RISK AND CAPITAL MANAGEMENT REPORT

Risk and capital management report

for the year ended 30 June

OVERVIEW

FirstRand 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.

Highlights

During the year ended 30 June 2012 the Group focused on refining origination scorecards in order to improve the credit quality of new business across all retail portfolios. Macro economic conditions, however, remain challenging affecting in-force portfolios. The wholesale portfolio has remained resilient and the Group will continue to focus on a credit strategy to capture an appropriate level of new business. Indications are that impairments have bottomed and limited benefit will be realised from any further interest rate decreases that may result from worsening economic conditions.

The Group's capital management strategy is aligned to its overall objective to deliver sustainable returns to shareholders within appropriate levels of volatility. The Group's current philosophy, given the uncertain macro environment, is to operate at the higher end of its targeted capital levels to ensure balance sheet resilience. Current targeted ranges and ratios are summarised in the table below.

Capital adequacy position

	FirstRand		FirstRand Bank*		Regulatory minimum
	Actual	Target	**Actual**	Target	
Capital adequacy ratio (%)	**14.7**	12.0 – 13.5	**14.6**	11.5 – 13.0	9.5**
Tier 1 ratio (%)	**13.2**	11.0	**12.6**	10.5	7.0
Core Tier 1 ratio (%)	**12.3**	9.5 – 11.0	**11.8**	9.0 – 10.5	5.25

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

** *The regulatory minimum excludes the bank-specific (Pillar 2b) add-on and capital floor.*

The Group focused on a number of regulatory changes during the year:

- implementing the Basel II standardised approach for the calculation of counterparty credit default risk capital;
- regulatory changes to measure the performance of market risk-taking activities;
- Banks Act changes relating to regulatory returns; and
- preparations for the implementation of Basel III:
  - quality and level of capital;
  - counterparty credit risk measures; and
  - the liquidity coverage ratio.

The COO and CFO's report on pages 14 to 28 provides a high-level overview of the Group's financial condition, performance and risk profile for the year ending 30 June 2012.

Basel Pillar 3 disclosure

Regulation 43 of the revised regulations of the Banks Act, 1990 (Act no. 94 of 1990), requires that a bank shall disclose in its annual financial statements and other disclosures to the public, reliable, relevant and timely qualitative and quantitative information that enables users of that information, 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 Accord. This is the Basel Pillar 3 report of FirstRand and complies with the risk disclosure requirements of Basel Pillar 3.

FirstRand is the listed holding company and regulated bank-controlling company of the Group. The wholly-owned subsidiaries of FirstRand are FirstRand Bank Limited (the Bank), FirstRand EMA Holdings Limited (FREMA) and FirstRand Investment Holdings (Pty)

Ltd (FRIHL) and are all regulated. Banking operations are included under the Bank, FREMA includes Africa and emerging markets and all other activities are under FRIHL. A simplified diagrammatic representation of the Group structure is provided on page 433.

Some differences between the practices, approaches, processes and policies of the Bank and its wholly-owned subsidiaries exist and these are highlighted by a reference to the appropriate entity, where necessary. For fully consolidated entities in the Group, no difference in the manner in which entities are consolidated for accounting and regulatory purposes exists.

This report has been internally verified by the Group's governance processes in line with the Group's public disclosure policy. All information in this report is unaudited unless otherwise indicated.

Recent regulatory changes

In July 2009, as part of its *Enhancements to the Basel II framework*, namely Basel 2.5, the Basel Committee on Banking Supervision (BCBS) introduced guidance to address a number of risk management weaknesses revealed during the financial crisis that started in 2007. A number of these were included in this report:

- Market risk: Combined Value-at-Risk (VaR) and stressed VaR were incorporated in the Group's local trading book on 1 January 2012. A number of additional concentration measures were also implemented.
- Securitisations: The new Regulation 43 disclosure requirements regarding resecuritisations, additional disclosures in respect of processes monitoring securitisation exposures, differentiation between banking and trading book exposures and accounting policies, the regulatory approach used to assess capital requirements on retained exposures, and updated quantitative disclosures for retained exposures.
- Remuneration: Qualitative and quantitative disclosures on compensation and remuneration were included. The remuneration report is included in the integrated annual report on page 79 and includes the Basel Pillar 3 disclosure requirements for remuneration.

Future regulatory changes

Basel III, released in December 2010, builds on Basel 2.5. It sets higher capital and liquidity requirements to be progressively phased in from 1 January 2013. This includes the phasing out of certain existing Tier 1 and 2 instruments that no longer qualify as regulatory capital over ten years starting from January 2013. In terms of the Basel III guidelines for liquidity, the Liquidity Coverage Ratio (LCR), which measures short-term liquidity stress, will be effective from January 2015 and the Net Stable Funding Ratio (NSFR), which measures the stability of long-term structural funding, will come into effect on 1 January 2018.

Remuneration and compensation

FirstRand's divisions operate across a variety of financial services activities, each with distinct employment and human resource pressures. The Group's remuneration policy takes account of the diverse needs of the Group's divisions and the implementation of appropriate industry specific remuneration practices in accordance with the Group's remuneration policy which is applicable at all operations, including international branches and subsidiaries. The Remuneration committee is a board committee mandated to ensure the Group's remuneration practices appropriately reflect company performance and are aligned with the interests of shareholders and other stakeholders. Its responsibilities include:

- to ensure compliance with international best practice including the BCBS and Financial Stability Board's guidelines and recommended practices;
- to ensure that the Group's remuneration practices appropriately reflect company performance and are aligned with the interest of shareholders and other stakeholders; and
- to provide oversight of remuneration and rewards of executive directors, senior management and reviews proposals on non-executive remuneration.

