FIRSTRAND GROUP

Risk and capital management report

Overview

FirstRand ("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 its shareholders. It is therefore deeply embedded in the Group's tactical and strategic decision making.

Risk taking is an essential part of the Group's business and FirstRand thus explicitly recognises risk assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates. Through its portfolio of leading franchises, FirstRand wants to be appropriately represented in all significant earnings pools across all chosen market and risk-taking activities. This entails building revenue streams that are diverse and creating long-term value through sustainable earning pools managed within acceptable earnings volatility parameters.

A high level overview of the Group's risk profile and management approach is included in the COO & CFO's report on pages 16 to 28.

BASEL II 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, amongst other things, to make an accurate assessment of the bank's financial condition, including its capital adequacy position, financial performance, business activities, risk profile and risk management practice. This disclosure requirement is commonly known as Pillar 3 of the Basel II Accord. The FirstRand risk and capital management report complies with the disclosure requirements of Basel II Pillar 3.

Effective 1 July 2010, FirstRand replaced FirstRand Bank Holdings Limited ("FRBH") as the regulated bank controlling company. As part of this change, the Group entered into a process to simplify the Group structure, whereby FirstRand Bank Limited ("the Bank") disposed of materially all its subsidiaries and associates to fellow wholly-owned Group subsidiary, FirstRand Investment Holdings (Pty) Limited ("FRIHL"). As of 1 July 2010, the Bank, FirstRand EMA Holdings Limited ("FREMA"), and FRIHL are all regulated as wholly-owned subsidiaries of FirstRand. A simplified diagrammatic representation of the Group structure is provided on page 5. Some differences between the practices, approaches, processes and policies of the Bank and its fellow wholly-owned subsidiaries exist and these are highlighted by a reference to the appropriate entity, where necessary. All the information in the risk and capital management report has been audited, except where otherwise indicated.

For fully consolidated entities in the Group, no difference in the manner in which entities are consolidated for accounting and regulatory purposes exist.

Risk and capital management report continued

Definitions

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

Risk category	Risk components	Definition	Page reference
Strategic and business risks	Includes strategic risk; business risk; 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. **Volume and margin risk** is the risk that the capital base is negatively impacted by a downturn in revenue due to market factors (e.g. margin compression), combined with the risk that the cost base is inflexible.	129
		Reputational risk is the risk of reputational damage due to compliance failures, pending litigations or 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 management	The Group manages capital by allocating resources effectively in terms of its risk appetite and in a manner that maximises value for shareholders. The overall objective of capital management is to maintain sound capital ratios, a strong credit rating, and to ensure confidence in the solvency of the Group during calm and turbulent periods in the economy and financial markets.	133
	Credit risk	Credit risk is 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.	142
	Counterparty credit risk	Counterparty credit risk is defined as the risk of a counterparty to a contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows.	177
	Market risk in the trading book	Market risk is the risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates.	179
	Equity investment risk	Equity investment risk is the risk of an adverse change in the fair value of an investment in a company, fund or any other financial instrument, whether listed, unlisted or bespoke.	183

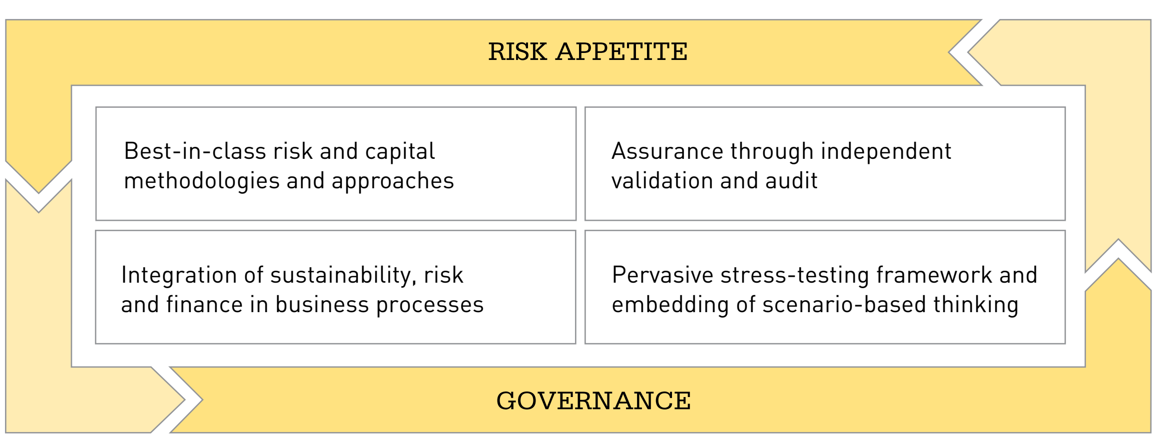
Risk category	Risk components	Definition	Page reference
Financial risks	Foreign exchange and translation risk in the banking book	**Foreign exchange risk** is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank has net open foreign currency positions and, as such, is exposed to currency risk in its foreign currency positions and foreign investments. **Translation risk** is the risk associated with banks that deal in foreign currencies or hold foreign assets. The greater the proportion of asset, liability and equity classes denominated in a foreign currency, the greater the translation risk.	185
	Liquidity risk	Liquidity risk is the risk that a bank will not be able to meet all payment obligations as liabilities fall due. It is also the risk of not being able to realise assets when required to do so to meet repayment obligations in a stress scenario. The definition of liquidity risk is expanded in the *Liquidity risk* section on page 186.	186
	Interest rate risk in the banking book ("IRRBB")	IRRBB is defined as the sensitivity of a bank's financial position and earnings to unexpected, adverse movements in interest rates.	192
Operational risk	Operational risk	Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes and systems or from external events and human error. It includes fraud and criminal activity (internal and external); project risk; legal risk; business continuity; information and IT risk; process and human resources risk. Strategic, business and reputational risks are excluded from the definition.	196
	Regulatory risk	Regulatory risk is the risk of statutory or regulatory sanction and material financial loss or reputational damage as a result of a failure to comply with any applicable laws, regulations or supervisory requirements.	199

FirstRand's approach to risk and capital management

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

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

Components of FirstRand's approach to risk and capital management



Risk and capital management report continued

These core components are discussed further in this report:

- The Group's **risk appetite** frames all organisational decision making and forms the basis for the refinement of risk identification, assessment and management capabilities (see below).
- Best practice **risk and capital methodologies** have been developed in and for the relevant business areas (see page 123).
- An integrated approach to **sustainability and managing risk** was established to facilitate the proactive exchange of information between individual risk areas, and between risk and finance functions (see page 123).
- The Group is deploying a comprehensive, consistent and integrated approach to **stress testing** that is embedded as a usiness planning and management tool, emphasising scenario-based analyses in all its decision processes. Stress testing includes the quantification of potential volatility of earnings under various scenarios and due to event risk. (see page 124).
- A strong **governance structure** and policy framework fosters the embedding of risk considerations in existing business processes and ensures that consistent standards exist across the Group's operating units (see page 127).
- **Independent oversight, validation and audit functions** ensure a high standard across methodological, operational and process components of the Group's risk and capital management processes (see page 126).

RISK APPETITE

The level of risk the Group is willing to take on – its risk appetite – is determined by the Board, which also assumes responsibility for ensuring that risks are adequately managed and controlled through the FirstRand Risk, capital management and compliance committee ("RCC committee") and subcommittees, as described in the *Risk governance structure* section on page 127.

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

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

- the level of earnings growth and volatility the Group is willing to accept from certain risks that are core to its business; and
- the level of capitalisation to meet regulatory capital requirements; maintain a capital buffer for unforeseen events and business expansion; and the return achieved on capital allocated.

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

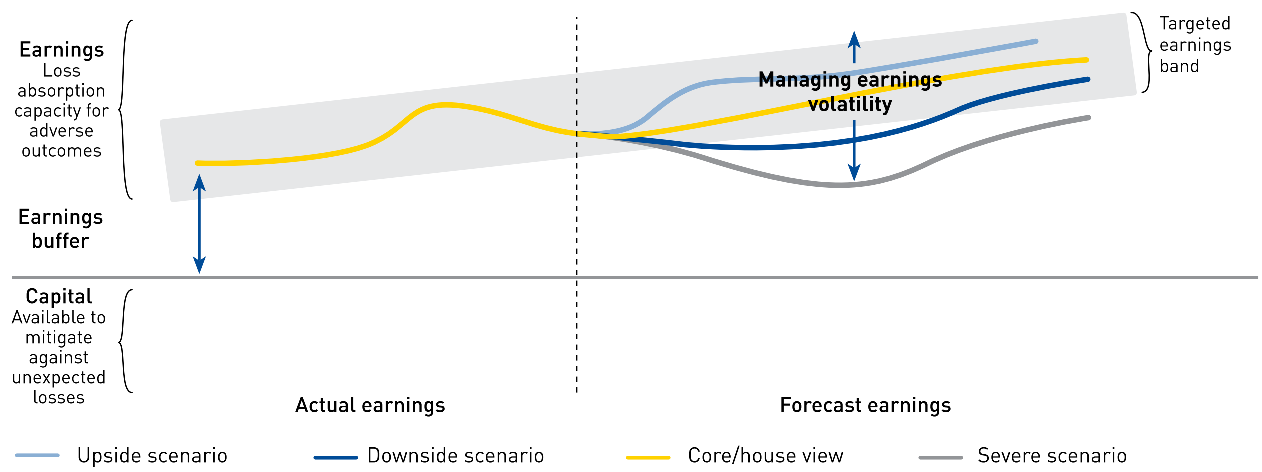
In setting the risk appetite, Executive management ("Exco") and the Board balance the organisation's overall risk capacity with a bottom-up view of the planned risk profile for each business. It is in this process that the Group ultimately seeks to achieve an optimal trade-off between its ability to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

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

The Group views earnings as the primary defence against adverse outcomes. The earnings buffer and capital base provide protection against unexpected events for stakeholders. FirstRand's capacity to absorb earnings volatility and fluctuations is therefore supported by the generation of sustainable profits.

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

Managing earnings volatility through the cycle



RISK AND CAPITAL METHODOLOGIES

The detailed sections commencing on page 129 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.

FOCUS ON SUSTAINABILITY AND INTEGRATION OF RISK AND FINANCE

The Group considers the sustainability of its earnings within acceptable volatility as a core objective and key performance measure. The value of its franchises is ultimately supported by its financial strength and the Group adopts a management approach that seeks to achieve an optimal deployed risk model.

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

The Balance Sheet Management ("BSM") unit within the Corporate Centre is the custodian of the macroeconomic house view. It provides the business units with a forecast of key variables that impact the balance sheet and spans a three-year forecast horizon. Given the volatility of the macroeconomic environment, a core forecast and two risk scenarios are presented to the business units for each key variable. A severe scenario is also included for stress testing purposes. These scenarios and forecasts are debated and then communicated to the business units. The outlook is monitored on a daily basis and updated on a quarterly basis, or more frequently if required.

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

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

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

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

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

- the link between business strategy, risk introduced and capital required to support the strategy;
- the establishment of frameworks, policies and procedures for the effective management of material risks;

Risk and capital management report continued

- embedding a responsible risk culture at all levels in the organisation;
- the effective allocation and management of capital in the organisation;
- the development of plausible stress tests to provide useful information which serves 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.

STRESS TESTING AND SCENARIO-BASED ANALYSES

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

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

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

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

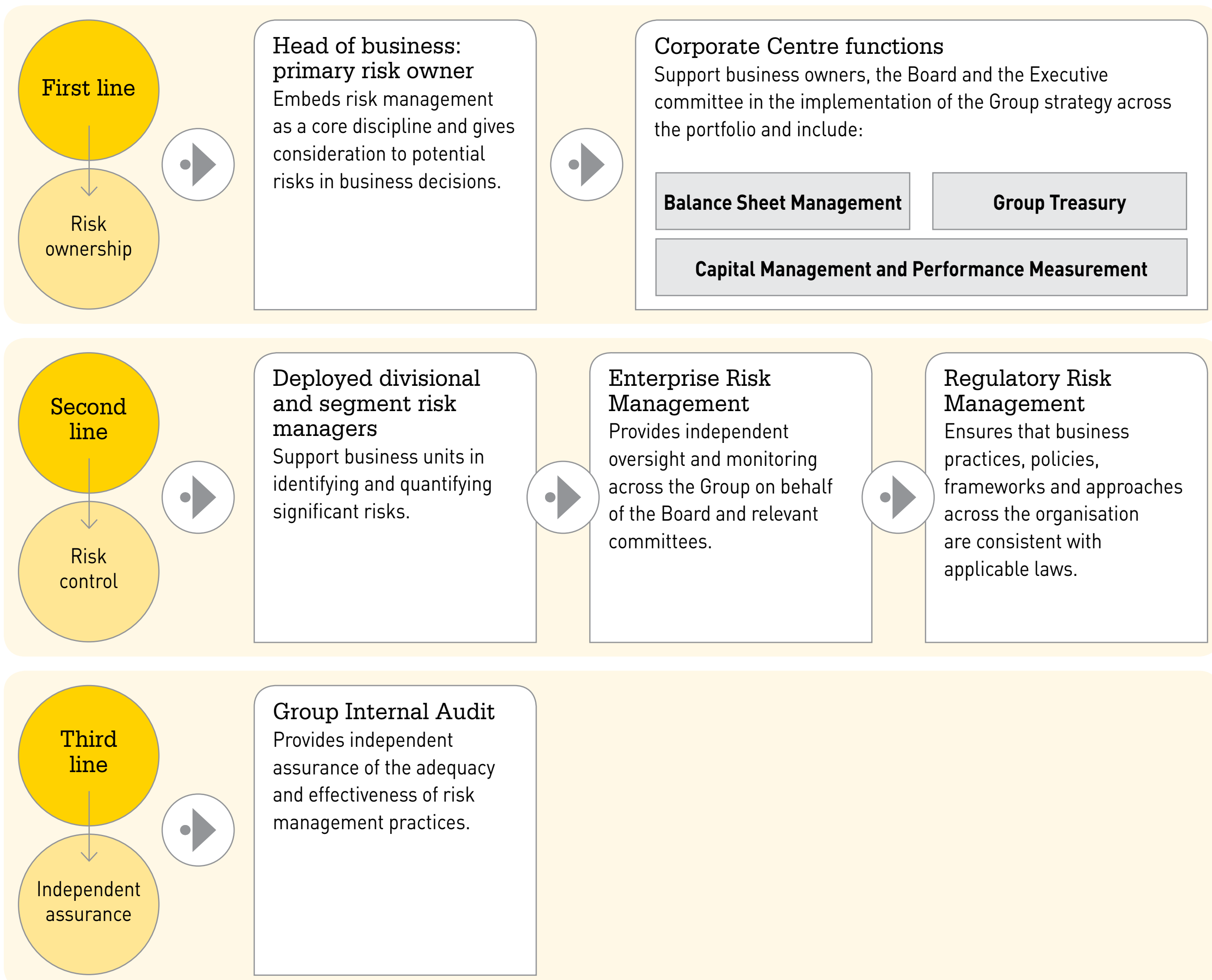
RISK MANAGEMENT FRAMEWORKS AND GOVERNANCE STRUCTURE

Risk governance framework

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

Effective risk management also requires multiple points of control or safeguards that should be applied consistently at various levels throughout the organisation. There are three primary lines of control across the Group's operations illustrated in chart below.

Lines of risk control



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. The BPRMF explicitly recognises the three lines of control.

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 with respect to identifying and managing risk appropriately. In order to achieve this, **the head of each business entity**:

- ensures the entity acts in accordance with mandates approved by the Board or its delegated authority;
- identifies, quantifies and monitors key risks to business under normal and stress conditions;
- implements the strategic and business plans as applicable to the business entity within approved risk appetite parameters;
- specifies the risk management processes whereby the key risks of the entity are managed;
- specifies and implements early warning measures, associated reporting, management and escalation processes;
- implements risk mitigation strategies;
- implements timeous corrective actions and loss control measures as required;
- reports risk information to Exco and the governance committee structure as appropriate through to the Board; and
- ensures staff understands responsibilities in relation to risk management.

Business owners, the Board and Exco are supported in these responsibilities by the **Corporate Centre functions** including BSM, Group Treasury, and Capital Management and Performance Measurement. The responsibilities of these functions are

Risk and capital management report continued

described in the *Focus on sustainability and integration of risk and finance* section on page 123.

Second line – risk control

Business heads are supported in this 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. To this end, they:

- approve, coordinate and monitor risk assessment and risk management processes;
- ensure that board-approved risk policies and risk tools are implemented and adhered to;
- ensure that performance, risk exposures and corrective actions are reported in an appropriate format and frequency;
- monitor appropriate implementation of corrective action;
- identify process flaws and risk management issues and initiate corrective action;
- compile, analyse and escalate risk reports through appropriate governance structures; and
- ensure all risk management and loss containment activities are performed in a timely manner as agreed with Enterprise Risk Management ("ERM").

Divisional and segment risk management activities are overseen by independent, central risk control functions, ERM and Regulatory Risk Management ("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. Furthermore ERM:

- takes ownership of and maintains risk frameworks;
- develops the Group's risk management strategy and communicates the risk management strategy plan and requirements to appropriate stakeholders;
- challenges risk profiles through review of risk assessments, evaluation of risk management processes and monitoring of exposures and corrective actions;
- reports risk exposures and performance in relation to management of risk exposures to relevant committees;
- ensures appropriate risk skills throughout the Group alongside an appropriate risk management culture for risk taking;
- performs risk measurement validation and maintains risk governance structures;
- deploys a comprehensive and integrated approach to stress testing; and
- manages regulatory relationships with respect to risk matters.

RRM is an integral part of managing risks inherent in the business of banking and ensures that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws. The risks, responsibilities and processes of RRM are discussed in the *Regulatory risk* section.

Third line – independent assurance

The third major line of control involves functions providing independent assurance on the adequacy and effectiveness of risk management practices across the Group. These are the internal audit functions at a business and at a Group level. **Group Internal Audit** ("GIA") is headed by the chief audit executive and reports to the Board through the FirstRand Audit committee chairman. To achieve its assigned responsibilities, GIA:

- reviews risk assessment results of business entities;
- assesses compliance with the directives of the BPRMF;
- evaluates the development and implementation of policies and procedures for risk management in line with policies of the Board or relevant committees;
- reviews the integrity, accuracy and completeness of risk reports to RCC committee and the Board;
- monitors results of internal and external audit processes;
- coordinates audit processes with ERM and RRM; and
- attends various governance and management committees to remain informed and align its risk-based audit approach accordingly.

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

Combined assurance

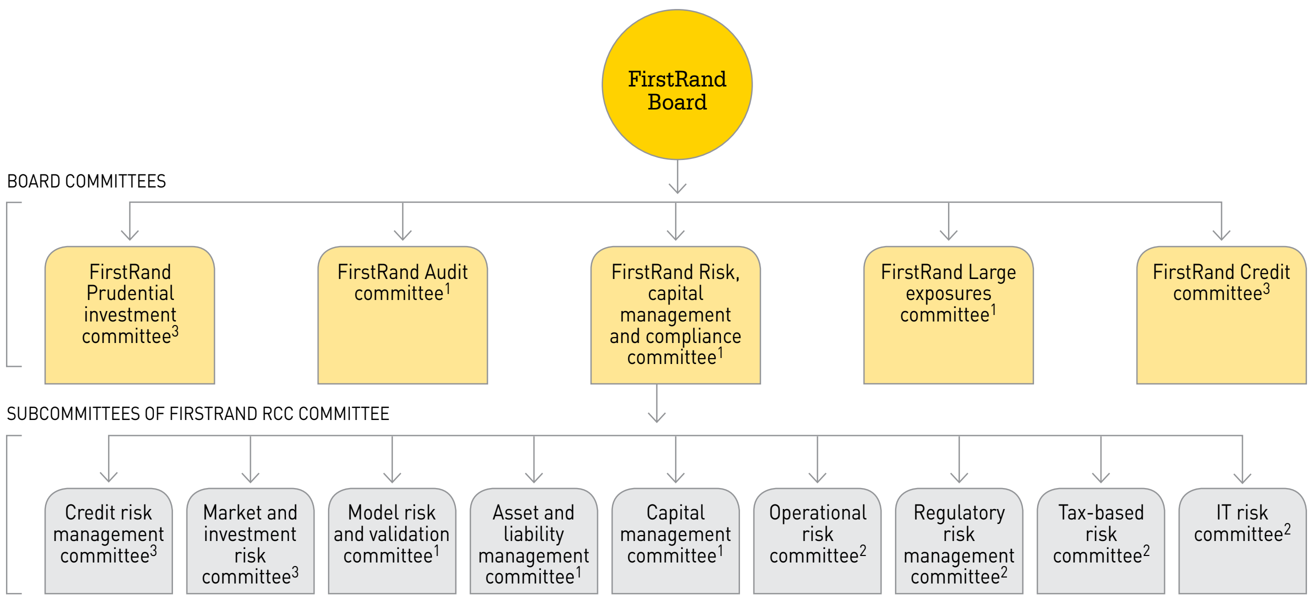
The Audit committee has overseen the establishment of formal enterprise-wide governance structures for enhancing the practice of combined assurance, involving the establishment of combined assurance forums at Group and subsidiary level. These combined assurance forums are specifically mandated to achieve coordination, alignment and integration of risk management and assurance processes within the Group to optimise and maximise the level of risk, governance, and control oversight over the organisation's risk landscape. This work has involved establishing common end-to-end business process and transaction life cycle frameworks against which different assurance processes are leveraged.

The initial outcomes of the combined assurance work completed during the year indicate greater efficiency of assurance processes through the elimination of duplication, more focused risk-based assurance against key control areas and the emergence of a more accurate multidimensional picture of the Group's risk and control universe.

Risk governance structure

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

Risk governance structure



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

The primary board committee overseeing risk matters across the Group is the FirstRand RCC committee. It has delegated responsibility for a number of specialist topics to various subcommittees. The RCC committee submits its reports and findings to the Audit committee for review. The responsibilities of the board committees and the subcommittees of the RCC committee are included in the table below.

Responsibilities of the committees in the risk governance structure

	Committee	Responsibility
Board committees	FirstRand Prudential investment committee	• ensures investment exposures comply with FirstRand's prudential investment guidelines.
	FirstRand Audit committee	• considers the annual financial statements for approval by the Board; and • monitors the quality of the internal financial controls and processes of FirstRand and the implementation of corrective actions.
	FirstRand Risk, capital management and compliance committee	• approves risk management policies, standards and processes; • monitors Group risk assessments; • monitors the effectiveness of risk management and high priority corrective actions; • monitors the Group's risk profile; and • approves risk and capital targets, limits and thresholds.
	FirstRand Large exposures committee	• approves credit exposures in excess of 10% of the Group's capital.
	FirstRand Credit committee	• credit approvals of group or individual credit facilities in excess of subcommittee mandates and limits; and • approves all wholesale credit policies.

