporate businesses, government and parastatals through debt capital market instruments;
- structured asset finance for client funding requirements in local and cross-border strategic African jurisdictions;
- structuring, raising and underwriting of equity capital and structured equity solutions;

- infrastructure and project finance;
- leveraged finance;
- real estate investment banking; and
- resource finance.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

The Group has a comprehensive credit governance committee structure with the responsibility to approve, monitor and oversee credit risk management and exposures of the Group. Additional management committees within the business assist in strengthening credit risk management.

The RCC committee and franchise excos regularly receive and review reports on the adequacy and robustness of credit risk identification, management and control processes, as well as on the current and projected credit risk profile across the Group. The credit risk management governance structures, related roles and responsibilities as well as lines of accountability are set out in the credit risk management framework (CRMF). Approved by the RCC committee and the FirstRand credit risk management committee (a subcommittee of the RCC committee), the CRMF is board-approved policy and a subframework of the BPRMF, discussed in the *Risk governance section.*

LEC (a board committee) and the FirstRand credit risk management committee support the RCC committee in its tasks. MRVC, also a subcommittee of the RCC committee, supports the RCC committee in its tasks relating specifically to risk capital models. For a description of the role and responsibilities of these committees refer to the *Risk governance* section.

The Group Credit Risk Management (GCRM) function

The GCRM function in ERM provides independent oversight of the credit risk management practices of the Group's operating franchises to ensure an effective and holistic credit risk management process. It is responsible for the CRMF and related policies and monitors the implementation of credit risk-related frameworks. In addition, its responsibilities include:

- the overall credit risk profile of the Group;
- setting standards for credit risk reporting;
- maintaining and overseeing the Group credit governance structures as well as the credit measurement process;
- performing independent validations of credit rating systems;
- ensuring accuracy and completeness of credit risk identification and management;
- disseminating credit risk methodologies and capabilities across the Group;
- facilitating and managing the credit risk appetite processes across the Group; and
- ensuring regulatory compliance.

The GCRM function is supported by credit risk functions within the franchises, which are managed by portfolio heads (Retail, Commercial and Wholesale).

Specific credit responsibilities lie with each credit portfolio head, including:

- accountability to the Group's governance forums and liaison with regulators;
- maintaining high competency levels/skills in each credit function;
- alignment of credit origination strategy and appetite;
- implementation and assessment of credit governance frameworks and policy compliance;
- streamlining and consolidation of functions, systems and mandates; and
- calculating of volatility profile for aggregate portfolios.

ASSESSMENT AND MANAGEMENT (AUDITED)

Calculation of internal ratings and rating process

The assessment of credit risk across the Group relies on internally-developed quantitative models for regulatory purposes under the *Banks Act Regulations* (Basel), as well as addressing business needs.

Credit risk models are widely employed in the assessment of capital requirements, pricing, impairment calculations and stress testing of the credit risk portfolio. All of these models are built on a number of client and facility rating models, in line with Basel AIRB approach requirements and the Group's model building frameworks. The credit risk approaches across the Group are shown in the following table.

Basel approach	FirstRand Bank	Remaining FirstRand subsidiaries
AIRB	✓	
Standardised approach		✓

Even though the remaining subsidiaries do not have regulatory approval to use the AIRB approach, the same or similar models are applied for the internal assessment of credit risk on the standardised approach. The models are used for the internal assessment of the following three primary credit risk components discussed in the following sections:

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

Management of the credit portfolio is reliant on these three credit risk measures. PD, EAD and LGD are inputs into the portfolio

and Group-level credit risk assessment where the measures are combined with estimates of correlations between individual counterparties, industries and portfolios to reflect diversification benefits across the portfolio of credit risks.

Probability of default

PD is defined as the probability of a counterparty defaulting on any of its obligations over the next 12 months and is a measure of the counterparty's ability and willingness to repay facilities granted. A default, in this context, is defined along two dimensions:

- time-driven: the counterparty is in arrears for more than 90 days or three instalments as appropriate; and
- event-driven: there is reason to believe that the exposure will not be recovered in full and has been classified as such.

This definition of default is consistently applied across all credit portfolios as well as in the recognition of NPLs for accounting purposes.

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

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

FR rating	Midpoint PD	International scale mapping*
FR 1 – 15	0.07%	AAA, AA, A
FR 16 – 25	0.32%	BBB
FR 26 – 32	0.77%	BB+, BB
FR 33 – 40	1.48%	BB-
FR 41 – 55	2.78%	B+
FR 56 – 86	7.95%	B
FR 87 – 91	15.47%	B-
FR 92 – 99	59.11%	Below B-
FR 100	100%	D (defaulted)

* *Indicative mapping to the international rating scales of Standard & Poor's. These mappings are reviewed and updated on a regular basis.*

FR 1 is the lowest PD and FR 100 is the highest. External ratings have also been mapped to the master rating scale for reporting purposes.

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

- Through-the-cycle (TTC) PD measures reflect long-term, average default expectations over the course of the economic cycle. TTC PDs are inputs in economic and regulatory capital calculations.
- Point-in-time (PIT) PD measures reflect default expectations in the current economic environment and thus tend to be more volatile than TTC PDs. PIT PDs are used in credit portfolio management, including risk appetite and portfolio monitoring.

Exposure at default

The EAD of a particular facility is defined as the expected exposure to a counterparty through a facility should the counterparty default over the next 12 months. It reflects commitments made and facilities granted that have not been paid out and that may be drawn over the period under consideration (i.e. off-balance sheet exposures). It is also a measure of potential future exposure on derivative positions.

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

Loss given default

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

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

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

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

Expected loss (EL)

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

Slotting approach

Specialised lending relates mainly to project and commodity finance. In terms of the slotting approach, the exposure is rated after assessing the risks and mitigations applied to reduce/eliminate the risk and mapped to one of four supervisory categories. This will apply where the Group finances an entity created to finance and/or operate physical assets where the primary source of repayment of the obligation is the income generated by the assets (i.e. specialised lending specifically in project and commodity finance).

Rating process

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

Credit portfolio rating process

Portfolio and type of exposures	Description of rating system
Large corporate portfolios (Wholesale: RMB, WesBank Corporate and Corporate Centre) 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 Basel requirements. **Rating process:** › 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; › rating models were developed using internal and external data covering more than ten years. Qualitative analysis is based on the methodology followed by international rating agencies; › the rating assessment is reviewed by the wholesale credit committee or delegated subcommittee and the rating (and associated PD) is approved by these committees; › no overrides of the ratings or the PDs are possible after approval by these committees; and › LGD and EAD estimates are based on modelling of a combination of internal and suitably adjusted international data with the same committee process responsible for reviewing and approving these measures.
Low default portfolios: sovereign and bank exposures **(Wholesale: RMB and Corporate Centre)** Exposures to sovereign and bank counterparties.	The default definitions applied in the rating systems are aligned to Basel requirements. **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 wholesale credit committee or delegated subcommittee and the rating (as well as the associated PD) is approved by these committees; and › no overrides of the ratings or the PDs are possible after approval by these committees.

<table>
<tr><th>Portfolio and type of exposures</th><th>Description of rating system</th></tr>
<tr><td>Specialised lending portfolios (Wholesale: RMB, FNB Commercial and Wealth (RMB Private Bank and FNB Private Clients)
Exposures to private-sector counterparties for the financing of income-producing real estate.</td><td>The default definitions applied in the rating systems are aligned to Basel requirements.
Rating process:
• 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 wholesale credit committee, commercial credit committee or delegated subcommittee and the rating (as well as the associated PD) is approved by these committees; and
• no overrides of the ratings or the PDs are possible after approval by these committees.</td></tr>
<tr><td>Commercial portfolio (SME corporate and SME retail counterparties in FNB Commercial and WesBank)
Exposures to SME clients.
A wide range of products give rise to credit exposure, including loan facilities, contingent products and term lending products.</td><td>The default definitions applied in the rating systems are aligned to Basel requirements.
SME retail rating process:
• the SME retail portfolio is segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, customer behaviour and delinquency status;
• PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools; and
• LGD and EAD estimates are applied on a portfolio level, estimated from internal historical default and recovery experience.
SME corporate rating process:
• PD: Counterparties are scored using Moody's RiskCalc™ in addition to other internal risk drivers, the output of which is calibrated to internal historical default data;
• LGD: Recovery rates are largely determined by collateral type and these have been set with reference to internal historical loss data, external data (Fitch) and Basel guidelines; and
• EAD: Portfolio level credit conversion factors are estimated on the basis of the Group's internal historical experience and benchmarked against international studies.</td></tr>
<tr><td>Residential mortgages (Retail portfolios in FNB HomeLoans, Wealth (RMB Private Bank and FNB Private Clients) and mortgage exposures in the FNB Smart segment)
Exposures to individuals for the financing of residential properties.</td><td rowspan="3">The default definition applied in the rating systems is aligned to the requirements of Basel.
Rating process and approach:
• retail portfolios are segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, loan characteristics, customer behaviour, application data and delinquency status;
• PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools;
• no overrides of the 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 the credit manager's judgement in a structured process supported by valid business reasons; and
• 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 recovery processes impacts on the level of LGD; and
• EAD measurement plays a significant role in the assessment of risk due to the typically high level of undrawn facilities that are characteristic of these product types. EAD estimates are based on actual historic EAD, segmented appropriately (e.g. straight versus budget in the case of credit cards).</td></tr>
<tr><td>Qualifying revolving retail exposures (Retail portfolios in FNB Card, FNB Core Banking Solutions and Wealth)
Exposures to individuals providing a revolving limit through a credit card or overdraft facility.</td></tr>
<tr><td>Other retail exposures (Retail portfolios in FNB Loans, FNB Smart segment, WesBank VAF and WesBank Loans)</td></tr>
</table>

Model validation

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

Independent validation of rating systems is carried out by the GCRM function in ERM. It is responsible for reviewing all rating systems and an annual comprehensive revalidation of all material rating systems. An audit team in GIA carries out sample revalidations of the rating systems. The results of these analyses are reported to MRVC and ultimately approved by the RCC 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 processes followed and data used to set parameters for the model. These documents are updated at least annually by the model development teams;
- independent validation reports, documenting the process followed during the annual validation exercise and results obtained from these analyses; and
- model build and development frameworks are reviewed and, where required, updated annually by GCRM. These frameworks provide guidance, principles and minimum standards which the model development teams are required to adhere to.

Credit risk mitigation

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

Although, in principle, the credit assessment focuses on the counterparty's ability to repay the debt, credit mitigation instruments are used where appropriate to reduce the Group's lending risk resulting in security against the majority of exposures. These include financial or other collateral, netting agreements, guarantees or credit derivatives. The collateral types are driven by portfolio, product or counterparty type:

- mortgage and instalment sale finance portfolios in FNB HomeLoans, FNB Wealth and WesBank are secured by the underlying assets financed;
- personal loans, overdrafts and credit card exposures are generally unsecured or secured by guarantees and sureties;
- FNB Commercial credit counterparties are secured by the assets of the SME counterparties and commercial property finance deals are secured by the underlying property and associated cash;
- working capital facilities in RMB Corporate Banking are unsecured and the structured facilities in RMB are secured as part of the structure through financial or other collateral including guarantees and credit derivative instruments and assets; and
- credit risk in RMB is mitigated through the use of netting agreements and financial collateral.

The Group employs strict policies governing the valuation and management of collateral across all business areas. Collateral is managed internally to ensure that title is retained over collateral taken over the life of the transaction. Collateral is valued at the inception of the credit agreement and subsequently where necessary through physical inspection or index valuation methods. For wholesale and commercial counterparties, collateral is reassessed during the annual review of the counterparty's creditworthiness to ensure that proper title is retained over collateral. For mortgage portfolios, collateral is revalued on an ongoing basis using an index model. For all retail portfolios, including the mortgage portfolio, collateral is revalued through physical inspections in the event of default and at the beginning of the recovery process.

The concentrations within credit risk mitigation types, such as property, are monitored and managed within the three credit portfolios. FNB HomeLoans and FNB Wealth monitor exposure to a number of geographical areas, as well as within loan-to-value bands.

Collateral is taken into account for capital calculation purposes through the determination of the LGD. The existence of collateral results in a reduced LGD, and the levels of the LGDs are determined through statistical modelling techniques based on the historical experience of the recovery processes.

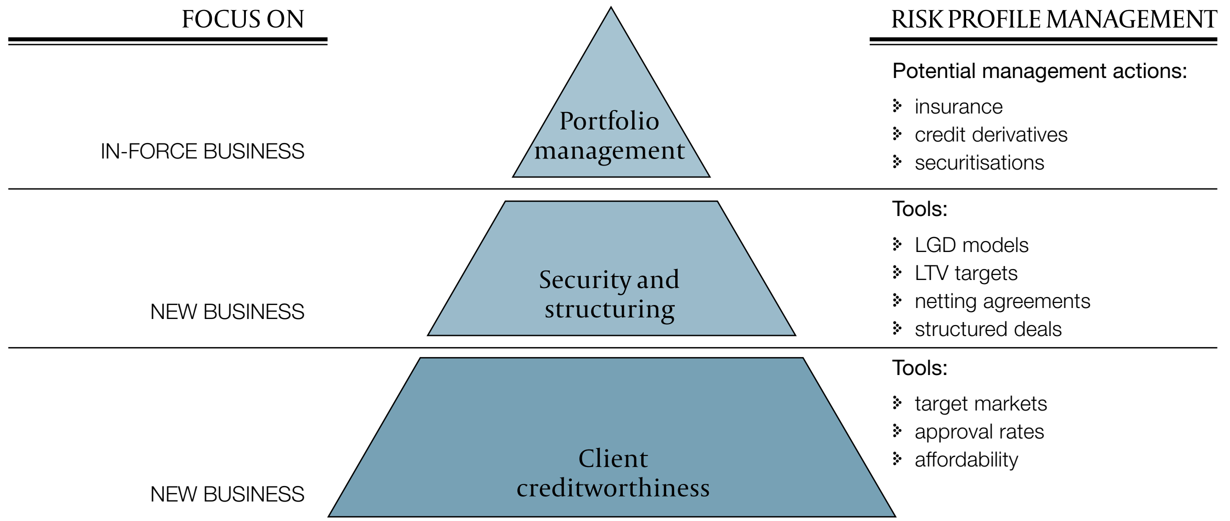
Monitoring of weak exposures

Credit exposures are actively monitored throughout the life of transactions. Portfolios are formally reviewed by the portfolio committees either monthly or quarterly to assess levels of individual counterparty risk, portfolio risks and to act on any early warning indicators. The performance and financial condition of borrowers is monitored based on information from internal performances, credit bureaux, borrowers and publicly-available information. The frequency of monitoring and contact with the borrower is determined from the borrower's risk profile. Reports on the overall quality of the portfolio are monitored at a business unit level, portfolio level and in aggregate for the Group.

Use of credit risk tools and measures (unaudited)

Credit risk measures are used in a large number of business processes, including pricing and setting impairments, determining capitalisation levels and business strategy, risk appetite, and the establishing of appropriate return targets. Credit risk tools and measures are used extensively in the determination of the Group's current credit risk profile and credit risk appetite.

Use of credit risk tools and measures (unaudited)



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

Use of credit measures in the credit lifecycle

	Wholesale	Retail
Determination of portfolio and client acquisition strategy	- assessment of overall portfolio credit risk determined by PD, EAD and LGD; and - acquisition and overall strategy set in terms of appropriate limits and Group risk appetite.	- see wholesale; and - credit models determine loss thresholds used in setting of credit risk appetite.
Determination of individual and portfolio limits	- industry and geographical concentrations; - ratings; - risk-related limits on the composition of portfolio; and - Group credit risk appetite.	- see wholesale; and - modelled versus actual experience is evaluated in setting of risk appetite.
Profitability analysis and pricing decisions	- PD, EAD and LGD used to determine pricing; and - economic profit used for profitability.	- see wholesale.
Credit approval	- consideration of applicant's ratings; - credit risk appetite limits; and - projected risk-adjusted return on economic capital (PD, EAD and LGD are key inputs in these measures).	- automated based on application scorecards (scorecards are reflective of PD, EAD and LGD); and - assessment of client's affordability.
Credit monitoring and risk management	- risk assessment based on PD, EAD and LGD; - counterparty FR grades updated based on risk assessment; and - portfolio model apportions and additional capital to large transactions that will increase concentration risk.	- see wholesale; and - monthly analysis of portfolio and risk movements used in portfolio management and credit strategy decisions.
Impairments	- PD and LGD used in assessment of impairments and provisioning; and - judgemental assessment to determine adequacy of provisions.	- loss identification period (LIP), PD, LGD and roll rates used for specific, portfolio and incurred but not reported (IBNR) provisions.
Regulatory and economic capital calculation	- primary credit risk measures – PD, EAD and LGD are the most important inputs.	- primary credit risk measures – PD, EAD and LGD are the most important inputs.
Reporting to senior management and board	- portfolio reports discussed at franchise and business unit risk committee meetings; and - quarterly portfolio reports submitted to credit risk management and RCC committees.	- portfolio reports discussed at franchise and business unit risk committee meetings; and - quarterly portfolio reports submitted to credit risk management and RCC committees.

CREDIT RISK PORTFOLIO

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

Total advances grew 14% during the year under review. Growth in investment banking and commercial loans to the mining, agriculture as well as the manufacturing and commerce sectors underpinned the commercial and wholesale advances increase. Retail advances benefited from strong growth in the VAF portfolio. Unsecured lending growth remains robust, with credit extension review actions continuously applied. Growth in the Africa book is consistent.

The level of NPLs has maintained a downward trend since the peak in June 2009. Retail defaults and retail NPLs as a percentage of advances continued to decline. Increases in NPLs for the unsecured portfolios have materialised as expected. The commercial portfolios saw a decline in NPLs as a result of continued curing and workout.

Retail credit portfolios

VAF book growth was particularly robust for the year under review. Residential mortgage growth remains low, with the focus on improving the risk profile. Impairments in this portfolio declined noticeably as a result. The unsecured lending portfolio continues to grow. A reduction of retail NPLs was driven by the slower inflow into NPLs in FNB HomeLoans. NPLs increases, however, occurred in all of the unsecured portfolios, in line with expectations and risk appetite and have been appropriately priced for.

The Group's impairment charge reflects increased impairments in the unsecured lending book, in line with expectations. The higher impairment charge in the retail secured portfolios was due to increased impairments in VAF.

Corporate credit portfolios

The wholesale advances book grew due to investment banking-related lending, particularly in mining and renewable energy, while the FNB Commercial's advances portfolio achieved growth attributed mainly to the leveraged finance, property term loan and agriculture portfolios.

NPLs in the corporate portfolio declined year-on-year and a significant increase in impairment charges was largely due to portfolio impairments.

Credit assets (audited)

The following table provides a breakdown of the Group's credit assets by segment, including off-balance sheet exposures.

Credit assets by type and segment

R million	2013	2012
Cash and short-term funds	**43 693**	33 587
– Money at call and short notice	**27 060**	18 153
– Balances with central banks	**16 633**	15 434
Gross advances	**608 361**	533 347
FNB*	**271 395**	245 994
– FNB Retail	**195 841**	184 614
– FNB Commercial**	**42 834**	35 960
– FNB Africa	**32 720**	25 420
WesBank	**142 055**	119 389
RMB Investment Banking	**184 615**	160 217
RMB Corporate Banking*	**5 101**	2 669
Corporate Centre	**5 195**	5 078
Derivatives	**52 316**	52 913
Debt investment securities (excluding non-recourse investments)	**97 752**	82 020
Accounts receivable	**7 471**	6 007
Reinsurance assets	**394**	898
Credit risk not recognised on the balance sheet	**122 748**	104 158
– Guarantees	**30 137**	22 741
– Acceptances	**270**	293
– Letters of credit	**8 925**	7 886
– Irrevocable commitments	**78 783**	69 348
– Credit derivatives	**4 633**	3 890
Total	**932 735**	812 930

* *The comparative information for certain portfolios has been restated to reflect the current segmentation of the business.*
** *Includes public sector.*

Reconciliation of gross advances to net advances

R million	2013	2012
Gross advances after interest in suspense	**608 361**	533 347
Less: total impairment loss (refer note 11 of the consolidated annual financial statements)	**(9 386)**	(8 840)
Net advances (refer consolidated statement of financial position)	**598 975**	524 507

Credit quality (audited)

Advances are considered past due in the following circumstances:

- loans with a specific expiry date (e.g. term loans) and consumer loans repayable by regular instalments (e.g. mortgage loans and personal loans) are treated as overdue where one full instalment is in arrears for one day or more and remains unpaid as at the reporting date; or
- loans payable on demand (e.g. overdrafts) are treated as overdue where a demand for repayment was served on the borrower but repayment has not been made in accordance with the stipulated requirements.