The remuneration report on page 79 provides an overview of executive remuneration and details of variable compensation for 2012 as well as additional disclosures to comply with regulatory requirements.

DEFINITIONS

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

Risk category reference	Risk components	Definition	Page
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.	132
		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 earnings and 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.	
		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.	136
	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.	145
	Securitisations and conduits	Securitisation is the structured process whereby loans and other receivables are packaged, underwritten and sold in the form of asset backed securities.	178
	Counterparty credit risk	Counterparty credit risk is the risk of a counterparty to a contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows.	185
	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.	188

Risk category reference	Risk components	Definition	Page
FINANCIAL RISKS	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.	192
	Foreign exchange and translation risk in the banking book	Foreign exchange risk is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank is exposed to currency risk in its net open foreign currency positions and foreign investments. Translation risk is the risk associated with banks that transact 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.	195
	Funding and liquidity risk	Funding liquidity risk is the risk that a bank will not be able to meet current and future cash flow and collateral requirements (expected and unexpected) without negatively affecting its reputation, daily operations and/or financial position. Market liquidity risk is the risk that market disruptions or lack of market liquidity will cause the bank to be unable (or able, but with difficulty) to trade in specific markets without affecting market prices significantly.	195
	Interest rate risk in the banking book (IRRBB)	IRRBB is the sensitivity of a bank's financial position and earnings to unexpected, adverse movements in interest rates.	203
OPERATIONAL RISKS	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.	207
	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.	211

Risk and capital management report continued

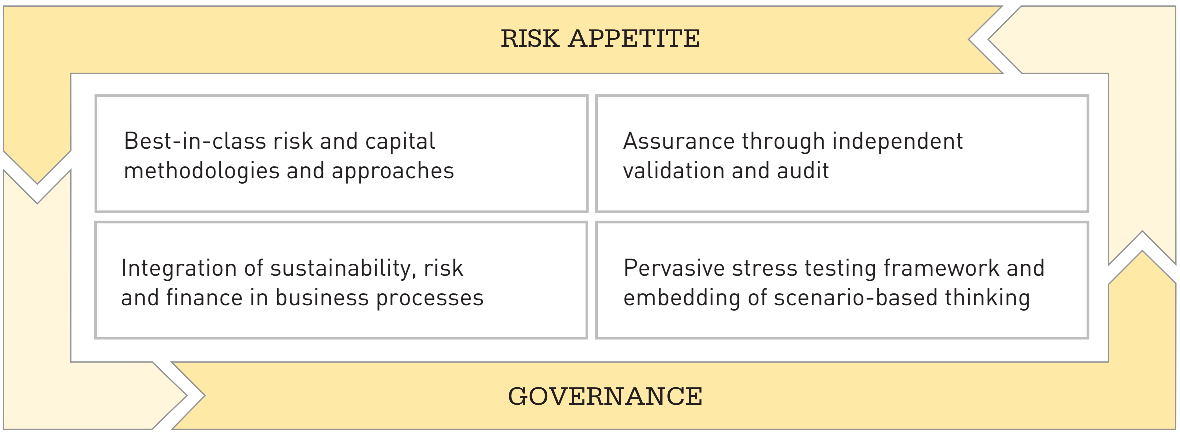
FIRSTRAND'S APPROACH TO RISK AND CAPITAL MANAGEMENT

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 part of the Group's tactical and strategic decision making. The Group aligns its risk management approach to its strategy discussed in the COO and CFO's report on page 14. Risk taking is an essential part of the Group's business. FirstRand recognises risk assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates.

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 following chart.

Components of FirstRand's approach to risk and capital management



These 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 page 123).
- 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 129).
- Best practice **risk and capital methodologies** have been developed in and for the relevant business areas (see page 132 to 212).
- An integrated approach to **sustainability and managing risk** was established to facilitate the exchange of information between individual risk areas, and between risk and finance functions (see page 124).
- The Group employs a comprehensive, consistent and integrated approach to **stress testing** that is ingrained as a business planning and management tool, emphasising scenario-based analyses in all its decisions. Stress testing includes the quantification of potential volatility of earnings under various scenarios and due to event risk. (see page 125).
- **Independent oversight, validation and audit functions** ensure a high standard of assurance across methodological, operational and process components of the Group's risk and capital management processes (see page 128).

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 Risk, capital management and compliance (RCC) committee and subcommittees, as described in the *Risk governance structure* section on page 129.

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 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 aligned against broader financial targets.

The Board established risk appetite principles in which business is tracked against certain measures. These principles include:

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

As a function of the business environment and stakeholders' expectations, together with the primary risk appetite measures, these principles provide firm boundaries for the organisation's chosen path of growth.

In setting the risk appetite, the Executive committee (Exco) and the Board balance the organisation's overall risk capacity with a bottom-up view of the planned risk profile for each business. In this 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.