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<table>
<tr><th></th><th>Committee</th><th>Responsibility</th></tr>
<tr><td rowspan="8">Subcommittees of the FirstRand RCC committee</td><td>Credit risk management committee</td><td>• approves credit risk management policies, standards, processes and new business origination within risk appetite;
• monitors effectiveness of credit risk management processes, credit risk profile and impairment charges;
• monitors scenario and sensitivity analysis, stress tests, credit economic capital and credit concentrations; and
• approves all retail and commercial credit policies.</td></tr>
<tr><td>Market and investment risk committee</td><td>• approves market and investment risk management policy, 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.</td></tr>
<tr><td>FSR Model risk and validation committee</td><td>• considers and approves all material aspects of model validation work including credit rating and estimation, internal models for market risk and advanced measurement operational risk models for the calculation of regulatory capital requirements.</td></tr>
<tr><td>Asset and liability committee</td><td>• approves and monitors effectiveness of management policies and processes for interest rate risk in the banking book and liquidity risk.</td></tr>
<tr><td>Capital management committee</td><td>• approves policies and principles relating to the management process of accounting, regulatory and economic capital; and
• approves buffers over regulatory capital and monitors capital adequacy ratios.</td></tr>
<tr><td>Operational risk committee</td><td>• monitors risk management processes, operational risk management, and effectiveness of risk management, process breakdowns and corrective actions.</td></tr>
<tr><td>Regulatory risk management committee</td><td>• approves regulatory risk management principles, frameworks, plans, policies and standards; and
• monitors the effectiveness of regulatory risk management, breaches and corrective action taken across the Group.</td></tr>
<tr><td>Tax-based risk committee</td><td>• monitors tax management processes, effectiveness of tax management process and corrective actions.</td></tr>
<tr><td></td><td>IT risk committee</td><td>• approves group-wide information and technology risk policies and standards to ensure the protection of information assets.</td></tr>
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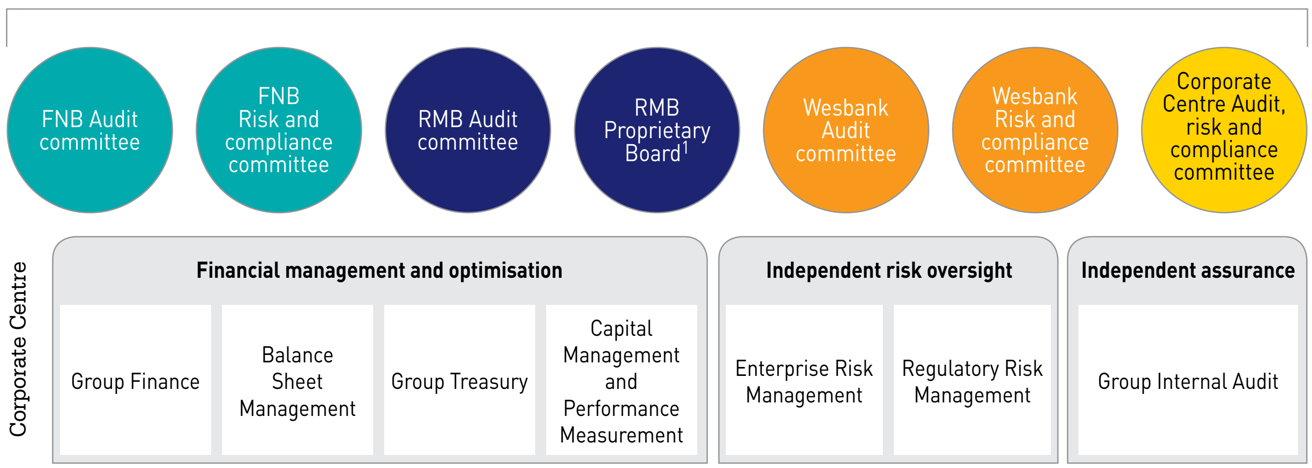
Franchise risk governance structure

Franchise committees support FirstRand in the third line of control across the Group



1. The RMB Proprietary Board is the Risk and regulatory committee for RMB.

The roles of the RCC committee and its subcommittees are further described with reference to the applicable governance structures and processes for each particular risk type in the major risk sections of this report. A number of the individual committee members are non-executive, further strengthening the Group's central, independent risk oversight and control functions.

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

REGULAR RISK REPORTING AND CHALLENGE OF CURRENT PRACTICES

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

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

6. Strategic and business risk

KEY DEVELOPMENTS AND FOCUS

Strategic and business risks	Macroeconomic and business conditions remain challenging with a fair degree of uncertainty. FirstRand continues to monitor strategic and business risks carefully in the current environment and emphasis is placed on indirect contagion that may follow from a worsening developed market sovereign debt crisis.
Environmental, social and governance or ESG risks	2011 is FirstRand's first year of detailed performance reporting against the Equator Principles. Of the 11 deals screened during the period, five were executed of which three are 'Category A' or high risk. The Group has formal governance structures in place for ensuring that risks are managed in line with the Group's predefined tolerances.

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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 thus minimising the chance of adverse outcomes occurring.

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 functions within Corporate Centre, review the external environment, industry trends, potential emerging risk factors, competitor actions and regulatory changes as part of the strategic planning process. Through this review, as well as regular scenario planning and stress-testing exercises, the risk to earnings and the level of potential business risk 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, therefore, 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 appetite and ICAAP processes.

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

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

Volume and margin risk

Volume and margin risk is considered part of strategic planning and is regularly assessed through the Group's management and governance processes and ICAAP. The manifestation of 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 cost.

The analysis of volume and margin risk is a process to determine the relationship between a fixed cost base and a variable income stream and what the impact may be if market developments lead to sudden decreases in income while costs cannot be reduced as quickly or sufficiently to offset the loss of revenue.

For capital purposes, a stress estimate is applied to the calculated cost-to-income variability of the Group (based on a historical analysis). The stressed ratio is then compared to operating income to determine whether volume and margin risk poses a significant threat to the Group's income.

Reputational risk

As a financial services provider, the Group's business is one that is inherently built on trust and close relationships with its clients. Safeguarding its reputation is therefore of paramount importance to ensure continued sustainability and is seen as the responsibility of every staff member. 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 both within and across risk types. In this respect, potential reputational risks are also taken into account as part of stress-testing exercises. The Group aims to establish a risk and earnings profile within the constraints of its risk appetite and seeks to limit potential stress losses from credit, market, liquidity or operational risks that may otherwise introduce an undesirable degree of volatility in its financial results and adversely affect its reputation.

Environmental, social and governance risk management

FirstRand has formal governance processes for managing ESG risks affecting the 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 and RCC and Audit committees.

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

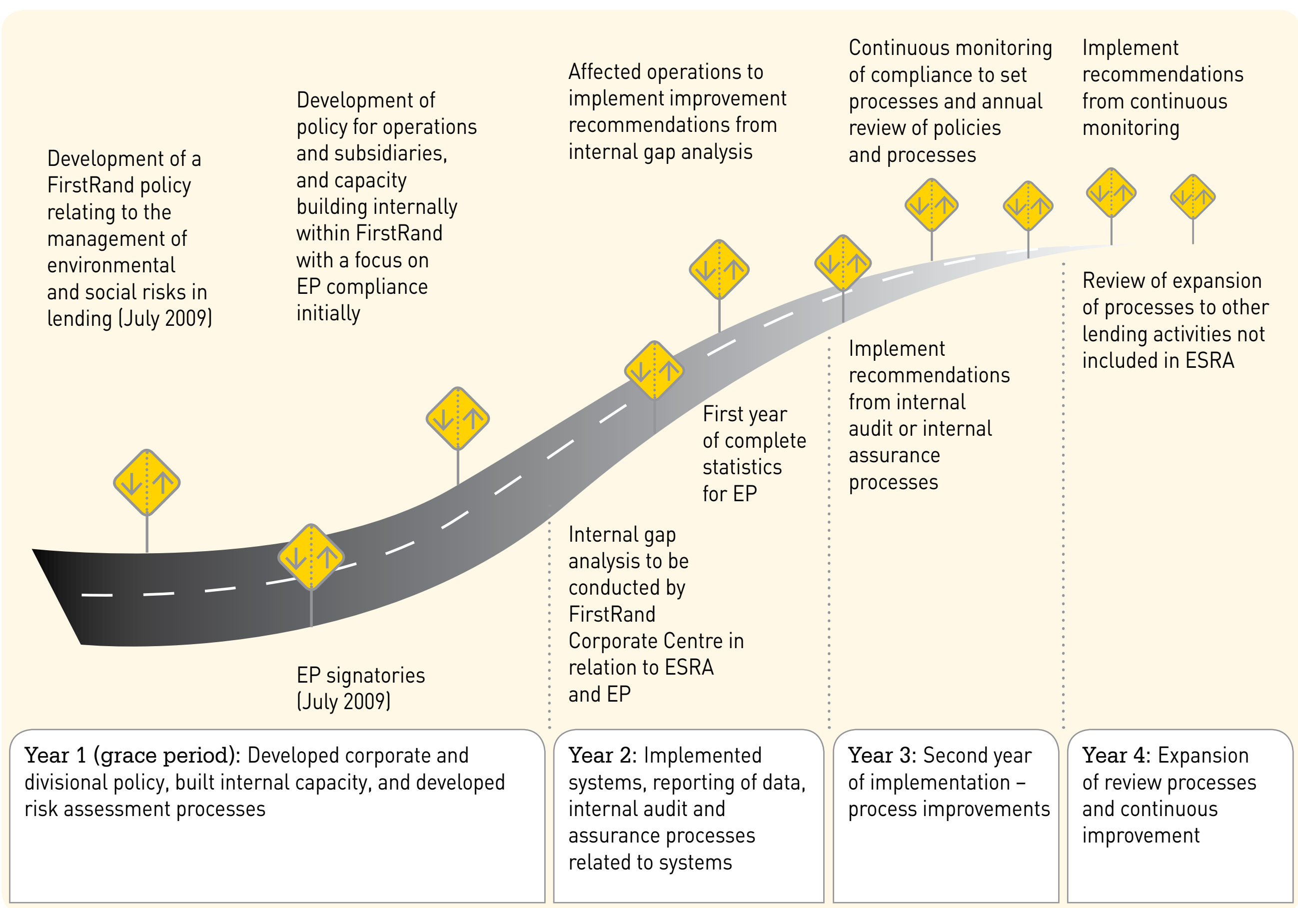
Equator Principles and environmental and social risk analysis ("ESRA")

FirstRand became an Equator Principles finance institution in July 2009. The Equator Principles ("EP") are a risk management framework for determining, assessing and managing environmental and social risks in project finance transactions. EP transactions are all structured project finance activities, as defined by Basel II, where the capital costs associated with the project are US$10 million or above.

During the 2010 financial year, FirstRand extended the ESRA practices beyond EP transactions to commercial, corporate and working capital lending activities where material environmental and social risks may exist.

Equator Principles and ESRA roadmap

FirstRand is currently in the second year of EPs implementation.



Risk and capital management report continued

2011 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.

IFC/equator category	Risks/impacts
Category A	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	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-compliances and reputational damage. Examples could include increased use of energy or increased atmospheric emissions.
Category C	Projects with minimal or no social or environmental impacts.

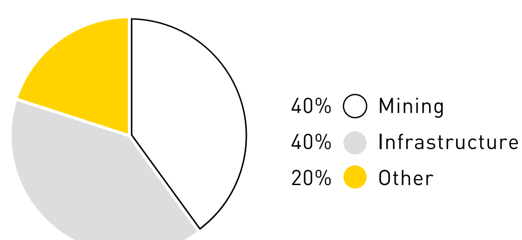
EP category	Projects receiving review at marketing or appraisal stage	Projects fully funded or executed
A (high risk)	5	3
B (medium risk)	2	–
C (low risk)	3	2
Total	10	5

The Group is confident that deals disclosed in the table above have been subjected to appropriate due diligence for environmental and social risks and that, where appropriate, mitigating action plans are in place.

Equator Principle transactions by geography and sector

All of the deals noted in the table above are southern African based projects.

Transaction by sector



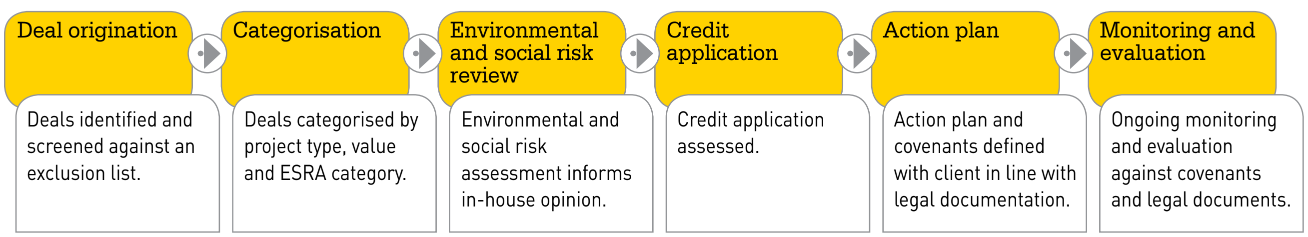
EP transactions during the period under review were categorised as falling into the mining sector, infrastructure sector, or "other" – which typically comprise deals related to large commercial property developments. This is not an unusual grouping of sectors in relation to EP due to the financial threshold associated with the EP projects, and the nature of project finance deals within these sectors.

ESRA process going forward

Each of the Group's operating franchises have formalised credit and compliance processes for the implementation of ESRA, with oversight provided by franchise risk and compliance committees, as well as affected credit committees. At a Group level oversight is provided by the RCC committee.

The ESRA implementation process is illustrated in the chart below. The first step in the process involves screening of proposed transactions against an exclusion list of activities that the Group has taken a decision not to finance. Examples include activities involving child labour, human rights abuse, illicit substances or other illegal activities.

ESRA implementation process



Although the evaluation and monitoring of EP transactions is embedded across the Group, continued focus will be given to both awareness training and the effective implementation of the ESRA process. The Waste Management Act is an area of integration into the ESRA processes which will be a focus going forward, particularly as it relates to the review of contamination risk in property financed or taken as security.

For more detail on the EP and ESRA processes please visit www.firstrand.co.za

Capital management

KEY DEVELOPMENTS AND FOCUS

Capital management continues to focus on maintaining strong capital levels, with a particular focus on the quality of capital. This is reflected in the Tier 1 ratios of the Bank and the Group, which remained above targeted levels throughout the year. Tier 1 continued to exceed economic capital requirements for a range of normal and severe scenarios as well as for stress events.

In the last 12 months the Group's core ratio has benefited from several windfalls, the largest of which arose from the sale of OUTsurance. Detailed capital forecasts that include the domestic growth requirements as well as international expansion requirements and proposed regulatory changes have been considered for the next three years. The Group is confident that these windfalls are surplus to the Group's needs and thus a special dividend is declared to return this excess to shareholders. This dividend was paid in October 2011.

The Group currently finds itself in an environment of significant regulatory uncertainty. The final Basel III framework released in December 2010, although comprehensive, left a number of key issues unresolved. These guidelines are yet to be incorporated into the South African Reserve Bank ("SARB") regulations. Guidance is expected from the Regulator during the first quarter of 2012. The Group continues to participate in the six-monthly Basel Committee on Banking Supervision's ("BCBS") quantitative impact study, with updated calculations showing that the Bank and the Group will continue to operate above the current regulatory minimum and internal minimum requirements. Although the Basel III proposals have not yet been outlined in the domestic regulations, the Group has increased the targeted capital levels in anticipation of the implementation of Basel III.

Performance measurement is on a risk-adjusted basis and is continually enhanced to drive the desired behaviour. Economic profit or net income after capital charge ("NIACC") is embedded in the management of the business. For the year ended 30 June 2011, the Group achieved positive NIACC and generated value for shareholders.

Risk and capital management report continued

INTRODUCTION AND OBJECTIVES

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 allow it to 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 its operations and the interests of its stakeholders are therefore maintained. In this respect, the overall capital management objective is to maintain sound capital ratios and a strong credit rating to ensure confidence in the solvency and quality of capital in the Group during calm and turbulent periods in the economy and the financial markets.

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

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 a key focus area. Sound capital management practices, therefore, form an important component of its overall business strategy. Moreover, performance measurement is aligned with the allocation of risk and continually enhanced to drive the desired behaviour.

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

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

In the last 12 months FirstRand's core capital has benefited from several windfalls, the largest of which arose from the sale of OUTsurance. Detailed capital forecasts that include the domestic growth requirements as well as international expansion requirements and proposed regulatory changes have been considered for the next three years. The Group is confident that these windfalls are surplus to the Group's needs and thus a special dividend of 70 cents per share is declared to return this excess to shareholders.

CAPITAL ADEQUACY AND PLANNING

The year under review

The capital planning process ensures that the total capital adequacy and Tier 1 ratios remain within the approved ranges or above target levels across the economic and business cycles. FirstRand is appropriately capitalised under a range of normal and severe scenarios as well as a range of stress events.

The Group currently finds itself in an environment of significant regulatory uncertainty. Although many of the Basel III changes have been finalised, these proposals are yet to be outlined in the domestic regulations. Targeted ranges have been increased in anticipation of the implementation of Basel III even though the levels in South Africa are not yet finalised. The current approach to capital levels is conservative and the Group would prefer to maintain strong capital ratios at the upper end of its targeted band.

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

FirstRand operated above its targeted capitalisation range with a total capital adequacy of 16.5% and solid Tier 1 ratio of 15.0%. Similarly the Bank, excluding subsidiaries and branches, comfortably operated above its target with a total capital adequacy of 14.2% and Tier 1 ratio of 12.4%.

Regulatory developments

The SARB has issued a set of draft regulations which cover the revised market risk and securitisation proposals as per Basel 2.5, as well as introducing a scalar for credit risk. These regulations will be implemented at the beginning of 2012. The draft regulations currently do not make provision for the proposed Basel III framework discussed below.

Enhancements to the Basel II framework ("Basel 2.5")

The BCBS introduced enhancements to the market risk and securitisations framework, effective 1 January 2012. These revisions incorporate new capital requirements to include the effects of stressed markets (stressed Value-at-Risk "VaR"), an incremental risk charge for default and rating migration risk of trading book positions and higher risk weightings for resecuritised exposures.

Basel III

The final Basel III framework "A global regulatory framework for resilient banks and banking systems" was issued in December 2010. The new regulations will be phased in from 1 January 2013 onwards with full compliance of capital levels (including buffers) by 1 January 2019.

Quantitative impact studies are currently being completed by regulators to assess the impact of the new Basel III rules. This exercise will be performed every six months. The Group has been involved in this exercise and current calculations result in lower Tier 1 and total capital adequacy ratios for the Group. However, both FirstRand and the Bank will remain above the current regulatory minimum and internal minimum requirements. The targeted levels may be further revisited once the Basel III proposals are incorporated into the SARB regulations. The Group expects further guidance from the SARB during the first quarter of 2012.

Supply of capital – Tier 1

The Group aims to back all economic risks with Tier 1 capital as it offers the greatest capacity to absorb losses. Consequently, required Tier 1 capitalisation levels are used as the primary driver of performance measurement across the various businesses. Tier 1 capitalisation ratios benefited from strong internal capital generation through earnings as well as realising once-off profits from the sale of investments in OUTsurance and Visa Inc.

Supply of capital – Tier 2

The uncertainty around the Basel III eligibility criteria of Tier 2 instruments made the issuance of these instruments unattractive during the year under review. The Group continues to investigate ways of optimising its capital base and will review the viability of Tier 2 instruments once the Basel III proposals have been incorporated into the SARB regulations.

On 16 August 2010, SARB approval was received to call the FRB01 and FRB02 subordinated debt instruments on 31 August 2010. The table below provides more detail on the Group's capital instruments at 30 June 2011.

Characteristics of capital instruments (unaudited unless otherwise indicated)

Capital type	Instrument	Nominal R million	Actual R million	Rate type	Coupon rate	Maturity date
Other Tier 1	Non-cumulative non-redeemable ("NCNR") preference share capital*	4 519	4 519	Floating	68% of prime	Perpetual
Upper Tier 2	FRBC21	628	601	Fixed	12%	21 Dec 2018
	FRBC22	440	441	Floating	3 month JIBAR + 300bps	21 Dec 2018
Lower Tier 2 (Subordinated debt)	FRB03	1 740	1 788	Fixed	9%	15 Sept 2014
	FRB05	2 110	2 032	Fixed	9%	21 Dec 2018
	FRB06	1 000	1 020	Floating	3 month JIBAR + 65bps	5 Nov 2012
	FRB07	300	304	Floating	3 month JIBAR + 65bps	6 Dec 2012
	FRB08	100	102	Floating	3 month JIBAR + 70bps	10 Jun 2016
	FRB09	100	102	Floating	3 month JIBAR + 70bps	10 Jun 2017
	FNBB001	104	104	Fixed	11%	1 Dec 2011
	FNB17	260	260	Fixed	9%	29 Mar 2012

** Audited.*

Demand for capital

Capital requirements expressed as a percentage of risk-weighted assets ("RWA") remain risk sensitive and cyclical under Basel II. This cyclicality, particularly for credit, is less evident at this point in the cycle.

FirstRand's RWA increased marginally during the year driven mostly by requirements in the Bank. The Bank's overall RWA increase was due to credit risk volume growth. The increase in market risk and operational risk was offset by lower equity investment risk, which was mainly the result of the sale of investment in Visa Inc and the sale of subsidiaries from the Bank to FRIHL (as part of the Group restructure).

Risk and capital management report continued

Regulatory capital

The targeted capital levels, which have been increased, as well as the current ratios at 30 June 2011 are summarised in the table below.

Capital adequacy position

%	FirstRand Actual	FirstRand Target	FirstRand Bank* Actual	FirstRand Bank* Target	Regulatory minimum
Capital adequacy ratio	16.5	12.0 – 13.5	14.2	11.5 – 13.0	9.5#
Tier 1 ratio	15.0	11.0	12.4	10.5	7.0
Core Tier 1 ratio	13.8	9.5 – 11.0	11.4	9.0 – 10.5	5.25

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

The following table shows the composition of regulatory capital for FirstRand at 30 June 2011, while the subsequent tables provide a breakdown of RWA and capital requirement.