In these instances, the full outstanding amount is considered overdue even if part is not yet due.

A past due analysis is performed for advances with specific expiry or instalment repayment dates. The analysis is not applicable to overdraft products or products where no specific due date is determined. The level of risk on these types of products is assessed and reported with reference to the counterparty ratings of the exposures. The following tables provide the age analysis of loans and advances for the Group.

Age analysis of advances

	2013					
			Past due but not impaired			
R million	**Neither past due nor impaired**	**Renegotiated but current**	**One full instalment past due**	**Two full instalments past due**	**Impaired**	**Total**
– FNB Retail	**182 868**	**507**	**2 457**	**1 394**	**8 615**	**195 841**
– FNB Commercial*	**41 260**	**101**	**29**	**15**	**1 429**	**42 834**
– FNB Africa	**30 922**	**82**	**688**	**351**	**677**	**32 720**
FNB	**255 050**	**690**	**3 174**	**1 760**	**10 721**	**271 395**
WesBank	**134 217**	**–**	**2 830**	**1 127**	**3 881**	**142 055**
RMB Investment Banking**	**182 303**	**–**	**112**	**800**	**1 400**	**184 615**
RMB Corporate Banking	**5 091**	**–**	**1**	**–**	**9**	**5 101**
Corporate Centre	**5 195**	**–**	**–**	**–**	**–**	**5 195**
Total	**581 856**	**690**	**6 117**	**3 687**	**16 011**	**608 361**

* *Includes public sector.*
** *Impaired advances for RMB Investment Banking are net of cumulative credit fair value adjustments on the non-performing book.*

	2012					
			Past due but not impaired			
R million	Neither past due nor impaired	Renegotiated but current	One full instalment past due	Two full instalments past due	Impaired	Total
– FNB Retail	170 475	288	2 604	1 307	9 940	184 614
– FNB Commercial*	34 240	–	38	17	1 665	35 960
– FNB Africa	24 467	45	259	174	475	25 420
FNB**	229 182	333	2 901	1 498	12 080	245 994
WesBank	111 680	–	2 612	956	4 141	119 389
RMB Investment Banking#	158 400	–	147	17	1 653	160 217
RMB Corporate Banking**	2 660	–	–	–	9	2 669
Corporate Centre	5 078	–	–	–	–	5 078
Total	507 000	333	5 660	2 471	17 883	533 347

* *Includes public sector.*
** *Certain portfolios have been restated to reflect the current segmentation of the business.*
# *Impaired advances for RMB Investment Banking are net of cumulative credit fair value adjustments on the non-performing book.*

Renegotiated advances (audited)

Financial assets that would otherwise be past due or impaired that have been renegotiated, are separately classified as neither past due nor impaired assets.

Renegotiated advances are advances where, due to deterioration in the counterparty's financial condition, the Group granted a concession where the original terms and conditions of the facility were amended and the counterparty is within the new terms of the advance.

Advances are only classified as renegotiated if the terms of the renegotiated contract have not yet expired and remain classified as such until the terms of the renegotiated contract expire. Where the advances are reclassified as neither past due nor impaired the adherence to the new terms and conditions is closely monitored. Renegotiated advances exclude advances which are extended or renewed as part of the ordinary course of business on similar terms and conditions as the original advances.

Non-performing advances cannot be reclassified as renegotiated unless the arrears balance has been repaid. Renegotiated but current financial assets are considered as part of the collective evaluation of impairment where financial assets are grouped on the basis of similar credit risk characteristics.

As part of the risk management and recoveries approach, the Group enters into arrangements with clients where concessions are made on payment terms (e.g. a reduction in payments for a specified period, changes in the payment profile or debt counselling payment plans). There are formally defined eligibility criteria appropriate for individual products to determine when clients are eligible for such arrangements. These accounts are monitored in a separate portfolio in each product segment and the performance is tracked for management and impairment purposes. Retail accounts classified as NPLs cannot be reclassified to performing until all arrears have been paid up as per the Group's policy.

Past due but not impaired (audited)

The classification of advances as past due but not impaired follows the standards set out in applicable accounting policies. Advances past due but not impaired in the tables above include accounts in arrears by one or two full repayments. For the year ended 30 June 2013 exposures to technical and partial arrears of R4.2 billion (June 2012: R5.4 billion) were classified as neither past due nor impaired in accordance with FirstRand's impairment methodology, primarily driven by retail exposures.

The following table provides the credit quality of advance of the in-force portfolio, detailed information on the movements on an asset class level is provided in the *PD, EAD and LGD profiles* section.

Credit quality of performing advances (audited)

	2013							
		FNB						
R million	**Total neither past due nor impaired***	**Retail**	**Commercial****	**FNB Africa**	**WesBank**	**RMB Investment Banking**	**RMB Corporate Banking**	**Corporate Centre**
FR 1 – 25	**151 147**	**42 919**	**2 037**	**5 630**	**3 578**	**92 521**	**3 388**	**1 074**
FR 26 – 91	**420 427**	**132 552**	**38 620**	**25 028**	**129 985**	**88 439**	**1 703**	**4 100**
Above FR 92	**10 972**	**7 904**	**704**	**346**	**654**	**1 343**	**–**	**21**
Total	**582 546**	**183 375**	**41 361**	**31 004**	**134 217**	**182 303**	**5 091**	**5 195**

* *Total neither past due nor impaired includes renegotiated but current advances.*
** *Includes public sector.*

	2012							
		FNB						
R million	Total neither past due nor impaired*	Retail	Commercial**	FNB Africa	WesBank	RMB Investment Banking	RMB Corporate Banking#	Corporate Centre
FR 1 – 25	118 874	28 601	1 939	5 377	2 999	76 868	508	2 582
FR 26 – 91	372 031	134 404	29 870	19 068	106 233	77 838	2 152	2 466
Above FR 92	16 428	7 758	2 431	67	2 448	3 694	–	30
Total	507 333	170 763	34 240	24 512	111 680	158 400	2 660	5 078

* *Total neither past due nor impaired includes renegotiated but current advances.*
** *Includes public sector.*
\# *Certain portfolios have been restated to reflect the current segmentation of the business.*

The following tables provide an overview of the credit quality of other financial assets that are neither past due nor impaired.

Credit quality of other financial assets (excluding advances) classified as neither past due nor impaired

	2013				
R million	Debt investment securities*	Derivatives	Cash and short-term funds	Reinsurance assets	Total
AAA to BBB	**90 716**	**34 193**	**41 998**	**394**	**167 301**
BB+ to B-	**6 442**	**18 078**	**1 417**	**–**	**25 937**
CCC	**517**	**36**	**207**	**–**	**760**
Unrated	**77**	**9**	**71**	**–**	**157**
Total	**97 752**	**52 316**	**43 693**	**394**	**194 155**

* *Excludes non-recourse investments.*

	2012				
R million	Debt investment securities*	Derivatives	Cash and short-term funds	Reinsurance assets	Total
AAA to BBB	77 584	36 369	31 329	898	146 180
BB+ to B-	4 385	16 440	2 214	–	23 039
CCC	–	93	–	–	93
Unrated	51	11	44	–	106
Total	82 020	52 913	33 587	898	169 418

* *Excludes non-recourse investments.*

Impairment of financial assets and NPLs (audited)

Refer to the policy for impairment of financial assets in the *Accounting policy* section and advances note in the consolidated annual financial statements for the analysis of the movement in the impairment of advances and NPLs.

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

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

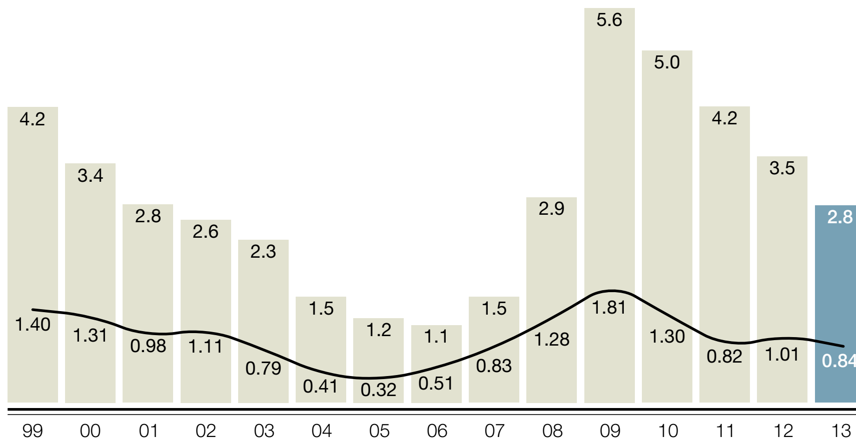
Specific impairments are created for non-performing advances where there is objective evidence that an incurred loss event will have an adverse impact on the estimated future cash flows from the asset. Potential recoveries from guarantees and collateral are incorporated into the calculation of the impairment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

All assets not individually impaired, as described, are included in portfolios with similar credit characteristics (homogeneous pools) and 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 uncollectable 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 recovery.

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

NPLs and impairments history (unaudited)

(%)



* *Impairment charges are shown before insurance proceeds where applicable. The impairment charge is calculated on an IFRS basis.*

Fair value sensitivity of wholesale advances due to credit risk

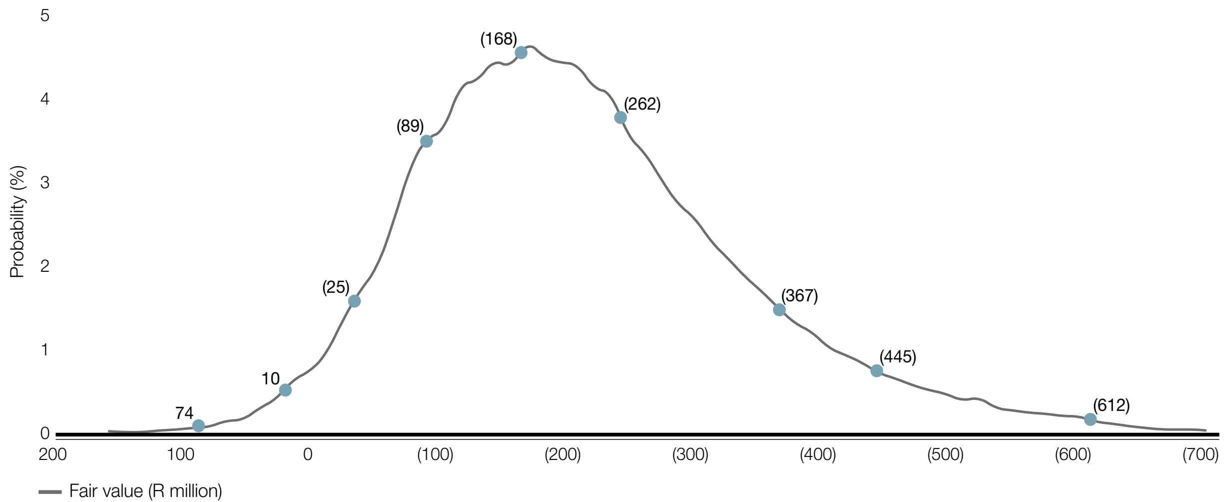
The Investment Banking division in RMB recognises a significant portion of the wholesale advances at fair value through profit or loss. The fair value adjustments directly impact the income statement and the value of advances. For risk management purposes a migration matrix is used to estimate the fair value impact of changes in credit risk. The matrix contains probabilities of downgrading or upgrading to another rating bucket.

The main benefits of using the migration matrix to estimate the fair value impact of credit risk are:

- more realistic downgrades as better rating grades are less likely to be downgraded compared to riskier rating grades;
- migration matrices which take into account higher volatility of riskier rating grades;
- rating migration can be positive or negative;
- rating migration is not restricted by one notch only and, in extreme cases, includes default risk; and
- migration matrices can be based on different economic conditions (for example long term, or downturn).

The following graph sets out the fair value impact based on actual observed rating migrations from Standard & Poor's over the long term. Based on this scenario the average fair value impact is a loss of approximately R168 million. The fair value at the 75th percentile (i.e. there is a probability of 25% of exceeding this value) of the distribution is a loss of approximately R262 million.

Distribution: Fair value impact – long-term scenario



Management of concentration risk (audited)

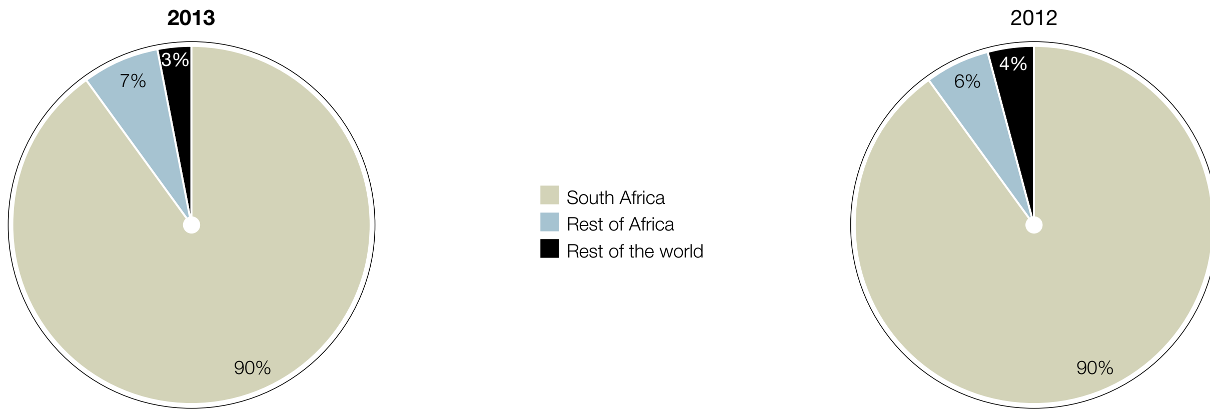
Credit concentration risk is the risk of loss to the Group arising from an excessive concentration of exposure to a single counterparty, industry, market, product, financial instrument or type of security, country or region, or maturity. This concentration typically exists when a number of counterparties are engaged in similar activities and have similar characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

Concentration risk is managed in the credit portfolios, based on the nature of the credit concentration within each portfolio. The Group's credit portfolio is well diversified. Diversification is achieved through setting maximum exposure guidelines to individual counterparties. The Group constantly reviews its concentration levels and sets maximum exposure guidelines to these. Excesses are reported to the RCC committee.

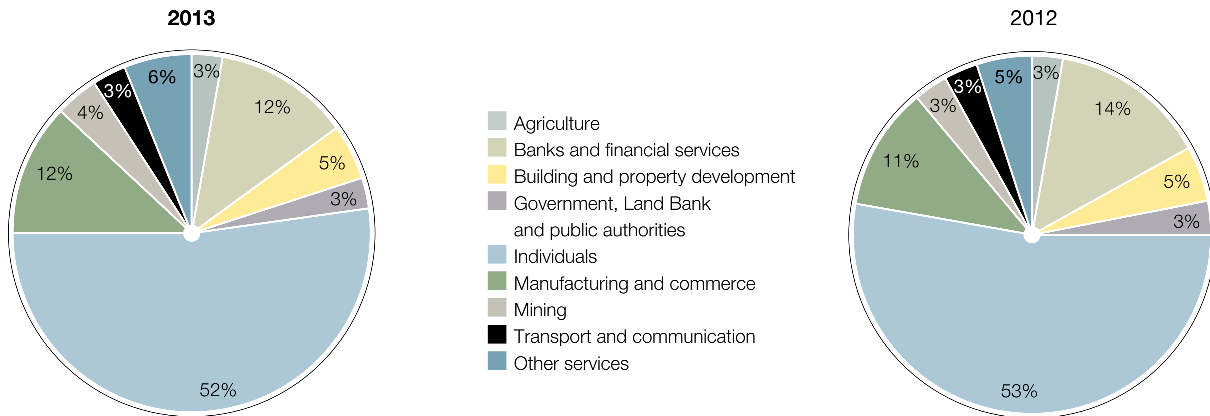
Geographic and industry concentration risk (audited)

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

Geographical split by exposure



Industry split by exposure



The Group seeks to establish a balanced portfolio profile and closely monitors credit concentrations. The following tables provide a breakdown of credit exposure across geographical areas.

Concentration of significant credit exposure (audited)

R million	South Africa	Rest of Africa	United Kingdom	Other Europe	North America	South America	Australasia	Asia	Total
	2013								
Advances	**539 052**	**45 644**	**15 949**	**3 374**	**1 172**	**372**	**1 357**	**1 441**	**608 361**
Derivatives	**29 865**	**298**	**18 673**	**2 194**	**872**	**7**	**–**	**407**	**52 316**
Debt investment securities*	**75 237**	**6 491**	**624**	**–**	**10 001**	**–**	**–**	**5 399**	**97 752**
Guarantees, acceptances and letters of credit**	**27 981**	**7 666**	**82**	**150**	**7**	**–**	**14**	**3 432**	**39 332**
Irrevocable commitments**	**68 411**	**7 312**	**1 485**	**517**	**530**	**124**	**–**	**404**	**78 783**

* Excludes non-recourse investments.
** Significant off-balance sheet exposures. Refer to the note on contingencies and commitments in the notes to the financial statements.

R million	South Africa	Rest of Africa	United Kingdom	Other Europe	North America	South America	Australasia	Asia	Total
	2012								
Advances	478 204	31 271	15 747	2 266	284	102	1 637	3 836	533 347
Derivatives	33 808	88	11 925	5 568	1 424	–	11	89	52 913
Debt investment securities*	71 152	5 456	1 525	–	1 636	–	–	2 251	82 020
Guarantees, acceptances and letters of credit**	23 912	5 674	–	529	7	2	–	796	30 920
Irrevocable commitments**	63 073	4 941	814	148	66	–	43	263	69 348

* Excludes non-recourse investments.
** Significant off-balance sheet exposures. Refer to the note on contingencies and commitments in the notes to the financial statements.

Average advances per major risk type (unaudited)

R million	**2013**	2012
Retail credit*	**321 617**	259 574
FNB Africa credit	**29 276**	24 722
Wholesale credit	**174 927**	146 197
Commercial credit	**39 718**	33 299

* The average advances of retail credit for June 2012 were restated.

The average amount of gross credit exposure during the reporting period is calculated on a monthly average basis.

Segmental analysis of advances (audited)

The following table provides a breakdown of credit exposures by the Group segments.