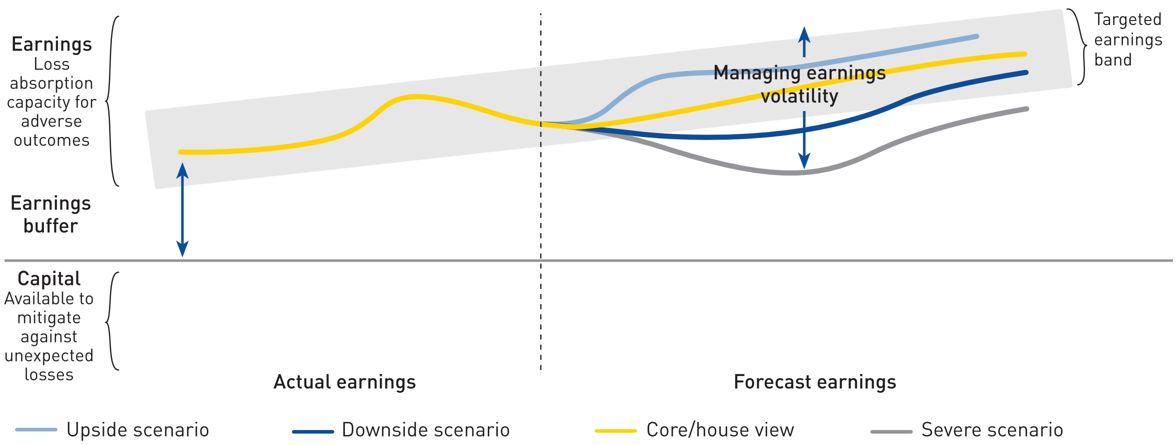
Risk appetite measures are included in risk and management reports across the businesses, as well as at board level. These measures are continually refined as more management information becomes available and stress test results are reported and discussed.

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

Risk and capital management report continued

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 132 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 the franchises is supported by the Group's financial strength and it adopts a management approach that seeks to achieve an optimal deployed risk model.

The franchises are 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, forecasting and credit origination strategies. The house view focuses on the key macro economic variables that impact the balance sheet and income statement. The macro outlook is reviewed on a monthly basis and spans a three year forecast horizon for a core scenario and two risk scenarios. These scenarios are debated internally and communicated to the business units. A severe stress scenario is also generated for stress testing purposes.

The objective of the Group's balance sheet management is to protect and enhance financial performance of the Group through the holistic management of the balance sheet and its income streams within the context of the macro economic environment. At the core of FirstRand's approach is a belief that the balance sheet and its income statement streams can be both protected and enhanced throughout the cycle to improve sustainability and predictability, by actively managing the investment and enterprise value risks which include:

- interest rate risk;
- credit portfolio risk;
- capital risks; and
- strategic funding risks.

To achieve this objective, the Group implements an integrated balance sheet management approach. This requires a detailed understanding of the economic cycle and the interplay between the risks created by the cycle and the levers within the business that can be used to mitigate those risks. Ultimately, the aim is to optimise the natural position of the balance sheet, look for natural hedges or implement appropriate macro hedges in the current structure and only make the balance sheet available to the origination businesses if the required risk-reward profile can be met.

FirstRand's integrated balance sheet management approach is aligned to the objectives of performance management in that it facilitates optimisation of the spread between ROE and cost of equity.

Group Treasury is responsible for the capital management. The capital position provides the final buffer against adverse business performance under extremely severe economic conditions.

Group Treasury is also responsible for the financial resources of the Group including funding and liquidity management, exchange control, interest rate risk and capital and market risk in the banking book management.

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

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

Internal capital adequacy assessment process (ICAAP)

The overall objective of capital management is to maintain sound capital ratios, a strong credit rating, ensure confidence in the solvency of the Group, comply with regulatory requirements and instil confidence during periods of uncertainty and turmoil in financial markets.

In order to achieve this objective the Group needs to:

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

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

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

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

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

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

Stress testing and scenario-based analyses

Stress testing and scenario-based analysis form an integral part of the overall governance and risk management culture of the Group and is an important risk management tool used to alert management of adverse unexpected outcomes related to a variety of risks and to provide an indication of how much capital is needed to absorb losses should these occur.

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 and competitors' strategies, and potential stress events forms an integral part of the strategy setting, planning and budgeting processes.

Additionally, stress testing is used amongst others to:

- validate existing quantitative risk models in order to assess whether the output derived in a negative stress scenario is consistent with model outputs at a similar severity level;

- set risk limits; and
- evaluate emerging risks.

FirstRand's approach to planning, including the stress and scenario analysis, requires comprehensive involvement of the franchises and the various units within the Group's Corporate Centre. The Board, through the RCC committee, is ultimately responsible to critically evaluate the:

- stress-test approach followed;
- scenario/s selected; and
- the impacts of the stress test results on the business and strategic direction of the Group.

From a business planning perspective, the business is managed in line with the core macro economic view (core scenario). Stress scenarios are overlaid on the core scenario to alert management of adverse unexpected outcomes which in turn impacts management action considerations. 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 planning and stress test provides for proactive and continuous identification of such potential events and establishes a process in which these are evaluated and discussed across the businesses.

From time to time, the regulator may call for the Group to run a supervisory stress test with prescribed assumptions and methodologies, which are also considered as part of the overall planning and stress test process.

RISK MANAGEMENT FRAMEWORK AND GOVERNANCE STRUCTURE

Risk governance framework

FirstRand's Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, monitored and managed. The Group believes that effective risk management is based 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 consistently applied at various levels throughout the organisation. There are three primary lines of control across the Group's operations illustrated in chart opposite.

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 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;
- designs business processes that will ensure that risks are managed appropriately;
- 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 understand responsibilities in relation to risk management.

Business owners, the Board and Exco are supported in these responsibilities by Group Treasury within the Corporate Centre. The responsibilities of Group Treasury, including Balance Sheet Management (BSM) and Capital Management and Performance Measurement, are described in the *Focus on sustainability and integration of risk and finance* section on page 124.

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.

Lines of risk control

First line — Risk ownership

Head of business: primary risk owner
Embeds risk management as a core discipline and gives consideration to potential risks in business decisions.

Group Treasury
Supports business owners, the Board and Exco in the implementation of Group strategy across the portfolio and includes:

- capital management and performance measurement;
- balance sheet management;
- management of liquidity, interest rate risk and foreign exchange mismatch; and
- management of funding and liquidity.