Composition of qualifying capital and capital ratios (unaudited unless otherwise indicated)

R million	FirstRand At 30 June 2011	%
Ordinary shareholders equity as per IFRS*	56 631	
Less: non-qualifying reserves*	(2 954)	
Cash flow reserve*	451	
Available-for-sale reserve*	(225)	
Share-based payment reserve*	(2 739)	
Foreign currency translation reserve*	(474)	
Other reserves*	33	
Ordinary shareholders equity qualifying as capital	53 677	
Ordinary share capital and share premium*	4 998	
Reserves	48 679	
Non-controlling interests	3 069	
NCNR preference shares*	4 519	
Less: total impairments	(3 521)	
Excess of expected loss over eligible provisions (50%)	(907)	
First loss credit enhancements in respect of securitisation structures (50%)	(247)	
Goodwill and other impairments	(2 367)	
Total Tier 1 capital	57 744	15.0
Upper Tier 2 instruments	1 042	
Tier 2 subordinated debt instruments	5 712	
Other reserves	202	
Less: total impairments	(1 154)	
Excess of expected loss over eligible provisions (50%)	(907)	
First loss credit enhancements in respect of securitisation structures (50%)	(247)	
Total Tier 2 capital	5 802	1.5
Total qualifying capital and reserves	63 546	16.5

** Audited.*

RWA by risk type (unaudited)

R million	FirstRand At 30 June 2011 RWA	FirstRand At 30 June 2011 Capital requirement*
Credit risk	258 589	24 566
Operational risk	63 649	6 046
Market risk	17 311	1 645
Equity investment risk	20 605	1 957
Other risk	25 036	2 378
Total RWA	**385 190**	**36 592**

** Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.*

RWA calculation approach for each risk type

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

RWA calculation approach for each risk type

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

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

R million	June 2011
Credit risk	**258 589**
AIRB approach	226 678
Corporate, banks and sovereigns	92 642
Small and medium enterprises ("SME")	37 584
Residential mortgages	42 388
Qualifying revolving retail	9 003
Other retail	40 481
Securitisation exposure	4 580
Standardised approach	31 911
Equity investment risk	20 605
Simple Risk Weighted method	10 460
Listed	2 914
Unlisted	7 546
Standardised approach	10 145

R million	June 2011
Operational risk	63 649
Standardised approach	9 110
AMA	50 438
Basic Indicator approach	4 101
Market risk*	17 311
Internal Model approach	7 016
Standardised approach	10 295
Other risk	25 036
Standardised approach	25 036
Total RWA	385 190

** Includes banking and trading book.*

Risk and capital management report continued

The following table shows the composition of regulatory capital for the Bank at 30 June 2011, while the subsequent tables provide a breakdown of RWA and capital requirement.

Composition of qualifying capital and capital ratios of FirstRand Bank (unaudited unless otherwise indicated)

	FirstRand Bank*			
R million	June 2011	%	June 2010	%
Ordinary shareholders equity as per IFRS**	37 965		33 085	
Less: non-qualifying reserves**	(333)		(477)	
Cash flow reserve**	452		466	
Available-for-sale reserve**	(443)		(532)	
Share-based payment reserve**	(342)		(411)	
Ordinary shareholders equity qualifying as capital	37 632		32 608	
Ordinary share capital and share premium**	11 459		10 969	
Reserves	26 173		21 639	
NCNR preference shares**	3 000		3 000	
Less: total impairments	(3 295)		(2 323)	
Excess of expected loss over eligible provisions (50%)	(907)		(379)	
First loss credit enhancements in respect of securitisation structures (50%)	(71)		(45)	
Qualifying capital in branches	(1 732)		(1 732)	
Other impairments	(585)		(167)	
Total Tier 1 capital	**37 337**	**12.4**	33 285	11.7
Upper Tier 2 instruments	1 042		1 068	
Tier 2 subordinated debt instruments	5 349		5 914	
Less: total impairments	(978)		(424)	
Excess of expected loss over eligible provisions (50%)	(907)		(379)	
First loss credit enhancements in respect of securitisation structures (50%)	(71)		(45)	
Total Tier 2 capital	**5 413**	**1.8**	6 558	2.3
Total qualifying capital and reserves	**42 750**	**14.2**	39 843	14.0

** Reflects solo supervision, i.e. the Bank excluding branches, subsidiaries and associates.*
*** Audited.*

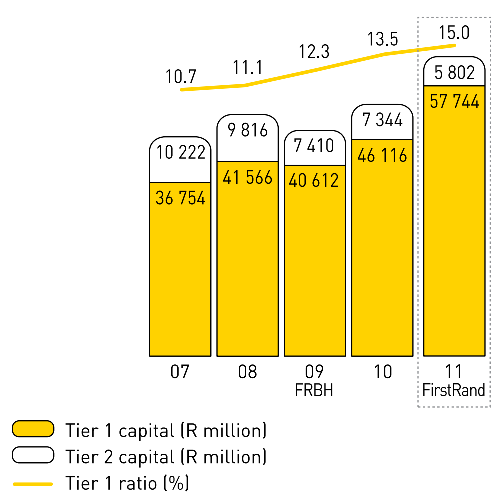
RWA by risk type of FirstRand Bank (unaudited)

	FirstRand Bank*			
	June 2011		June 2010	
R million	RWA	Capital requirement**	RWA	Capital requirement**
Credit risk	**226 678**	**21 534**	210 328	19 981
Operational risk	**42 659**	**4 053**	38 223	3 631
Market risk	**7 016**	**667**	4 669	444
Equity investment risk	**10 460**	**994**	16 835	1 599
Other risk	**14 027**	**1 333**	13 690	1 301
Total RWA	**300 840**	**28 581**	283 745	26 956

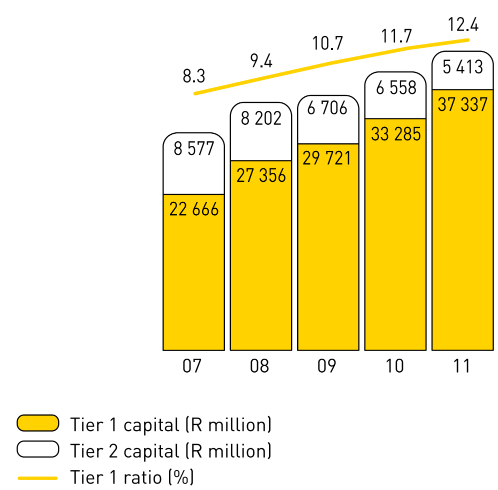
* *Reflects solo supervision, i.e. the Bank excluding branches, subsidiaries and associates.*
** *Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.*

The graphs below provide a historical overview of the capital adequacy for FirstRand and the Bank.

FirstRand regulatory capital position (unaudited)



FirstRand Bank regulatory capital position (unaudited)



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

Risk and capital management report continued

Capital adequacy position for FirstRand and its subsidiaries

Based on the outcome of detailed stress testing each entity targets a capital level in excess of the regulatory minimum. Capital generated by subsidiaries in excess of targeted levels is returned to FirstRand, usually in the form of dividends. During the year under review, no significant restrictions were experienced on the repayments of such dividends or capital to the Group.

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

RWA and capital adequacy position for FirstRand and its subsidiaries

	June 2011		June 2010	
	RWA R million	Total capital adequacy %	RWA R million	Total capital adequacy %
Basel II				
Bank controlling company*	**385 190**	**16.5**	341 608	15.6
FirstRand Bank South Africa	**300 840**	**14.2**	283 745	14.0
FirstRand Bank London	**4 718**	**12.5**	5 210	12.8
FirstRand Bank India	**1 296**	**43.0**	241	247.5
FirstRand Ireland	**496**	**24.9**	5 042	31.0
RMB Australia	**5 476**	**24.0**	4 887	21.5
FNB Namibia**	**11 230**	**16.6**	9 910	20.1
Basel I**				
FNB Botswana	**7 678**	**15.7**	6 834	17.4
FNB Lesotho	**236**	**20.0**	228	17.9
FNB Mozambique	**646**	**16.6**	699	12.9
FNB Swaziland	**1 525**	**24.2**	1 467	20.9
FNB Zambia	**348**	**33.0**	173	64.5

* *Effective 1 July 2010, FirstRand became the new regulated entity. Prior to 1 July 2010, FRBH was the bank controlling company. The registered banks in FirstRand must comply with the SARB regulations and those of their home regulators.*

** *Ratios based on local rules.*

Economic capital

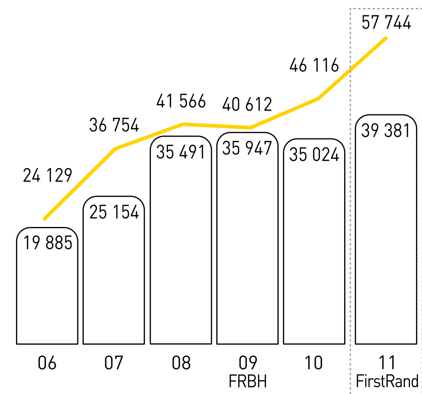
In addition to the regulatory capital requirements disclosed in the previous section, economic capital requirements are also calculated on the basis of a number of internally developed models. Economic capital is defined as the level of capital that must be held commensurate with the Group's risk profile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

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

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

The graph below provides an overview of the evolution of economic capital requirements and Tier 1 capital for the Group.

Economic capital (unaudited)



Economic capital required
Tier 1 capital

NORMALISED RETURN ON EQUITY

The Group achieved a normalised ROE for continuing operations of 18.7% compared to 17.7% for the prior year.

The Group's total normalised ordinary shareholders' equity and reserves (excluding non-controlling interests) totalled R58 858 million as at 30 June 2011 (2010: R49 382 million). The average ordinary shareholders' equity and reserves for the year amounted to R54 120 million (2010: R46 774 million). Ordinary shareholders equity comprises share capital and premium, distributable and non-distributable reserves.

ECONOMIC PROFIT

The Group's performance measures are aligned with risk considerations.

The use of economic profit or net income after capital charge ("NIACC") is embedded across the businesses and management culture. As a function of the normalised earnings and capital utilised in the businesses, economic profit provides a clear indication of the economic value added by a transaction or business unit. Positive internal capital generation through earnings and a consistent cost of equity produced economic value for shareholders during the year under review. The following table and chart provide an overview of the relevant calculation and the creation of economic profit over time for continuing operations of FirstRand on a normalised basis.

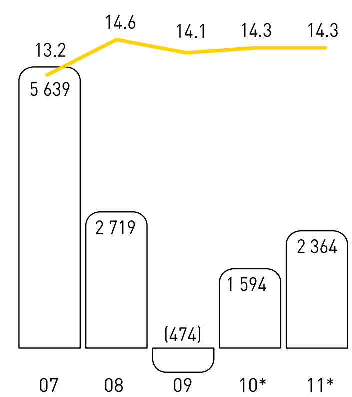
Economic profit and normalised ROE (unaudited)

R million	2011	2010
Normalised earnings attributable to ordinary shareholders	**10 117**	8 283
Charge for capital*	**(7 753)**	(6 689)
Net economic profit**	**2 364**	1 594
Average ordinary shareholders' equity and reserves	**54 120**	46 774
Return on average ordinary shareholders' equity and reserves (%)	**18.7**	17.7
Average cost of equity	**14.3**	14.3

* *Capital charge based on average cost of capital.*

** *Economic profit = normalised earnings-(average cost of equity x average ordinary shareholders' equity and reserves).*

Evolution of economic profit and cost of equity



Economic profit (R million)
Average cost of equity (%)

** June 2010 onwards restated for continuing operations.*

Risk and capital management report continued

Credit risk

KEY DEVELOPMENTS AND FOCUS

During the year under review the Group continued to refine the credit risk appetite framework to ensure that corresponding origination strategies are aligned with and remain within the risk appetite. The Group further focused on strengthening its credit risk management and governance including enhancements to the Group's impairment framework and the retail credit portfolio governance structure; and renewed focus on economic capital measurement with the aim of further integrating this into business processes going forward.

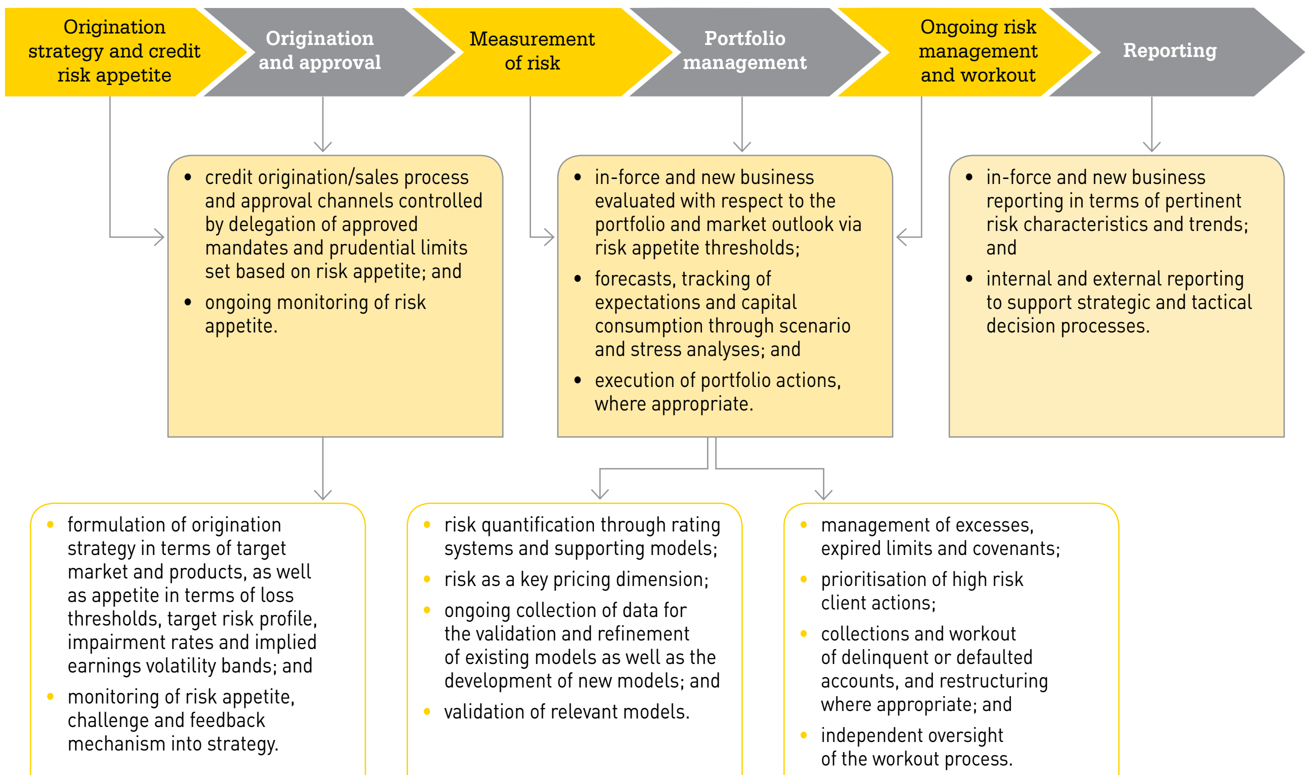
INTRODUCTION AND OBJECTIVES

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

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

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

Scope of credit risk management and identification practices



ORGANISATIONAL STRUCTURE AND GOVERNANCE

The RCC committee and franchise Exco's 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, the CRMF is a policy of the Board and a sub-framework of the BPRMF.

The credit-focused board committees, namely the FirstRand Credit committee, the Large exposures credit committee and the Model risk and validation committee ("MRVC"), as well as the FirstRand Credit risk management committee (a subcommittee of the RCC committee), support the RCC committee in its task. For a description of the role and responsibilities of these committees refer to the *governance structure* on page 127.

The Group Credit Risk Management function

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

- active participation in the formulation of credit and origination strategies, in particular with a view to the implementation and management of the Group's credit risk appetite across the business units;
- credit risk-related stress testing and scenario analysis;
- monitoring the credit components of the risk appetite framework;
- monitoring and reporting the credit risk profile and default experience;
- quantification of credit economic capital, including the credit risk assessment employed for ICAAP;
- reviewing all credit rating systems and independent revalidation of credit rating systems;

Risk and capital management report continued

- management of relationships with external stakeholders such as relevant regulators with respect to credit matters;
- oversight of the credit impairment process; and
- consolidated regulatory reporting.

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

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

To support GCRM in the oversight of credit risk management, the Performance Measurement function in the Corporate Centre performs certain functions with respect to credit risk. Its tasks include the assessment, analysis, forecasting and reporting of impairments, and credit risk reporting to stakeholders such as the Credit risk management committee.

ASSESSMENT AND MANAGEMENT

Calculation of internal ratings and rating process

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

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

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

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

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

Management of the credit portfolio is heavily reliant on these three credit risk measures. PD, EAD and LGD are inputs into the portfolio and Group-level credit risk assessment where the measures are combined with estimates of correlations between individual counterparties, 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 year and is a measure of the counterparty's ability and willingness to repay facilities granted to it. A default, in this context, is defined along two dimensions:

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

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

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

FR rating	Midpoint PD	International scale mapping*
FR 1 – 12	0.04%	AAA, AA, A
FR 13 – 25	0.27%	BBB
FR 26 – 32	0.77%	BB+, BB
FR 33 – 37	1.34%	BB-
FR 38 – 48	2.15%	B+
FR 49 – 60	3.53%	B+
FR 61 – 83	6.74%	B
FR 84 – 91	15.02%	B-
FR 92 – 94	60.46%	Below B-
FR 95 – 100	100%	D (defaulted)

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

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

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

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

Exposure at default

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

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

Loss given default

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

In most portfolios, LGD is strongly dependent on:

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

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

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

Expected loss ("EL")

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

Specialised lending

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.

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

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

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.

Risk and capital management report continued

Credit portfolio rating process

Portfolio and type of exposures	Description of rating system
Large corporate portfolios (Wholesale: FNB Corporate, WesBank Corporate, Corporate Centre and RMB) Exposures to private sector counterparties including corporates and securities firms and public sector counterparties. A wide range of products give rise to credit exposure, including loan facilities, structured finance facilities, contingent products and derivative instruments	The default definitions applied in the rating systems are aligned to Basel II 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 FirstRand Credit committee and the rating (and associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee. • LGD and EAD estimates are based on modelling of a combination of internal and suitably adjusted international data.
Low default portfolios: sovereign and bank exposures (Wholesale: FNB Corporate, Corporate Centre and RMB) Exposures to sovereign and bank counterparties.	The default definitions applied in the rating systems are aligned to Basel II 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 FirstRand Credit committee and the rating (as well as the associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee.
Specialised lending portfolios (Wholesale: FNB Corporate, RMB and FNB Commercial) Exposures to private-sector counterparties for the financing of income-producing real estate.	The default definitions applied in the rating systems are aligned to the requirements of Basel II. **Rating process:** • The rating system is based on hybrid models using a combination of statistical cash flow simulation models and qualitative scorecards calibrated to a combination of internal data and external benchmarks. • The rating assessment is reviewed by the FirstRand Credit committee and the rating (as well as the associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee.
Commercial portfolio (SME corporate and SME retail counterparties in FNB Commercial and WesBank) Exposures to SME clients. A wide range of products give rise to credit exposure, including loan facilities, contingent products and term-lending products.	The default definitions applied in the rating systems are aligned to Basel II 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. • LGD and EAD estimates are applied on a portfolio level, estimated from internal historical default and recovery experience. **SME corporate rating process:** • PD: Counterparties are scored using Moody's RiskCalc, the output of which 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 II guidelines. • EAD: Portfolio level credit conversion factors ("CCFs") are estimated on the basis of the Group's internal historical experience and benchmarked against international studies.

<table>
<tr><th>Portfolio and type of exposures</th><th>Description of rating system</th></tr>
<tr><td>Residential mortgages (Retail portfolios in FNB HomeLoans, RMB Private Bank exposures and mortgage exposures in the Mass segment)
Exposures to individuals for the financing of residential properties.</td><td rowspan="3">The default definition applied in the rating systems is aligned to the requirements of Basel II.
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 pertinent business reasons.
• LGD and EAD estimates are based on subsegmentation with reference to the collateral or product type as well as associated analyses and modelling of historical internal loss data.
Additional notes on qualifying revolving retail exposures:
• These exposures are unsecured and therefore only the efficiency of recovery processes impacts on the level of LGD.
• EAD measurement plays a significant role in the assessment of risk due to the typically high level of undrawn facilities that are characteristic of these product types. EAD estimates are based on actual historic EAD, segmented appropriately (e.g. straight vs. budget in the case of credit cards).</td></tr>
<tr><td>Qualifying revolving retail exposures (Retail portfolios in FNB Card, FNB Consumer overdrafts and RMB Private Bank)
Exposures to individuals providing a revolving limit through a credit card or overdraft facility.</td></tr>
<tr><td>Other retail exposures (Retail portfolios in FNB Personal loans, Smart products and WesBank Retail auto finance and Personal 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 the prudent choice of model parameters and the inclusion of downturn periods such as 2001 and 2007 – 2009 in calibration.

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 actuarial auditing team in GIA carries out additional reviews of the rating systems, as well as sample revalidations. The results of these analyses are reported to MRVC. As part of this process, extensive documentation covering all steps of the model development lifecycle from inception through to validation is maintained. This includes:

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

Credit risk mitigation

Since the taking and managing of credit risk is core to the Group's business, it 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.

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

- mortgages and instalment sale finance are secured by the financed assets;
- personal loans, overdrafts and credit card exposures are unsecured or secured by guarantees and suretyships;
- FNB Commercial credit facilities are secured by the assets of the SME counterparties, and commercial property transactions are typically supported by the financed property and associated cash flows;
- working capital facilities in FNB Corporate are often not secured by claims on specific assets, but risk in structured

Risk and capital management report continued

facilities granted by RMB is mitigated by financial or other collateral such as guarantees or credit derivatives; and
- credit risk in RMB's Fixed Income, Currency and Commodities ("FICC") business is mitigated through the use of netting agreements and financial collateral.

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

Management of concentration risk

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

In the wholesale credit portfolio, through:

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

In the commercial portfolios through:

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

Monitoring of weak exposures

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

Across the wholesale credit portfolios:

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

In retail credit portfolios:

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

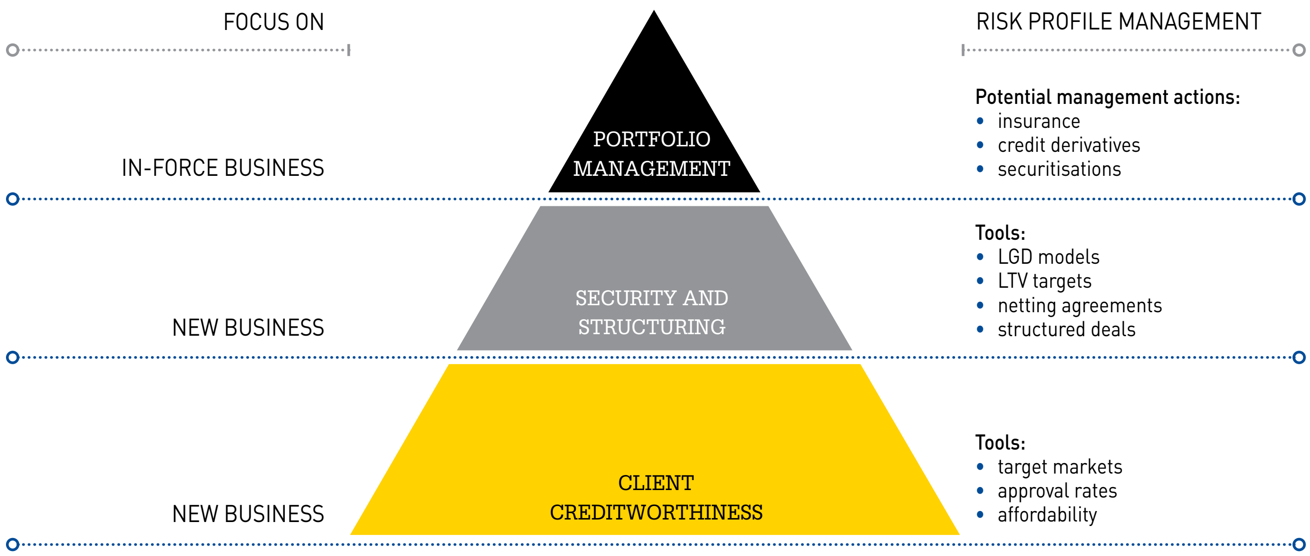
Commercial and other portfolios of clients that fall between the corporate and retail segments are treated in a hybrid manner, dependent on the number of exposures and the size of individual transactions.