R million/%	2013				
	Advances	**NPLs**	**NPLs as a % of advances**	**Total impairment charge**	**Impairments as % of average advances**
FNB*	**271 395**	**10 721**	**3.95**	**2 838**	**1.10**
– FNB Retail	**195 841**	**8 615**	**4.40**	**2 330**	**1.22**
– Residential mortgages	**163 046**	**6 911**	**4.24**	**507**	**0.32**
– Card	**13 001**	**302**	**2.32**	**23**	**0.19**
– Personal loans	**12 885**	**943**	**7.32**	**1 402**	**11.39**
– Other retail	**6 909**	**459**	**6.64**	**398**	**7.47**
– FNB Commercial**	**42 834**	**1 429**	**3.34**	**318**	**0.81**
– FNB Africa	**32 720**	**677**	**2.07**	**190**	**0.65**
WesBank	**142 055**	**3 881**	**2.73**	**1 632**	**1.25**
– WesBank asset–backed finance	**134 808**	**3 437**	**2.55**	**1 202**	**0.97**
– WesBank Retail	**87 342**	**2 463**	**2.82**	**945**	**1.18**
– WesBank Corporate	**34 210**	**924**	**2.70**	**160**	**0.49**
– WesBank International	**13 256**	**50**	**0.38**	**97**	**0.86**
– WesBank loans	**7 247**	**444**	**6.13**	**430**	**6.54**
RMB Investment Banking	**184 615**	**2 390**	**1.29**	**83**	**0.05**
RMB Corporate Banking*	**5 101**	**9**	**0.18**	**29**	**0.75**
Corporate Centre	**5 195**	**–**	**–**	**–**	**–**
Subtotal	**608 361**	**17 001**	**2.79**	**4 582**	**0.80**
Special impairments#	**–**	**–**	**–**	**230**	**0.04**
Total	**608 361**	**17 001**	**2.79**	**4 812**	**0.84**

* *Comparative information of certain portfolios has been restated to reflect the current segmentation of the business.*
** *Includes public sector.*
# *Special impairments related to FNB Commercial R215 million (2012: R405 million) and RMB Corporate Banking R15 million (2012: R300 million).*

2012				
Advances	NPLs	NPLs as a % of advances	Total impairment charge	Impairments as % of average advances
245 994	12 080	4.91	2 449	1.03
184 614	9 940	5.38	2 161	1.20
157 851	8 697	5.51	878	0.56
11 291	271	2.40	27	0.24
11 730	710	6.05	955	10.13
3 742	262	7.00	301	10.40
35 960	1 665	4.63	167	0.50
25 420	475	1.87	121	0.50
119 389	4 141	3.47	1 100	0.99
113 488	3 828	3.37	836	0.79
72 601	2 621	3.61	362	0.55
31 621	1 134	3.59	377	1.20
9 266	73	0.79	97	1.26
5 901	313	5.31	264	4.85
160 217	2 436	1.52	89	0.06
2 669	9	0.34	(27)	(1.03)
5 078	–	–	749	11.06
533 347	18 666	3.50	4 360	0.87
–	–	–	705	0.14
533 347	18 666	3.50	5 065	1.01

BASEL DISCLOSURE

Credit rating systems and processes used for Basel

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

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

Credit exposure by type, segment and Basel approach

		AIRB	Standardised approach subsidiaries	
R million	2013	FirstRand Bank (SA)	Regulated bank entities within FNB Africa	Other subsidiaries
Cash and short-term funds	**43 693**	37 068	3 821	2 804
– Money at call and short notice	**27 060**	22 745	1 544	2 771
– Balances with central banks	**16 633**	14 323	2 277	33
Gross advances	**608 361**	543 631	32 720	32 010
FNB	**271 395**	238 451	32 720	224
– FNB Retail	**195 841**	195 841	–	–
– FNB Commercial*	**42 834**	42 610	–	224
– FNB Africa	**32 720**	–	32 720	–
WesBank	**142 055**	125 910	–	16 145
RMB Investment Banking	**184 615**	170 174	–	14 441
RMB Corporate Banking	**5 101**	5 101	–	–
Corporate Centre	**5 195**	3 995	–	1 200
Derivatives	**52 316**	51 755	74	487
Debt investment securities (excluding non-recourse investments)	**97 752**	85 413	6 842	5 497
Accounts receivable	**7 471**	4 564	563	2 344
Loans due by holding company and fellow subsidiaries	**–**	20 882	7 160	(28 042)
Reinsurance assets	**394**	–	–	394
Credit risk not recognised on the balance sheet	**122 748**	111 372	6 982	4 394
– Guarantees	**30 137**	27 268	2 279	590
– Acceptances	**270**	270	–	–
– Letters of credit	**8 925**	8 631	292	2
– Irrevocable commitments	**78 783**	70 570	4 411	3 802
– Credit derivatives	**4 633**	4 633	–	–
Total	**932 735**	**854 685**	**58 162**	**19 888**

* *Includes public sector.*

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

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%	–
10%	–
20%	**4 411**
35%	**11 592**
50%	**2 661**
75%	**2 769**
100%	**36 464**
Specific impairments	**265**
Total	**58 162**

PD, EAD and LGD profiles

A summary of credit risk parameters as reported for regulatory capital purposes is shown in the following tables for each significant AIRB asset class. The parameters reflect TTC PDs and downturn LGDs. The Group uses EAD-weighted PDs based on the FR master rating scale which are then mapped to Basel rating buckets (1–25) for regulatory reporting purposes.

The tables provide a summary of the EAD distribution by prescribed counterparty risk bands (Basel risk buckets). The EAD-weighted downturn LGD, EAD-weighted PD and average risk weight for the performing and total book are also shown as well as comparatives for the prior year.

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

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

The following tables include the EAD% distribution per Basel risk bucket for different asset classes.

Risk profile per asset class: EAD% distribution per Basel risk bucket

%	EAD									
	FRB*		Corporate		Sovereign		Specialised lending		Banks and securities firms**	
Basel PD risk buckets	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
1 – 5	**9.3**	9.1	**0.4**	0.6	**83.1**	78.5	**0.1**	0.2	**3.9**	7.8
6 – 10	**16.0**	15.2	**33.8**	36.4	**13.5**	16.9	**14.8**	19.7	**67.7**	73.3
11 – 15	**36.9**	39.5	**53.3**	51.2	**2.3**	3.0	**54.7**	40.2	**22.6**	15.5
16 – 20	**31.2**	28.3	**10.3**	9.3	**0.6**	1.2	**23.0**	31.8	**4.9**	0.6
21 – 25	**4.5**	5.2	**2.0**	2.0	**0.2**	0.3	**2.2**	1.0	**0.9**	0.1
NPLs	**2.1**	2.6	**0.1**	0.5	**0.4**	–	**5.2**	7.1	**–**	–

%	EAD									
	SME corporate		SME retail		Retail mortgages		Retail revolving		Other retail#	
Basel PD risk buckets	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
1 – 5	**2.0**	–	**–**	–	**–**	–	**–**	–	**–**	–
6 – 10	**0.8**	–	**13.7**	12.4	**2.2**	–	**20.8**	22.8	**–**	1.7
11 – 15	**56.0**	54.0	**24.8**	27.9	**53.6**	55.9	**32.5**	32.0	**7.3**	21.9
16 – 20	**37.7**	41.2	**54.3**	51.4	**36.5**	34.6	**34.9**	34.2	**76.6**	55.5
21 – 25	**3.5**	3.4	**4.3**	4.6	**4.5**	5.3	**9.8**	8.9	**12.4**	16.8
NPLs	**2.0**	1.4	**2.8**	3.7	**3.2**	4.1	**2.1**	2.1	**3.7**	4.1

* *The movements in FRB from June 2012 to June 2013 are explained in each seperate asset class. Distributions are stable with NPLs reducing in line with the macro environment over the year under review.*

** *Banks and securities firms: the main contributor to the movement from June 2012 to June 2013 is the movement in the pre-settlement facilities which is a characteristic of these exposures. In addition, through the re-rating process, a number of counterparty ratings have changed.*

\# *Other retail: the main contributor to the movement from June 2012 to June 2013 is the recalibration of the respective PD models.*

Risk profile per asset class: Nominal EAD per Basel risk bucket

R million	Nominal EAD									
	FRB*		Corporate		Sovereign		Specialised lending		Banks and securities firms**	
Basel PD risk buckets	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
1 – 5	**67 222**	58 752	**621**	779	**64 718**	50 082	**41**	59	**1 833**	7 820
6 – 10	**111 135**	96 452	**51 741**	48 952	**10 489**	10 777	**5 709**	7 188	**31 518**	18 038
11 – 15	**267 689**	251 149	**81 772**	68 856	**1 782**	1 927	**21 087**	14 638	**10 500**	9 291
16 – 20	**226 451**	179 736	**15 818**	12 509	**448**	757	**8 848**	11 575	**2 280**	3 393
21 – 25	**32 860**	33 128	**3 124**	2 651	**157**	197	**848**	363	**406**	325
NPLs	**15 073**	16 684	**199**	682	**317**	24	**1 994**	2 582	**–**	–
Total	**720 430**	635 901	**153 275**	134 429	**77 911**	63 764	**38 527**	36 405	**46 537**	38 867

R million	Nominal EAD									
	SME corporate		SME retail		Retail mortgages		Retail revolving		Other retail#	
Basel PD risk buckets	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
1 – 5	**9**	–	**–**	–	**–**	–	**–**	–	**–**	12
6 – 10	**314**	–	**–**	3 902	**4 226**	–	**7 108**	6 071	**30**	1 524
11 – 15	**23 392**	18 308	**8 797**	8 779	**101 273**	101 307	**11 121**	8 537	**7 965**	19 506
16 – 20	**15 753**	13 948	**19 297**	16 185	**68 918**	62 792	**11 952**	9 122	**83 137**	49 455
21 – 25	**1 469**	1 163	**1 544**	1 433	**8 543**	9 632	**3 341**	2 368	**13 428**	14 996
NPLs	**821**	471	**1 011**	1 177	**6 036**	7 512	**721**	547	**3 974**	3 689
Total	**41 758**	33 890	**30 649**	31 476	**188 996**	181 243	**34 243**	26 645	**108 534**	89 182

* *The movement in FRB from June 2012 to June 2013 are explained in each seperate asset class. Distributions are stable with NPLs reducing in line with the macro environment over the year under review.*

** *Banks and securities firms: the main contributor to the movement from June 2012 to June 2013 is the movements in the pre-settlement facilities which is a characteristic of these exposures. In addition, through the re-rating process, a number of counterparty ratings have changed.*

\# *Other retail: the main contributor to the movement from June 2012 to June 2013 is the recalibration of the respective PD models.*

The following tables include the PD%, LGD%, EL/EAD and RWA/EAD ratio per asset class.

PD%, LGD%, EL/EAD and RWA/EAD per asset class

	2013									
%	**FRB***	**Corporate**	**Sovereign****	**Specialised lending#**	**Banks and securities firms**	**SME corporate**	**SME retail**	**Retail mortgages**	**Retail revolving**	**Other retail**
Average performing PD	**2.5**	**1.2**	**0.1**	**1.8**	**0.5**	**2.5**	**2.9**	**2.9**	**4.1**	**6.0**
Average performing LGD	**28.3**	**34.5**	**28.4**	**23.2**	**30.2**	**26.5**	**30.7**	**13.9**	**65.2**	**32.8**
Performing EL/EAD	**0.8**	**0.5**	**0.1**	**0.7**	**0.2**	**0.6**	**0.8**	**0.4**	**2.7**	**2.5**
Performing RWA/EAD	**39.9**	**57.5**	**8.0**	**55.1**	**26.9**	**53.9**	**37.7**	**26.2**	**53.2**	**53.1**
Average total book PD	**4.5**	**1.3**	**0.5**	**6.9**	**0.5**	**4.4**	**5.7**	**6.0**	**6.2**	**9.4**
Average total book LGD	**28.7**	**34.5**	**28.4**	**25.0**	**30.2**	**27.4**	**31.0**	**14.2**	**65.3**	**33.6**
Total book EL/EAD	**1.6**	**0.6**	**0.1**	**3.1**	**0.2**	**1.7**	**2.0**	**1.2**	**4.1**	**4.2**
Total book RWA/EAD	**41.2**	**57.4**	**8.0**	**52.4**	**26.9**	**56.3**	**40.4**	**26.0**	**54.6**	**54.4**

	2012†									
%	FRB*	Corporate	Sovereign**	Specialised lending#	Banks and securities irms	SME corporate	SME retail	Retail mortgages	Retail revolving	Other retail
Average performing PD	2.7	1.1	0.2	2.1	0.6	2.4	3.0	3.2	3.9	6.4
Average performing LGD	28.4	35.1	29.1	22.6	32.5	28.2	29.6	14.7	66.3	34.2
Performing EL/EAD	0.9	0.5	0.1	0.5	0.2	0.7	0.8	0.5	2.6	3.1
Performing RWA/EAD	40.0	51.0	8.8	64.6	28.4	60.2	38.8	29.4	46.1	54.1
Average total book PD	5.2	1.6	0.2	9.0	0.6	3.8	6.6	7.2	5.9	10.2
Average total book LGD	28.7	35.2	29.1	24.1	32.5	28.6	30.2	14.9	66.5	35.4
Total book EL/EAD	1.8	0.7	0.1	3.2	0.2	1.5	2.2	1.4	4.0	4.8
Total book RWA/EAD	41.4	52.0	8.9	60.7	28.4	60.0	43.8	28.8	47.2	62.0

* *The movements in FRB from June 2012 to June 2013 are explained in each separate asset class. Distributions are stable with NPLs reducing in line with the macro environment over the year under review.*
** *Includes public sector entities, local government and municipalities and sovereign exposures (including central government and central bank).*
\# *Includes high volatility commercial real estate, income-producing real estate, commodities finance and project finance exposures.*
† *A number of June 2012 figures have been restated. Additional information required in regulatory returns enabled more accurate information.*

The following tables include the nominal value of the credit extended, drawn exposure and EAD per asset class.

Nominal credit extended, drawn exposure and EAD per asset class

	2013									
R million	**FRB***	**Corporate**	**Sovereign****	**Specialised lending#**	**Banks and securities firms**	**SME corporate**	**SME retail**	**Retail mortgages**	**Retail revolving**	**Other retail**
Total book credit extended	**919 707**	**205 107**	**83 334**	**39 252**	**155 387**	**49 445**	**36 735**	**195 405**	**46 262**	**108 780**
Total book drawn exposure	**601 736**	**118 854**	**72 680**	**37 524**	**29 123**	**35 338**	**28 174**	**153 618**	**19 278**	**107 147**
Total book nominal EAD	**720 430**	**153 275**	**77 911**	**38 527**	**46 537**	**41 758**	**30 649**	**188 996**	**34 243**	**108 534**

	2012†									
R million	FRB*	Corporate	Sovereign**	Specialised lending#	Banks and securities firms	SME corporate	SME retail	Retail mortgages	Retail revolving	Other retail
Total book credit extended	733 962	165 192	63 011	36 569	84 512	40 751	32 087	185 843	36 815	89 182
Total book drawn exposure	517 696	102 389	58 539	32 898	19 006	27 999	25 622	148 620	14 699	87 924
Total book nominal EAD	635 901	134 429	63 764	36 405	38 867	33 890	31 476	181 243	26 645	89 182

* *The movements in FRB from June 2012 to June 2013 are explained in each seperate asset class. Distributions are stable with NPLs reducing in line with the macro environment over the year under review.*

** *Includes public sector entities, local government and municipalities and sovereign exposures (including central government and central bank).*

\# *Includes high volatility commercial real estate, income-producing real estate, commodities finance and project finance exposures.*

† *A number of June 2012 figures have been restated. Additional information required in regulatory returns enabled more accurate information.*

Maturity breakdown

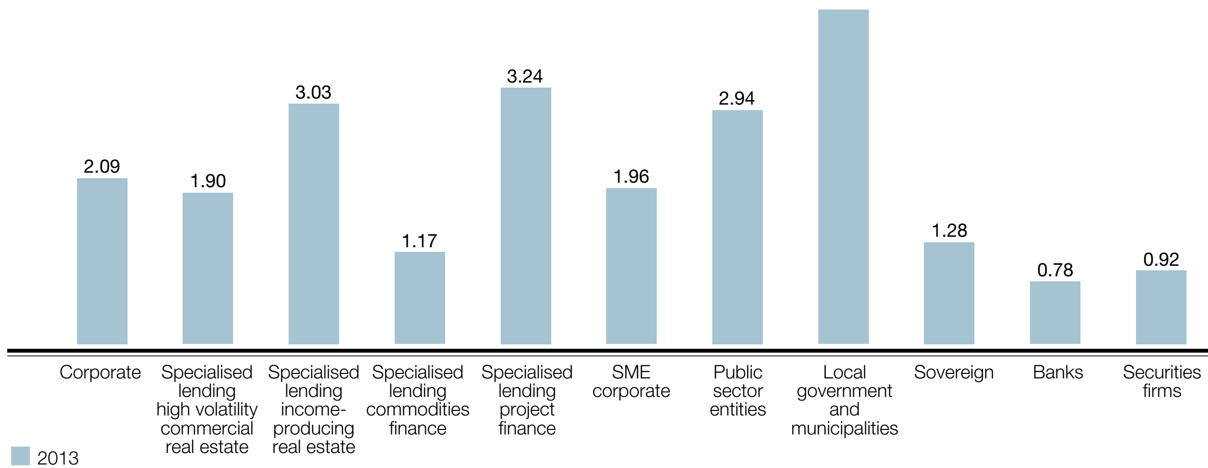
Maturity is defined as the average time at which a bank will receive its contractual payments (cash flows), calculated for each account or exposure weighted by the size of each of the cash flows.

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

Maturity breakdown of AIRB asset classes within the wholesale credit portfolio is disclosed in the following chart.

Maturity breakdown per wholesale AIRB asset class

(Maturity in years)



Actual versus expected loss analysis

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

Expected loss here refers to regulatory expected loss. This provides a one-year forward looking view, based on information available at the beginning of the year (i.e. 1 July 2012). Risk parameters include:

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

Actual losses during the year consist of the level of specific impairments at the start of the period (1 July 2012) and the net specific impairment charge recorded through the income statement for the period as determined by IFRS. It excludes the effect of post-write off recoveries which would reduce the actual loss number. The calculation is based on the assumption that the specific provisions raised are a fair estimate of what final losses on defaulted exposures would be, although the length of the workout period creates uncertainty in this assumption.

The measure of actual losses includes specific impairments raised for exposures which defaulted during the year, but which did not exist at 1 July 2012. These exposures are not reflected in the expected loss value described.

The following table provides the comparison of actual loss to regulatory expected loss for each significant AIRB asset class of the Group. PDs used for regulatory capital purposes are based on long run experience and are expected to underestimate actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle, under normal circumstances.

It should also be noted that the regulatory expected loss shown is based on the expected loss derived from the regulatory capital models that were applied as at 30 June 2012. This comparison is supplemented with more detailed analyses in the following tables, comparing actual and expected outcomes for each risk parameter (PD, LGD and EAD) over the year under review.

Expected values are based on regulatory capital models applied as at 30 June 2012. For PDs, this is applied to the total performing book as at 30 June 2012. For LGDs and EADs, it is applied to all facilities that defaulted over the subsequent 12 months.

Actual values are based on actual outcomes over the 12-month period July 2012 to June 2013. Due to the length of the workout period, there is uncertainty in the measure provided for actual LGDs as facilities that default during the year would only have had between one and twelve months to recover to date – depending on when the default event occurred.

The EAD-estimated to actual ratio is derived as the ratio of expected nominal exposure at default (for all accounts that defaulted during the 12-month period July 2012 to June 2013) to the actual nominal exposure at default for the same accounts.

Actual versus expected loss per portfolio segment

	2013		2012		2011	
R million*	**Expected loss**	**Actual loss**	Expected loss*	Actual loss	Expected loss	Actual loss
Corporate (corporate, banks and sovereign)**	**1 621**	**70**	1 499	313	847	16
SMEs (SME corporate and SME retail)#	**1 146**	**989**	1 507	1 094	1 354	1 189
Residential mortgages	**2 674**	**2 470**	2 793	2 961	3 102	3 773
Qualifying revolving retail#	**1 126**	**973**	1 179	808	1 168	1 122
Other retail†	**1 718**	**2 413**	904	1 990	790	1 013
WesBank†	**2 780**	**3 236**	3 160	3 371	3 142	3 663
Total	**11 065**	**10 151**	11 042	10 537	10 403	10 776

* *The composition used above differs slightly from that used in the remainder of this section, due to impairment charges on a business unit level as opposed to AIRB asset class level. The expected losses for the year ended June 2012 were restated to reflect the correct expected losses as at 1 July 2011.*

** *The expected losses for the corporate portfolio are much higher than the actual losses due to it being a low default portfolio. As a result, the models use conservative data inputs.*

SMEs, residential mortgages and qualifying revolving retail actual losses are below expected losses which is expected given the current point in the economic cycle and that expected loss parameters are based on long run and downturn conditions.