Second line — Risk control

Deployed divisional and segment risk managers
Support business units in identifying and quantifying significant risks.

Enterprise Risk Management
Provides independent oversight and monitoring across the Group on behalf of the Board and relevant committees.

Regulatory Risk Management
Ensures that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws.

Third line — Independent assurance

Group Internal Audit
Provides independent assurance of the adequacy and effectiveness of risk management practices.

Risk and capital management report continued

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;
- approve the design of business risk processes that will ensure that risks are managed appropriately;
- 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 timeously performed as agreed with Enterprise Risk Management (ERM).

Divisional and segment risk management activities are overseen by the 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 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 banking risks 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 on page 211.

Third line – independent assurance

The third major line of control involves internal audit and external advisors providing independent and objective assurance to the Board, Audit committee and regulators. The assurance is provided on the overall adequacy and effectiveness of governance, risk management and control within the Group as established by the first (management oversight) and second (management of risk) lines of control.

FirstRand Group has an established internal audit function, namely Group Internal Audit (GIA).

GIA is an independent, objective assurance and consulting activity designed to add value and improve the operations of FirstRand and its subsidiaries, joint ventures, trusts, offshore operations and business interests. GIA assists executive management and the Audit committee to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes within the Group.

GIA is headed by the chief audit executive (CAE) and reports to the Board through the Audit committee chairman. The CAE has direct, unrestricted access to the Group CEO and executives, and respective subsidiaries as well as to all FirstRand business unit functions, records, property and personnel. The CAE reports administratively to the CEO and functionally to the chairman of the Audit committee, which is in line with Institute of Internal Auditing standards and good corporate governance principles.

To achieve its objectives, GIA:

- assesses whether management establishes and monitors the adequacy and effectiveness of the internal control systems, internal risk management procedures and methodologies;
- assesses the adequacy and effectiveness of the organisation's corporate governance, risk management and internal control frameworks;
- assesses if governance processes and ethics are designed and operating in line with legislation and best practice guidelines;
- reviews the adequacy of manual and automated internal controls to ensure compliance with policies, plans, procedures, regulatory requirements, and business objectives;
- evaluates whether approved business processes adequately address the risks that should be controlled and if they are operating effectively throughout the period under review; if not, adjusts substantial work to address deficiencies in these business processes;
- reviews internal control, management, financial and information systems, including electronic systems to ensure that sound general and processing controls are incorporated to produce accurate, valid and complete financial and regulatory reporting disclosure;
- appraises the economy, efficiency and effectiveness of resource utilisation;

- assesses the adequacy of processes implemented to ensure that all tangible and intangible assets are safeguarded and accounted for;
- assesses if systems of fraud prevention and detection are functioning as intended; and
- escalates significant internal control weaknesses, together with practical recommendations to management and the Audit committee and follows up on recommendations to ensure effective remedial action has taken place.

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

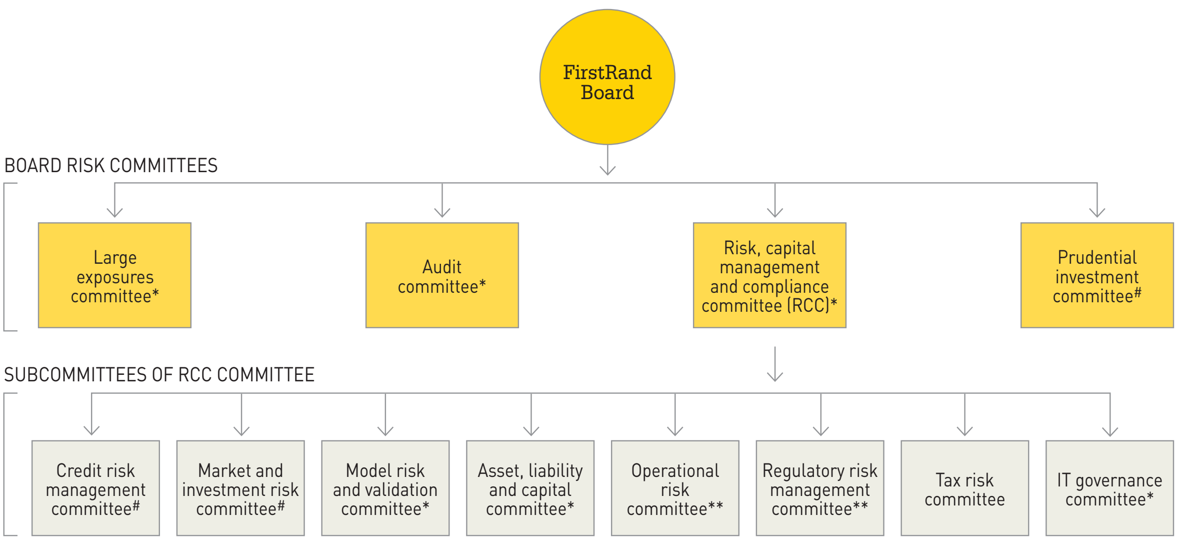
The Audit committee has overseen the establishment of formal enterprise-wide governance structures for enhancing the practice of combined assurance forums at Group and subsidiary level. Through the assurance framework, GIA coordinates its work with senior management and ERM, RRM and external audit. The primary objective of the Group and assurance forums is for the assurance providers to work together with management to deliver the right assurance in the right areas by people with the best skills and experience and skills as cost effectively as possible.