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

Use of credit risk tools and measures

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

Use of credit risk tools and measures



Risk and capital management report continued

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

Use of credit measures in the credit lifecycle

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

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 on pages 171).

The Group's credit origination strategies, combined with the series of interest rate reductions from 2008 into 2010, have facilitated a reduction in new NPL inflows and credit impairment charges in most retail portfolios. These portfolios were also positively impacted by positive income growth and increased wages.

Although investment spending by business remains subdued, advances growth in the wholesale portfolios remained resilient over the reporting period mainly due to the approval of new investment-grade deals.

Retail credit portfolios

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

Wholesale portfolios

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

Credit assets

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

Credit assets by type and segment (audited)

R million	2011	2010
Cash and short-term funds	29 239	22 707
Money at call and short notice	1 371	2 136
Balances with central banks and guaranteed by central banks	15 660	11 513
Balances with other banks	12 208	9 058
Gross advances	472 615	443 750
FNB[1]	208 680	199 113
FNB Retail	174 906	168 802
FNB Corporate[2]	3 003	2 133
FNB Commercial	30 771	28 178
WesBank	102 125	92 724
RMB	130 958	130 312
FNB Africa	22 639	19 645
Other	8 213	1 956
Derivatives	37 206	39 764
Debt investment securities (excluding non-recourse investments)	89 280	90 275
Accounts receivable	7 289	5 706
Loans to Insurance Group	–	5 428
Reinsurance assets	484	524
Credit risk not recognised on the balance sheet	95 852	84 024
Guarantees	24 727	24 036
Acceptances	289	299
Letters of credit	6 331	5 541
Irrevocable commitments	63 298	52 809
Credit derivatives	1 207	1 339
Total	731 965	692 178

1. Certain portfolios have been restated to reflect the current segmentation of the business.
2. Includes public sector.

Risk and capital management report continued

Reconciliation of gross advances to net advances

R million	2011	2010
Gross advances after interest in suspense	472 615	443 750
Consolidation adjustment	–	15
	472 615	443 765
Less total impairments (refer note 10 of the annual integrated report	(8 022)	(8 972)
Net advances	464 593	434 793

For further information on the fair value of investment securities refer to note 38 of the consolidated financial statements – *Investment securities and other investments.*

Credit quality

Advances are considered past due where a specific payment date was not met, or where regular instalments are required and such payments were not received. A loan payable on demand is classified as overdue where a demand for repayment was served but repayment was not made in accordance with the stipulated requirements.

The following tables provide the age analyses of loans and advances for the Group.

Age analysis of advances (audited)

	2011						
			Past due but not impaired				
R million	Neither past due nor impaired	Renegotiated but current	1 – 30 days	31 – 60 days	61 – 90 days	Impaired	Total
FNB Retail	153 630	474	5 439	2 633	1 359	11 371	174 906
FNB Corporate[1]	2 983	–	–	–	–	20	3 003
FNB Commercial	28 604	–	165	106	31	1 865	30 771
FNB	185 217	474	5 604	2 739	1 390	13 256	208 680
WesBank	93 879	–	2 812	978	89	4 367	102 125
FNB Africa	21 824	7	326	48	64	370	22 639
RMB[2]	126 752	3 094	12	7	–	1 093	130 958
Other	8 213	–	–	–	–	–	8 213
Total	435 885	3 575	8 754	3 772	1 543	19 086	472 615

1. Includes public sector.

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

Age analysis of advances (audited) continued

	2010						
			Past due but not impaired				
R million	Neither past due nor impaired	Renego-tiated but current	1 – 30 days	31 – 60 days	61 – 90 days	Impaired	Total
FNB Retail	144 200	783	5 773	2 701	1 717	13 628	168 802
FNB Corporate[1]	2 132	–	–	–	–	1	2 133
FNB Commercial	25 945	–	261	34	21	1 917	28 178
FNB[2]	172 277	783	6 034	2 735	1 738	15 546	199 113
WesBank	85 284	–	1 577	647	118	5 098	92 724
FNB Africa	17 269	–	1 149	459	361	407	19 645
RMB[3]	129 409	1	31	17	6	848	130 312
Other	1 928	–	–	–	–	28	1 956
Total	406 167	784	8 791	3 858	2 223	21 927	443 750

1. Includes public sector.

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

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

Renegotiated advances

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

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

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

Past due but not impaired

The classification of advances as past due but not impaired follows the standards set out in applicable accounting policies; refer to accounting policy note 15. Advances past due not impaired in the tables above include two types of arrear accounts. These are normal arrears (i.e. accounts in arrears by one up to three full repayments) and technical arrears (e.g. accounts in arrears due to partial payment of the instalment due). Normal arrears are split into the three time buckets provided in the tables above, whereas the majority of technical arrears are in the 1 – 30 days bucket. Exposure to technical arrears of R3.7 billion (2010: R4.5 billion) was included in the advances past due but not impaired total of R14.2 billion (2010: R14.9 billion) and was primarily driven by retail exposures.

Risk and capital management report continued

Credit quality of performing advances (audited)

	2011							
R million	Total neither past due nor impaired	FNB Retail	FNB Corporate[1]	FNB Commercial	WesBank	RMB	FNB Africa	Other
FR 1 – 25	91 994	5 241	257	307	3 373	74 977	224	7 615
FR 26 – 91	320 474	140 543	2 726	25 295	82 434	48 739	20 165	572
Above FR 92	23 417	7 846	–	3 002	8 072	3 036	1 435	26
Total	**435 885**	**153 630**	**2 983**	**28 604**	**93 879**	**126 752**	**21 824**	**8 213**

1. Includes public sector.

	2010							
R million	Total neither past due nor impaired	FNB[1] Retail	FNB[1] Corporate[2]	FNB[1] Commercial	WesBank	RMB	FNB Africa	Other
FR 1 – 25	76 494	4 855	173	2 311	801	67 607	59	688
FR 26 – 91	307 639	129 754	1 946	22 792	74 824	60 374	16 721	1 228
Above FR 92	22 034	9 591	13	842	9 659	1 428	489	12
Total	406 167	144 200	2 132	25 945	85 284	129 409	17 269	1 928

1. Certain portfolios have been restated to reflect the current segmentation of the business.
2. Includes public sector.

Both prior and subsequent to the implementation of recalibrations, the risk profile improved and PDs decreased consistently, due to positive risk migration, with the lower interest rate environment positively impacting the existing portfolio. In addition, stricter lending criteria resulted in higher quality new business being written. Monthly trend analyses from July 2010 to June 2011 show a once-off increase in PDs, due to the recalibrations, thereafter a consistent decrease due to the positive risk migration.

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) neither past due nor impaired (audited)

	2011					
R million	Investment securities*	Derivatives	Cash and short-term funds	Loans to Insurance Group	Re-insurance assets	Total
AAA to BBB	43 284	10 767	27 745	–	484	82 280
BB, B	45 876	26 046	1 159	–	–	73 081
CCC	–	85	–	–	–	85
Unrated	120	308	335	–	–	763
Total	89 280	37 206	29 239	–	484	156 209

** Excludes non-recourse investments.*

	2010					
R million	Investment securities*	Derivatives	Cash and short-term funds	Loans to Insurance Group	Re-insurance assets	Total
AAA to BBB	42 954	18 847	19 896	5 428	524	87 649
BB, B	46 023	20 111	2 513	–	–	68 647
CCC	–	108	76	–	–	184
Unrated	1 298	698	222	–	–	2 218
Total	90 275	39 764	22 707	5 428	524	158 698

** Excludes non-recourse investments.*

Risk and capital management report continued

Impairment of financial assets and NPLs

Refer to the policy for *impairment of financial assets* in the accounting policy section on page 209 and to note 11 *Impairment of advances* of the annual integrated report for the analysis of movement in 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, the creation of impairments for these differs.

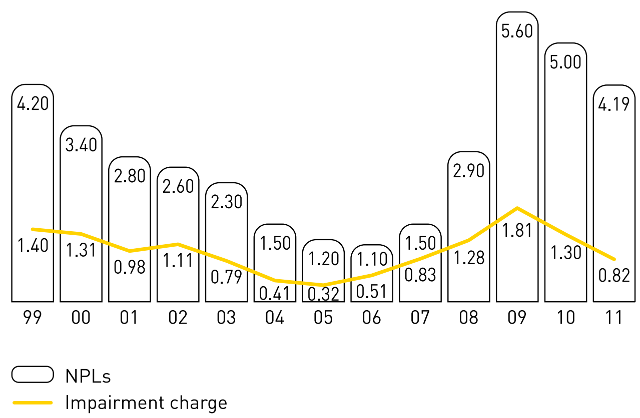
For amortised cost advances, impairments are recognised through the creation of an impairment reserve and an impairment charge in the income statement. For fair value advances, the credit valuation adjustment is charged to the income statement through trading income and recognised as a change to the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

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

All assets not individually impaired, as described, are included in portfolios with similar credit characteristics (homogeneous pools) and are collectively assessed. Portfolio impairments are created with reference to these performing advances based on historical patterns of losses in each part of the performing book. Points of consideration for this analysis are the level of arrears, arrears roll rates, PIT PDs, LGDs and the economic environment. Loans considered 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 graph below shows the history of the credit losses reflected by the impairment charge and NPLs percentages.

NPLs and impairment history (%) (unaudited)



Impairment charges are reflected before insurance proceeds where applicable.

Fair value sensitivity of wholesale advances due to credit risk

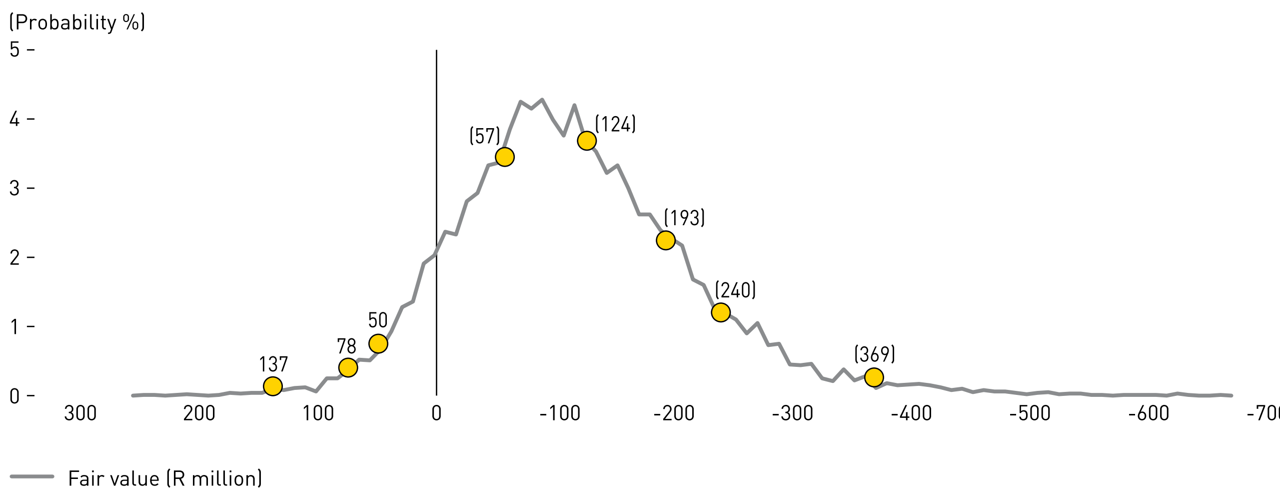
The Investment Banking division within RMB recognises a significant portion of the wholesale advances at fair value through profit or loss. The fair value adjustments made to these advances directly impact the income statement and the value of the advance. For risk management purposes a migration matrix 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:

- downgrades are more realistic because better rating grades are less likely to be downgraded compared to riskier rating grades;
- migration matrices 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.

The graph below 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 R67 million while the fair value impact at the 90th percentile (i.e. a probability of 10% to exceed this value) is a loss of approximately R193 million.

Distribution: Fair value impact – long-term scenario (audited)

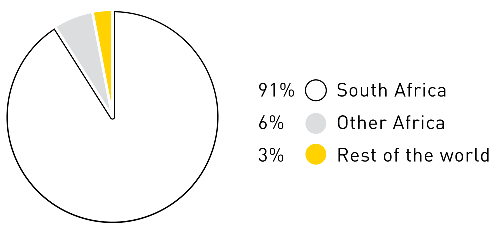


Risk and capital management report continued

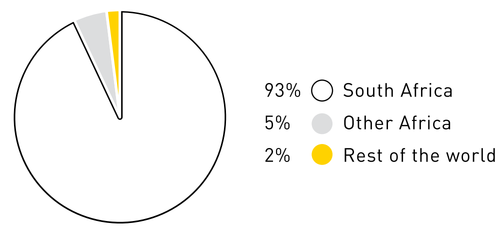
Geographic and industry concentration risk

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

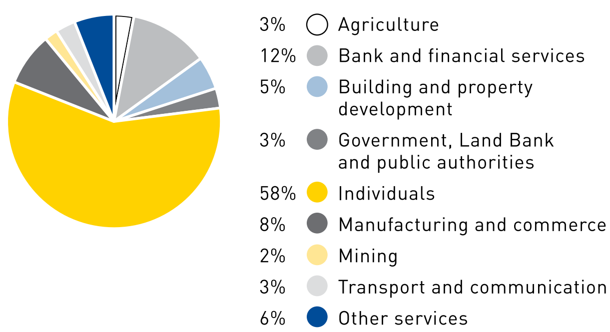
Geographical split by exposure 2011 (audited)



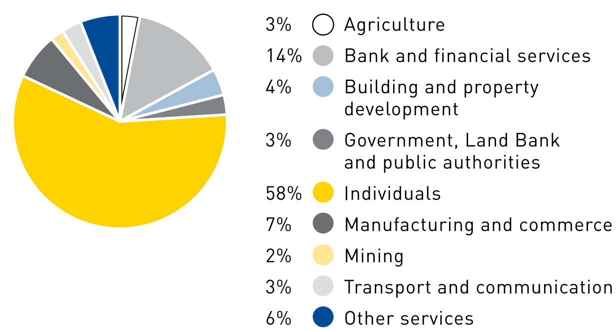
Geographical split by exposure 2010 (audited)



Industry split by exposure 2011 (audited)



Industry split by exposure 2010 (audited)



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

Concentration of significant credit exposure (audited)

	2011								
R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	430 377	25 817	11 474	–	2 032	375	171	2 369	472 615
Derivatives	23 198	157	5 611	–	6 215	1 874	40	111	37 206
Debt investment securities	76 223	5 631	468	–	4 538	1 356	–	1 064	89 280
Guarantees, acceptances and letters of credit[1]	26 913	3 204	–	–	546	–	16	668	31 347
Irrevocable commitments[1]	56 901	5 192	363	–	794	9	–	39	63 298

1. Significant off-balance sheet exposures.

	2010								
R million	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	410 264	22 741	7 186	68	660	819	391	1 621	443 750
Derivatives	26 364	257	6 128	2	5 070	1 696	11	236	39 764
Debt investment securities	74 044	7 742	471	–	6 004	999	–	1 015	90 275
Guarantees, acceptances and letters of credit[1]	26 631	2 608	–	–	282	–	5	350	29 876
Irrevocable commitments[1]	48 339	3 195	78	–	1 149	38	–	10	52 809

1. Significant off-balance sheet exposures.

Average advances per major risk type (unaudited)

R million	2011	2010
Retail credit	289 963	277 300
Africa	21 096	18 469
Wholesale credit	132 274	118 585
Commercial credit	29 263	27 306

Risk and capital management report continued

Segmental analysis of advances (audited)

The table below provides a breakdown credit exposure by FirstRand segment.

	2011				
R million/%	Advances	NPLs	NPLs as a % of advances	Total impairment charge	Impairments as a % of average advances
FNB	208 680	13 256	6.35	2 444	1.20
FNB Retail	175 231	11 409	6.51	1 934	1.12
Residential mortgages	155 974	10 515	6.74	1 216	0.79
– FNB HomeLoans (Consumer segment)	106 864	7 335	6.86	740	0.69
– Wealth	40 913	2 796	6.83	405	1.03
– Affordable Housing (Mass segment)	8 197	384	4.68	71	0.98
Credit card	10 758	446	4.15	149	1.39
Personal banking	4 593	132	2.87	178	4.66
Mass (Secured and unsecured)	3 906	316	8.09	391	11.37
FNB Commercial	30 771	1 865	6.06	334	1.13
FNB Corporate Banking	2 523	18	0.71	9	0.43
FNB Other	155	(36)	(23.23)	167	>100
WesBank	102 125	4 367	4.28	1 291	1.33
WesBank asset-backed finance	97 124	4 025	4.14	1 141	1.23
– WesBank Retail	59 865	2 492	4.16	607	1.07
– WesBank Business and Commercial	31 109	1 490	4.79	452	1.47
– WesBank International	6 150	43	0.70	82	1.48
WesBank loans	5 001	342	6.84	150	3.35
RMB	130 958	1 798	1.37	(25)	(0.02)
FNB Africa	22 639	370	1.63	64	0.30
Corporate Centre and consolidation adjustments	8 213	(1)	(0.01)	4	0.08
Total	**472 615**	**19 790**	**4.19**	**3 778**	**0.82**

2010				
Advances	NPLs	NPLs as a % of advances	Total impairment charge	Impairments as a % of average advances
199 113	15 546	7.81	3 421	1.70
169 232	13 685	8.09	2 877	1.72
152 512	12 563	8.24	1 420	0.95
108 541	9 730	8.96	1 178	1.07
37 710	2 537	6.73	217	0.62
6 261	296	4.73	25	0.46
10 705	673	6.29	776	6.92
3 043	149	4.90	202	6.18
2 972	300	10.09	479	16.22
28 178	1 916	6.80	441	1.59
1 697	1	0.06	34	0.68
6	(56)	>100	69	5.12
92 724	5 098	5.50	2 048	2.21
88 761	4 778	5.38	1 722	1.94
53 391	2 882	5.40	929	1.77
30 415	1 760	5.79	697	2.21
4 955	136	2.74	96	2.09
3 963	320	8.07	326	8.47
130 312	1 126	0.86	195	0.16
19 645	407	2.07	68	0.37
1 956	28	1.00	(46)	(2.01)
443 750	22 205	5.00	5 686	1.30

Risk and capital management report continued

BASEL II DISCLOSURE

Credit rating systems and processes used for Basel II

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

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

Credit exposure by type, segment and Basel II approach (unaudited)

		AIRB	Standardised Approach subsidiaries	
R million	2011	FirstRand Bank (SA)	Regulated bank entities within FNB Africa	London branch and other subsidiaries
Cash and short-term funds	**29 239**	24 690	2 574	1 975
Money at call and short notice	**1 371**	1 099	85	187
Balances with central banks and guaranteed by central banks	**15 660**	14 448	1 180	32
Balances with other banks	**12 208**	9 143	1 309	1 756
Gross advances	**472 615**	432 346	22 639	17 630
FNB	**208 680**	205 838	–	2 842
FNB Retail	**174 906**	172 064	–	2 842
FNB Corporate	**3 003**	3 003	–	–
FNB Commercial	**30 771**	30 771	–	–
WesBank	**102 125**	94 614	–	7 511
RMB	**130 958**	125 320	–	5 638
FNB Africa	**22 639**	–	22 639	–
Other	**8 213**	6 574	–	1 639
Derivatives	**37 206**	36 629	11	566
Debt investment securities	**89 280**	76 742	5 731	6 807
Accounts receivable	**7 289**	2 673	362	4 254
Loans due by holding company and fellow subsidiaries	**–**	18 908	1 526	(20 434)
Reinsurance assets	**484**	–	–	484
Credit risk not recognised on the balance sheet	**95 852**	86 839	6 954	2 059
Guarantees	**24 727**	22 022	2 215	490
Acceptances	**289**	289	–	–
Letters of credit	**6 331**	6 043	287	1
Irrevocable commitments	**63 298**	57 278	4 452	1 568
Credit derivatives	**1 207**	1 207	–	–
Total	**731 965**	678 827	39 797	13 341

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

The following table provides the breakdown of exposures rated through the standardised approach in FNB Africa by risk bucket after taking risk mitigation into account.

FNB Africa exposures by risk bucket (unaudited)

Risk bucket	Exposure R million
0%	85
10%	–
20%	4 445
35%	8 361
50%	1 476
75%	2 878
100%	22 388
Specific impairments	165
Total	**39 797**

PD, EAD and LGD profiles

A summary of credit risk parameters as reported for regulatory capital purposes is shown below for each significant AIRB asset class. The parameters reflect through-the-cycle PDs and downturn LGDs. The scale used from 1 – 25 per the Basel II accord is for performing assets, with 1 representing the lowest risk and NPL representing defaulted exposures. The Bank uses EAD-weighted PDs based on the FirstRand master-rating scale (see page 144) which are then mapped to Basel rating buckets (1 – 25) for regulatory reporting purposes.

The graphs provide a summary of the EAD distribution by prescribed counterparty risk bands (Basel risk buckets). The EAD weighted downturn LGD and the EAD weighted PD for the performing and total book are also shown. Comparatives for the prior year are also shown.