† *Other retail and WesBank have experienced high levels of growth during the year, although it is not reflected in the expected losses which are based on accounts that are in-force at the start of the year. However, these new accounts will contribute to the actual losses as a result of additional provisions that will be raised. As a result, actual losses are expected to be greater.*

Risk parameters used to determine regulatory expected loss

	2013				
	PD		**LGD**		**Estimated EAD to actual EAD ratio**
Asset class	**Estimated %**	**Actual %**	**Estimated %**	**Actual %**	**%**
Corporate, banks and sovereign*	**0.94**	**0.28**	**15.78**	**34.61**	**107.88**
Specialised lending – property finance	**2.12**	**1.16**	**31.01**	**3.32**	**102.73**
SME corporate	**2.26**	**1.33**	**29.28**	**28.38**	**109.93**
SME retail	**2.94**	**2.81**	**32.13**	**26.32**	**111.63**
Residential mortgages	**3.45**	**2.63**	**15.65**	**12.57**	**104.73**
Qualifying revolving retail	**3.63**	**2.63**	**67.65**	**63.33**	**91.85**
Other retail	**6.31**	**5.56**	**33.43**	**33.26**	**104.12**
Total	**2.75**	**2.02**	**22.15**	**28.53**	**106.04**

* *Corporate, banks and sovereign are shown as one asset class to align with the respective asset class in the actual versus expected loss table.*

Risk parameters used to determine regulatory expected loss continued

	2012				
	PD		LGD		Estimated EAD to actual EAD ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereign*	0.73	0.11	37.33	10.86	194.54
Specialised lending – property finance	2.70	2.31	21.82	28.84	116.04
SME corporate	4.85	2.33	26.97	28.98	144.33
SME retail	3.21	2.96	28.83	20.87	113.27
Residential mortgages	3.57	2.92	15.30	11.53	104.43
Qualifying revolving retail	3.02	2.46	72.37	68.53	98.94
Other retail	5.99	5.07	45.99	43.66	102.91
Total	2.72	1.96	30.55	27.52	107.98

* *Corporate, banks and sovereign are shown as one asset class to align with the respective asset class in the actual versus expected loss table.*

	2011				
	PD		LGD		Estimated EAD to actual EAD ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereign*	0.88	0.19	24.94	28.28	122.96
SME corporate	4.54	2.15	35.81	14.04	108.56
SME retail	3.40	3.27	36.93	26.98	114.81
Residential mortgages	3.06	3.13	15.46	14.44	104.82
Qualifying revolving retail	2.58	2.64	64.78	66.63	127.53
Other retail	5.89	5.92	33.61	31.73	106.00
Total	2.57	2.18	26.32	24.27	108.08

* *Corporate, banks and sovereign are shown as one asset class to align with the respective asset class in the actual versus expected loss table.*

The corporate, banks and sovereign regulatory capital models remain conservative as these are low default portfolios with actual default rates remaining lower than expected.

Differences between the actual and expected LGDs for corporates, banks and sovereigns as well as specialised lending – property finance are due to the low default volumes where individual default loss experience can dominate the result. The difference in the outputs as compared to prior years is primarily as a result of actual and expected LGD being based only on counterparties which have defaulted during the respective years. Differences in the loss characteristics of accounts which default over time can be significant, particularly in the wholesale and commercial portfolios where defaults are sparse.

Deviations in the actual versus expected EADs can be seen where the estimated EAD to actual EAD ratio deviates from 100%. A ratio above 100% indicates an overprediction and a ratio below 100% indicates an underprediction of EAD. The qualifying revolving retail asset class EAD models applied for regulatory capital as at June 2012 underestimated EADs and reflect the model in use at the time. An updated model is in the pipeline and will predict EADs at a more appropriate level.

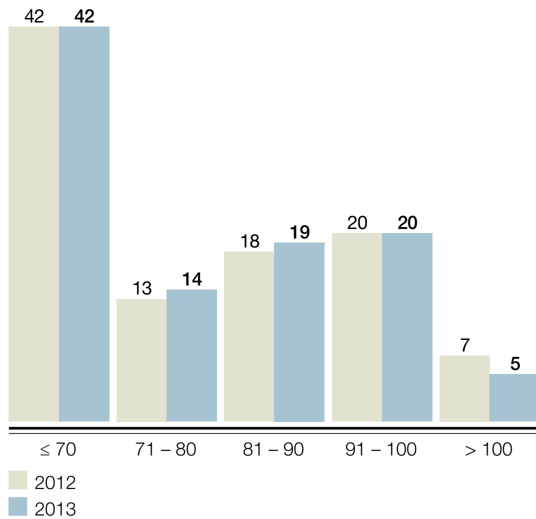
SELECTED RISK ANALYSES

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

The following graphs provide the balance-to-value distributions and the ageing of the residential mortgages portfolios. The recent focus on the loan-to-value ratios for new business has resulted in an improvement in the balance-to-original value although the broader strategy is to place more emphasis on the counterparty creditworthiness as opposed to only on the underlying security. Pressures on property market values have negatively impacted the balance-to-market value distribution.

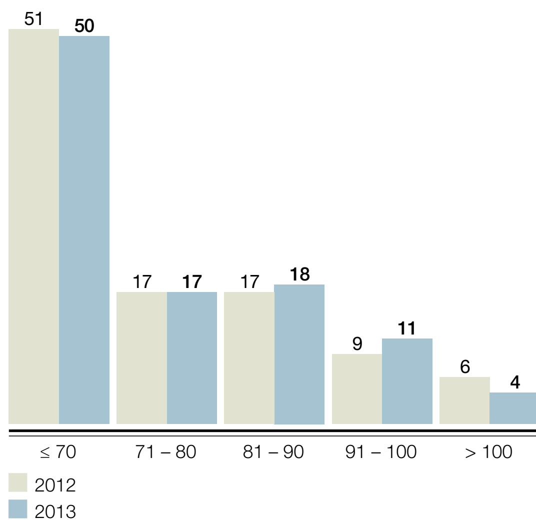
Residential mortgages balance-to-original value

(%)



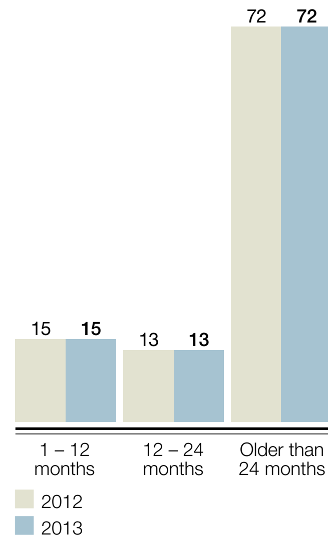
Residential mortgages balance-to-market value

(%)



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 total advances balance.

FNB HomeLoans arrears

(%)

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

FNB HomeLoans vintage analysis

(%)

3 months — 6 months — 12 months

For FNB HomeLoans, the three, six and twelve month cumulative vintage analysis illustrates a marked improvement in the quality of business written since mid-2008 despite further deterioration in macro conditions in the succeeding period.

The more recent decreases in the default experience reflect a combination of the credit origination strategies and the improvement in macro conditions, resulting in an improved risk profile.

WesBank retail vintage analysis

(%)

3 months — 6 months — 12 months

The WesBank retail six and twelve month cumulative vintage analysis continues to show a noticeable improvement in the quality of business written since mid-2007. This is due to improved customer profiles and enhanced collection strategies.

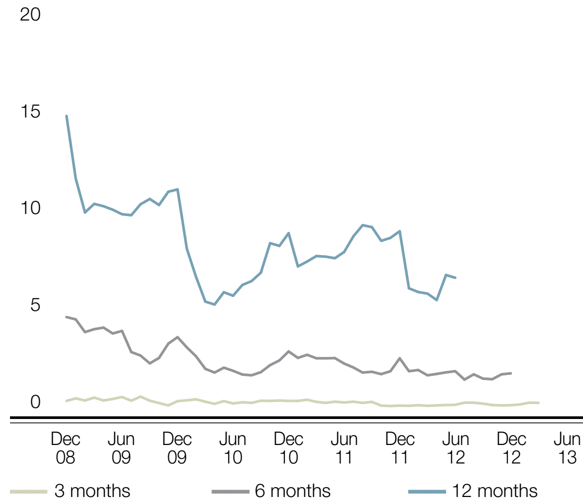
FNB Card vintage analysis

(%)

3 months — 6 months — 12 months

The level of inflows into NPLs continued to decrease.

Unsecured (excluding FNB Card) vintage analysis



The default experience of the FNB and WesBank unsecured portfolios is within risk appetite. Continued action is undertaken to ensure these portfolios remain within risk appetite.

The Group's South African repossessed retail properties are shown in the following table.

Retail properties in possession

	2013	2012	% change
Number of properties	**300**	609	(51)
Value (R million)	**16**	103	(84)

SECURITISATIONS AND CONDUITS

INTRODUCTION AND OBJECTIVES

Securitisation is the structured process whereby interests in loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities to capital market investors.

Asset securitisations enable the Group to access funding markets at debt ratings higher than its overall corporate rating, which generally provides access to broader funding sources at more favourable rates. By removing the assets and supporting funding from the balance sheet, the Group is able to reduce some of the costs of on-balance sheet financing and manage potential asset-liability mismatches and credit concentrations.

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

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

Securitisation transactions

R million	Asset type	Year initiated	Expected close	Rating agency	
Traditional securitisations**					
Nitro 4	Retail: Auto loans	2011	2016	Moody's	
Turbo Finance 1	Retail: Auto loans	2011	2013	Moody's and Fitch	
Turbo Finance 2	Retail: Auto loans	2012	2015	Moody's and Fitch	
Turbo Finance 3	Retail: Auto loans	2012	2015	Moody's and Fitch	
Synthetic securitisations**					
Fresco 2	Corporate receivables	2007	2013	Fitch	
Total					

* *Does not include cash reserves.*
** *This table includes transactions that have been structured by the Group and therefore excludes third-party transactions.*

Rating distribution of retained and purchased securitisation exposures*

R million	AAA(zaf)	AA(zaf)	AA–(zaf)	A+(zaf)	A(zaf)	BBB+(zaf)	BBB(zaf)	BB(zaf)	B+(zaf)	Not rated	Total
Traditional											
At 30 June 2013	**98**	**–**	**–**	**81**	**–**	**–**	**–**	**–**	**–**	**1 300**	**1 479**
At 30 June 2012	2 000	–	–	81	–	59	442	–	–	825	3 407
Synthetic											
At 30 June 2013	**–**	**–**	**–**	**–**	**–**	**3 020**	**–**	**52**	**–**	**123**	**3 195**
At 30 June 2012	–	–	17 839	–	–	–	–	180	53	190	18 262
Third party											
At 30 June 2013	**503**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**503**
At 30 June 2012	625	–	–	–	51	–	–	–	–	–	676

* *While national scale ratings have been used in this table, global-scale equivalent ratings are used for internal risk management purposes. This table includes the rating distribution of transactions retained by the Group and those purchased from third parties.*

TRADITIONAL AND SYNTHETIC SECURITISATIONS

The following tables show the traditional and synthetic securitisations currently in place, the rating distribution of any exposures retained and a breakdown of the various roles performed by the Group. Whilst national scale ratings have been used in this table, global scale equivalent ratings are used for internal risk management purposes and regulatory capital reporting.

		Assets outstanding*		Notes outstanding		Retained exposure	
	Assets securitised	**2013**	2012	**2013**	2012	**2013**	2012
	16 209	**7 019**	7 491	**7 823**	8 130	**1 479**	3 407
	3 982	**1 453**	2 573	**1 747**	3 007	**589**	1 366
	3 620	**–**	1 487	**–**	1 486	**–**	1 208
	4 037	**2 200**	3 431	**2 402**	3 637	**409**	833
	4 570	**3 366**	–	**3 674**	–	**481**	–
	20 000	**5 000**	20 000	**5 000**	20 000	**3 195**	18 262
	20 000	**5 000**	20 000	**5 000**	20 000	**3 195**	18 262
	36 209	**12 019**	27 491	**12 823**	28 130	**4 674**	21 669

The Group's role in securitisation transactions

Transaction	Originator	Sponsor	Servicer	Investor	Liquidity provider	Credit enhancement provider	Swap counterparty
Fresco 2	✓	✓	✓	✓		✓	
Nitro 4	✓	✓	✓	✓			✓
Turbo Finance 2	✓	✓	✓	✓			
Turbo Finance 3	✓	✓	✓	✓			

Third party securitisations

Transaction	Originator	Sponsor	Servicer	Investor	Liquidity provider	Credit enhancement provider	Swap provider
Homes obligor mortgage enhanced securities					✓		
Private residential mortgages 2					✓		
Superdrive investments				✓			
Torque securitisation					✓		

RESECURITISATIONS

A resecuritisation exposure is a securitisation exposure in which the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation exposure. Securitisation paper is, on occasion, acquired by the conduit structures and managed as part of the underlying portfolio. This makes up a minimal portion of the total portfolio and is accounted for as a resecuritisation exposure for regulatory capital purposes.

Resecuritisation exposure

Programme*	Resecuritisation exposure (R million)	% of total programme
iVuzi	47.5	1.1

* *Excludes distributions relating to iNguza underlying exposure as this is driven by note holders and does not impact third parties.*

OVERSIGHT AND CREDIT RISK MITIGATION

The Group monitors retained securitisation exposures in a number of ways:

- proposed securitisations follow a rigorous internal approval approach and are reviewed for approval by ALCCO, the RCC committee and the board;
- off-balance sheet transactions are discussed and monitored at a bimonthly meeting of Group Treasury's off-balance sheet forum;
- changes to retained exposures (ratings, redemptions, losses) reflect in the monthly BA 500 regulatory reporting; and
- transaction investor reports, alignment with special purpose vehicle (SPV) financial reporting and the impact of underlying asset performance are reviewed on the quarterly BA501 regulatory reporting.

The Group does not employ credit risk mitigation techniques to hedge credit risk on retained securitisation tranches. The Group determines the applicable capital requirements for retained exposures according to the Basel securitisation framework.

SECURITISATION ACCOUNTING POLICIES

From an accounting perspective, traditional securitisations are treated as sales transactions. At inception, the assets are sold to a SPV at carrying value and no gains or losses are recognised. 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.

Securitisation entities are consolidated into FRIHL for financial reporting purposes. Any retained notes are accounted for as available-for-sale investment securities within the banking book.

The Group does not currently employ any form of warehousing prior to structuring a new securitisation transaction.

SUMMARY OF SECURITISATION ACTIVITY

Maturity of Turbo Finance plc

Launched on 2 February 2011, Turbo Finance plc (Turbo Finance 1), represented the Group's first securitisation of offshore assets originated by its UK vehicle finance business, MotoNovo Finance. Strong asset performance together with good prepayment levels resulted in the full redemption of the investor-held Class A tranche in September 2012. With the Group holding the remaining notes, the decision was taken to repurchase all the outstanding assets and thereby terminate the securitisation. The legal process to repurchase the outstanding assets was completed in early October 2012, with all notes fully redeemed on 22 October 2012.

Issuance of Turbo Finance 3

In November 2012, the Group closed its third UK traditional auto loan securitisation, Turbo Finance 3 plc (Turbo Finance 3). Turbo Finance 3 is a cash securitisation of fixed rate auto loans extended to obligors by MotoNovo Finance. The note issuance of GBP332.7 million is rated by both Fitch and Moody's. The performance of past and existing Turbo Finance transactions has helped to improve the rating assumptions used by the rating agencies, allowing for a reduction in the level of subordination required for the Aaa/AAA Class A note (18% compared to 28% for Turbo Finance 1). The following table provides further detail regarding the notes issued.

Turbo Finance 3 notes issued

Tranche	Rating (Moody's/Fitch)	Amount (GBP million)	Credit enhancement* (%)	Coupon
A	Aaa(sf)/AAA(sf)	273.4	17.82	1m LIBOR + 60
B	A1(sf)/A(sf)	27.8	9.47	1m LIBOR + 140
C	NR/NR	26.2	1.59	7.00%
D	NR/NR	5.3	–	20.00%
Total		**332.7**		

* *Calculated including the class D notes/cash component.*

There was sufficient demand for high quality credit assets allowed the marketing of the Class B tranche as well. FirstRand, acting through its London branch, continues to act as servicer for the transaction. The transaction is compliant with Article 122a of the EU Capital Requirement Directive where FRB chose to use the on-balance sheet retention method to meet the 5% retained interest requirements of Article 122a.

Scheduled amortisation of Fresco 2

Scheduled amortisation of Fresco 2 commenced in November 2012, with the portfolio balance at R5 billion at 30 June 2013. As a consequence of the deleveraging of the reference portfolio, Fitch issued a ratings upgrade of Fresco 2 notes on 15 February 2013. The Class A, B and C notes were upgraded by one notch. The transaction's performance since closing has remained in line with expectations.

Fresco 2 ratings revision

	Fitch domestic rating	
Tranche	Previous	Revised
A	BBB (zaf)	A (zaf)
B	BB (zaf)	BBB (zaf)
C	B+ (zaf)	BB (zaf)
D	B (zaf)	B (zaf)
E	B (zaf)	B (zaf)
F	B (zaf)	B (zaf)
G	B- (zaf)	B- (zaf)

Rating downgrade of Nitro Securitisation 4 Issuer Trust (Nitro 4)

In September 2012, Moody's Investor Services downgraded the South African government debt rating from A3 to Baa1, effectively lowering the local currency country ceiling to A1. Consequently, the rating of the Nitro 4 Class A tranche was downgraded from Aa2(sf) to A1(sf) on a local currency international scale basis.

Based on a realignment of the national scale to international scale mapping, the Class A notes remain rated Aaa(sf).za. The transaction was structured to obtain matched term funding for the Group and is currently performing in line with expectations. Targeted maturity for the Nitro 4 structure is August 2016.

Nitro 4 rating downgrade

	Moody's rating		Moody's national scale rating
Tranche	Previous	Revised	
A	Aa2 (sf)	A1 (sf)	Aaa.za(sf)
B	Baa2 (sf)	Baa2 (sf)*	A1.za (sf)
C	Ba2 (sf)	Ba2 (sf)*	Ba2.za (sf)

* *No change, placed on rating watch negative.*

CONDUIT PROGRAMMES

The Group has conduit programmes incorporated under both securitisation scheme and commercial paper regulations. The iNdwa and iVusi conduit programmes are incorporated under securitisation scheme regulations. These are debt capital market vehicles, which provide investment-grade corporate South African counterparties with an alternative source of funding to directly access capital markets via their own domestic medium-term debt programmes or traditional bank funding. It also provides institutional investors with highly-rated short-term alternative investments. The fixed income fund, iNkotha is a call-loan bond fund, which offers overnight borrowers and lenders an alternative to traditional overnight bank borrowings or overnight deposits.

The commercial paper programme, iNguza, issues bespoke notes to investors. These notes reference the credit risk of separate and distinct transactions of a different underlying borrower or obligors. Note holders will have recourse only to the assets in relation to the underlying transaction and will not have recourse to any other assets. Risk relating to the underlying transactions is transferred directly to note holders and managed by them according to their risk appetite levels. Notes are listed on the Interest Rate Market of the JSE and may be traded through members of the JSE.

Both the fixed income fund and the commercial paper programme have been incorporated under commercial paper regulations.

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

The conduit programmes have proved resilient during difficult financial market conditions and have experienced a tightening of credit spreads in line with the corporate debt market. Supply of assets and demand for notes issued by the conduits remain healthy, albeit within the constraints of newly introduced collective investment scheme (CIS) regulations.

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

Conduit programmes*

					Non-recourse investments		Credit enhancement provided	
R million	Underlying assets	Year initiated	Rating agency	Programme size	**2013**	2012	**2013**	2012
Securitisations**								
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**5 160**	6 687	**–**	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**4 123**	4 487	**1 070**	670
Total				30 000	**9 283**	11 174	**1 070**	670
Fixed income fund#								
iNkotha	Overnight corporate loans	2006	GCR†	10 000	**2 957**	2 654	**–**	–
Total				10 000	**2 957**	2 654	**–**	–
Commercial paper programme#								
iNguza	Corporate and structured finance term loans	2008	GCR†	15 000	**10 964**	8 616	**–**	–
Total				15 000	**10 964**	8 616	**–**	–

* *Conduit programmes are consolidated into FRIHL for financial reporting purposes.*
** *Conduits incorporated under regulations relating to securitisation scheme.*
# *Conduits incorporated under regulations relating to commercial paper.*
† *Global credit rating.*

Rating distribution of conduits

R million	F1+(zaf)	AAA(zaf)	AA+(zaf)	AA(zaf)	AA-(zaf)	A+(zaf)	A(zaf)	A-(zaf)	Total
Securitisations									
At 30 June 2013	**–**	**–**	**820**	**2 841**	**1 777**	**1 945**	**1 284**	**616**	**9 283**
At 30 June 2012	–	121	730	2 628	3 778	1 071	1 765	1 081	11 174
Fixed income funds									
At 30 June 2013	**–**	**–**	**–**	**648**	**827**	**601**	**321**	**560**	**2 957**
At 30 June 2012	–	–	–	1 097	479	519	–	559	2 654

This table excludes distributions relating to iNguza underlying exposure as this is driven by note holders and does not impact third parties.