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

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



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

Risk and capital management report continued

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

Responsibilities of the board risk committees

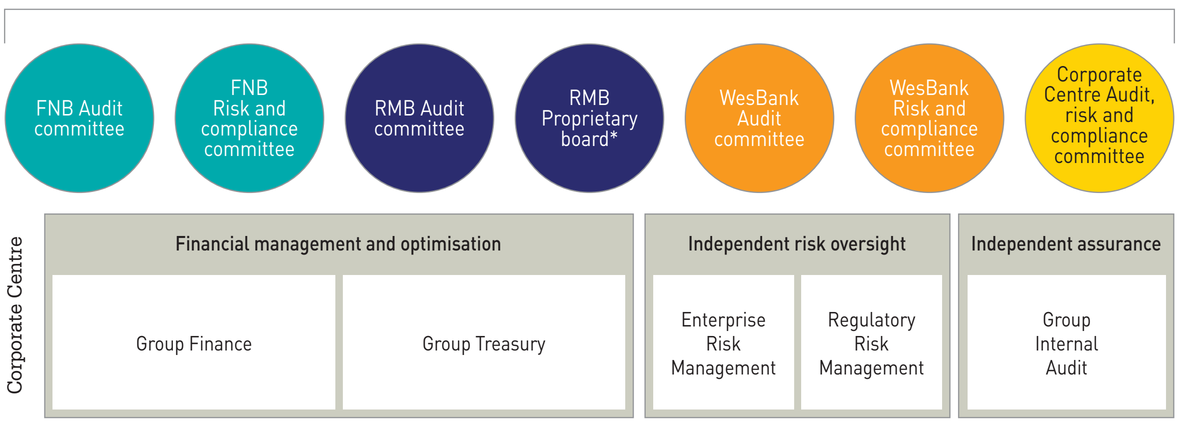
Committee	Responsibility
Large exposures committee (LEC)	• approves credit exposures in excess of 10% of the Group's capital; and • delegates the mandate for the approval of group and individual credit facilities to the FirstRand Wholesale credit committee, Commercial credit committee and Retail credit committee, as appropriate.
Audit committee	• considers the annual financial statements for approval by the Board; and • monitors the quality of the internal financial controls and processes of control in FirstRand, and the implementation of corrective actions. The Audit committee report is included on page 92 of the FirstRand integrated annual report.
Risk, capital management and compliance committee (RCC)	• 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.
Prudential investment committee (PIC)	• ensures investment exposures comply with FirstRand's prudential investment guidelines.

Responsibilities of the subcommitees of the RCC committee

Committee	Responsibility
Credit risk management committee	• approves credit risk management policies, standards, processes and new business origination within risk appetite; • monitors effectiveness of credit risk management processes, credit loss forecasting and impairment charges; • monitors the quality of the credit risk profile, in-force business and new business origination, and underlying assets in the securitisation process; • monitors scenario and sensitivity analysis, stress tests, credit economic capital and credit concentrations; • ensures the uniform interpretation of the credit regulatory requirements and acceptable standards of credit reporting; • reviews the credit economic conditions outlook from BSM and ensures that business units align credit origination strategies with the FirstRand view; and • delegates the approval of wholesale, commercial and retail credit policies to its subcommittees, namely the FirstRand Wholesale credit, Commercial credit and Retail credit committees.
Market and investment risk committee (MIRC)	• approves market and investment risk management policies, standards and processes; • monitors the effectiveness of market and investment risk management processes; • monitors the market and investment risk profile; and • approves market and investment risk-related limits.

Committee	Responsibility
Model risk and validation committee (MRVC)	• 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.
Asset, liability and capital committee (ALCCO)	• approves and monitors effectiveness of management policies and processes for liquidity and funding risk, capital risk and market risk in the banking book (interest rate risk in the banking book, credit and counterparty credit risk, foreign exchange and translation risk, Corporate Centre macro hedges and investment risk); • monitors the management of funding of the Group's balance sheet; • provides governance and oversight of the level and composition of capital, and considers the supply and demand of capital across the Group; • approves buffers over regulatory capital and monitors capital adequacy ratios; and • approves frameworks and policies relating to internal funds transfer pricing (FTP) for the Group.
Operational risk committee (ORC)	• provides governance, oversight and coordination of relevant operational risk management practices.
Regulatory risk management committee (RRM committee)	• 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.
Tax risk committee	• monitors tax management processes, effectiveness of tax management process and corrective actions.
IT governance committee	• approves group-wide information and technology risk policies and standards to ensure the protection of information assets; and • ensures the effectiveness of information and technology systems, and processes across the Group.

Franchise risk governance structure



* *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 staffed by members of the respective committees of the individual franchise boards so as to ensure a common understanding of the challenges business faces and how these are addressed across the Group.

Risk and capital management report continued

Regular risk reporting

ERM drives the implementation of more sophisticated risk assessment methodologies through the design of appropriate policies and processes, including the deployment of skilled risk management personnel in each of the franchises.

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

STRATEGIC AND BUSINESS RISK

Introduction and objectives

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

Business risk is considered in strategic planning 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.

In an environment of continued weakness of the South African economy and the risks imposed by the continued weak world economy, FirstRand continues to focus on cost containment whilst pursuing growth opportunities both locally and in selected African markets. While the Group has negligible direct exposure to counterparties in the peripheral European countries, the risk lies in the growth impact on South Africa's economy as Europe is a major trading partner.

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 the Corporate Centre, review the external environment, industry trends, potential emerging risk factors, competitor actions and regulatory changes as part of strategic planning. Through this review, as well as regular scenario planning and stress-testing exercises, the risk to earnings and 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 important part of the Group's risk processes.

Volume and margin risk

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

Reputational risk

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

The Group's reputation is built on the way in which it conducts business and it protects its reputation by managing and controlling these risks across its operations. It seeks to avoid large risk concentrations by establishing a risk profile that is balanced 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 an 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 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 the 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 (EP) finance institution in July 2009. Within FirstRand, the application of EP forms part of ESRA and is a very specific credit risk management framework for determining, assessing and managing ESG risk 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.