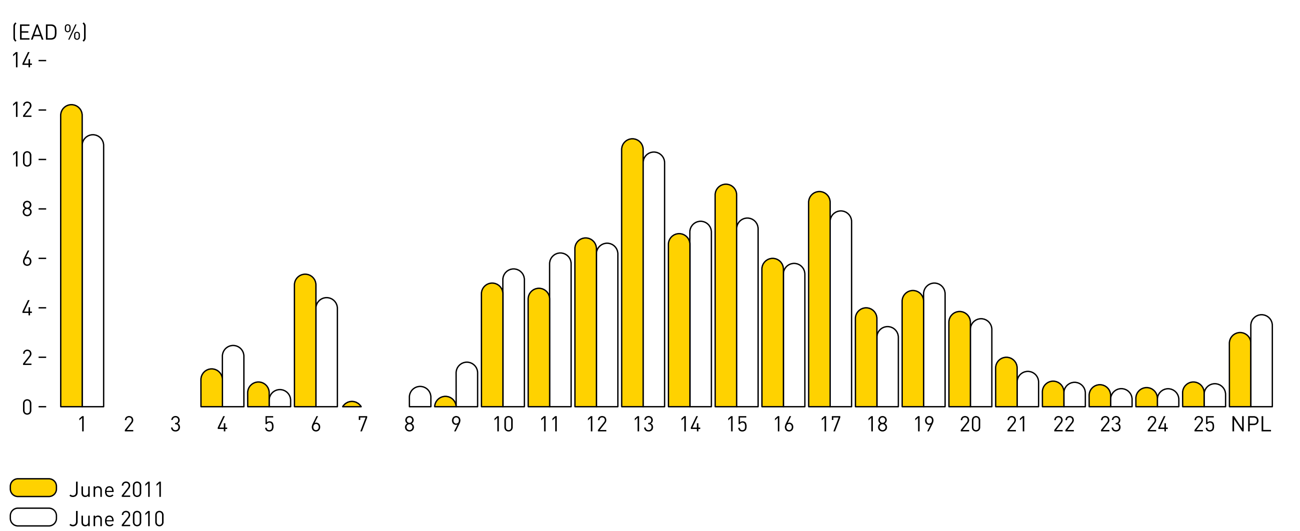
Year-on-year trends will be impacted by the risk migration in the existing book (reflecting changes in the economic environment), quality of new business originated and any model recalibrations implemented during the course of the year.

The majority of the retail portfolios exhibited significant positive risk migration for the period under review. This was, however, negated by model recalibrations implemented during the financial year, incorporating further defaults after the peak of the economic downturn.

The performance of the credit portfolio was in line with that of the industry over the reporting period.

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

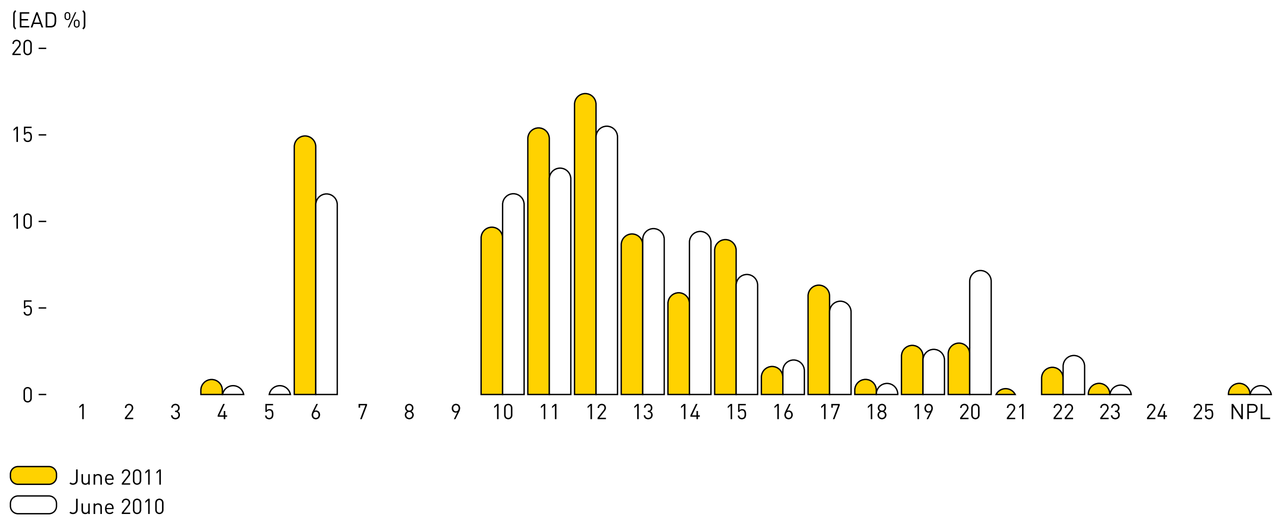
Risk profile for FirstRand Bank: EAD% distribution per Basel risk buckets (unaudited)



Average performing PD %	3.07%	Average total book PD%	6.45%
Average performing LGD%	27.84%	Average total book LGD%	28.10%
Performing book EL/EAD	0.86%	Total book EL/EAD	1.81%

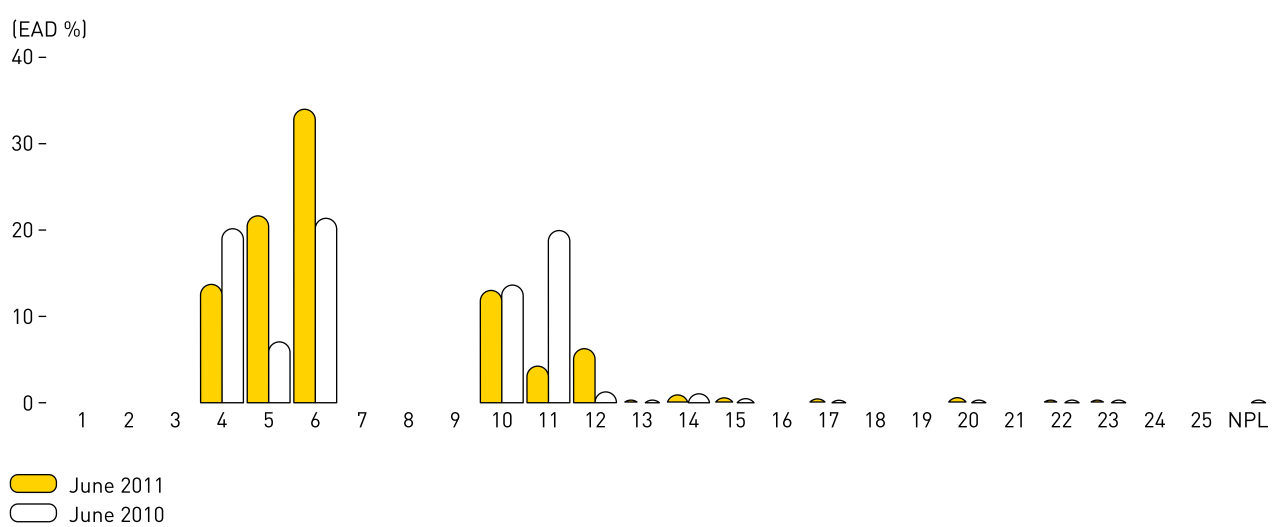
Risk and capital management report continued

Risk profile for corporate exposures: EAD% distribution per Basel risk buckets (unaudited)



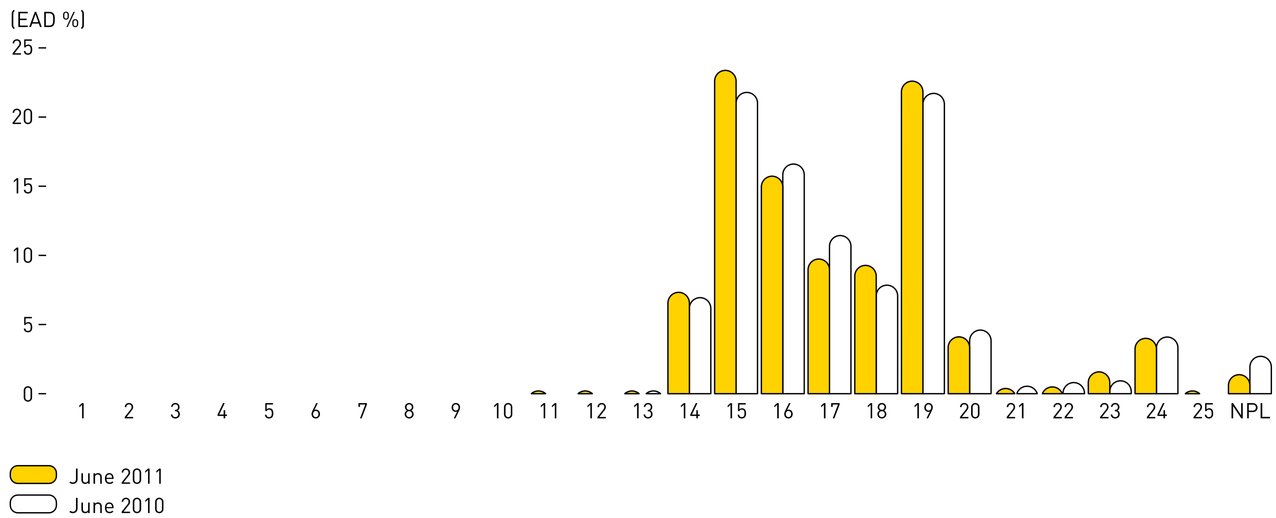
Average performing PD %	1.49%	Average total book PD%	2.34%
Average performing LGD%	36.00%	Average total book LGD%	36.11%
Performing book EL/EAD	0.54%	Total book EL/EAD	0.84%

Risk profile for banks exposures: EAD% distribution per Basel risk buckets (unaudited)



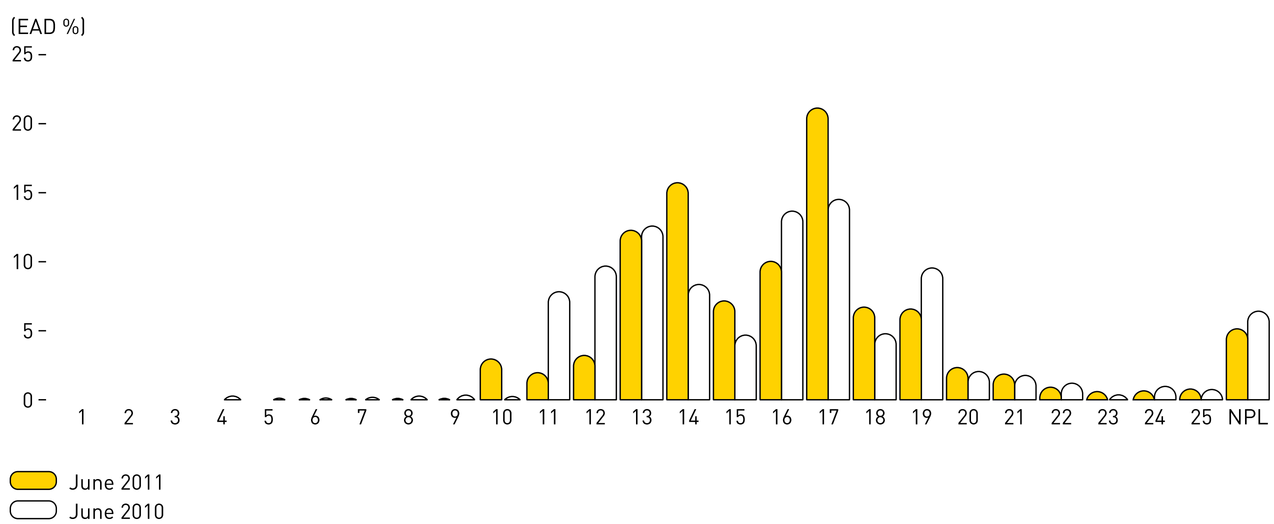
Average performing PD %	0.22%	Average total book PD%	0.22%
Average performing LGD%	32.97%	Average total book LGD%	32.97%
Performing book EL/EAD	0.07%	Total book EL/EAD	0.07%

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



Average performing PD %	4.79%	Average total book PD%	5.77%
Average performing LGD%	33.66%	Average total book LGD%	33.77%
Performing book EL/EAD	1.61%	Total book EL/EAD	1.95%

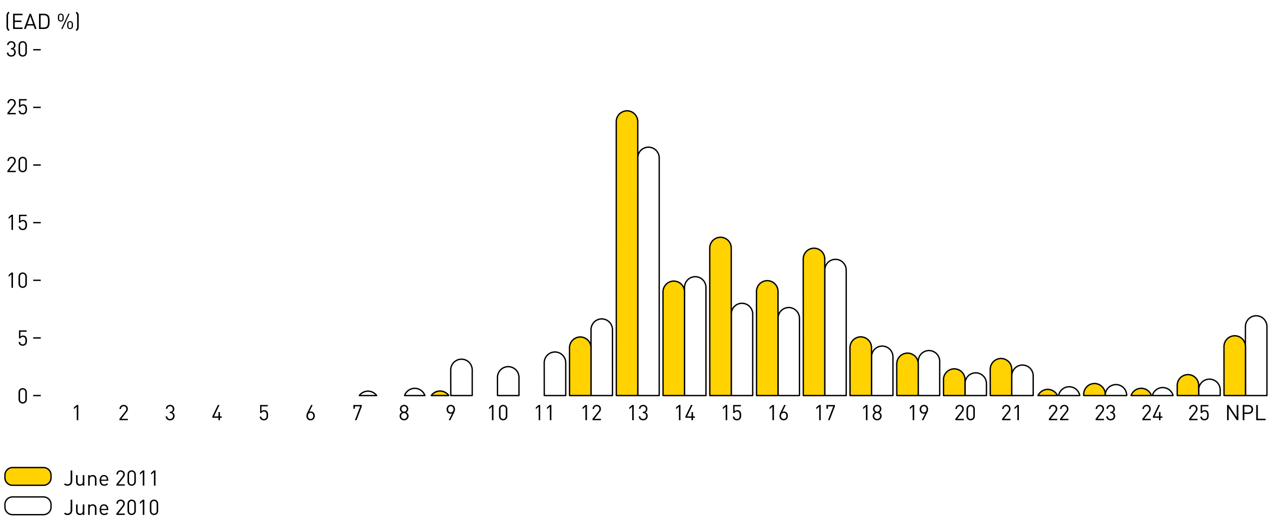
Risk profile for SME retail exposures: EAD% distribution per Basel risk buckets (unaudited)



Average performing PD %	2.74%	Average total book PD%	10.71%
Average performing LGD%	34.17%	Average total book LGD%	35.49%
Performing book EL/EAD	0.94%	Total book EL/EAD	3.80%

Risk and capital management report continued

Risk profile for retail mortgage exposures: EAD% distribution per Basel risk buckets (unaudited)

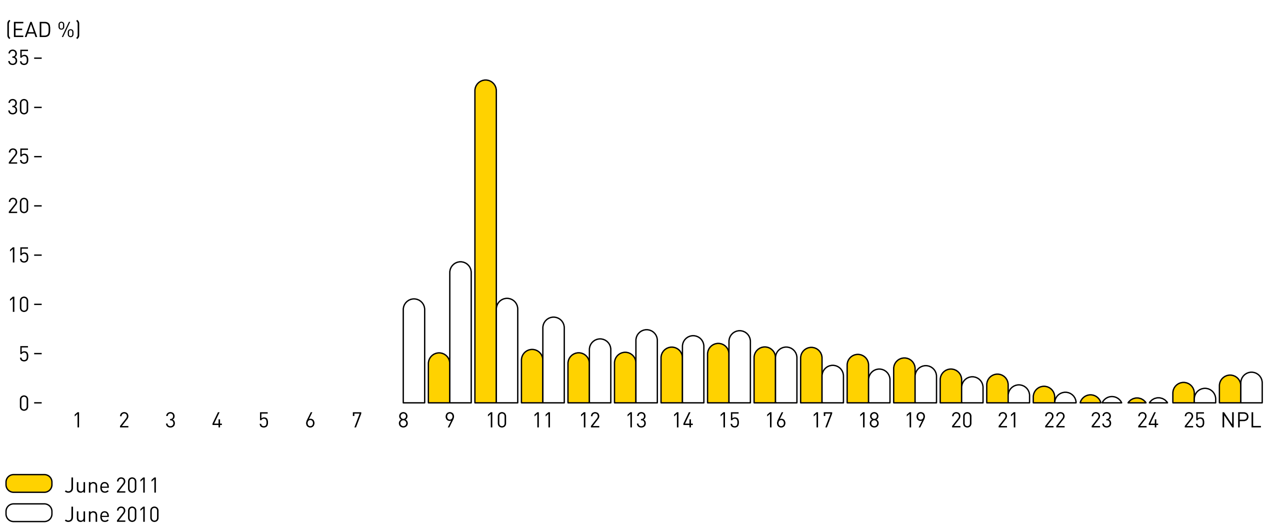


Average performing PD %	3.86%	Average total book PD%	11.40%
Average performing LGD%	12.95%	Average total book LGD%	13.31%
Performing book EL/EAD	0.50%	Total book EL/EAD	1.52%

The deterioration in the risk profile in the above chart is the result of rating system recalibrations (which resulted in an increase in PDs) and not a reflection of deterioration in credit quality.

Both prior and subsequent to the implementation of recalibrations, the risk profile improved and PDs decreased consistently due to positive risk migration, with the lower interest rate environment positively impacting the existing portfolio. In addition, stricter lending criteria resulted in higher quality new business being written. Monthly trend analyses from July 2010 to June 2011 show a once-off increase in PDs, due to the recalibrations, thereafter a consistent decrease due to positive risk migration.

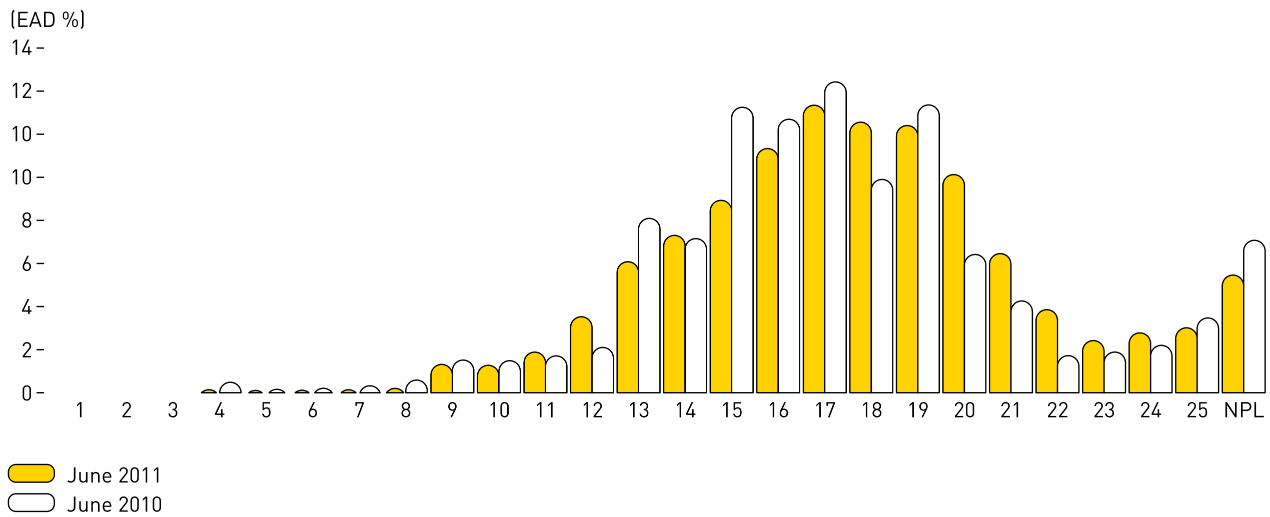
Risk profile for retail revolving exposures: EAD% distribution per Basel risk buckets (unaudited)



Average performing PD %	3.73%	Average total book PD%	6.39%
Average performing LGD%	70.75%	Average total book LGD%	71.08%
Total book EL/EAD	2.64%	Performing book EL/EAD	4.54%

Once again, the deterioration in the risk profile in the chart above is attributed to the recalibrations implemented in October 2010, incorporating the higher defaults experienced recently. With the exception of this once-off increase in PDs, PDs decreased consistently from July 2010 to June 2011 reflecting the effect of lower interest rates.

Risk profile for other retail exposures: EAD% distribution per Basel risk buckets (unaudited)



Average performing PD %	8.33%	Average total book PD%	13.53%
Average performing LGD%	32.40%	Average total book LGD%	33.62%
Performing book EL/EAD	2.70%	Total book EL/EAD	4.55%

A significant proportion of the other retail asset class is made up of vehicle and asset finance, which is secured by the underlying asset. As such, the LGD is lower than what would be expected in unsecured other retail portfolios. As with retail mortgages and retail revolving asset classes, this can be attributed to recalibrations incorporating the higher defaults experienced recently. With the exception of this once-off increase in PDs, PDs decreased consistently from July 2010 to June 2011 reflecting the impact of lower interest rates.

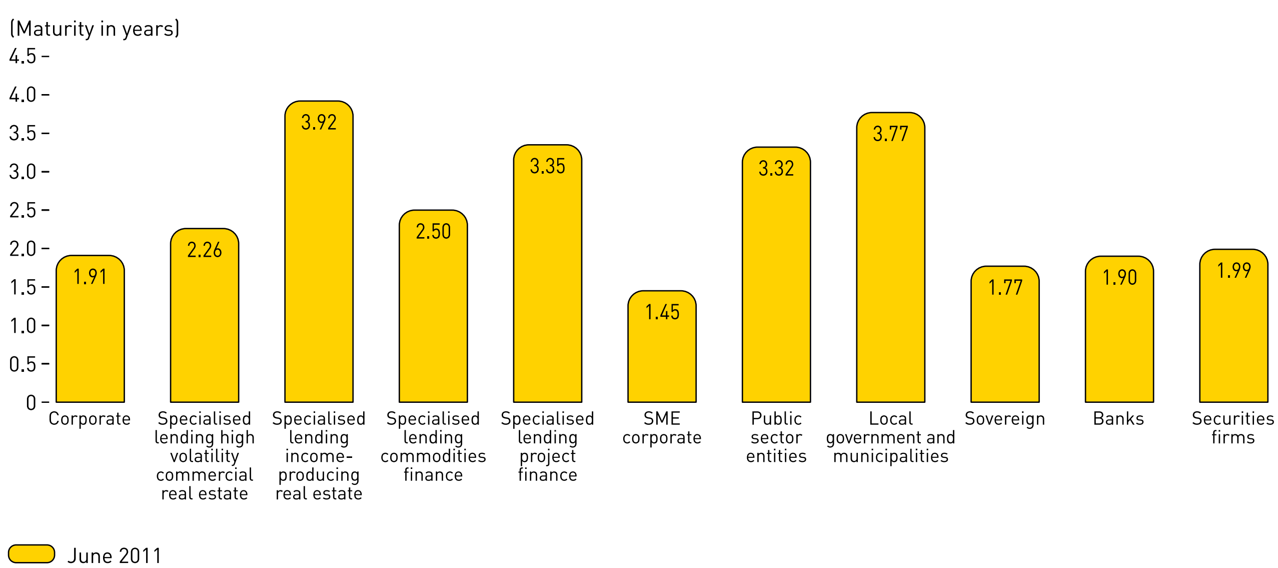
Maturity breakdown

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.