The Group's role in conduits

Transaction	Sponsor	Originator	Investor	Servicer	Liquidity provider	Credit enhancement provider	Swap counterparty
iNdwa	✓			✓	✓		✓
iNkotha				✓			
iVuzi	✓			✓	✓	✓	✓
iNguza				✓			

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

LIQUIDITY FACILITIES

The following table provides a summary of the liquidity facilities provided by the Group.

Liquidity facilities

R million	Transaction type	2013	2012
Own transactions		**5 751**	8 157
iNdwa	Conduit	**3 866**	4 713
iVuzi	Conduit	**1 885**	3 444
Third party transactions	Securitisations	**1 522**	558
Total		**7 273**	8 715

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

ADDITIONAL INFORMATION

The following table provides the securitisation exposures retained or purchased as well as associated capital requirements per risk band. The Group applies a number of methodologies in determining the capital requirements for securitisation and conduit exposures.

For domestic transactions, the Group applies the internal ratings based approach, supervisory formula and standardised approach, the choice of which is determined by the most efficient use of capital.

Retained or purchased securitisation exposure and the associated regulatory capital charges

	Exposure		Capital*		Capital deduction**	
R million	**2013**	2012	**2013**	2012	**2013**	2012
Risk weighted bands						
≤10%	**3 989**	7 443	**33**	55	**–**	–
>10% ≤20%	**750**	810	**9**	11	**–**	–
>20% ≤50%	**–**	1 235	**–**	42	**–**	–
>50% ≤100%	**1 331**	81	**82**	6	**–**	–
>100% ≤650%	**–**	59	**–**	26	**–**	–
1250%/deduction	**1 423**	1 457	**1 422**	46	**–**	1 015
Look through	**6 027**	22 745	**281**	797	**–**	–
Total	**13 520**	33 830	**1 847**	983	**–**	1 015

* *Capital is calculated at the Basel III 9.5% requirement (excluding the bank-specific ICR) and includes a 6% capital scalar.*
** *Exposure previously held as deductions have moved from supply to demand side of credit in line with regulatory changes.*

The Group did not securitise any exposures that were impaired or past due at the time of securitisation.

COUNTERPARTY CREDIT RISK

INTRODUCTION AND OBJECTIVES (AUDITED)

Counterparty credit risk is a counterparty's ability to satisfy its obligations under a contract that has positive economic value to a bank at any point during the life of the contract. It differs from normal credit risk in that the economic value of the transaction is uncertain and dependent on market factors that are typically not under the control of the bank or the client.

Counterparty credit risk is a risk taken mainly in the Group's trading and securities financing businesses. The objective of counterparty credit risk management is to ensure that risk is appropriately measured, analysed and reported on, and is only taken within specified limits in line with the Group's risk appetite framework as mandated by the board.

During the year under review the Group implemented the Basel standardised approach for the calculation of counterparty credit default risk capital. This measure is more risk-sensitive than CEM used previously. The improved risk sensitivity of the measure implies that capital now more accurately reflects the risk profile of the book. In the current financial year the Group has implemented Basel III CVA capital charge, AVC multiplier, as well as Basel III capital charge for centrally cleared exposures.

FirstRand is, and will continue to be, an active participant in processes to implement legislative and structural reforms in the local derivatives market. Changes to international regulations relating to derivative market reforms are regularly monitored.

The risk to bilateral over-the-counter (OTC) counterparties is reduced by restricting transactions to higher-rated counterparties and collateralising all mark-to-market movements in the majority of cases. The risk to clients in securities financing is reduced by improved margining and restricting exposure to higher quality underlying assets.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

RMB's credit department is responsible for the overall management of counterparty credit risk. It is supported by RMB's derivative counterparty risk department which is responsible for ensuring that market and credit risk methodologies are consistently applied in the quantification of risk.

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 exposures.

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

The derivative counterparty risk committee supports the credit risk management committee and its subcommittees with analysis and quantification of counterparty credit risk for traded product exposures.

ASSESSMENT AND MANAGEMENT (AUDITED)

Quantification of risk exposure

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

To this end, appropriate quantification methodologies of potential future exposure over the life of a product, even under distressed market conditions, are developed and approved at the relevant technical committees.

Individual counterparty risk limit applications are prepared using the approved risk quantification methodologies, and assessed and approved at the dedicated counterparty credit committee, which has appropriate executive and non-executive representation.

All counterparty credit risk limits are subject to annual review, while counterparty exposures are monitored by the respective risk functions on a daily basis. Overall counterparty risk limits are allocated across a number of products. 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
- counterparty credit risk reporting.

Limit breaches are dealt with in accordance with the approved excess mandate. Significant limit breaches necessitate reporting to the head of the business unit, head of risk for the affected business unit and derivative counterparty risk management function. Any remedial actions are agreed amongst these parties and failure to remedy such a breach is reported to the RMB proprietary board, ERM and RCC committee.

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

Advanced monitoring of the creditworthiness of developed market counterparty banks is conducted through the real-time analysis of the spreads on listed securities that have been issued or referenced by these banks.

Counterparty credit risk mitigation

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

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

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

Collateral to be provided in the event of a credit rating downgrade

In rare instances, FirstRand has signed ISDA agreements where both parties would be required to post additional collateral in the event of a rating downgrade. The additional collateral to be provided by the Group in the event of a downgrade is not material and would not adversely impact its financial position.

When assessing the portfolio in aggregate, the collateral that would need to be provided in this hypothetical event is subject to many factors, not least of which are market moves in the underlying traded instruments and netting of existing positions.

While these variables are not quantifiable, the following table, in addition to showing the effect of counterparty credit risk mitigation, provides a guide to the order of magnitude of the netted portfolio size and collateral placed with the Group. In aggregate, all of the positive mark-to-market values shown would need to reverse before the Group would be a net provider of collateral.

COUNTERPARTY CREDIT RISK PROFILE

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

Composition of counterparty credit risk exposure

R million	2013	2012*
Gross positive fair value	**107 161**	97 704
Netting benefits	**(12 105)**	(8 444)
Netted current credit exposure before mitigation	**95 056**	89 260
Collateral value	**(82 268)**	(73 415)
Netted potential future exposure	**3 661**	3 194
Exposure at default**	**21 097**	21 174

* *The comparative numbers were restated to reflect the correct numbers as at 30 June 2012.*

** *EAD includes exposures calculated under both the standardised and current exposure method. FRB implemented the standardised approach in June 2012. The standardised approach implementation covers all material portfolios with full coverage to be attained in the new financial year. EAD under the standardised approach is quantified by scaling either the current credit exposure less collateral or the net potential future exposure by a factor of 1.4. The latter explains why the summation of the netted current exposure, collateral value and netted potential future exposure in the table above differs from computed EAD.*

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

Credit derivatives exposure

	2013			
R million	**Credit default swaps**	**Total return swaps**	**Other**	**Total**
Own credit portfolio				
– protection bought	**–**	**–**	**–**	**–**
– protection sold	**2 145**	**–**	**–**	**2 145**
Intermediation activities				
– protection bought	**3 511**	**–**	**–**	**3 511**
– protection sold	**4 633**	**–**	**–**	**4 633**

	2012			
R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	–	–	–	–
– protection sold	1 900	–	–	1 900
Intermediation activities				
– protection bought	3 149	–	–	3 149
– protection sold	3 865	–	–	3 865

MARKET RISK IN THE TRADING BOOK

INTRODUCTION AND OBJECTIVES (AUDITED)

The Group's market risk emanates mainly from the provision of hedging solutions for clients, market making activities and term lending products. Market risk in the trading book of the Group is taken and managed by RMB. The relevant businesses within RMB function as the centres of expertise with respect to all market risk-related activities and ensuring that market risk is managed and contained within the Group's appetite.

Compared to previous years and, following the strategic review of RMB's business and cessation of outright proprietary trading, overall levels of market risk have reduced, particularly with respect to equity risk on the domestic balance sheet.

The performance of market risk-taking activities is measured as the higher of the Group's internal expected tail loss (ETL) measure (as a proxy for economic capital) and regulatory capital based on VaR plus stressed VaR.

Interest rate risk in the banking book is managed by Group Treasury and is disclosed in the *Interest rate in the banking book* section of this report.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

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

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

ASSESSMENT AND MANAGEMENT (AUDITED)

Quantification of risk exposures

Market risk exposures are primarily measured and managed using an ETL measure and ETL limits. The ETL measure used by RMB is a historical simulation measure assessing the average loss beyond a selected percentile. RMB's ETL is based on a confidence interval of 99% and applicable holding periods. Since ETL is adjusted for the trading liquidity of the portfolio, it is referred to as liquidity-adjusted ETL. Holding periods, ranging between 10 to 90 days, are used in the calculation and are based on an assessment of distressed liquidity of portfolios. Historical data sets are chosen to incorporate periods of market stress such as data from the 2008/2009 global financial crisis included during the year under review.

VaR calculations over holding periods of 1 day and 10 days are used as an additional tool in the assessment of market risk. VaR triggers and loss escalation procedures are used to highlight positions to be reviewed by management.

The Group's VaR number should be interpreted in light of the limitations of the methodology used, as follows:

- due to its nature, historical simulation VaR may not provide an accurate estimate of future market moves;
- use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile. ETL is a better measure to quantify losses beyond that percentile (but still subject to similar limitations as stated for VaR);
- use of a 1-day time horizon is not a fair reflection of profit or loss for positions with low trading liquidity, which cannot be closed out or hedged within one day;
- as exposures and risk factors can change during daily trading, exposures and risk factors are not necessarily captured in the VaR calibration which uses end-of-day trading data; and
- where historical data is not available, time series data is approximated or backfilled using appropriate quantitative methodologies. Use of proxies is, however, limited.

These limitations mean that the Group cannot guarantee that losses will not exceed VaR.

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

Stress testing

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

Additional stress testing, to supplement ETL assessment, is conducted using historical market downturn scenarios and includes the use of what-if hypothetical and forward-looking simulations. The stress test calibrations are reviewed regularly to ensure that results are indicative of the possible impact of severely distressed and event-driven market conditions. Stress and scenario analyses are regularly reported to and considered by the relevant governance bodies.

Earnings volatility

A key element of the Group's risk appetite framework is an assessment of potential earnings volatility that may arise from underlying activities. Earnings volatility for market risk is quantified by subjecting key market risk exposures to predetermined stress conditions, ranging from business-as-usual stress through severe stress and event risks.

In addition to assessing the maximum acceptable level of earnings volatility, stress testing is used to understand sources of earnings volatility and highlight unused capacity within the Group's risk appetite. Market risk earnings volatility is calculated and assessed on a monthly basis.

Back testing

Back testing is performed in order to verify the predictive ability of the VaR model and ensure ongoing appropriateness. The regulatory standard for back testing is to measure daily profits and losses against daily VaR at the 99th percentile. The number of breaches over a period of 250 trading days is calculated, and, should the number exceed that which is considered appropriate, the model is recalibrated. More granular back testing is performed at the individual desk level, in line with the proposals published in the Basel Committee on Banking Supervision (BCBS) consultative document, *Fundamental review of the trading book,* during May 2012.

Regulatory and economic capital for market risk

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

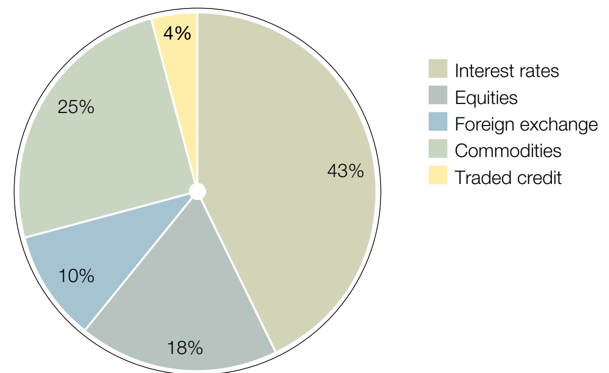
Economic capital for market risk is calculated using liquidity-adjusted ETL plus an assessment of specific risk.

MARKET RISK IN THE TRADING BOOK PROFILE

The following chart shows the distribution of exposures per asset class across the Group's trading activities at 30 June 2013 based on the VaR methodology. VaR equity exposure shown relates mainly to listed equity exposures in RMB Australia Holdings. These exposures are predominantly in the junior resources sector and are reflected on the RMB Australia Holdings balance sheet. The interest rate asset class represented the most significant exposure at year end.

VaR exposures per asset class (audited)

(%)



VaR analysis by risk type (audited)

The following table reflects VaR over a 1-day holding period at a 99% confidence level. Results indicate overall lower levels of market risk during the 2013 financial year compared to the previous year. The equity asset class results reflect the continued derisking that has taken place in residual exposures.

1-day 99% VaR analysis by instrument

	2013				2012
R million	**Min***	**Max***	**Average**	**Period end**	Period end
Risk type**					
Equities	**13.7**	**45.1**	**21.8**	**13.9**	30.6
Interest rates	**13.7**	**57.8**	**25.3**	**33.7**	45.8
Foreign exchange	**7.5**	**35.2**	**17.1**	**7.9**	15.8
Commodities	**6.4**	**35.2**	**18.7**	**19.6**	24.6
Traded credit#	**1.8**	**10.8**	**4.4**	**2.9**	10.3
Diversification effect				**(22.8)**	(54.5)
Diversified total	**26.4**	**72.3**	**49.2**	**55.2**	72.6

* *The maximum and minimum VaR figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table.*

** *Banking book exposures are managed by Group Treasury and are reported under the banking book interest rate risk section.*

Traded credit in disclosure from June 2013, although it does not form part of the Group's internal VaR model calculation, it is included in the disclosure to indicate the total risk. The prior year figure for traded credit is unaudited.

Other risk measures

Other risk factors are considered in the assessment and management of market risk. These include interest rate and equity specific risk. Specific risk accurately measures idiosyncratic risk not captured by ETL and VaR measures for interest rate and equity risk, such as default, credit migration and event risks, and identifies concentrations in a portfolio. The following table details specific risk for the year.

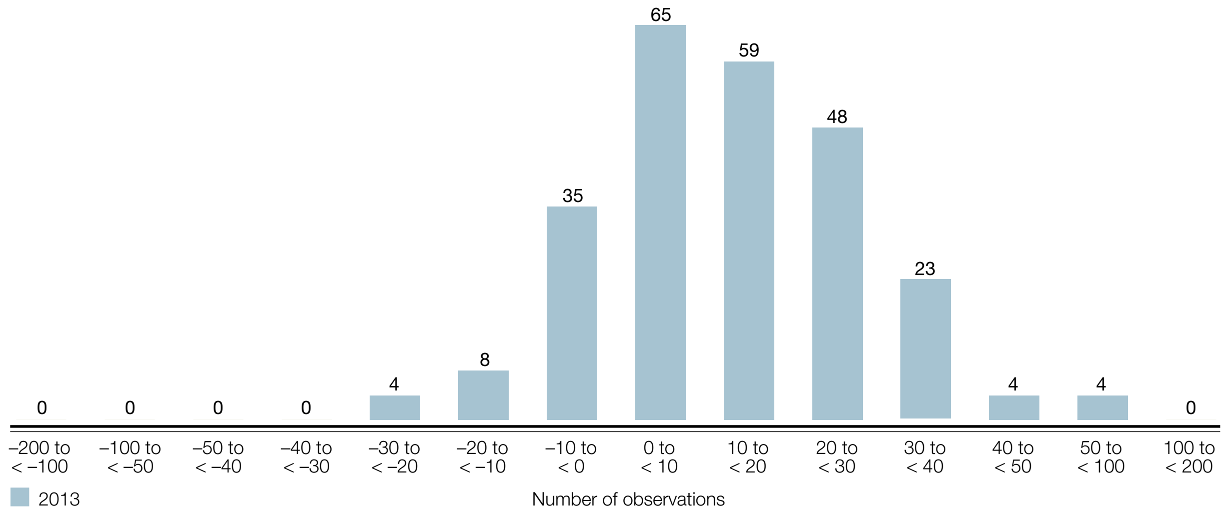
Specific risk measures

R million	**2013**	2012
Interest rate specific risk	**71**	76
Equity specific risk	**24**	68

Distribution of daily trading earnings from trading units

The following histogram shows the daily revenue for the local trading units in Group for the year under review.

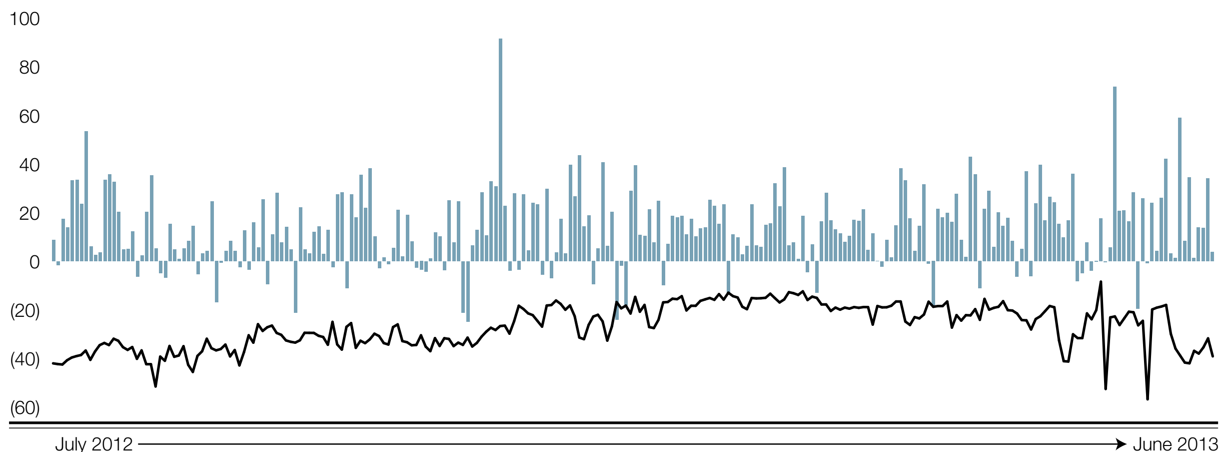
Distribution of daily earnings



Back testing: daily regulatory trading book earnings and VaR

The Group tracks its daily local earnings profile as illustrated in the following chart. The earnings and 1-day VaR relate to the Group's internal VaR model. Exposures were contained within risk limits during the trading period and the earnings profile is skewed towards profitability.

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



Trading book earnings exceeded 1-day VaR on one occasion during the year under review, due to the widening of a commodities basis risk position. This indicates a reasonably accurate quantification of market risk provided by the Group's internal model.

International

RMB Australia Holdings and the Bank's India branch hold the highest exposure to market risk amongst the international operations. The same approach is employed for the measurement and management of market risk as in the domestic portfolio. During the year under review, market risk was contained within approved limits.

FRIHL – VaR analysis by risk type

The following table reflects VaR over a 1-day holding period at a 99% confidence level for FRIHL. Market risk in FRIHL relates to the trading activities taking place in RMB Australia Holdings Ltd and RMB Securities Trading (Pty) Ltd (RST), and represents a subset of the VaR analysis by asset class reflected above for the group.

The following table reflects decreased equity risk, due to continued derisking and a rebalancing of the Australian portfolio in favour of debt.