Once an applicable transaction has been identified, the activity for which finance is requested is categorised according to its potential impact on the environment or on social systems associated with the activity or operations. This categorisation process then determines the level of approval and review that is required for the particular transaction.

Specialist resources within the franchises are technical advisors to senior management and employees involved with credit transactions and provide assessment and review, consultation and specialist advice on lending transactions.

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 officers, credit committees throughout the Group and divisional social and ethics committees in cases of sensitivity. At a Group level oversight is provided by the RCC and Audit committees. The ESRA review process is illustrated in the chart below.

ESRA review process

Deal origination →	Categorisation →	Environmental and social risk review →	Credit application →	Action plan →	Monitoring and evaluation
Deal identified and screened against an exclusion list.	Deals categorised by project type, value and ESRA category.	Environmental and social risk assessment informs in-house opinion.	Credit application assessed.	Action plan and covenants defined with client in line with legal documentation.	Ongoing monitoring and evaluation against covenants and legal documents.

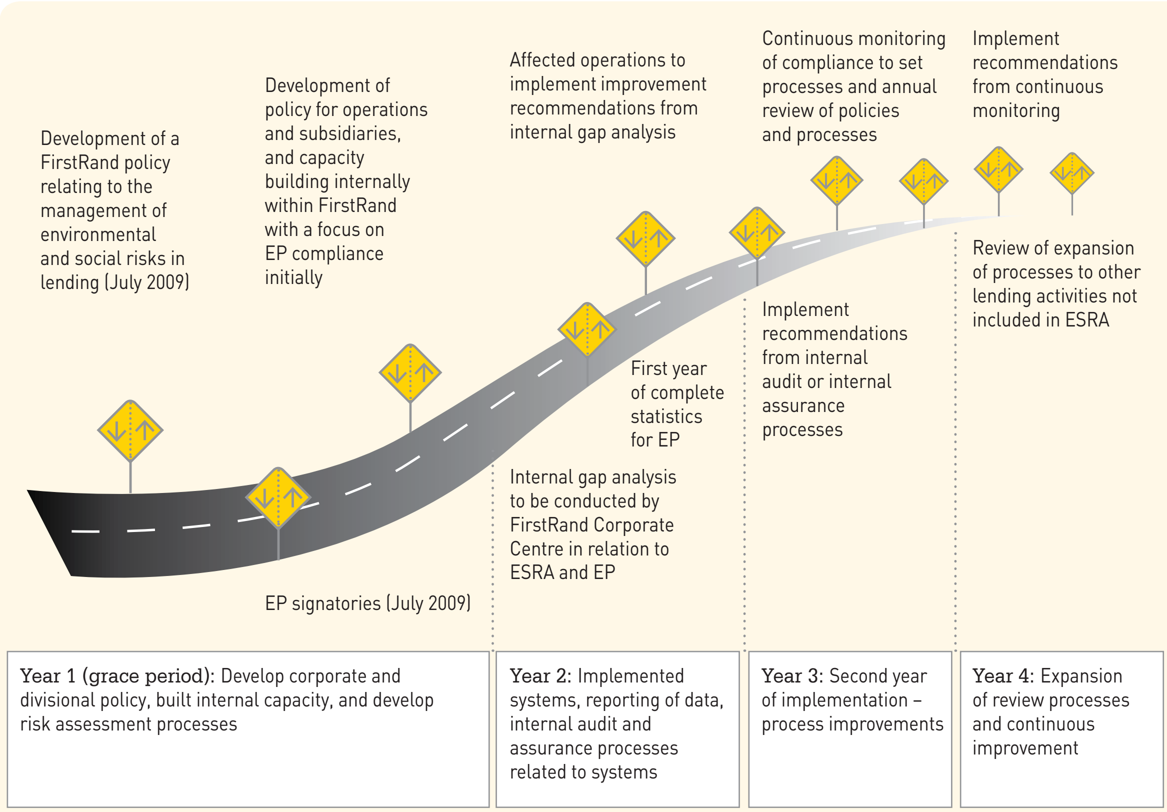
ESRA transaction by type

Transaction type	Threshold amount after which an ESRA review is triggered
Project finance transactions (subject to EP)	Total project capital costs at or above US$10 million.
Project finance advisory (subject to EP)	Total project capital costs at or above US$10 million.
Project finance transactions	All category A (high risk) and B (medium risk) transactions with a total project capital costs of less than US$10 million are subject to review.
Corporate loans	No threshold applied.
Equity investment deals	No threshold applied.
Affected commercial loans (inclusive of property finance)	Property finance or property securitised loans – no threshold is applied. Commercial loans (non-property related) – total facility amount above R7 million.
Asset finance for commercial or corporate purposes	Total facility amount above R50 million.
Commercial and corporate related working capital and overdraft loans	Total facility amount above R7 million.

Risk and capital management report continued

Progress on implementation

FirstRand is currently in the third year of ESRA implementation.



2012 Equator Principles performance

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

Definition of EP performance categories

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

EP transactions

EP category	2012		2011	
	Projects screened for the first time during the year	**Projects that reached financial close during the year**	Projects screened for the first time during the year	Projects that reached financial close during the year
A (high risk)	**2**	**1**	5	3
B (medium risk)	**9**	**8**	2	-
C (low risk)	**6**	**7**	3	2
Total	**17**	**16**	10	5

The projects screened are the structured EP defined project finance deals, which were reviewed by an in-house environmental and social risk specialist, and had been subjected to an independent EP review, where applicable, to establish the environmental and social risks of the project for the first time during the reporting period. The projects that reached financial close are defined as the number of structured EP defined project finance deals which reached financial close during the reporting period. Financial close is assumed when all conditions precedent to initial drawing of the debt have been satisfied or waived.