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

Maturity breakdown per wholesale AIRB asset class as at 30 June 2011 (unaudited)



Risk and capital management report continued

Actual vs expected loss analysis

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

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

Risk parameters include:

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

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

The measure of actual losses includes specific provisions raised for exposures which defaulted during the year, but which did not exist at 30 June 2010. These exposures are not reflected in the expected loss value described below.

The table below provides the comparison of actual loss to regulatory expected loss for each significant AIRB asset class of the Bank. PDs used for regulatory capital purposes are based on long run experience and would be anticipated to underestimate actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle, as is evident from the following table.

Actual vs. expected loss per portfolio segment for FirstRand Bank (unaudited)

	2011	
R million	**Expected loss**	**Actual loss**
Corporate (corporate, banks and sovereigns)	**847**	**16**
SME (SME corporate and SME retail)	**1 354**	**1 189**
Residential mortgages	**3 102**	**3 773**
Qualifying revolving retail	**1 168**	**1 122**
Other retail	**790**	**1 013**
WesBank	**3 142**	**3 663**
Total	**10 403**	**10 776**

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

	2010	
R million	Expected loss	Actual loss
Corporate (corporate, banks and sovereigns)	801	187
SME (SME corporate and SME retail)	1 066	977
Residential mortgages	3 163	4 057
Qualifying revolving retail	1 995	2 065
Other retail	987	1 710
WesBank	2 471	3 519
Total	10 483	12 515

It should also be noted that the regulatory expected loss shown above is based on the expected loss derived from the regulatory capital models that were applied as at 30 June 2010. The models currently applied have since incorporated further defaults after the peak of the economic downturn and resulted in an increase in expected losses. A restatement of the above comparison using the capital models currently applied would result in a closer alignment of actual vs. expected losses.

This comparison is supplemented with more detailed analyses below, 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 2010. For PDs, this is applied to the total performing book as at 30 June 2010. 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 year July 2010 to June 2011. It should be noted that due to the length of the workout period, there is uncertainty in the measure provided for actual LGDs as facilities that default during the year would only have had between 1 and 12 months to recover to date – depending on when the default event occurred.

The EAD estimated to actual ratio is derived as the ratio of expected nominal exposure at default (for all accounts that defaulted during the 2011 financial year) to the actual nominal exposure at default for the same accounts. A ratio above 100% indicates an over-estimation.

Risk parameters used to determine regulatory expected loss for FirstRand Bank (unaudited)

	2011				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereigns[1]	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

1. Corporate, banks and sovereigns shown as one asset class to align with the respective asset class in the actual vs expected loss table.

	2010				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate	1.55	–	37.73	n/a	n/a
Banks	0.15	–	31.00	n/a	n/a
SME corporate	3.45	4.38	44.98	32.07	110.58
SME retail	3.28	4.43	37.80	15.27	107.85
Residential mortgages	2.68	4.48	18.66	12.66	103.92
Qualifying revolving retail	3.53	3.62	64.47	64.82	122.92
Other retail	7.85	8.13	31.84	35.75	104.94
Total	3.06	3.52	32.04	24.66	106.25

As no defaults were experienced within the banks asset class during the year under review, actual LGDs and EADs could not be calculated for this asset class. PDs used for regulatory capital purposes are based on long-run experience and would be anticipated to underpredict actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle. The analysis is based on regulatory capital models that were applied at 30 June 2010. The models currently being applied have since incorporated further defaults experienced during the latter part of the recent economic downturn and resulted in an increase in expected losses. The actual PDs and LGDs above, being lower than their respective estimates, reflect the effect of an improving economic cycle.

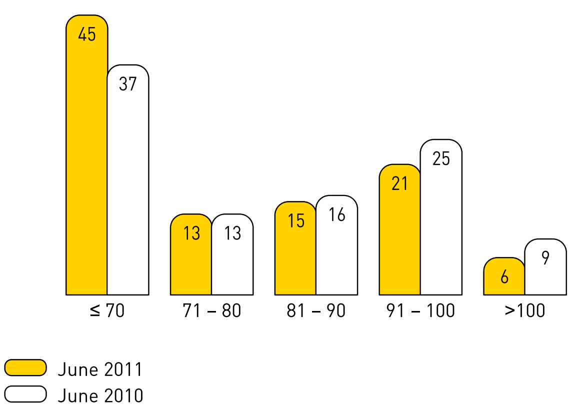
Risk and capital management report continued

SELECTED RISK ANALYSES

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

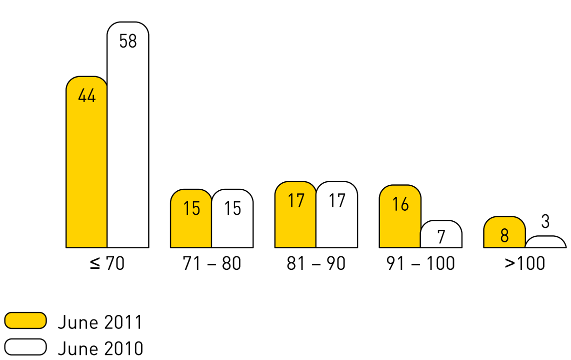
The graphs below provide the balance-to-value distributions and the aging of the residential mortgage portfolios. The recent focus on the loan-to-value ratios for new business resulted in an improvement in the balance-to-original value although the broader strategy is to place more emphasis on the counterparty credit worthiness as opposed to only on the underlying security. However, pressures on market value negatively impacted on the balance-to-market value distribution.

Residential mortgages balance-to-value – original value (%) (unaudited)



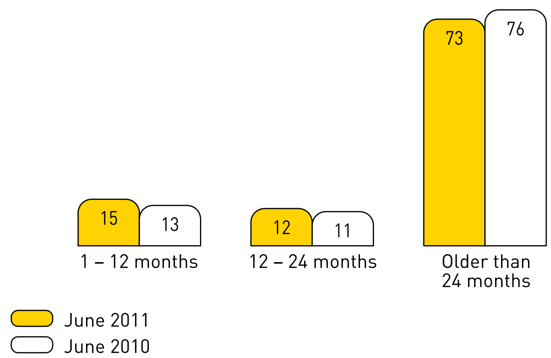
The balance-to-market value shows a significant proportion of the book in the lower risk categories.

Residential mortgages balance-to-value – market value (%) (unaudited)



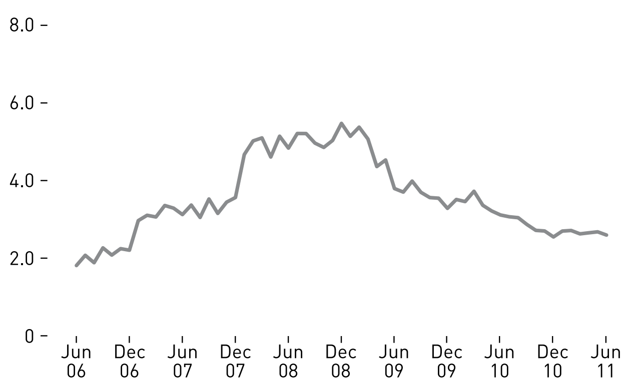
The low levels of new business are evident in the age distribution shown below:

Residential mortgages age distribution (%) (unaudited)



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 % of the total advances balance.

FNB HomeLoans arrears (%) (unaudited)

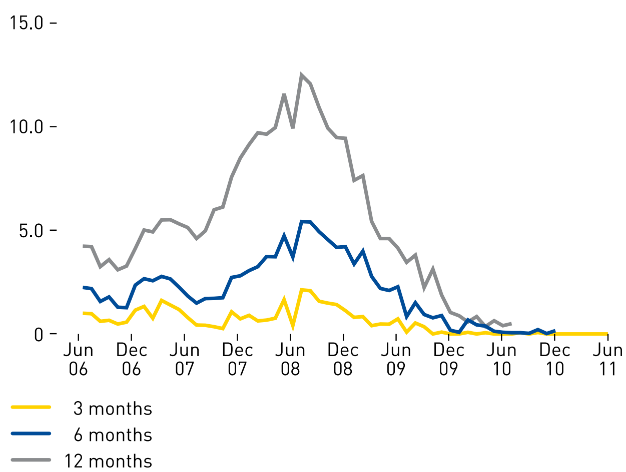


FNB HomeLoans arrears are stabilising. Similar trends are also observed in the WesBank and credit card portfolios.

The following graphs provide the vintage analyses for FNB HomeLoans and WesBank retail. Vintage graphs provide the default experience 3, 6 and 12 months after each origination date. It reflects the impact of origination strategies and the macroeconomic environment.

For FNB HomeLoans, the 3, 6 and 12 month cumulative vintage analysis illustrates a marked improvement in the quality of business written since mid-2008 despite further deterioration in macroeconomic 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 macroeconomic conditions.

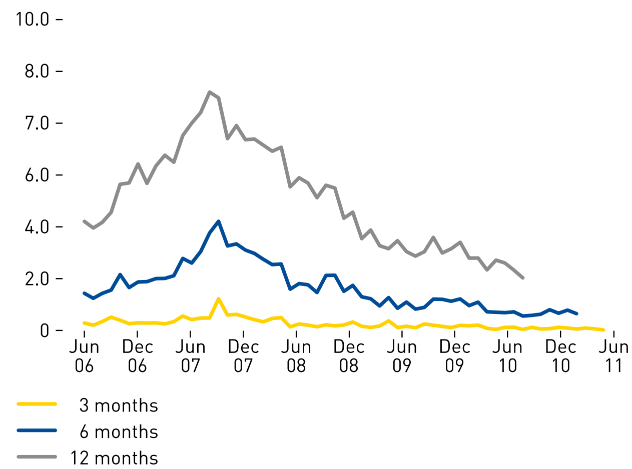
FNB HomeLoans vintage analysis (%) (unaudited)



The Group's South African repossessed properties decreased from R513 million (1 564 properties) at 30 June 2010 to R282 million (1 117 properties) at 30 June 2011.

The WesBank retail 6 and 12 month cumulative vintage analysis continues to show a noticeable improvement in the quality of business written since mid-2007 and the more benign macro environment.

WesBank retail vintage analysis (unaudited)



In the asset finance business, repossession and stock holding levels continue to decline relative to the comparative period. The gradually reducing trend is likely to continue, but at a slower rate.

Risk and capital management report continued

Securitisations and conduits

KEY DEVELOPMENTS AND FOCUS

In October 2010 FirstRand Bank sought and received approval from the SARB to repurchase all outstanding auto loan assets from Nitro Securitisation 3 (Pty) Limited ("Nitro 3"). A detailed description of this action is provided on page 174. The R2.0 billion synthetic auto loan securitisation, Procul (Pty) Ltd ("Procul"), matured successfully in August 2010 (see page 174). There were a number of rating actions on several classes of Fresco 2 notes and iKhaya 1 and 2 notes during the year under review (see page 174 for detail).

In February 2011, the Group closed its first UK auto loan securitisation in order to obtain matched term funding. Turbo Finance plc issued £340 million of notes (see page 174 for further detail on the transaction).

INTRODUCTION AND OBJECTIVES

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

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

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

Securitisation transactions (unaudited)

R million	Asset type	Year initiated	Expected close	Rating agency
Traditional securitisations				
Nitro 3	Retail: Auto loans	2007	2011	Moody's and Fitch
iKhaya 1	Retail mortgages	2007	2011	Fitch
iKhaya 2	Retail mortgages	2007	2012	Fitch
Turbo Finance	Retail: Auto loans	2011	2013	Moody's and Fitch
Synthetic securitisations				
Procul	Retail: Auto loans	2002	2010	Fitch
Fresco II	Corporate receivables	2007	2013	Fitch
Total				

Rating distribution of retained securitisation exposure (unaudited)

R million	AAA(zaf)	AA+(zaf)	AA(zaf)	A+(zaf)
Traditional				
At 30 June 2011	**596**	**–**	**5**	**–**
At 30 June 2010	15	–	10	–
Synthetic				
At 30 June 2011	**17 839**	**–**	**–**	**–**
At 30 June 2010	17 991	–	180	53

While national scale ratings have been used in the table above, global-scale equivalent ratings are used for internal risk management purposes.

are recognised. The securitisation entities are subsequently consolidated into FRIHL for financial reporting purposes. For synthetic securitisations, the credit derivatives used in the transaction are recognised at fair value, with any fair value adjustments reported in profit or loss.

TRADITIONAL AND SYNTHETIC SECURITISATIONS

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

	Assets securitised	Assets outstanding		Notes outstanding		Retained exposure	
		2011	2010	2011	2010	2011	2010
	13 404	**5 476**	3 907	**5 474**	4 276	**1 260**	254
	5 000	**–**	736	**–**	1 129	**–**	39
	1 900	**1 164**	1 317	**1 131**	1 321	**84**	87
	2 884	**1 625**	1 854	**1 580**	1 826	**148**	128
	3 620	**2 687**	–	**2 763**	–	**1 028**	–
	22 000	**20 000**	22 000	**20 000**	22 000	**18 262**	19 138
	2 000	**–**	2 000	**–**	2 000	**–**	875
	20 000	**20 000**	20 000	**20 000**	20 000	**18 262**	18 263
	35 404	**25 476**	25 907	**25 474**	26 276	**19 522**	19 392

	A(zaf)	BBB+(zaf)	BBB(zaf)	BB(zaf)	B+(zaf)	Not rated	Total
	4	**–**	**374**	**–**	**–**	**282**	**1 260**
	4	15	–	–	–	210	254
	–	**–**	**–**	**180**	**53**	**190**	**18 262**
	–	–	–	–	–	914	19 138

Risk and capital management report continued

Rating actions by Fitch Ratings ("Fitch")

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

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

Fitch downgraded Fresco 2 Class A to G tranches and assigned loss severity ("LS") ratings to seven tranches.

The rating actions were as follows:

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

Since closing, the transaction's performance has been in line with expectations.

Exercise of clean-up call option for Nitro 3

Nitro 3 was launched on 17 May 2007 with a size of R5 billion and 11.2% subordination below the Aaa.za rated notes. The subordinated loan of R100 million and the Class D notes (from April 2008) were held by the originator (the Bank). By August 2010, notes to the value of R920.1 million were outstanding, representing some 18% of the outstanding principal amount of the notes on issue date. Due to lower than expected levels of prepayments, the assets of Nitro 3 were not maturing as quickly as the issued notes. Structuring features of the vehicles precluded the raising of additional funding, and limited the use of liquidity facilities to only covering interest payments and not redemptions.

Consequently, in September 2010, the Bank sought and obtained approval from the SARB and note holders to repurchase the Nitro 3 assets, on market-related terms. The repurchase took place on 12 October 2010, and the proceeds were utilised for the early redemption of the outstanding Nitro 3 notes. The objective of the Group to obtain matched term funding at a time when its retail asset book was growing rapidly, had been achieved and the structure proved resilient despite the recent difficulties experienced in the retail consumer environment.

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

Maturity of Procul

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

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

During August 2010, ten South African RMBS transactions rated by Fitch, including iKhaya 1 and 2, were placed on RWN as a result of a revision of rating methodology.

Turbo Finance plc

In February 2011, the Bank closed its first UK auto loan securitisation. The securitisation is backed by fixed rate auto loan receivables originated by FirstRand Bank (London Branch) under the Carlyle Finance trade name. Turbo Finance plc was set up as a special purpose vehicle and issued £340 million of notes rated by Moody's and Fitch. The following table provides further detail regarding the notes issued.

Tranche	Rating (Moody's/ Fitch)	Amount (£m)	Credit enhancement (%)	Coupon
A	Aaa(sf)/ AAA(sf)	246.20	27.60	1m Libor + 185
B	Aa3(sf)/ A(sf)	54.20	11.70	5.50%
C	NR/BB(sf)	34.28	1.60	7.00%[1]
D	NR/NR	5.45	0.00	20.00%
Total		340.14		

1. *Represents senior coupon only, subordinated coupon of 8% will also be paid.*

The joint lead managers for the transaction were UBS Limited and BNP Paribas, with the latter also providing an interest rate swap for Class A notes. FirstRand Bank, acting through its London branch, acts as servicer of the transaction. The transaction is compliant with Article 122a of the EU Capital Requirement Directive where the Bank chose to use the on-balance sheet retention method to meet the 5% retained interest requirements of Article 122a.

The transaction was structured to obtain matched term funding for the Group, reduce cross-border funding risk, and establish market familiarity with Carlyle's business.

CONDUIT PROGRAMMES AND FIXED-INCOME FUNDS

The Group's conduit programmes are debt capital market vehicles, which provide investment-grade corporate South African counter-parties with an alternative source of funding compared to directly assessing 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 is a call-loan bond fund, which offers overnight borrowers and lenders an alternative to traditional overnight bank-lending products on a matched basis.

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

The conduit programmes have enjoyed the benefit of more benign liquidity than experienced by the market in general, whilst the demand for borrowings reflected a slowdown in line with general corporate borrowing activity.

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

Conduits and fixed income funds (unaudited)

Transaction					Non-recourse investments		Credit enhancement provided	
R million	Underlying assets	Year initiated	Rating agency	Programme size	2011	2010	2011	2010
Conduits								
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	8 779	7 373	–	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	6 741	5 772	753	758
Total				30 000	15 520	13 145	753	758
Fixed income fund								
iNkotha	Overnight corporate loans	2006	Fitch	10 000	2 948	2 163	–	–
Total				10 000	2 948	2 163	–	–

Rating distribution of conduits and fixed income funds (unaudited)

R million	F1+(zaf)	AAA(zaf)	AA+(zaf)	AA(zaf)	AA-(zaf)	A+(zaf)	A(zaf)	A-(zaf)	Total
Conduits									
At 30 June 2011	–	853	248	4 438	5 074	1 449	2 025	1 433	15 520
At 30 June 2010	–	1 435	633	1 487	4 683	1 480	2 592	835	13 145
Fixed income fund									
At 30 June 2011	–	–	–	969	652	548	453	326	2 948
At 30 June 2010	–	656	–	–	1 194	–	116	197	2 163

Risk and capital management report continued

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

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

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

LIQUIDITY FACILITIES

The table below provides a summary of the liquidity facilities provided by the Bank.

Liquidity facilities (unaudited)

R million	Transaction type	2011	2010
Transaction			
Own transactions		12 671	10 442
iNdwa	Conduit	7 159	5 898
iVuzi	Conduit	5 512	4 544
Third party transactions	Securitisations	1 372	1 577
Total		14 043	12 019

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 Bank. 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 their associated IRB capital requirements per risk band.

Retained or purchased securitisation exposure and the associated regulatory capital charges (unaudited)

	Exposure		IRB capital		Capital deduction	
R million	2011	2010	2011	2010	2011	2010
Risk weighted bands						
= <10%	24 322	17 840	183	122	–	–
>10% = <20%	1 378	12 042	16	88	–	–
>20% = <50%	5 517	180	133	6	–	–
>50% = <100%	4	931	–	66	–	–
>100% = <650%	180	773	114	198	–	–
1 250%/deduction	415	414	–	–	415	414
Total	31 816	32 180	446	480	415	414

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

Deductions arising from securitisation exposures (unaudited)

R million	Corporate receivables	Retail mortgages	Retail: instalment sales and leasing	Total
Traditional	–	218	64	282
Synthetic	190	–	–	190
Total	190	218	64	472

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

Counterparty credit risk

KEY DEVELOPMENTS AND FOCUS

During the past financial year, the Group focused on improving the control environment of the securities financing businesses. Amongst other things, the Group instituted a margin methodology more closely aligned with the internal market risk measurement methodology. Deep-dive reviews of all portfolios exposed to counterparty credit risk were also conducted.

In the next financial year, the focus will be on the implementation of a counterparty credit risk-specific framework. This framework will include Basel III requirements in relation to counterparty credit risk and collateral management and the implementation of an industrialised credit valuation adjustment ("CVA") solution. Furthermore, the Group will continue to cooperate with the Regulator to ensure readiness for Basel III.

INTRODUCTION AND OBJECTIVES

Counterparty credit risk is concerned with a counterparty's ability to satisfy its obligations under a contract that has a positive economic value to a bank at any point in time 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, and 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.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

RMB's credit department is responsible for the overall management of counterparty credit risk and is supported by RMB's portfolio and crossover 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 subcommittees as well as deployed and central risk management functions. Refer to the *Risk management framework and governance* section, and the *Credit risk governance* section for more details.

ASSESSMENT AND MANAGEMENT

Quantification of risk exposure

The measurement of counterparty credit risk aligns closely with credit risk measurement practices and is focused both on establishing appropriate limits at counterparty level, as well as 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. The two-way credit (and debit) valuation adjustment is calculated and priced on bespoke transactions.

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

Risk and capital management report continued

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, the head of risk for the affected business unit and the RMB risk and compliance function. Any remedial actions are agreed amongst these parties and failure to remedy such a breach is reported to the RMB Proprietary Board, ERM and the RCC committee.

As part of the ongoing process of understanding the drivers of counterparty credit risk, regular analysis is carried out on over-the-counter derivative and securities financing portfolios on a "look-through" basis. This portfolio review process seeks to identify concentrations, the hypothetical impact of stress scenarios, and to better understand the interaction of underlying market risk factors and credit exposure. The benefits gained include clearer insight into potential collateral, earnings and capital volatility, and potentially unduly 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 by or referencing 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 and International Securities Market Association agreements for the purpose of netting derivative transactions and repurchase transactions respectively. These master agreements as well as associated credit support annexes ("CSA") set out internationally accepted valuation and default covenants, which are evaluated and applied on a daily basis, including daily margin calls based on the approved CSA thresholds.

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

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

The collateral that would need to be provided in the hypothetical event of a rating downgrade is subject to many factors, not least of which are market moves in the underlying traded instruments, as well as netting of existing positions.

While these variables are not quantifiable, the table below, 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 FirstRand. In aggregate, all of the positive mark-to-market shown below would need to reverse before FirstRand 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 (unaudited)

R million	2011	2010
Gross positive fair value	114 070	90 367
Netting benefits	(38 462)	(36 693)
Netted current credit exposure before mitigation	75 608	53 674
Collateral value	(63 772)	(43 701)
Netted potential future exposure	12 293	14 511
Exposure at default	**24 129**	24 484

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 table.

Credit derivatives exposure (unaudited)

	2011			
R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	18	–	–	18
– protection sold	3 259	–	–	3 259
Intermediation activities				
– protection bought	46	–	–	46
– protection sold	1 091	–	–	1 091

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

Market risk in the trading book

KEY DEVELOPMENTS AND FOCUS

During the year under review the basis of expected tail loss ("ETL") measures were changed to a 750-day scenario set incorporating the recent 2008/2009 period of market distress. Market risk ETL is now calculated over 750 unique scenarios at a 99% confidence interval. In addition, improved measures were implemented to manage the Group's concentrated risk exposures across all asset classes, including crossover between risk types. In the 2012 financial year, the Group will focus on preparation for the new Basel 2.5 market risk capital requirements.