1-day 99% VaR analysis for FRIHL (audited)

	2013				2012
R million	**Min***	**Max***	**Average**	**Period end**	Period end
Diversified total	**10.8**	**42.9**	**18.1**	**10.8**	27.2

* *The maximum and minimum VaR figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table.*

Regulatory market risk for FRIHL is measured using the standardised approach. Commensurate with the decrease in VaR observed above, market risk calibrated using the regulatory standardised approach has decreased substantially since the previous year.

Market risk standardised approach for FRIHL*

R million	**2013**	2012
Specific risk	**44.2**	107.0
General risk	**46.9**	83.0

* *The above FRIHL regulatory market risk numbers are made up of RST and RMB Resources.*

FNB Africa subsidiaries – standardised approach

Market risk for the African subsidiaries is measured using the standardised approach. In addition, the same ETL and VaR methodologies as described above are used as supplementary measures. In line with the Group's Africa expansion strategy, market risk has increased since the previous period with increased flow trading activity taking place in the subsidiaries supporting our client activities. During the year under review market risk was contained within approved limits and effectively managed.

Market risk standardised approach for the African subsidiaries

	2013				2012
R million	**Min***	**Max***	**Average**	**Period end**	Period end
Risk type					
Interest rates	**2.2**	**32.9**	**11.4**	**13.7**	10.5
Foreign exchange	**4.2**	**35.6**	**16.3**	**15.4**	9.9
Total	**8.5**	**55.1**	**28.0**	**29.1**	20.4

* *The maximum and minimum VaR figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table.*

INTEREST RATE RISK IN THE BANKING BOOK

INTRODUCTION AND OBJECTIVES (AUDITED)

Interest rate risk is the sensitivity of the balance sheet and income statement to unexpected, adverse movements in interest rates. Interest rate risk arises primarily from the endowment effect and interest rate mismatch. The endowment effect, which results from a large proportion of endowment liabilities (including stagnant deposits and equity) that fund variable-rate assets (e.g. prime-linked mortgages), remains the primary driver of interest rate risk in the banking book (IRRBB) and results in Group earnings being vulnerable to interest rate cuts. For its interest rate mismatch, the Group also hedges its residual fixed-rate position, which has been adjusted for optionality.

Interest rate risk arises in trading and non-trading/banking book activities. In the trading book, interest rate risk is primarily quantified and managed using ETL measures and limits, VaR calculations are performed over a 1- and 10-day holding period as an additional risk measure. This is covered in *Market risk in the trading book* section of this report.

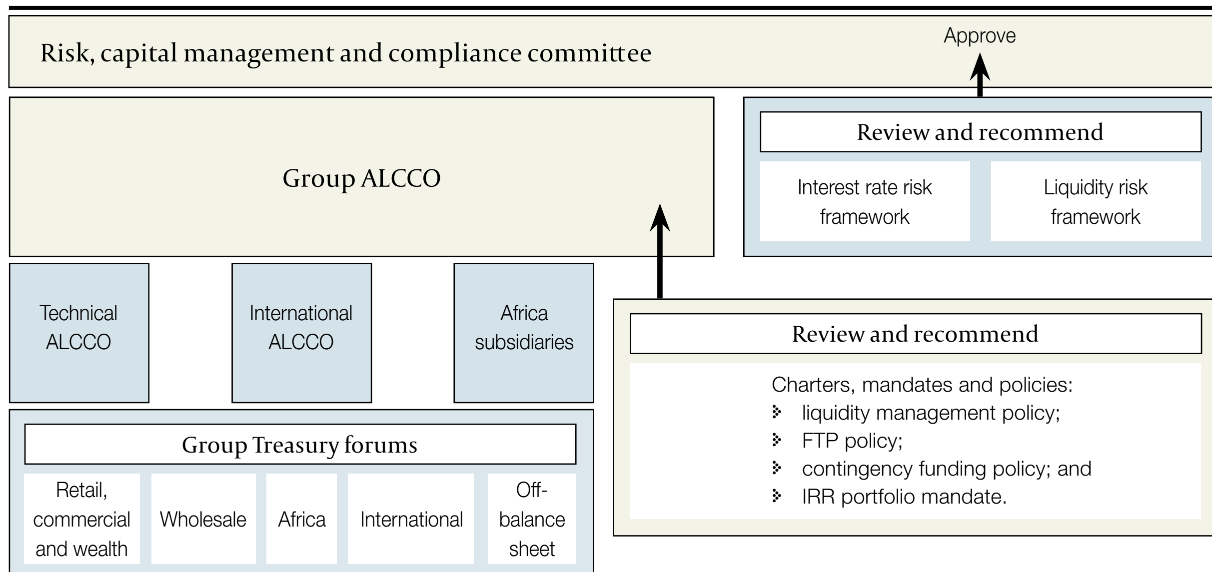
IRRBB originates from the differing repricing characteristics of balance sheet instruments, yield curve risk, basis risk and client optionality embedded in banking book products. It is an inevitable risk associated with banking and can be an important source of profitability and shareholder value. IRRBB continues to be managed from an earnings approach, with the aim to protect and enhance the Bank's earnings and economic value within approved risk limit and appetite levels.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

The control and management of IRRBB is governed by the framework for the management of IRRBB, which is a subframework of the BPRMF. Ultimate responsibility for determining risk limits and appetite for the Group vests with the board. Independent oversight for monitoring is done through the RCC committee, who, in turn, has delegated the responsibility for IRRBB to FirstRand ALCCO. ALCCO also maintains responsibility on behalf of the board for the allocation of sublimits and remedial action to be taken in the event of any limit breaches.

Individual ALCCOs exist in each of the African subsidiaries and international branches which monitor and manage in-country IRRBB. Material issues from individual ALCCOs are reported through to FirstRand ALCCO. The IRRBB management and governance structure is illustrated.

Interest rate risk management and governance structure



ASSESSMENT AND MANAGEMENT (AUDITED)

FirstRand Bank

Management and monitoring of the FirstRand domestic banking book is split between the RMB book and the remaining domestic banking book. RMB manages the banking book under its market risk framework; risk is measured and monitored in conjunction with the trading book with management oversight provided by MIRC. The RMB banking book interest rate risk exposure was R31.5 million on a 10-day ETL basis at 30 June 2013 (June 2012: R79.7 million). (Refer to *Market risk in the trading book* section). Any further references relating to the banking book in this section exclude the RMB banking book.

The remaining banking book consists predominantly of retail balances from FNB and WesBank, and Corporate Centre balance sheet. This is managed centrally by Group Treasury with oversight from Corporate Centre risk management. The Group Treasury Investment committee meets regularly to discuss and propose strategies and to ensure that management action is within the Group's risk limit and appetite levels.

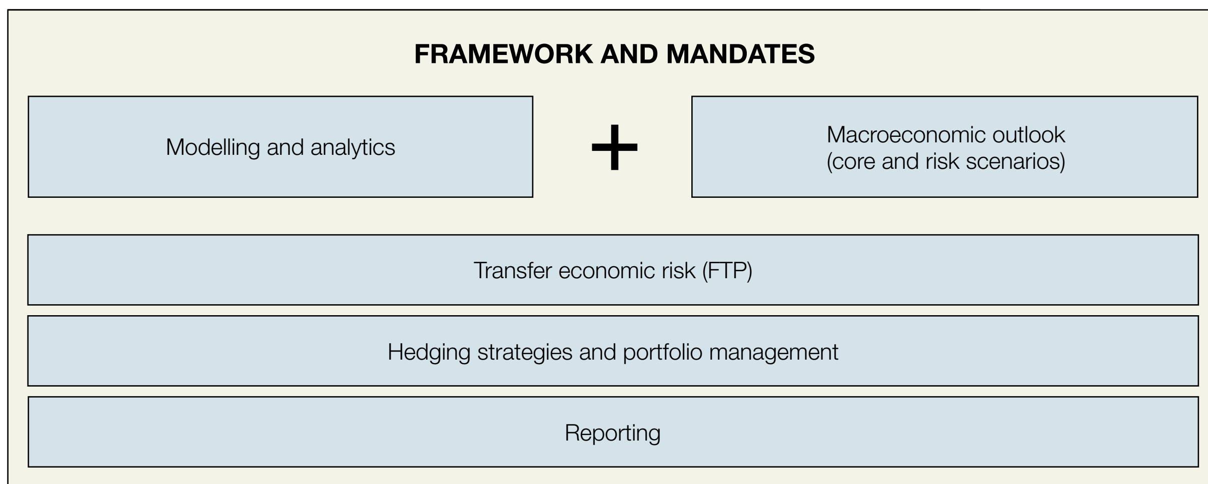
The internal funds transfer pricing (FTP) process is used to transfer interest rate risk from the franchises to Group Treasury, where risk can be managed holistically in line with the Group's macroeconomic outlook. This is achieved by balance sheet optimisation or alternatively through the use of derivative transactions. Derivative instruments used are mainly interest rate swaps, for which there is a liquid market. Where possible, hedge accounting is used to minimise accounting mismatches, thus ensuring that amounts deferred in equity are released to the income statement at the same time as movements attributable to the underlying hedged asset/liability.

A number of measurement techniques are used to measure IRRBB. These focus on the NII sensitivity/earnings risk and the overall impact on economic value of equity (EVE) and daily PV01 (present value of 1 bps increase in rates) measures.

The interest rate risk from the fixed book is managed to low levels with remaining risk stemming from timing and basis risk. The primary driver of NII sensitivity relates to the non- and low-rate products in the balance sheet and the endowment book. This has an adverse impact on the Group's NII margin in a cutting cycle as the decrease in NII from assets repricing to lower rates is not offset by a corresponding interest saving from liabilities. In the current rate cycle, the average repo rate for the period dropped by 48 bps, resulting in a negative impact on the Group's margin.

International subsidiaries and branches (audited)

Management of the African subsidiaries and international branches is performed by in-country management teams with oversight provided by Group Treasury and Corporate Centre risk management. For subsidiaries, NII measures are used to measure, monitor and manage interest rate risk in line with the Group's appetite.



CURRENT REPRICING PROFILE (AUDITED)

In calculating the repricing gap, all banking book assets, liabilities and derivative instruments are placed in gap intervals based on their repricing characteristics. Where applicable the disclosed repricing gap has been behaviourally adjusted to align with NII assumptions. No prepayment assumptions are applied. The overall balance sheet continues to be sensitive to rate cuts.

Repricing schedules for the Group's banking book

	2013				
	Term to repricing				
R million	< 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	**5 423**	**6 083**	**49 011**	**20 653**	**(81 170)**
Cumulative repricing gap	**5 423**	**11 506**	**60 517**	**81 170**	**–**
FNB Africa					
Net repricing gap	**3 433**	**(2 387)**	**429**	**603**	**(2 078)**
Cumulative repricing gap	**3 433**	**1 046**	**1 475**	**2 078**	**–**
Total cumulative repricing gap	**8 856**	**12 552**	**61 992**	**83 248**	**–**

	2012				
	Term to repricing				
R million	< 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	71 077	(4 164)	(5)	15 650	(82 558)
Cumulative repricing gap	71 077	66 913	66 908	82 558	–
FNB Africa					
Net repricing gap	2 555	(1 398)	(484)	1 558	(2 231)
Cumulative repricing gap	2 555	1 157	673	2 231	–
Total cumulative repricing gap	73 632	68 070	67 581	84 789	–

* *This repricing gap analysis excludes the banking books of RMB and the international balance sheet, both of which are managed separately. In the current financial year the disclosed repricing gap has been behaviourally adjusted to align with NII assumptions. For comparability, prior year numbers have been restated to reflect this behavioural adjustment.*

SENSITIVITY ANALYSIS

NII sensitivity

NII models are run on a monthly basis to provide a measure of the NII sensitivity of the existing balance sheet to shocks in interest rates. Different scenarios are modelled including parallel and key rate shocks as well as yield curve twists and inversions as appropriate. Underlying transactions are modelled on a contractual basis, assuming a constant balance sheet size and mix. No adjustments are made for prepayments in the underlying book, however, prepayment assumptions are factored into the calculation of hedges for fixed rate lending. Roll-over assumptions are not applied to off-balance sheet positions.

The following tables show the 12-month NII sensitivity for a 200 bps downward parallel shock to interest rates. The decreased sensitivity in June 2013 from June 2012 is attributable to an increase in the use of derivative positions to manage interest rate risk in line with the macroeconomic outlook. The book was positioned for rate cuts in the current financial year as a result of global growth concerns and domestic challenges.

Assuming no change in the balance sheet and no management action in response to interest rate movements, an instantaneous and sustained parallel decrease in interest rates of 200 bps would result in a reduction in projected 12-month NII of R1 049 million, a similar increase in interest rates would result in an increase in projected 12-month NII of R934 million.

Sensitivity of the Group's projected NII

R million	2013		
	Change in projected 12 month NII		
	FirstRand Bank	**FNB Africa**	**FirstRand**
Downward 200 bps	**(789)**	**(260)**	**(1 049)**
Upward 200 bps	**676**	**258**	**934**

R million	2012		
	Change in projected 12 month NII		
	FirstRand Bank	FNB Africa	FirstRand
Downward 200 bps	(1 514)	(241)	(1 755)
Upward 200 bps	1 562	238	1 800

The NII sensitivity analysis excludes the banking books of RMB and the international balance sheet, both of which are managed separately. The Group's average endowment book was R88 billion and the negative endowment impact was approximately R422 million for the year.

Economic value of equity

EVE sensitivity measures are calculated on a monthly basis. The impact on equity is as a result of the net open position after hedging used to manage IRRBB. The impact on equity occurs either as a result of fair value movements on these positions being recognised in the income statement, or movements deferred to the available for sale/cash flow hedging reserves.

The following table shows the EVE measures for a -200 bps and +200 bps instantaneous, parallel shock to rates on open positions run in Group Treasury. This is shown as a percentage of total Tier 1 and Tier 2 capital for the Group (which is unaudited). The change in the current year is attributable to growth in the retail fixed book.

Sensitivity of the Group's reported reserves to interest rate movements

R million	2013	2012
Downward 200 bps		
Available-for-sale	**1 085**	1 008
Cash flow	**(1 486)**	(1 006)
Total sensitivity	**(401)**	2
As % of Tier 1 and Tier 2 capital (%)	**(0.473)**	0.004
Upward 200 bps		
Available-for-sale	**(934)**	(871)
Cash flow	**1 350**	916
Total sensitivity	**416**	45
As % of Tier 1 and Tier 2 capital (%)	**0.490**	0.065

The sensitivity analysis excludes the banking books of RMB and international balance sheet, both of which are managed separately. The majority of the sensitivity originates from the endowment book, which averaged R88 billion for the 2013 financial year.

EQUITY INVESTMENT RISK IN THE BANKING BOOK

INTRODUCTION AND OBJECTIVES (AUDITED)

Historically equity investment risk has arisen from portfolio investments in equity instruments undertaken in RMB. These positions are originated mainly through its Private Equity, Resources and Investment Banking divisions.

Given the mandate to grow the investment management strategy of the Group, Ashburton Investments was launched to provide a wider asset management service. This might require the seeding of new traditional and alternative funds both locally and offshore, which may expose the Group to equity investment risk.

In addition, equity investments risk arises from strategic investments held by WesBank, FNB and the Corporate Centre.

The Group actively monitors regulatory developments, including amendments to current Basel capital requirements and the impact of Basel III. This has resulted in changes to the risk weighting of certain classes of investments.

The overall quality of the investment portfolio remains acceptable and is within risk appetite. During the year under review, there were few equity realisations with several new equity investments undertaken as part of a portfolio rebuilding strategy.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

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

- PIC, chaired by the RMB chief investment officer, and its delegated subcommittees are responsible for the approval of all portfolio investment transactions in equity, quasi-equity or quasi-debt instruments;
- where the structure of the investments also incorporate significant components of senior debt, approval authority will rest with the respective credit committees and LEC, as appropriate;
- the biannual Investment risk oversight committee assesses the quality, size and performance of the investment portfolio across RMB and reviews movements in light of risk appetite;
- the RMB CRO, in consultation with the Group CRO and with support from the deployed and central risk management functions, provides independent oversight and reporting of all investment activities in RMB to the RMB proprietary board, as well as MIRC. FNB and WesBank executive management monitor and manage investments through the financial reporting process; and
- RCC and MIRC committees are responsible for the oversight of investment risk measurement and management across the Group;

In Ashburton Investments, new fund investments are approved by the investment forum before review and approval by its investment product development, investment distribution and executive committees. Also prior to seeding, capital and investment limits are provided by the capital management committee and MIRC respectively. Ashburton is in the process of establishing its own capital management committee to monitor and report on these positions to the appropriate Group governance committees. Ashburton Investments currently reports into the Corporate Centre audit and risk committees.

ASSESSMENT AND MANAGEMENT

Management of exposures (audited)

The equity investment risk portfolio is managed through a rigorous evaluation and review process from inception to exit of a transaction. All investments are subject to a comprehensive due diligence, during which a thorough understanding of the target company's business, risks, challenges, competitors, management team and unique advantage or value proposition is developed.

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

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

Recording of exposures – accounting policies (audited)

IAS 39 requires equity investments to be classified as financial assets at fair value through profit and loss, or available-for-sale financial assets.

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

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

Measurement of risk exposures (audited)

Risk exposures are measured as potential losses under stress conditions. A series of standardised stress tests are used to assess potential losses under current market conditions, adverse market conditions, as well as severe stress/event risk. These stress tests are conducted at individual investment and portfolio levels.

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

Stress testing (audited)

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

Regulatory and economic capital

The Basel simple risk weighted method (300% or 400%) under the market based approach is applied for the quantification of regulatory capital. Under Basel III and *Regulations relating to Banks*, the risk weightings to investments in financial institutions are subject to the aggregate value of the Group's shareholding in these investments and also in relation to the Group's capital. The shareholdings in the investments are bucketed depending on the size of investment.

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

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

EQUITY INVESTMENT RISK PROFILE

Market prices in selected industries continue to present the Group with opportunities to build its private equity portfolio. Unrealised profits for the investment portfolio continue to remain resilient. The private equity portfolio has been subject to a portfolio rebuilding initiative during the financial year.

Investment risk exposure and sensitivity of investment risk exposure

R million	2013	2012
Listed investment risk exposure included in the equity investment risk ETL process*	**431**	687
ETL on above equity investment risk exposures*	**194**	377
Estimated sensitivity of remaining investment balances**		
– Sensitivity to 10% movement in market value on investment fair value#	**462**	502
Cumulative gains realised from sale of positions in the banking book during the period	**550**	1 642

* *The decline in both exposure and ETL for listed investments from June 2012 to June 2013 was largely due to further run down of the legacy portfolios, derisking of the listed equity exposures and mark-to-market losses in the resources portfolio.*

** *These are the investment balances not subject to the equity investment risk ETL process.*

Audited.

The following table provides information relating to equity investments in the banking book.

Investment valuations and associated regulatory capital requirements

	2013		
R million	**Publicly quoted investments**	**Privately held**	**Total**
Carrying value of investments*	**2 521**	**9 262**	**11 783**
Latent revaluation gains not recognised in the balance sheet**	**–**	**3 610**	**3 610**
Fair value#	**2 521**	**12 872**	**15 393**
Total unrealised losses recognised directly in balance sheet through equity instead of the income statement**	**517**	**–**	**517**
Capital requirement†	**718**	**3 279**	**3 997**

* *The carrying value includes investments in financial entities, which from 1 January 2013 are subject to the Basel III 250% risk weighting.*
** *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
# *The fair values of listed private equity investments were not considered to be materially different from the quoted market prices.*
† *Capital requirement calculated at 9.5% of RWA (excluding the bank-specific ICR), and includes capital on investments in financial entities. These investments are included as other assets in the RWA table in the Capital section.*

	2012		
R million	Publicly quoted investments	Privately held	Total
Carrying value of investments	2 509	10 064	12 573
Latent revaluation gains not recognised in the balance sheet*	–	3 054	3 054
Fair value**	2 509	13 118	15 627
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement*	55	44	99
Capital requirement#	715	3 824	4 539

* *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
** *The fair values of listed private equity investments were not considered to be materially different from the quoted market prices.*
# *Capital requirement calculated at 9.5% of RWA (excluding the bank-specific ICR).*

FOREIGN EXCHANGE AND TRANSLATION RISK IN THE BANKING BOOK

INTRODUCTION AND OBJECTIVES (AUDITED)

Foreign exchange risk arises from on- and off-balance sheet positions whose valuation in rand is subject to currency movements. Key activities giving rise to these positions are foreign currency placements, lending and investing activities, raising of foreign currency funding and from trading and client facilitation activities in foreign currencies. The objective of foreign exchange risk management is to ensure that currency mismatches are managed within the Group's risk appetite and to ensure that it is overseen and governed in keeping with the risk governance structures.