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

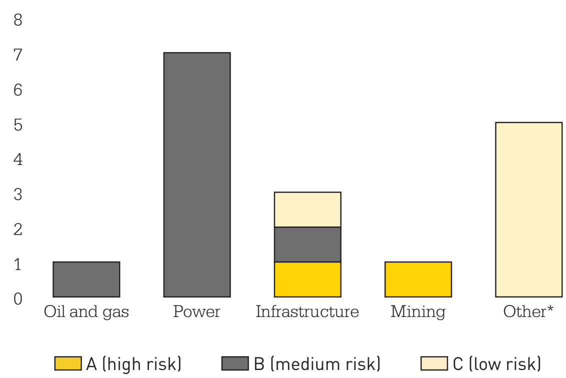
Analysis of EP transactions

EP transactions during the period under review were categorised into the mining and infrastructure sectors, renewable energy projects 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.

All of the transactions noted are southern African based projects.

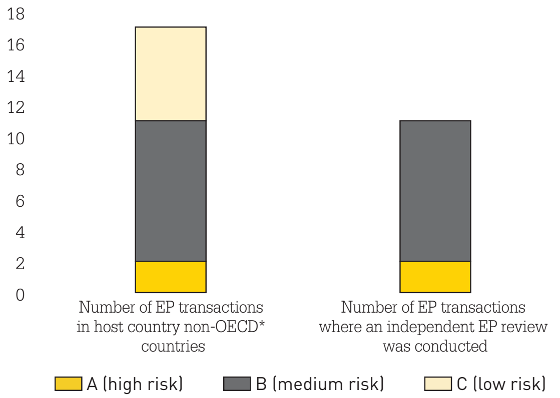
The chart below illustrates the number of EL transaction screened per industry category.

EP finance transactions screened per industry category (number of transactions)



* *Transactions in the other category are typically deals related to large commercial property developments.*

Category of EP transactions (number of transactions)



* *Organisation for economic cooperation and development (OECD). During the year under review there were no EP transactions screened hosted in OECD countries.*

ESRA process going forward

Although the evaluation and monitoring of EP transactions are embedded across the Group, continued focus will be given to the effective implementation of the ESRA process. Planning for future reporting on further implementation of the ESRA process will allow for performance reporting in relation to ESRA transactions that go beyond project finance transactions as defined in EP.

The National Environmental Management Act: Waste Act is an area that will be a future focus area, particularly as it relates to the review of ecological contamination of financed property or taken as security.

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

CAPITAL MANAGEMENT

Introduction and objectives (audited)

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

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

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

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

The effectiveness of capital allocation decisions and the efficiency of the Group's 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. The plan also takes into account volatile earnings brought on by fair value accounting, anticipated earnings yield on capital employed, organic growth requirements and a safety margin for unexpected fluctuations in business plans.

Capital adequacy and planning

The year under review (audited)

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

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

Regular reviews of economic capital 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 risk with Tier 1 capital, which offers the greatest capacity to absorb losses.

Targeted ranges were increased in the prior year in anticipation of the implementation of Basel III, even though the levels for South Africa are not yet finalised. Given the continued uncertainty, the Group follows a conservative approach to capital levels and prefers to maintain capital ratios at the upper end of its targeted capitalisation range. The Group will revisit the internal target capitalisation levels once the SARB finalises the regulations incorporating Basel III.

Throughout the year under review, the Group operated above its targeted capitalisation range, reporting a total capital adequacy ratio of 14.7% and a solid Core Tier 1 ratio of 12.3% at 30 June 2012.

Similarly the Bank, excluding foreign branches, operated comfortably above its targets with a total capital adequacy of 14.6% and Core Tier 1 ratio of 11.8%.

Although the Group's internal capital generation remains strong, regulatory uncertainty and the ongoing capital requirements for the Africa strategy lead the Group to continue to adopt a conservative approach to capital levels.

The targeted capital levels as well as the ratios at 30 June 2012 are summarised in the table below.

Capital adequacy position

	FirstRand		FRB*		Regulatory minimum
	Actual	Target	Actual	Target	
Capital adequacy ratio (%)	14.7	12.0 – 13.5	14.6	11.5 – 13.0	9.5**
Tier 1 ratio (%)	13.2	11.0	12.6	10.5	7.0
Core Tier 1 ratio (%)	12.3	9.5 – 11.0	11.8	9.0 – 10.5	5.25

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

** *The regulatory minimum excludes the bank-specific (Pillar 2b) add-on and capital floor.*

Basel III

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

The SARB is currently drafting regulations incorporating the Basel III proposals. The second draft was released on the 17 August 2012 for implementation on 1 January 2013. The Basel III impact on the Group's Core Tier 1 ratio is expected to be minimal. There is, however, a more pronounced negative impact on the total capital adequacy ratio as the current NCNR preference share capital and subordinated debt instruments do not meet the new loss absorbency criteria. Given the transitional period for the implementation of Basel III, the Group remains focused on optimising its capital base. The Basel III impact on the supply and demand of capital is discussed below.

The Group continues to participate in the SARB's bi-annual quantitative impact studies to assess the impact of Basel III on capital adequacy ratios.

The BCBS introduced a simple, transparent non-risk based leverage ratio that is calibrated to act as a credible supplementary measure to the risk-based capital requirements. The SARB has proposed a minimum Tier 1 capital leverage ratio of 4%, which is higher than the BCBS's requirement of 3%. The Group's current leverage ratio is well in excess of this requirement and therefore this does not introduce any constraints to the Group.