INTRODUCTION AND OBJECTIVES

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

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

ORGANISATIONAL STRUCTURE AND GOVERNANCE

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

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. During the year, holding periods used in the calculation were increased and are now based on an assessment of distressed liquidity of portfolios. As a consequence,

Risk and capital management report continued

holding periods ranging between 10 to 90 days are used. Historical data sets are chosen to incorporate periods of market stress with the recent 2008/2009 stress period incorporated into the historical data set 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 absolute loss thresholds are used to highlight positions to be reviewed by management.

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

Stress testing

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

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

Back testing

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

Regulatory and economic capital for market risk

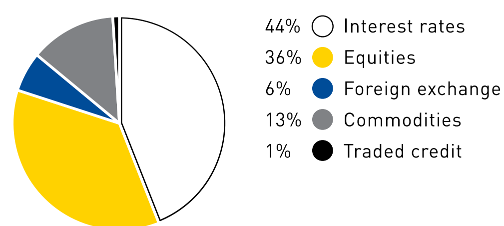
The internal VaR model for general market risk was approved by the SARB for local trading units and is consistent with the methodologies as stipulated under the Basel II framework. For all international legal entities, the Standardised approach is used for regulatory market risk capital purposes.

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

TRADING BOOK MARKET RISK PROFILE

The following chart shows the distribution of exposures per asset class across the Group's trading activities at 30 June 2011 based on the ETL methodology.

Composition of ETL exposure for FirstRand (audited)



VaR and ETL analysis by risk type

The tables below reflect the VaR over a 10-day holding period and the liquidity adjusted ETL at a 99% confidence level for trading book activities. Results for the year ended 30 June 2011 reflect that the VaR and ETL utilisations were within risk appetite, with the interest rate component of risk being the most dominant over the period under review.

10-day 99% VaR analysis by instrument (audited)

	2011				2010
R million	Min[1]	Max[1]	Ave	Period end	Period end[2]
Risk type					
Equities	33.5	132.5	80.0	33.5	66.4
Interest rates	42.7	138.5	87.0	71.2	53.3
Foreign exchange	9.1	88.2	23.2	17.2	9.0
Commodities	7.0	87.0	44.6	43.0	7.1
Traded credit	0.1	5.4	3.6	4.1	0.1
Diversification effect				(80.6)	(52.9)
Diversified total	65.5	186.7	130.5	88.4	83.0

Distressed ETL analysis by instrument (audited)

	2011				2010
R million	Min[1]	Max[1]	Ave	Period end	Period end[2]
Risk type					
Equities	139.2	301.9	214.5	196.3	160.4
Interest rates	94.7	429.7	237.0	238.8	119.1
Foreign exchange	20.7	136.6	52.0	31.7	20.2
Commodities	15.0	135.2	74.8	72.9	11.1
Traded credit	1.8	8.0	5.7	5.9	1.6
Diversification effect				(185.0)	(105.4)
Diversified total	189.7	512.8	314.3	360.6	207.0

Notes:

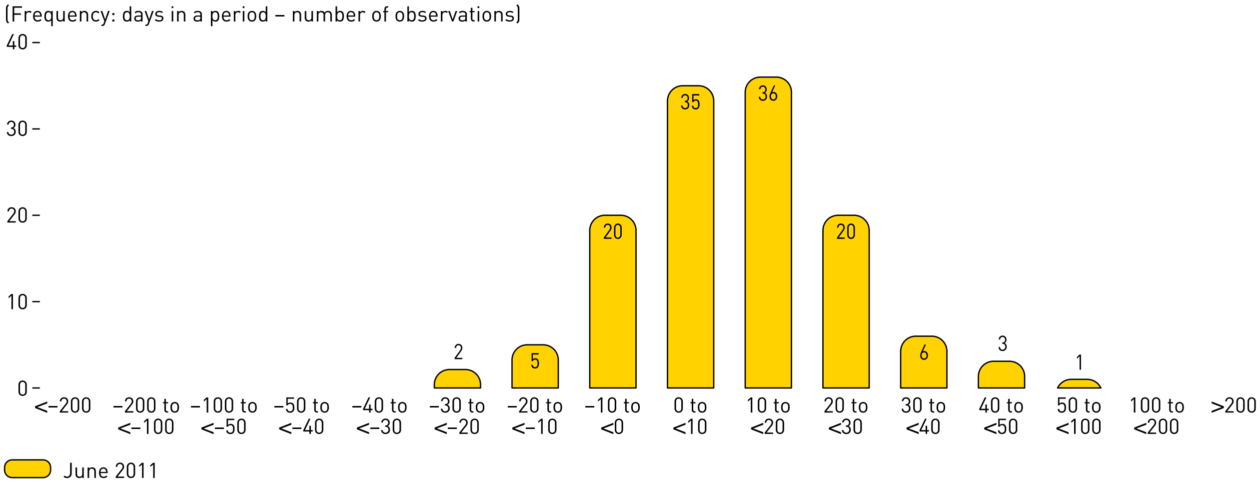
1. *The maxima and minima VaR and ETL figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table.*
2. *The ETL measures as at 30 June 2011 are based on a 750-day scenario, incorporating both the recent 2008/2009 and 2001/2002 stress periods (i.e. two static periods of stress), whereas the ETL measures at 30 June 2010 are based on a 500-day scenario set incorporating only the 2001/2002 period of market distress (i.e. only one static period of stress).*
3. *Interest rate risk in the banking book is excluded from the above analysis and is separately managed and reported (see pages 192 to 196).*
4. *The diversified 90-day ETL measure for the equity investment book subject to market price risk as at 30 June 2011 is R1 297 million (interest rates: R1.7million, equities: R1 357 million, foreign exchange: R64 million).*
5. *The diversified 1-day 99% VaR as at 30 June 2011 is R49 million (interest rates: R32 million, equities: R11 million, foreign exchange: R3 million, commodities: R32 million).*
6. *A revision of the market risk limits for the equity asset class necessitated some portfolio rebalancing. A number of equities positions were reclassified from market risk (short term) to investment risk (long term) in order to better reflect the risk characteristics of the exposures and the time horizon staged for value extraction to materialise.*

Risk and capital management report continued

Distribution of daily trading earnings from trading units

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

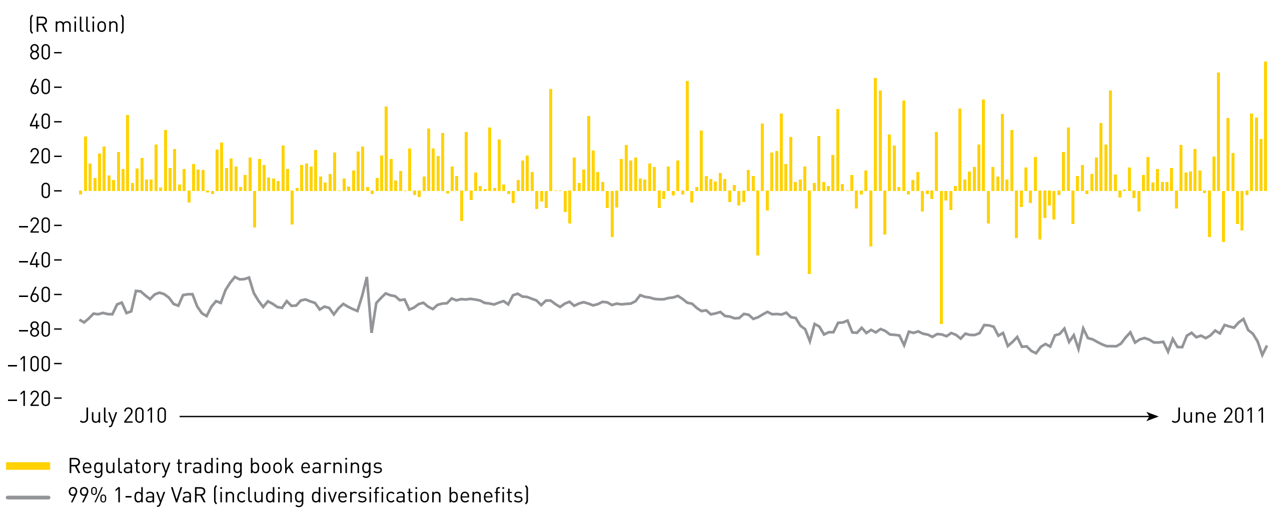
Distribution of daily earnings (unaudited)



Back testing: daily regulatory trading book earnings and VaR

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

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



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

International

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

FNB Africa subsidiaries

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

Equity investment risk

KEY DEVELOPMENTS AND FOCUS

The investment portfolio remained resilient over the past year. Overall the quality of the investment portfolio remains acceptable and within risk appetite. The Private Equity division earnings performance was dominated by the realisation of the Davita Trading exposure. Legacy assets continued to be closely monitored.

An enhanced investment risk management framework was developed and implemented during the year. This framework included refinements on governance, risk appetite quantification, investment valuation and stress testing.

INTRODUCTION AND OBJECTIVES

Portfolio investments in equity instruments are primarily undertaken in RMB, but certain equity investments have been made by WesBank, FNB and Corporate Centre. Positions in unlisted investments in RMB are taken mainly through its Private Equity, Resources and Investment Banking divisions, while listed investments are primarily made through the Equities division.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

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

- The Prudential investment committee ("Investment committee") chaired by the RMB chief investment officer and its delegated 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 also rest with the respective credit committees and the Board's Large exposures committee, as appropriate.
- The RCC and MIRC committees are responsible for the oversight of investment risk measurement and management across the Group.
- 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. WesBank's executive management monitors and manages its investments through the financial reporting process.

ASSESSMENT AND MANAGEMENT

Management of exposures

The equity investment risk portfolio is managed through a rigorous evaluation and review process from inception to exit of a transaction. All investments are subject to a comprehensive due diligence, during which a thorough 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 the company's operations.

The investment thesis, results of the due diligence process, and investment structure are challenged at the Investment committee before final approval is granted. In addition, normal semi-annual reviews 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

IAS 39 requires equity investments to be classified as:

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

Refer to note 15 *Financial Instruments* of the accounting policies for a description of the policy.

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

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

Measurement of risk exposures

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

Risk and capital management report continued

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

Stress testing

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

Regulatory and economic capital

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

For economic capital purposes, an approach using market value shocks to the underlying investments is 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

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

The Group continues to build its private equity portfolio with the view that the current market presents a limited number of attractively priced investment opportunities. Some segments of the portfolio exposed to specific industries and/or geographies have come under pressure given the current macroeconomic environment with impairments being raised in certain instances. Overall unrealised profits for the portfolio remain resilient.

A revision of the market risk limits for the equity asset class necessitated some portfolio rebalancing during the year. A number of equities positions (R1 449 million) were reclassified from short-term market risk to long-term market risk in order to better reflect the risk characteristics of the exposures and the time period envisaged for value extraction to materialise. The long-term equity risk ETL calculation was expanded to incorporate these long-term market risk positions together with the investment risk exposures.

Listed long-term market risk and investment risk exposures of R3 333 million (2010: R1 376 million) were included in the long-term equity risk ETL calculation. The ETL on these exposures amounted to R1 297 million (2010: R575 million).

The estimated sensitivity of the remaining investment balances (i.e. those not subject to the equity investment risk ETL process) to a 10% movement in market value is an impact of R169 million (2010: R375 million) on investment fair values.

RMB continues to prudently manage its legacy portfolio of investment assets with no significant new impairments deemed necessary. The strategy remains to hold and manage the legacy exposures to realise value over the longer term.

The cumulative gains realised from the sale of positions held in the Group's banking book during the current financial year amounted to R972 million (2010: R567 million).

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

Investment valuations and associated economic capital requirements (unaudited)

	2011[1]			2010[1]		
R million	Publicly quoted investments	Privately held	Total	Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	3 236	8 068	11 303	2 415	4 106	6 521
Fair value[2]	3 236	10 973	14 208	2 415	6 708	9 123
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement[3]	49	134	183	769	93	862
Latent revaluation gains not recognised in the balance sheet[3]	–	2 905	2 905	–	2 602	2 602
Capital requirement[4]	493	1 459	1 952	534	1 009	1 543

1. *Effective 1 July 2010, FirstRand became the regulated bank controlling company. Prior to 1 July 2010, FRBH was the regulated bank controlling company. The June 2011 figures are therefore not comparable to the June 2010 figures.*
2. *Fair values of listed private equity associates based on their value in use exceeded the quoted market prices by R249 million (2010: R 72 million).*
3. *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
4. *Capital requirement calculated at 9.5% of RWA (excluding the bank specific Pillar 2b add on). In 2010 the capital requirement was calculated at 8%.*

Foreign exchange and translation risk in the banking book

KEY DEVELOPMENTS AND FOCUS

As an authorised dealer in foreign exchange, the Group has a restriction on the gross amount of foreign currency holdings and other foreign exposure it may hold, capped at 25% of its local liabilities. Furthermore, banking regulations regarding the net open forward position in foreign exchange ("NOFP") limits the net open overnight position to no more than 10% of net qualifying capital. The two aspects (gross macro foreign exposure limit and the NOFP) overlay each other and ensure a complementary prudential approach to foreign currency risk management.

INTRODUCTION AND OBJECTIVES

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

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Foreign exchange risk results from the 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 FICC. Foreign currency funding, foreign exposure and liquidity 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 NOFP are overseen by MIRC, a subcommittee of the RCC committee, and mismatch risk is governed through the FirstRand ALCO and International ALCO 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 these risks on an ongoing basis.

ASSESSMENT AND MANAGEMENT

In addition to the regulatory prudential limit on foreign exposure, the Board has set internal limits on FirstRand's total foreign currency exposure, within the regulatory limit but allowing opportunity for expansion and growth. Internal limits are also set per franchise, taking into account existing foreign asset exposure

Risk and capital management report continued

and future growth plans. Internal limits and utilisation are continuously monitored, and are reviewed when necessary.

The Group's NOFP position is within the regulatory limit of approximately $600 million. Senior management implemented various levels of internal prudential limits, again below the regulatory limit but large enough to cater for the 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 remediation is monitored by both the deployed risk manager 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 contained well within regulatory limits at all times. The NOFP internal management limit was recently adjusted upwards to cater for increased (unhedged) currency risk related to foreign investment positions held directly by the Group and to cater for increased buffer trading for RMB and Group Treasury trading positions. The macro foreign exposure of the Group remained far below both regulatory and board limits and there is significant headroom for expansion into foreign assets.

Liquidity risk

KEY DEVELOPMENTS AND FOCUS

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 wholesale funding for banks which has higher liquidity risk than retail deposits.

Given these structural issues and as a result of the significant growth in risk weighted assets between 2005 and 2007, SA banks' overall proportion of institutional funding increased. This in turn means that short-term, expensive institutional deposits are utilised to fund longer-dated assets such as mortgages. Liquidity risk in the South African banking system is therefore structurally higher than in most other markets.

In December 2010 the BCBS published two documents proposing fundamental reforms to the regulatory capital and liquidity framework (referred to as "Basel III"). The Basel III guidelines propose two new liquidity metrics: the Liquidity Coverage Ratio ("LCR"), effective 1 January 2015, which measures short-term liquidity stress; and the Net Stable Funding Ratio ("NSFR"), effective 1 January 2018, which measures the stability of long-term structural funding. The BCBS committee has put processes in place to ensure the rigorous and consistent global implementation of the Basel III framework. The standards will be phased in gradually so that the banking sector can move to the higher liquidity standards while supporting lending to the economy. Both the LCR and the NSFR will be subject to an observation period and will include a review clause to address any unintended consequences.

Currently FirstRand and most South African banks do not meet the minimum quantitative requirements. This is due to the structural funding issues described. These issues have been recognised by the South African regulators, banking industry and National Treasury. In response, and under the guidance of National Treasury, a Structural funding and liquidity task team has been established and mandated to assess the impact and subsequently make recommendations to the Finance Ministry on how the banking industry will effectively deal with the proposed regulations.

INTRODUCTION AND OBJECTIVES

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 liquefiable assets are held to either 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.

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 FirstRand to effectively identify, measure, report and manage liquidity risk.

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

FirstRand Bank

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

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

FNB Africa

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

International subsidiaries

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

Dispensation was granted by the Financial Services Authority ("FSA") for a waiver on a "Wholefirm Liquidity Modification application" basis where the FSA considers local risk reporting and compliance of the parent bank sufficient to waive FSA requirements for FirstRand Bank (London branch). FSA reporting commenced from January 2011.

ASSESSMENT AND MANAGEMENT

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

Measurement and assessment

The primary tools and techniques employed for the assessment of liquidity risk are discussed below.

Liquidity mismatch analyses

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

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

For each of these categories, multiple key risk indicators are defined that highlight potential risks within defined thresholds. 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. Their current status and relevant trends are reported to the FirstRand ALCO and RCC committee monthly and quarterly, respectively.

Stress testing and scenario analysis

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

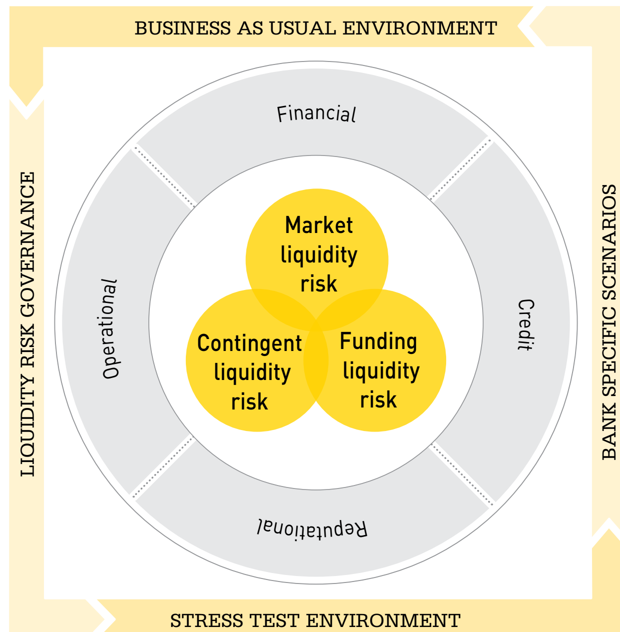
- quantifying the potential exposure to future liquidity stresses;
- analysing the possible impact of economic and event risks on cash flows, liquidity, profitability and solvency position; and
- proactively evaluating the potential secondary and tertiary effects of other risks on the Group.

Risk and capital management report continued

Effective liquidity risk management

Effective liquidity risk management begins with the establishment of a comprehensive and strong internal governance process for identifying, measuring and controlling liquidity risk exposure. The liquidity risk management infrastructure naturally considers business as usual, bank-specific scenarios, and stress test environments. The liquidity risk management process covers market and funding risks, and how risks are interconnected and can "compound" in ways that create elevated levels of risk and potential exposure. Measures of liquidity risk should be based on both structural conditions and prospective cash flow measures.

Liquidity risk management framework



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

Aspects of liquidity risk management

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

Liquidity contingency funding planning

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

Cash flow management

The Group has a diversified portfolio of funding sources and has set internal board limits to ensure that there is no concentration risk in one particular sector.

Top ten depositors and funding from associates remained relatively constant at 7% and 2% respectively as a percentage of funding liabilities. The top overnight depositor for June 2011 was 0.8% of the total funding liabilities (2010: 0.5%), well within the internal board limit.

Basel III

The Basel III guidelines, published in December, propose two new liquidity metrics: the LCR, effective 1 January 2015, which measures short-term liquidity stress; and the NSFR, effective 1 January 2018, which measures the stability of long-term structural funding.

The BCBS Committee has put processes in place to ensure the rigorous and consistent global implementation of the Basel III Framework. The standards will be phased in gradually so that the banking sector can move to the higher liquidity standards while supporting lending to the economy. Both the LCR and the NSFR will be subject to an observation period and will include a review clause to address any unintended consequences.

When applying the metrics to the Group's balance sheet at 31 December, both FirstRand and most of the South African banking industry do not meet the minimum quantitative requirements. This is due to the specific structure of funding in the domestic financial services industry, particularly the issue of low discretionary savings, the closed Rand domestic market and the fact that South Africa is an emerging economy.

These structural issues have been recognised by the South African regulators, banking industry and National Treasury. In response, and under the guidance of National Treasury, a Structural funding and liquidity task team has been established and mandated to assess the impact and subsequently make recommendations to the Finance Ministry on how the banking industry will effectively deal with the proposed regulations.

Liquidity risk profile

Undiscounted cash flow

The table below 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 agree with the balance sheet for the following reasons:

- the balances are contractual, undiscounted amounts whereas the balance sheet is prepared using discounted amounts;
- the 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 because 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.

Risk and capital management report continued

Liquidity cash flows (undiscounted cash flows) (audited)

	2011			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	>12 months
Maturity analysis of liabilities based on the undiscounted amount of the contractual payment				
EQUITY AND LIABILITIES				
Liabilities				
Deposits and current accounts	557 256	399 397	69 523	88 336
Short trading positions	12 413	12 413	–	–
Derivative financial instruments	37 028	35 650	884	494
Creditors and accruals	18 838	7 377	2 252	9 209
Long-term liabilities	9 927	–	–	9 927
Policyholder liabilities under insurance contracts	1 047	151	308	588
Policyholder liabilities under investment contracts	93	1	4	88
Loans from Insurance Group	–	–	–	–
Financial and other guarantees	31 346	25 801	3 175	2 370
Facilities not drawn	63 299	38 616	1 433	23 250

	2010			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	>12 months
Maturity analysis of liabilities based on the undiscounted amount of the contractual payment				
EQUITY AND LIABILITIES				
Liabilities				
Deposits and current accounts	517 551	349 489	89 777	78 285
Short trading positions	16 735	16 735	–	–
Derivative financial instruments	37 034	33 027	2 151	1 856
Creditors and accruals	9 070	5 090	3 665	315
Long-term liabilities	10 719	–	–	10 719
Policyholder liabilities under insurance contracts	2 141	410	48	1 683
Policyholder liabilities under investment contracts	102	7	6	89
Loans from Insurance Group	5 866	3 044	2 303	519
Financial and other guarantees	29 876	23 414	3 511	2 951
Facilities not drawn	52 808	35 725	968	16 115

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, are used to fund long-term assets, for e.g. mortgages.