Translation risk is the risk to the rand-based South African reported earnings from fluctuations in the exchange rate when applied to the value, earnings and assets of foreign operations. Translation risk is, at present, seen as an unavoidable risk which results from having offshore operations. The Group does not actively hedge this risk.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Foreign exchange risk results from activities of all the franchises, but management and consolidation of all these positions occur in one of two business units. Client flow and foreign exchange trading, including daily currency mismatch, are consolidated under and executed by RMB Global Markets. Foreign currency funding, foreign assets as well as foreign currency exposure, liquidity and term mismatch are consolidated under and managed by Group Treasury.

Market risk, foreign exposure and mismatch limits are approved by the board and the primary governance body is the RCC committee. Trading risk and the net open forward position in foreign exchange (NOFP) are overseen by MIRC, a subcommittee of the RCC committee and mismatch risk is governed through FirstRand ALCCO and international ALCCO processes. In addition to the committee structures, business units charged with frontline management of these risks have deployed risk managers within their units who assess and report on an ongoing basis.

ASSESSMENT AND MANAGEMENT (AUDITED)

In addition to the regulatory prudential limit on foreign asset exposure (25% of local liabilities), the board has set internal limits on FirstRand's total foreign currency exposure, within the regulatory limit but allowing opportunity for expansion and growth. Internal limits are also set per franchise, taking into account existing foreign asset exposure and future growth plans. Internal limits and utilisation are continuously monitored and reviewed when necessary.

The Group's NOFP is within the regulatory limit of USD650 million, with the actual exposure ranging at ±USD200 million. Senior management implemented various levels of internal prudential limits, taking into account fluctuating exchange rates and the Group's capital position, again below the regulatory limit but large enough to cater for hedging, settlement and execution positions of business units. Group Treasury is the clearer of all currency positions in FirstRand and is, therefore, tasked with the responsibility for managing the Group's position within all internal and prudential limits. Any breaches are reported through the risk management structures and corrective action is monitored by both the deployed risk managers and ERM.

FOREIGN EXCHANGE AND TRANSLATION RISK PROFILE

Over the past year no significant foreign exchange positions have been run, apart from translation risk in strategic foreign investments. Mismatches have been well contained within regulatory limits at all times. The NOFP internal management limit was recently adjusted upwards to cater for increased (unhedged) currency risk related to foreign investment positions held directly by the Group and to cater for increased buffer trading for RMB and Group Treasury trading positions. Allowances were also made for newly established foreign entities of the Group, allowing slightly higher internal management triggers so as not to constrain growth in the start-up phase. The standard management triggers are applied to the mature foreign entities. The macro foreign asset exposure of the Group remained below both regulatory and board limits and there is significant headroom for expansion into foreign assets.

FUNDING AND LIQUIDITY RISK

INTRODUCTION AND OBJECTIVES (AUDITED)

The Group distinguishes three types of liquidity risk:

- **funding liquidity risk** is the risk that a bank will not be able to effectively meet current and future cash flow and collateral requirements without negatively affecting the normal course of business, financial position or reputation;
- **market liquidity risk** is the risk that market disruptions or lack of market liquidity will cause the bank to be unable (or able, but with difficulty) to trade in specific markets without affecting market prices significantly; and
- **mitigation of market and funding liquidity risks** is achieved via contingent liquidity risk management. Buffer stocks of highly liquid assets are held either to be sold into the market or provide collateral for loans to cover any unforeseen cash shortfall that may arise.

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

Funding structure

The banking sector in South Africa is characterised by certain structural features, such as a low discretionary savings rate and a higher degree of contractual savings that are captured by institutions such as pension funds, provident funds and providers of asset management services. A portion of these contractual savings translate into institutional funding for banks which has higher liquidity risk than retail deposits. The structural liquidity risk is therefore higher in South Africa than in most other markets. This risk is, however, to some extent mitigated by the following factors:

- the closed rand system where all rand transactions are cleared and settled in South Africa through registered banks and clearing institutions domiciled in South Africa;
- the prudential exchange control framework in place in South Africa; and
- the low dependency of South African banks on foreign currency funding.

In the light of the structural funding issues focus is currently placed on a risk-adjusted diversified funding profile in line with Basel III requirements. The release of the updated Basel III LCR reduces the reliance on the SARB committed liquidity facility. The increase in LCR is driven by lower outflow factors for non-operational cash flows, increased availability of qualifying high-quality liquid assets and reduced contingent outflows. In addition, the time frame for compliance has been adjusted to a phased-in approach with a 60% requirement in 2015 and 10% incremental step-ups each year.

Surplus liquidity buffers for cash flow management are amended in line with available liquidity in government debentures, treasury bills and bonds. The current level is considered sufficient relative to current market conditions.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Liquidity risk management is governed by the liquidity risk management framework (LRMF), which provides relevant standards in accordance with regulatory requirements and international best practices. As a subframework to the BPRMF, the LRMF is approved by the board and sets out consistent and comprehensive standards, principles, policies and procedures to be implemented throughout the Group to effectively identify, measure, report and manage liquidity risk.

The board retains ultimate responsibility for the effective management of liquidity risk. The board has delegated its responsibility for the assessment and management of this risk to the RCC committee, which in turn delegated this task to FirstRand ALCCO. FirstRand ALCCOs primary responsibility is the assessment, control and management of both liquidity and interest rate risk for the Bank, FNB Africa, and international subsidiaries and branches, either directly or indirectly, through providing guidance, management and oversight to the asset and liability management functions and ALCCOs in these subsidiaries and branches.

South Africa

Liquidity risk for FRB solo, i.e. FRB excluding foreign branches, is centrally managed by a dedicated liquidity and funding team in Group Treasury. Governance is provided by an independent risk team responsible for ensuring that the liquidity risk management framework is implemented appropriately.

The Group's liquidity position, exposures and auxiliary information are reported weekly to the funding and liquidity portfolio management committee and monthly at the funding executive committee. In addition, management aspects of the liquidity position are reported to Group Treasury. The liquidity risk management team also provides regular reports to FirstRand ALCCO.

Rest of Africa

Individual ALCCOs have been established in each of the FREMA businesses which manage liquidity risk on a decentralised basis, in line with the principles under delegated mandates from the respective boards. Reports from these committees are regularly presented to FirstRand ALCCO and management and control of liquidity risk in the subsidiaries follows the guidance and principles that have been set out and approved by FirstRand ALCCO.

International subsidiaries

Similarly, liquidity risk for international subsidiaries is managed on a decentralised basis in line with the Group's LRMF. Each international subsidiary and branch reports into the international ALCCO, which is a subcommittee of FirstRand ALCCO and meets quarterly to review and discuss region-specific liquidity and interest rate risk issues. Individual ALCCOs are held locally monthly which include representation from Group Treasury.

FirstRand has been granted renewable dispensation by the Prudential Regulatory Authority (PRA) for a waiver on a *Whole-firm Liquidity Modification application* basis where the PRA considers local risk reporting and compliance of the parent bank sufficient to waive PRA requirements for FirstRand Bank (London branch). PRA reporting commenced from January 2011.

LIQUIDITY RISK MANAGEMENT

The Group acknowledges liquidity risk as a consequential risk that may be caused by other risks as demonstrated by the reduction in liquidity in many international markets as a consequence of the recent credit crisis. The Group is, therefore, focused on continuously monitoring and analysing the potential impact of other risks and events on the funding and liquidity position of the organisation to ensure business activities preserve and improve funding stability. This ensures the Group is able to operate through a period of stress when access to funding is constrained.

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

Aspects of liquidity risk management

Structural LRM	Daily LRM	Contingency LRM
The risk that structural, long-term on-and off-balance sheet exposures cannot be funded timeously or at a reasonable cost.	Ensuring that intraday and day-to-day anticipated and unforeseen payment obligations can be met by maintaining a sustainable balance between liquidity inflows and outflows.	Maintaining a number of contingency funding sources to draw upon in times of economic stress.
- liquidity risk tolerance; - liquidity strategy; - ensuring substantial diversification across 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 adequate structural liquidity gap; and - maintaining a funds transfer pricing methodology and processes.	- managing intraday liquidity positions; - managing daily payment queue; - monitoring 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 net daily cash positions; - managing and maintaining market access; and - managing and maintaining collateral.	- managing early warning and key risk indicators; - performing stress testing including sensitivity analysis and scenario testing; - maintaining product behaviour and optionality assumptions; - ensuring that an adequate and diversified portfolio of liquid assets and buffers are in place; and - maintaining the contingency funding plan.

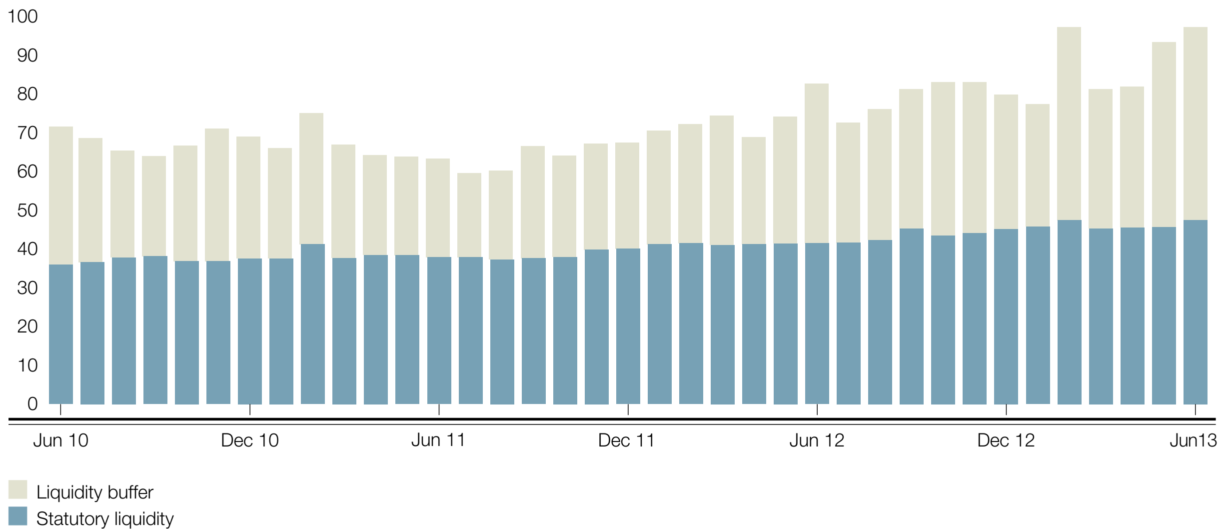
Available liquidity

Liquidity buffers are actively managed via high quality, highly liquid assets that are available as protection against unexpected events or market disruptions. The buffer methodology has been defined and linked to regular stress testing and scenario analysis. The methodology is adaptive and will be responsive to Basel III changes on the LCR.

The following chart shows the liquidity buffer and statutory liquidity requirements.

FRB's liquidity buffer and statutory liquidity requirements*

(R billion)



* *Reflects solo supervision, FRB excluding foreign branches.*

In addition to the measurement and management of liquidity profiles, various key risk indicators are defined that highlight potential risks within defined thresholds. Two levels of severity are defined for each indicator. Monitored on a daily and monthly basis, the key risk indicators may trigger immediate action where required. Current status and relevant trends are reported to the FirstRand ALCCO and the RCC committee quarterly.

Stress testing and scenario analysis

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

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

Liquidity contingency planning

Frequent volatility in funding markets and the fact that financial institutions can and have experienced liquidity problems even during good economic times have highlighted the relevance of quality liquidity risk and contingency management processes.

The Group's ability to meet all of its daily funding obligations and emergency liquidity needs is of paramount importance and, in order to ensure that this is always adequately managed, the Group maintains a liquidity contingency plan (LCP).

The objective of LCP is to achieve and maintain funding levels in a manner that allows the Group to emerge from a potential funding crisis with the best possible reputation and financial condition for continuing operations. The plan is expected to:

- support effective management of liquidity and funding risk under stressed conditions;

- establish clear roles and responsibilities in the event of a liquidity crisis; and
- establish clear invocation and escalation procedures.

The LCP provides a pre-planned response mechanism to facilitate swift and effective responses to contingency funding events. These events may be triggered by financial distress in the market (systemic) or a bank-specific event (idiosyncratic) which may result in the loss of funding sources.

It is reviewed annually and tested biannually via a Group-wide liquidity stress simulation exercise to ensure the document remains up to date, relevant and familiar to all key personnel within the Group that have a role to play should the Group ever experience an extreme liquidity stress event.

Recovery plan

The Group is currently in the latter stage of the development of its recovery plan per the SARB guidance to ensure that regulatory requirements are met.

FUNDING STRATEGY

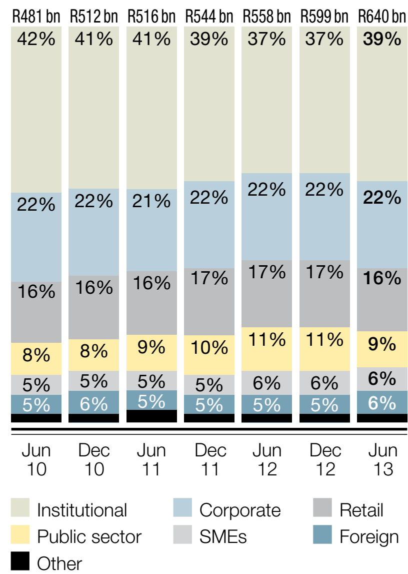
The Group's objective is to fund its activities in a sustainable, diversified, efficient and flexible manner, underpinned by strong counterparty relationships within prudential limits and requirements. The objective is to maintain natural market share of transactional accounts and balances, but also to outperform at the margin, which will provide the Group with a natural liquidity buffer.

Compliance with the Basel III LCR influences the funding strategy, in particular as it seeks to restore the correct risk-adjusted pricing of deposits. FirstRand is actively building its deposit franchise through innovative and competitive products and pricing, while improving the risk profile of its wholesale funding.

The following table illustrates the Bank's sources of funding by counterparty and the total deposit funding base.

FRB funding analysis by source*

(R billion)

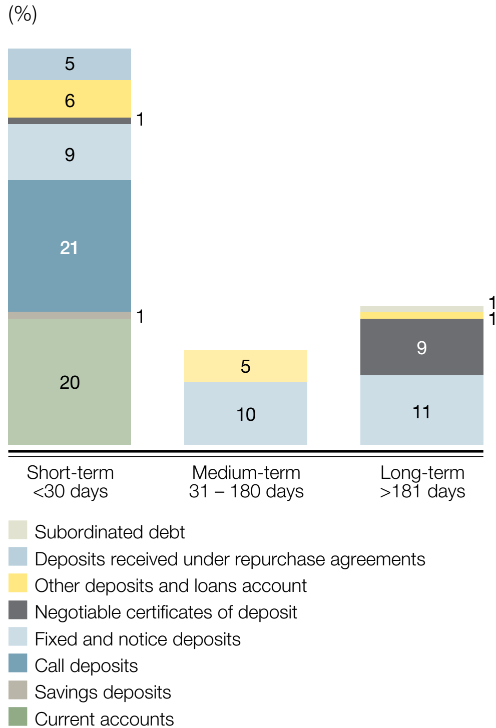


** Reflects solo supervision, FRB excluding foreign branches.*

The following charts illustrate the Group's funding instruments by instrument type and term structure of funding.

FRB funding liabilities by instrument type at 30 June 2013*

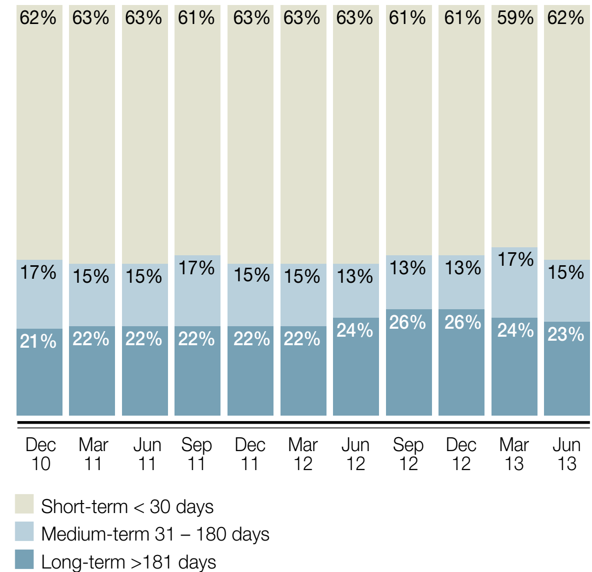
(%)



** Reflects solo supervision, FRB excluding foreign branches.*

Term structure of FRB funding liabilities*

(%)



** Reflects solo supervision, FRB excluding foreign branches.*

The business is incentivised to preserve and enhance funding stability via the funds transfer pricing framework, which ensures the pricing of assets is in line with liquidity risk, liabilities in accordance with funding maturity and contingencies in respect of the potential funding draws on the Group.

LIQUIDITY RISK PROFILE (AUDITED)

Undiscounted cash flow

The following table presents the undiscounted cash flows of liabilities and includes all cash outflows related to principal amounts as well as future payments. These balances will not reconcile to the balance sheet for the following reasons:

- balances are contractual, undiscounted amounts whereas the balance sheet is prepared using discounted amounts;
- table includes contractual cash flows with respect to items not recognised on the balance sheet;
- all instruments held for trading purposes are included in the call to three-month bucket and not by contractual maturity as trading instruments are typically held for short periods of time; and
- cash flows relating to principal and associated future coupon payments have been included on an undiscounted basis.

Liquidity cash flows (undiscounted cash flows) – maturity analysis of liabilities based on the undiscounted amount of the contractual payment

	2013			
		Term to maturity		
R million	Carrying amount	Call – 3 months	4 – 12 months	> 12 months
Liabilities				
Deposits and current accounts	**738 900**	**503 872**	**100 472**	**134 556**
Short trading positions	**2 991**	**2 991**	**–**	**–**
Derivative financial instruments	**53 171**	**51 280**	**508**	**1 383**
Creditors and accruals	**11 361**	**10 046**	**761**	**554**
Tier 2 liabilities	**11 494**	**151**	**556**	**10 787**
Other liabilities	**7 453**	**2 682**	**1 023**	**3 748**
Policyholder liabilities under insurance contracts	**1 112**	**172**	**266**	**674**
Policyholder liabilities under investment contracts	**–**	**–**	**–**	**–**
Financial and other guarantees	**39 931**	**35 018**	**2 328**	**2 585**
Operating lease commitments	**2 514**	**225**	**580**	**1 709**
Facilities not drawn	**78 783**	**59 165**	**4 348**	**15 270**

	2012			
		Term to maturity		
R million	Carrying amount	Call – 3 months	4 – 12 months	> 12 months
Liabilities				
Deposits and current accounts	641 809	432 128	76 444	133 237
Short trading positions	5 343	5 343	–	–
Derivative financial instruments	53 958	52 016	443	1 499
Creditors and accruals	9 080	8 294	521	265
Tier 2 liabilities	10 437	13	1 346	9 078
Other liabilities	7 445	72	825	6 548
Policyholder liabilities under insurance contracts	1 523	339	56	1 128
Policyholder liabilities under investment contracts	71	–	8	63
Financial and other guarantees	30 920	25 327	2 733	2 860
Operating lease commitments	3 217	142	897	2 178
Facilities not drawn	69 348	57 438	3 100	8 810

Contractual discounted cash flow analysis

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

Due to South Africa's structural liquidity position, banks tend to have a particularly pronounced negative (contractual) gap in the shorter term short-term institutional funds which represent a significant proportion of banks' liabilities. These are used to fund long-term assets, e.g. mortgages.