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

Contractual discounted cash flow analysis (audited)

	2011			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	> 12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	697 928	260 516	56 392	381 020
Total equity and liabilities	697 928	476 233	73 356	148 339
Net liquidity gap	–	(215 717)	(16 964)	232 681
Cumulative liquidity gap	–	(215 717)	(232 681)	–

	2010			
		Term to maturity		
R million	Carrying amount	Call – 3 months	3 – 12 months	> 12 months
Maturity analysis of assets and liabilities based on the present value of the expected payment				
Total assets	653 155	227 041	68 335	357 779
Total equity and liabilities	653 155	420 436	98 352	134 367
Net liquidity gap	–	(193 395)	(30 017)	223 412
Cumulative liquidity gap	–	(193 395)	(223 412)	–

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

Risk and capital management report continued

Interest rate risk in the banking book

KEY DEVELOPMENTS AND FOCUS

The endowment effect, which results from a large proportion of "endowment" liabilities (including "sticky" 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, and results in bank earnings being vulnerable to interest rate cuts. The negative endowment effect impacted net interest income ("NII") in the year to June 2011, as rates were on average 114 basis points lower than in the comparative period.

Interest rate risk is managed as part of a holistic balance sheet management approach, in conjunction with other factors, such as credit impairments and balance sheet growth, and in accordance with the Group's house view. If required, the interest rate profile is adjusted through hedging strategies.

INTRODUCTION AND OBJECTIVES

The Group's interest rate risk is managed in two distinct categories:

- Interest rate risk emanating from trading activities is managed on an ETL/VaR basis (refer to the *Market risk in the trading book* section on page 179).
- Interest rate risk in the banking book, as is covered here.

This risk is identified and categorised in the following components:

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

The assumption and management of interest rate risk can be an important source of profitability and shareholder value, but excessive interest rate risk positions may pose a significant threat to the Group's earnings and capital base. Effective interest rate risk management practices should contain interest rate risk exposure within board-approved limits and risk appetite. Limits are expressed in terms of NII sensitivity and, where practical, internal measures also include fair value limits of the banking book instruments that can be fair valued.

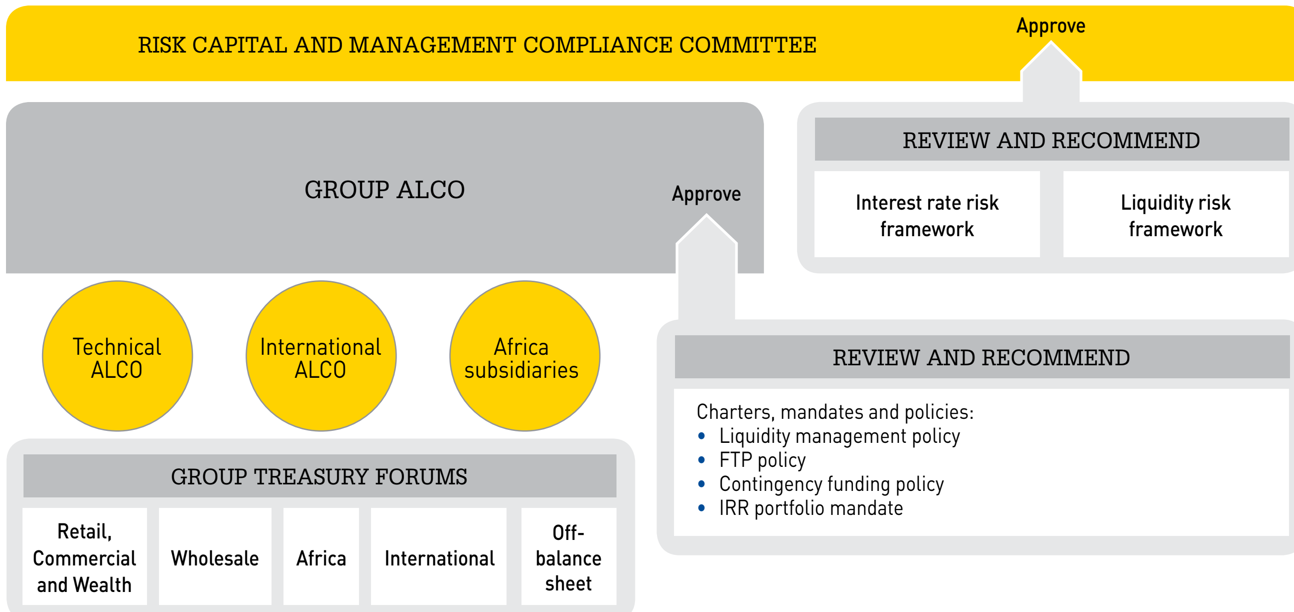
The objective of interest rate risk management is, therefore, to protect the balance sheet and earnings level from potential adverse effects arising from the various interest rate risk types described above.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

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

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

Interest rate risk management and governance structure



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

Interest rate risk, unlike credit risk, can only be adequately assessed and managed at an aggregate level for the banking book. The net interest rate risk profile of the domestic banking book (i.e. FRB, excluding RMB) is centrally managed by Group Treasury subject to oversight and governance from ERM and FirstRand ALCO.

RMB has a delegated mandate from FirstRand ALCO for the management of its IRRBB (in line with the Market risk management framework) as well as for ensuring that the limits of the Group's risk appetite are observed. ERM oversees and controls the management of interest rate risk in the banking books of Group Treasury and RMB. The RMB banking book interest rate risk exposure was R45.9 million on a 10-day ETL basis at 30 June 2011 (2010: R69.5 million). The *Market risk* section of this report provides a description of the ETL methodology.

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

ASSESSMENT AND MANAGEMENT

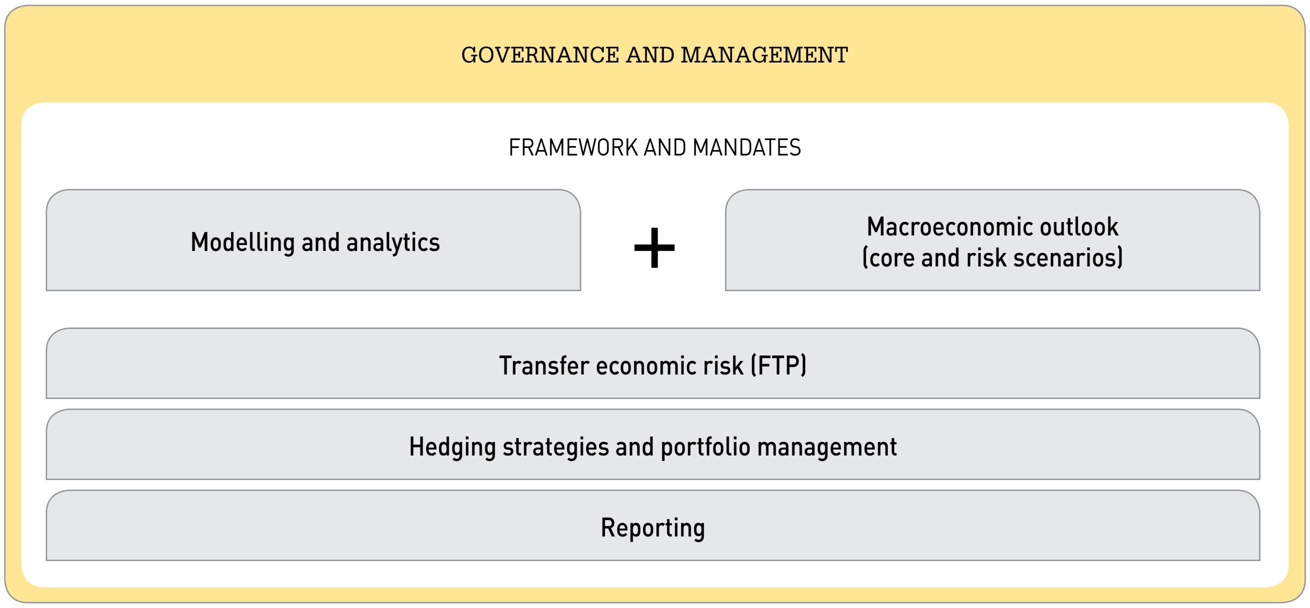
A number of measurement techniques are employed to quantify IRRBB as defined above, focusing both on the potential risk to earnings and the potential impact on overall economic value.

In line with industry practice the analyses cover parallel rate shocks, yield curve twists, complex stress tests and static repricing gap analyses. Results from these analyses are reported to FirstRand ALCO for review on a monthly basis. Additionally hedge positions and strategies are monitored daily, and are managed within defined risk appetite levels.

Risk and capital management report continued

The Group's IRRBB management and assessment activities are summarised in the following chart.

Interest rate risk management and assessment



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

In addition to measuring and hedging risk at an aggregate (net position) level, individual, large and complex transactions may be hedged at a micro level where appropriate. Management of the interest rate risk profile is carried out within the limits approved by the ALCOs.

An investment committee oversees these activities for the domestic banking operations and proposes portfolio actions.

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

Modelling assumptions

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

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

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

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

IRRBB PROFILE

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

Repricing schedules for the Group's banking book (audited)

	2011				
	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	52 582	(2 746)	(12 145)	(8 061)	(29 630)
Cumulative repricing gap	52 582	49 836	37 691	29 630	–
FNB Africa					
Net repricing gap	5 263	(715)	(562)	642	(4 628)
Cumulative repricing gap	5 263	4 548	3 986	4 628	–
Total cumulative repricing gap	57 845	54 384	41 677	34 258	–

	2010				
	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	(14 385)	11 987	15 999	2 085	(15 686)
Cumulative repricing gap	(14 385)	(2 398)	13 601	15 686	–
FNB Africa					
Net repricing gap	5 608	(960)	(1 141)	693	(4 200)
Cumulative repricing gap	5 608	4 648	3 507	4 200	–
Total cumulative repricing gap	(8 777)	2 250	17 108	19 886	–

This repricing gap analysis excludes the banking books of RMB and FRB's India and London branches, which are separately managed on a fair value basis.

Risk and capital management report continued

Sensitivity analysis

NII sensitivity increased by R1 273 million compared to the previous year. As explained previously, the Group remains sensitive to downward movement in interest rates. The "endowment" effect was partly hedged in June 2010. The hedges have been reduced in June 2011, resulting in an increased positive gap (and increased sensitivity) as disclosed in the above tables, in line with the Group's macroeconomic outlook.

NII sensitivity is subject to approved internal board limits. Utilisation of the risk limit was well within permitted exposures during and at the end of the year.

Assuming no management action in response to interest rate movements, an instantaneous sustained parallel decrease of 200 basis points in all interest rates would result in a reduction in projected 12-month NII of R2 186 million. A similar increase in interest rates would result in an increase in projected 12-month NII of R2 200 million.

Sensitivity of the Group's projected NII (audited)

	2011		
	Change in projected 12 month NII		
R million	FirstRand Bank	FNB Africa	FirstRand
Downward 200 bps	(2 013)	(173)	(2 186)
Upward 200 bps	2 027	173	2 200

	2010		
	Change in projected 12 month NII		
R million	FirstRand Bank	FNB Africa	FirstRand
Downward 200 bps	(789)	(124)	(913)
Upward 200 bps	798	124	922

This NII sensitivity analysis excludes the banking books of RMB and FRB's India and London branches, which are separately managed on a fair value basis.

Effective 1 July 2010, FirstRand became the regulated bank controlling company. Prior to 1 July 2010, FRBH was the regulated bank controlling company. The 2011 figures for FirstRand are therefore not comparable to the 2010 FRBH figures.

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

	2011	2010
Downward 200 bps	(0.51%)	0.39%
Upward 200 bps	0.68%	(0.11%)

Operational risk

KEY DEVELOPMENTS AND FOCUS

During the year under review the Group continued to improve operational process efficiencies and implemented a process-based platform for risk control, identification and assessment. Enhancements to and automation of operational risk measurement tools continue to be a focus area. In the next financial year the Group will continue to embed the combined assurance approach to risk management.

INTRODUCTION AND OBJECTIVES

Operational risk vs. reward is seldom proportional, yet it is an inherent and unavoidable part of doing business and exists, to a varying degree, in all organisational activities.

The Group recognises that operational risk exposure is incurred in generating sustainable profits, but advocates that it only does so within the Group defined risk tolerance levels.

The objective of operational risk management is thus not to eliminate all operational risk exposure but to set a framework for effectively managing and mitigating operational risk within acceptable and approved risk tolerance levels. Management's continued focus on improving process efficiencies is yielding positive business benefits.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

The management of operational risk is governed by the board-approved operational risk management framework ("ORMF") a subframework of the BPRMF. 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.

The Board has delegated its responsibility for the adequate identification and management of operational risk to the RCC committee, which in turn delegated this task to the Operational risk committee ("ORC"), a subcommittee of the RCC committee.

The ORC provides governance, supervision, oversight, and coordination of relevant risk processes as set out in the ORMF. To ensure appropriate visibility at board level, the ORC includes two non-Exco members, one of whom is a board member. Other members include franchise CROs, franchise heads of operational risk and senior personnel of the central ERM function.

In addition, there are governance committees at all levels of the Group (business unit, segment and franchise) that have been designed and established to support the ORC and the RCC in executing their risk management duties and responsibilities.

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

ASSESSMENT AND MANAGEMENT

Operational risk assessment approaches and 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 provides oversight, sets the risk appetite and challenges the risk profile. GIA in the third line of control provides independent assurance of the adequacy and effectiveness of operational risk management practices.

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

Operational risk tools and approaches

OPERATIONAL RISK TOOLS AND APPROACHES		
Risk control self assessments ("RCSA")	**Key risk indicators ("KRI")**	**Audit findings**
• 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. • Customised RCSA templates have been developed for specialised areas such as IT, business continuity and physical security.	• Used across the Group in all businesses as an early warning measure. • Highlight areas of changing trends in exposures to specific operational risks. • KRI reports are tabled at management and risk governance meetings to ensure that changes in the risk profile are brought to the attention of senior management.	• GIA acts as the third line of risk controls across the Group. • GIA provides an independent view on the effectiveness of existing controls and their effectiveness in mitigating risks associated with key and supporting processes. • Audit findings are tracked, monitored and reported on through the risk committee structures.
Internal/external loss data	**Internal validation**	**Risk scenarios**
• The capturing of loss data is well entrenched within the Group. • Internal loss data reporting and analyses occurs at all levels with specific focus on the root cause analysis and corrective action. • External loss data bases are used to learn from other organisations and as an input to the risk scenario process.	• A Group-wide internal validation is undertaken annually to ensure consistency in the application and output of the various tools. • This process involves a robust challenge of all the risk tools at all levels within the Group. • A report is issued on the final result to the business.	• Risk scenarios are widely used to identify and quantify extreme loss events. • Senior executives of the business actively participate in the bi-annual reviews. • The results are tabled at the appropriate risk committees and used as input to the capital modelling process.

Risk and capital management report continued

In addition to these operational risk tools and approaches, other specialised operational risk tools are used for specific risks, such as business resilience and IT risks. FirstRand also uses an integrated and renowned operational risk system which provides the technology for the automation of certain operational risk functions. This system is well positioned as the core operational risk system, and provides a solid platform for further automation, which is currently a key focus area for operational risk management. Other key objectives include the development, deployment and integration of an integrated risk and performance management solution which includes the implementation of an enhanced RCSA process which has been expanded to include process identification and assessment.

Operational risk losses

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. fraud) and are budgeted for appropriately. Business areas seek to 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 seeks to minimise these incidences and contain severity within risk appetite limits.

Given the ever-changing and complex nature of its business and processes, the Group employs a dynamic approach to managing operational risk and this approach results in continuous change or renewal. It is common practice, when implementing change of this nature, to address less than optimal operational procedures with meaningful adjustments to risk management. The Board and management continue to refine the consistent and disciplined approach of linking business processes to the operational risk and control environment.

Basel II – Advanced measurement approach

FirstRand began applying AMA under Basel II from 1 January 2009 for the Group's domestic operations. Offshore subsidiaries and operations continue to utilise the standardised approach for operational risk and all previously unregulated entities that are now part of FRIHL utilise the Basic indicator approach.

Under AMA, FirstRand is allowed to use a sophisticated statistical model for the calculation of capital requirements, which enables more granular and accurate risk-based measures of capital for all business units on AMA.

A number of **operational risk scenarios** (covering key risks that, although low in probability, may result in severe losses) and **internal loss data** are the inputs into this model.

- Scenarios are derived through an extensive analysis of the Group's operational risks in consultation with business and risk experts from the respective business units. Scenarios are cross referenced to external loss data, internal losses, the control environment and other pertinent information about relevant risk exposures. To ensure the ongoing accuracy of 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 II event types across various internal business lines. Data collection is the responsibility of the respective business units and is overseen by the central operational risk function 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. Regulatory capital requirements are then calculated (for the Group and each franchise) as the operational VaR at the 99.9th percentile of the aggregate loss distribution, excluding the effects of insurance, expected losses and potential diversification effects.

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.

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

Management processes

A comprehensive and integrated approach to managing operational risk includes the monitoring of some specialist operational risk processes. These are described below.

Business resilience management

Business resilience management ("BRM") is focused on ensuring that the Group's operations are resilient to the risk of severe disruptions caused by internal failures or external events.

The business continuity practices of the Group are documented in the business resilience, emergency response and incident management policy and supporting standards, which are approved at the Business resilience steering committee a subcommittee of the ORC. The policy requires the development and maintenance of business continuity strategies and plans. It also requires regular business continuity testing to be carried out in all business units.

The Group carries out regular reviews of BRM practices, and any disruptions or incidents are regularly reported to the relevant risk committees. Over the reporting period, all material areas remained at an acceptable status of readiness.

Legal risk

The legal risk management framework addresses and seeks to guide the operations of the Group in areas such as the creation and ongoing management of contractual relationships, the management of disputes, which do or might lead to litigation, the protection and enforcement of property rights, (including intellectual property) and the impact of changes in the law brought about by legislation or the decisions of the courts (unless such changes are covered as part of the compliance programme under RRM).

The legal risk management programme which flows from this is subject to continual review and refinement to ensure that sound operational risk governance practices and solutions are adopted and that it aligns with the Group's overall risk management programme. The legal risk committee, a subcommittee of the ORC, has oversight of legal risk management. During the year under review there were no significant legal risk-related incidents.

Information risk

Information risk is the risk of adverse business impacts, including reputational damage caused by a failure of data confidentiality, integrity and availability controls and is therefore a key area of ongoing focus.

The Group's information technology risk management framework ("IT framework") requires the application of the operational risk tools as discussed above. The tools have been adapted to align with IT standards and best practice. The IT framework is approved by the Technology and information risk management committee, an ORC subcommittee and applies to all operations across the Group.

The IT framework clearly defines the objectives for managing information risk, and outlines the processes that need to be embedded, managed and monitored across the Group.

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

Fraud and security risks

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

Oversight and governance of fraud and security risk is ensured via specific frameworks and policies that are applicable across the Group.

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

Regulatory risk

KEY DEVELOPMENTS AND FOCUS

The regulatory landscape is dynamic with many changes and enhancements being proposed and introduced by regulators. These emanate, in the main, from international standard-setting bodies responding to the lessons learned from the global financial crisis. South African banking regulation is based on international standards and best practice and is constantly being enhanced in line with the BCBS's reform programme and its ongoing work to strengthen the resilience of banks and the global banking system.

In this regard, the South African banking regulator is in the process of finalising current proposed amendments to the banking legislative framework in its ongoing effort to incorporate measures issued by the various international standard-setting bodies. Amongst others, these new or amended requirements and standards aim to further enhance the safety and soundness of the domestic banking system in support of financial stability. It is anticipated that, going forward, these and other measures will remain focus areas to ensure that the South African legal and regulatory framework pertaining to the banking sector remains effective in strengthening the regulation, supervision and risk management of the banking sector.

FirstRand is supportive of the banking regulator's objectives and endorses improvements in risk management and governance practices as an active participant in the changing regulatory landscape. The same approach is also applied in respect of cooperation with other regulatory authorities and much effort and resources are dedicated in a cost efficient manner in order to reap maximum benefits emanating from the implementation of best practice and the resultant enablement of our business activities.

Risk and capital management report continued

INTRODUCTION AND OBJECTIVES

The Group's RRM function plays an integral part in managing the risks inherent in the business of 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 Group embeds and endorses a culture that emphasises standards of honesty and integrity in which the Board and senior management lead by example. The compliance culture also embraces broader standards of integrity and ethical conduct and concerns all employees.

Non-compliance may potentially have serious consequences, which could lead to both civil and criminal liability, including penalties, claims for loss and damages or restrictions imposed by regulatory bodies.

The 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.

It is of paramount importance to ensure compliance with, among other, the provisions of the Banks Act, 1990 (Act No. 94 of 1990 – "the Act") and the Regulations relating to Banks ("the Regulations"), and to ensure that all compliance issues identified in this context are effectively and expeditiously resolved by senior management with the assistance of RRM.

In order to achieve this, all staff members are continually made aware of compliance requirements in order to ensure a high level of understanding and awareness of the regulatory framework applicable to the Group and the potential regulatory risks to which the Group is exposed.

Furthermore, ethical behaviour is both a keystone and an important contributor to the success of the entire compliance process. In view thereof, the Group expects all staff to maintain standards of honesty, integrity and fair dealing and to act with due skill, care and diligence.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Responsibility for ensuring compliance with all relevant laws, internal policies, regulations and supervisory requirements rests with the Board. 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 committee, the RCC committee and the FirstRand Audit committee, all of which receive regular detailed reports on the level of compliance and instances of material non-compliance from RRM.

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

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 their respective franchises.

ASSESSMENT AND MANAGEMENT

The high-level activities of RRM are described in the chart below.

Regulatory risk management activities

<table>
<tr><th>Regulatory risk and ethics strategy development</th><th>Regulatory risk and ethics management</th><th>Centre of excellence</th><th>Relationship management</th></tr>
<tr><td rowspan="2">Defines overall strategy for FirstRand – and ensures alignment of brand strategy</td><td>Performs strategic risk identification, assessment, mitigation and provides assurance</td><td rowspan="2">Provide expertise, advice and guidance</td><td rowspan="3">Provides regulatory liaison and relationship management</td></tr>
<tr><td>Monitors, analyses and reports ethics and regulatory risks</td></tr>
<tr><td rowspan="2">Sets framework, policies, standards for RRM and ethics</td><td>Gathers and manages ethics and regulatory risk data/information</td><td rowspan="2">Facilitates knowledge management, training and awareness</td></tr>
<tr><td>Sets core control functions at FirstRand level for standards/ policy setting</td><td rowspan="3">Stakeholder relationship management (internal and external)</td></tr>
<tr><td rowspan="2">Fosters a culture of ethical conduct and compliance</td><td>Challenges, tests and makes final trade-off decisions at divisional level (dependent on decision rights)</td><td rowspan="2">Runs selected core activities</td></tr>
<tr><td>Ensures sustainability through regulatory risk and ethics strategy</td></tr>
</table>

The RRM function's Board mandate prescribes full compliance with statutes and regulations. To achieve this, RRM has implemented appropriate structures, policies, processes and procedures to identify regulatory and supervisory risks monitor the management thereof and report on the level of compliance risk management to both the Board and the Registrar of Banks. These include:

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

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