Therefore, in addition to the analysis in the previous table, the Group carries out an adjusted liquidity mismatch analysis, which estimates the size of the asset and liability mismatch under normal business conditions. This analysis is also used to manage this mismatch on an ongoing basis.

Contractual discounted cash flow analysis (audited) – maturity analysis of assets and liabilities based on the present value of the expected payment

	2013			
		Term to maturity		
R million	**Carrying amount**	**Call – 3 months**	**4 – 12 months**	**> 12 months**
Total assets	**869 669**	**309 920**	**99 331**	**460 418**
Total equity and liabilities	**869 669**	**572 026**	**98 597**	**199 046**
Net liquidity gap	**–**	**(262 106)**	**734**	**261 372**
Cumulative liquidity gap	**–**	**(262 106)**	**(261 372)**	**–**

	2012			
		Term to maturity		
R million	Carrying amount	Call – 3 months	4 – 12 months	> 12 months
Total assets	769 765	295 061	66 046	408 658
Total equity and liabilities	769 765	498 741	78 177	192 847
Net liquidity gap	–	(203 680)	(12 131)	215 811
Cumulative liquidity gap	–	(203 680)	(215 811)	–

As illustrated in the table above, the negative contractual liquidity short-term gap deteriorated slightly in the short end on a cumulative basis. Management continues to align stress funding buffers both locally and offshore, taking into account prevailing economic and market conditions.

OPERATIONAL RISK

INTRODUCTION AND OBJECTIVES

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. The Group believes that effective management of operational risk is key to the achievement of its business strategy. Accordingly, there is ongoing evaluation of existing frameworks, policies, methodologies, processes, systems and infrastructure for relevance and to ensure that operational risk management practices are in line with regulatory developments and emerging best practices.

Operational risk strategic objectives for the year ahead continue to focus on building an effective and forward-looking operational risk management programme, encompassing, amongst other things, the management and oversight of IT and infrastructure risk, internal and external fraud, litigation, business disruption and process risk. The key operational risk strategic objectives are:

- embedding operational risk management systems and processes implemented in the previous financial year;
- optimising benefits of automated and integrated risk tools;
- embedding and monitoring adherence to operational risk appetite limits;
- ongoing refinement of the maturity of the AMA components and methodologies;
- continuing improvements to the control environment; and
- maintaining the AMA status.

The year under review

The year under review was characterised by a number of initiatives aimed at improving operational risk maturity and driving efficiency in operational risk management processes.

The principal operational risks currently facing the Group are:

- commercial and violent crime;
- information security risk (risk of loss or theft of information), this risk is rapidly changing with increasingly sophisticated global attacks by cybercrime groups; and
- execution, delivery and process management risk (risk of process weaknesses and control deficiencies) as the business continues to grow and evolve.

Risk maturity assessments were conducted across the Group to identify key processes requiring improvements. Projects to address these are tracked and reported at Group level through the risk governance process.

The integration and automation of the Group's operational risk management and measurement tools onto a single platform to enhance operational risk management processes is near completion.

Business areas within the Group continued to rollout using a phased-in approach, the process-based risk and control identification and assessment methodology aimed at comprehensive identification and assessment of risks and controls within end-to-end business processes per product/service.

Operational risk appetite at Group and divisional levels has been set. This enables the Group and its divisions to measure and monitor operational risk profiles against respective approved operational risk appetite levels, and to set the boundaries for operational risk within which business decisions can be made.

Due to improved controls (e.g. continued deployment of Euro, MasterCard, Visa (EMV) cards, improvement in user authentication processes and fraud detection capabilities at a transaction level) losses from commercial and violent crime decreased compared to the prior year. In the year ahead, focus will be placed on cybercrime which is perceived to be the dominant future threat in the financial services sector globally.

The Group implemented its own work area recovery facility and upgraded power supply, management equipment and infrastructure for key facilities. A third redundant data centre is being implemented to improve the Group's business resilience capability.

The Group's IT risk and governance functions have been integrated within ERM, with relevant governance forums in place to ensure continued monitoring and mitigation of IT risk across the Group. The Group's IT and related frameworks are being reviewed to ensure alignment with changing business models and technology landscapes.

Information, whether the Group's or that entrusted to it by customers, staff or business partners, is a valuable asset and the management of information remains integral to the way the Group operates. To this end, an information governance framework was developed to ensure that information is managed in accordance with its value, sensitivity and the risks to which it is exposed.

Key focus has been on the refinement of information governance structures, processes and the improvement of data quality and records management practices. Information governance committees have been established in all divisions and information governance now forms an integral part of the overall risk management framework of the Group.

Looking ahead, the Group will continue to improve its information management capabilities by embedding governance structures, continuous improvement of the information control environment and rolling out awareness programmes on relevant topics including records management, data quality management and data privacy management.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

The board has delegated its approval and review authority for operational risk to the operational risk committee (ORC), a subcommittee of the RCC committee. ORC is responsible for monitoring the implementation of the ORMF and oversight over the management of operational risk across the Group. The ORMF prescribes the authorities, governance and monitoring structures, duties and responsibilities, processes, methodologies and standards which have to be implemented and adhered to when managing operational risk.

Within operational risk, a number of key risks exist for which specialised teams, frameworks, policies and processes have been established. Fraud and physical security, business resilience, legal, information technology and insurance have dedicated specialist teams who provide oversight which is integrated into the broader operational risk management and governance processes.

The central operational risk management team in ERM is responsible for embedding the operational risk governance structure across the Group.

MEASUREMENT

Basel – advanced measurement approach

FirstRand applies AMA under Basel for the Group's domestic operations. Offshore subsidiaries and operations continue to use TSA for operational risk and all previously unregulated entities that are now part of FRIHL use BIA. FirstRand continuously assesses the feasibility of migrating TSA and BIA entities to AMA (subject to internal and regulatory constraints).

Under AMA, FirstRand uses a sophisticated statistical model for the calculation of capital requirements, which enables more accurate risk-based measures of capital for all business units on AMA.

Operational risk scenarios (covering key risks that, although low in probability, may result in severe losses) and internal loss data are inputs into this model.

Scenarios are derived through an extensive analysis of the Group's operational risks in consultation with business and risk experts from the respective business areas. Scenarios are cross referenced to external loss data, internal losses, key risk indicators, risk and control self assessments and other pertinent information about relevant risk exposures. To ensure ongoing accuracy of risk and capital assessments, all scenarios are reviewed, supplemented or updated semi-annually, as appropriate.

The loss data used for risk measurement, management and capital calculation is collected for all seven Basel event types across various internal business lines. Data collection is the responsibility of the respective business units and is overseen by the operational risk management team in ERM.

The modelled operational risk scenarios are combined with modelled loss data in a simulation model to derive the annual, aggregate distribution of operational risk losses. Basel Pillar 1 minimum capital requirements are then calculated (for the Group and each franchise) as the operational VaR at the 99.9^{th} percentile of the aggregate loss distribution, excluding the effects of insurance, expected losses and correlation/diversification.

Capital requirements are calculated for each franchise using the AMA capital model and then allocated to the legal entities within the Group based on gross income contribution ratios. This split of capital between legal entities is required for internal capital allocation, regulatory reporting and performance measurement purposes.

TSA and BIA capital calculations are based on a multiplication factor applied to gross income, as specified by Basel and SARB regulations. No risk-based information is used in these capital calculations and allocations.

Business practices continuously evolve 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 exposures and associated capital requirements take the following into account:

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

ASSESSMENT AND MANAGEMENT

Operational risk assessment and management tools

The Group obtains assurance that the principles and standards in the ORMF are being adhered to by the three lines of control model integrated in operational risk management. In this model, business units own the operational risk profile as the first line of control. In the second line of control, ERM is responsible for consolidated operational risk reporting, policy ownership and facilitation and coordination of operational risk management and governance processes. GIA, as the third line of control, provides independent assurance of the adequacy and effectiveness of operational risk management processes and practices.

In line with international best practice, a variety of tools are employed and embedded in the assessment and management of operational risk. The most relevant of these are outlined in the following chart.

Operational risk assessment and management tools

Risk control self assessments and process-based risk and control identification and assessments	Key risk indicators
• integrated in the day-to-day business and risk management processes; • used by business and risk managers to identify and monitor key risk areas and assess the effectiveness of existing controls; and • process-based risk and control identification and assessment (currently being rolled out) per product/service based on key business processes.	• used across the Group in all businesses as an early warning measure; • highlight areas of changing trends in exposures to specific key operational risks; and • inform operational risk profiles which are reported periodically to the appropriate management and risk committees and are monitored on a continuous basis.
Internal/external loss data	**Risk scenarios**
• the capturing of internal loss data is well entrenched within the Group; • internal loss data reporting and analyses occur at all levels with specific focus on root cause and process analysis and corrective action; and • external loss databases are used to learn from loss experiences of other organisations and as inputs to the risk scenario processes.	• risk scenarios are widely used to identify and quantify low frequency extreme loss events; • senior executives of the business actively participate in the biannual reviews; and • results are tabled at the appropriate risk committees and are used as input to the capital modelling process.

The process-based risk and control identification and assessments are being rolled out across the Group will and replace the risk control self assessments to ensure a comprehensive understanding of end-to-end business processes.

FirstRand uses an integrated and reputable operational risk system which is well positioned as the core operational risk system and provides a solid platform for automation of all operational risk tools. The automation and integration of all the operational risk tools on the operational risk system is near completion.

Operational risk events

As operational risk cannot be avoided or mitigated entirely, frequent operational risk events resulting in small losses are expected as part of business operations (e.g. external fraud) and are budgeted for appropriately. Business areas minimise these losses through continuously monitoring and improving relevant business and control practices and processes. Operational risk events resulting in substantial losses occur much less frequently and the Group strives to minimise these and contain frequency and severity within its risk appetite levels.

Operational risk management processes

Within operational risk, a number of key risks exist in respect of which specialised teams, frameworks, policies and processes have been established and integrated into the broader operational risk management and governance processes as described for the major operational risks, which includes business resilience management, legal risk, IT risks and information governance, fraud and security risks and risk insurance.

Business resilience management

Business resilience management focuses on ensuring that the Group's operations are resilient to the risk of severe disruptions caused by internal failures or external events. The business resilience steering committee, a subcommittee of the ORC, has oversight of business resilience management.

The business resilience practices of the Group are documented in the Group's business resilience policy and supporting standards, which are approved at the ORC. The policy, a subframework of the ORMF, requires the development and maintenance of business continuity strategies and plans. It also requires regular business continuity assessments and testing to be carried out in all business units and the results reported to the business resilience steering committee.

The Group carries out regular reviews of business resilience management practices and any disruptions or incidents are assessed and regularly reported to the relevant risk committees.

Legal risk

The legal risk management framework, a subframework of the ORMF, addresses and seeks to guide the operations of the Group in areas such as the creation and ongoing management of contractual relationships, management of disputes, which do or might lead to litigation, protection and enforcement of property rights (including intellectual property) and failure to account for the impact of the law or changes in the law brought about by legislation or decisions of the courts. Whilst compliance with law is a major element of legal risk, RRM, through the regulatory risk management governance framework and attendant programme, manages this aspect of legal risk. Added to these substantive and direct risks is the management of risk around the procurement of external legal resources.

A legal risk management programme is in place to work towards the goal of ensuring that comprehensive, sound operational risk governance practices and solutions are adopted in respect of legal risk management which represent best practice and align to the Group's overall risk management programme. The legal risk committee, a subcommittee of the ORC, has oversight of legal risk management.

IT risks and information governance

Information risk is concerned with the quality and protection of information and information systems against unauthorised access, destruction, modification, use and disclosure. The goal is to ensure confidentiality, availability and integrity of all information and systems that maintain, process and disseminate this information. To this end a distinction is made between:

- IT risk management and governance (protection of systems); and
- information governance (accountability for and quality of information).

The Group's IT risk management framework, acceptable use of information resources policy and information security policy provide the basis for the management of IT risk and information security within the Group.

The IT risk management framework defines the objectives of IT risk management and processes that are to be embedded, managed and monitored across the Group for effective management of IT risk.

The information governance framework, based on the best practices and principles contained in national and international standards, has been tailored to reflect the business and regulatory environment within which FirstRand operates.

Fraud and security risks

Fraud risk is defined as the risk of loss resulting from unlawfully making, with intent to defraud, misrepresentation which causes actual prejudice or which is potentially prejudicial to another. Fraud incorporates both internal (staff) criminal activities as well as those that emanate from an external source.

Fraud risk is governed by the fraud risk management framework, which is a subframework of the ORMF. The Group utilises a deployed fraud risk management model that requires businesses to institute processes and controls specific and appropriate to operations within the constraints of a consistent governance framework. This is overseen by the fraud risk management function reporting to the Group CRO.

The Group is committed to creating an environment that safeguards customers, staff and assets against fraud or security risks by continually investing in people, systems and processes for both preventative and detective measures.

Risk insurance

The Group has a structured insurance risk financing programme in place, which has been developed over many years to protect the Group against unexpected material losses arising from non-trading risks. The insurance risk programme is continuously refined through ongoing assessment of changing risk profiles, organisational strategy and growth, and monitoring of international insurance markets. The levels and extent of the various insurance covers are reviewed and benchmarked annually.

The Group's insurance-buying philosophy is to carry as much risk on its own account as is economically viable and to only protect itself against catastrophic risks through the use of third party insurance providers. Accordingly, the majority of cover is placed into the Group's wholly-owned first party dedicated insurance company, FirstRand Insurance Services Company Limited (FRISCOL). All cover on the main programme is placed with reinsurers with a minimum credit rating of A-. The insurance programme includes, *inter alia*, cover for operational risk exposures such as professional indemnity, directors and officers liability, crime bond, public and general liability, etc. The Group, however, does not consider insurance as a mitigant in the calculation of capital for operational risk purposes.

REGULATORY RISK

INTRODUCTION AND OBJECTIVES

The Group's RRM function plays an integral part in managing risks inherent in banking. The Group fosters a compliance culture in its operations that contributes to the overall objective of prudent regulatory compliance and risk management, by observing both the spirit and the letter of the law as an integral part of its business activities. The compliance culture also embraces broader standards of integrity and ethical conduct which concerns all employees.

The objective of the RRM function is to ensure that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws and that regulatory risks are identified and managed proactively throughout the Group. This culminates in the maintenance of an effective and efficient regulatory risk management framework with sufficient operational capacity throughout the Group to promote and oversee compliance with legislative and best practice requirements. In order to achieve the Group's regulatory risk management objectives, staff members are trained and made aware of compliance requirements in order to ensure a high level of understanding and awareness of the applicable regulatory framework.

The Group seeks to achieve full compliance with statutes and regulations and every effort is made to ensure that governance policies and practices and the implementation thereof appropriately aligns to regulatory and industry best practice requirements. 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.

It is of paramount importance that the Group ensures compliance with laws and regulations applicable to its operations. These include, among other, the provisions of the Banks Act, 1990, the *Regulations relating to Banks*, the Financial Intelligence Centre Act, 2001, the Financial Advisory and Intermediary Services Act, 2002 and the Consumer Protection Act, 2008. All compliance issues identified in this context should be effectively and expeditiously resolved by senior management with the assistance of RRM. This requires close cooperation with and interaction between RRM, other Group functions and various regulatory authorities.

The year under review

Banking legislation

The new *Regulations relating to Banks* became effective on 1 January 2013. It incorporates, among other, the requirements contained in the Basel III framework which is being phased in. Ongoing amendments to the Regulations are expected to ensure that the South African regulatory framework for banks remains aligned to internationally-agreed regulatory and supervisory standards.

Twin peaks

The most notable development and focus area of regulatory reforms is the anticipated implementation of a twin peaks model of financial regulation in South Africa. In terms of the broad policy objectives, it is expected that these reforms will be implemented in two phases, along with the development of legislation necessary to enable the relevant regulators to deliver on their revised mandates. As a key stakeholder, the Group will continue to foster close interaction and cooperation with the regulators in this regard.

The Group's ethics framework

The Group's Ethics Office is part of RRM and strategically directs an ethics framework which has attained increased maturity and impact during the year under review. Several culture- and people-risk assessments were conducted, some of which resulted in strategic and operational changes in certain areas and the proactive identification and management of several risk types. The focus on promotion of responsible business conduct was maintained and included intensified training on whistle blowing, conflict of interests avoidance, anti-bribery and corruption. Another focus area is the promotion of responsible market conduct and ensuring that the Group remains compliant with market conduct regulations and related industry best practice. Further enhancements to the robustness of the Group's responsible competitive practice programme are expected to mitigate related risks.

Protection of Personal Information (PoPI) Bill

The PoPI Bill is applicable to all personal information held by the Group in respect of employees, customers and suppliers. The Group is, in preparation of the anticipated legislation, devoting attention and resources to aspects such as security safeguards, processing and purpose specification of personal information, quality of personal information held, customer notification and consent, third party processors of personal information and complaints handling, to ensure compliance with the legislation, once enacted.

Greenhouse gas protocol guidance (GHG)

The Group has actively participated in the climate change technical advisory group on the development of GHG for financed GHG emissions through the United Nations Environment Program – finance initiative.

Carbon disclosure project (CDP)

As an investor signatory to the CDP, the Group submits, on an annual basis, a carbon disclosure report. The Group received a platinum rating for its carbon performance management and a

gold award for its carbon disclosure with an overall rating of 96 per cent during 2012, which placed the Group amongst the top JSE-listed companies. The report contains information on carbon and climate change strategy and provides insight on how regulatory, physical and other related risks are managed. It also provides commentary on issues such as opportunities relating to carbon management and climate change, the Group's annual global carbon footprint and disclosure of performance against carbon emission reduction targets.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Responsibility for compliance with all relevant laws, related internal policies, regulations and supervisory requirements are delegated by the board to senior management and RRM. In order to assist board members to make informed judgements on whether the Group is managing its regulatory and compliance risks effectively, the head of RRM has overall responsibility for coordinating the management of the Group's regulatory risk, including monitoring, assessing and reporting on the level of compliance to senior management and the board. RRM complies with the prescribed requirements in terms of regulation 49 of the Regulations and its mandate is formalised in the Group's compliance risk management framework.

Governance oversight of the RRM function is conducted by a number of committees such as the RRM, RCC and Audit committees, all of which receive regular detailed reports from RRM on the level of compliance and instances of material non-compliance.

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

FirstRand has a formal social and ethics committee to exercise oversight over the governance and functioning of the Group-wide ethics programme. The FirstRand Group code of ethics is the cornerstone of FirstRand's ethics management framework.

RRM retains an independent reporting line to the Group CEO as well as to the board through its designated committees.

ASSESSMENT AND MANAGEMENT

RRM's board mandate is to ensure full compliance with statutes and regulations. To achieve this, RRM has implemented appropriate structures, policies, processes and procedures to identify regulatory and supervisory risks. RRM monitors the management of these risks and reports on the level of compliance risk management to both the board and the Registrar of Banks. These include:

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

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 effective functioning of the compliance processes.

PUBLIC POLICY AND REGULATORY AFFAIRS OFFICE

The Group's Public Policy and Regulatory Affairs Office (PPRAO) provides the Group with a central point of engagement, representation and coordination in respect of relevant regulatory and public policy-related matters, at a strategic level. The PPRAOs function is differentiated from the existing and continuing engagement with regulators at an operational level (i.e. regulatory reporting, compliance and audit) with its main objective to ensure that Group executives and the franchises are aware of key developments relating to public policy, legislation and regulation, which are considered pertinent to the Group's business activities and to support executives in developing the Group's position on issues pertaining to government policy, proposed and existing legislation and regulation.

The PPRAO reports directly to the Group CEO and indirectly, through designated subcommittees, to the board. The PPRAO maintains close working relationships with RRM, ERM and the business unites where specific technical expertise reside.

REMUNERATION AND COMPENSATION

FirstRand's compensation policies and practices observe international best practice and comply with the requirements of the Banks Act, 1990 (Act No. 94 of 1990) and *FSB Principles for Sound Compensation Practices*. In accordance with the requirements of regulation 43 of the revised *Regulations relating to Banks* and the Basel requirements, full disclosure of the Group's compensation policies, practices and performance are included in the *Remuneration committee* report on pages 81 to 90 of this annual integrated report, and is published on FirstRand's website, www.firstrand.co.za.