Supply of capital – Tier 1

Tier 1 capitalisation ratios benefited from stronger internal capital generation through earnings, offset by the special dividend paid in October 2011. All profits were appropriated at 30 June 2012.

The draft regulations allow for the inclusion of disclosable reserves (i.e. share-based payment, foreign currency translation and available-for-sale reserves) in the supply of capital. This is offset by the exclusion of certain minority interests, additional regulatory deductions for the expected loss over provisions and the grandfathering of the NCNR preference share capital over a ten-year period.

Risk and capital management report continued

Supply of capital – Tier 2

During the year, the Bank, FNB Botswana and FNB Namibia issued subordinated debt that meets the Basel III entry criteria (excluding loss absorbency). These instruments qualify for the grandfathering arrangements under Basel III. The Group's old-style Tier 2 instruments also do not meet the loss absorbency criteria under Basel III and will be grandfathered.

Demand for capital

Risk weighted assets (RWA) movement for the year was driven mainly by the following:

- credit risk – the increase is due to credit risk recalibrations, volume growth and the 6% scalar applied to exposures on the advanced internal ratings-based (AIRB) approach (Basel 2.5 requirement);
- market risk – decreased market risk positions were offset by the Basel 2.5 stressed VaR requirements and incremental risk charge; and
- equity investment risk - effective 1 July 2011, the SARB requested that all equity investment risk exposures be risk weighted under the simple risk weighted method (previously risk weighted under the standardised approach). This is only applicable to the non-bank entities and has increased the RWA movement for the Group.

Under Basel III RWA are expected to increase further mainly due to the credit valuation adjustment for counterparty credit risk, as well as the requirement for capital on central clearing parties.

Capital adequacy

Composition of capital

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

Composition of qualifying capital and capital ratios for FirstRand

	FirstRand			
R million	**2012**	**%**	2011	%
Ordinary shareholders equity as per IFRS*	**62 521**		56 631	
Less: non-qualifying reserves	**(3 983)**		(2 954)	
– Cash flow reserve*	**753**		451	
– Available-for-sale reserve*	**(626)**		(225)	
– Share-based payment reserve*	**(3 247)**		(2 739)	
– Foreign currency translation reserve*	**(1 052)**		(474)	
– Other reserves*	**189**		33	
Ordinary shareholders equity qualifying as capital	**58 538**		53 677	
– Ordinary share capital and share premium*	**5 271**		4 998	
– Reserves	**53 267**		48 679	
Non-controlling interests	**2 767**		3 069	
Less: total impairments	**(3 419)**		(3 121)	
– Excess of expected loss over eligible provisions (50%)	**(400)**		(907)	
– First loss credit enhancements in respect of securitisation structures (50%)	**(508)**		(247)	
– Goodwill and intangibles	**(1 743)**		(1 691)	
– Other impairments	**(768)**		(276)	
Total Core Tier 1 capital	**57 886**	**12.3**	53 625	13.9
NCNR preference share capital*	**4 519**		4 519	
Less: impairments	**(400)**		(400)	
Total Tier 1 capital	**62 005**	**13.2**	57 744	15.0
Upper Tier 2 instruments	**1 045**		1 042	
Tier 2 subordinated debt instruments	**6 973**		5 712	
Other reserves	**215**		202	
Less: total impairments	**(908)**		(1 154)	
– Excess of expected loss over eligible provisions (50%)	**(400)**		(907)	
– First loss credit enhancements in respect of securitisation structures (50%)	**(508)**		(247)	
Total Tier 2 capital	**7 325**	**1.5**	5 802	1.5
Total qualifying capital and reserves	**69 330**	**14.7**	63 546	16.5

* *Audited.*

Risk and capital management report continued

The table below provides more detail on the Group's capital instruments at 30 June 2012.

Characteristics of capital instruments for FirstRand

Capital type	Instrument	Nominal (R million)	Actual (R million)	Rate type	Maturity date**
Core Tier 1	Ordinary share capital and premium*	5 271	5 271		Perpetual
Other Tier 1	NCNR preference share capital*	4 519	4 519	Floating	Perpetual
Upper Tier 2	FRBC21	628	604	Fixed	21 Dec 2018
	FRBC22	440	441	Floating	21 Dec 2018
Lower Tier 2 (Subordinated debt)	FRB03	1 740	1 826	Fixed	15 Sept 2014
	FRB05	2 110	2 041	Fixed	21 Dec 2018
	FRB06	1 000	1 009	Floating	5 Nov 2012
	FRB07	300	301	Floating	6 Dec 2012
	FRB08	100	100	Floating	10 Jun 2016
	FRB09	100	100	Floating	10 Jun 2017
	FRB10	1 000	1 014	Floating	25 Jan 2017
	FNB002	120	155	Floating	1 Dec 2016
	FNB003	27	25	Fixed	1 Dec 2016
	FNBX22	110	113	Fixed	29 Mar 2017
	FNBJ22	280	280	Floating	29 Mar 2017

* *Audited.*

** *Represents the call date of the instrument.*

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

RWA and capital requirements

	FirstRand				
	June 2012				June 2011
	RWA				
R million	**Advanced approach**	**Standardised approach**	**Total**	**Capital requirement#**	RWA
Credit risk					
Corporate, banks and sovereigns	**108 719**	**8 842**	**117 561**	**11 168**	92 642
Small and medium enterprises (SME)	**34 134**	**11 359**	**45 493**	**4 322**	37 584
Residential mortgages	**52 224**	**3 708**	**55 932**	**5 314**	42 388
Qualifying revolving retail	**12 564**	**97**	**12 661**	**1 203**	9 003
Other retail	**55 311**	**8 399**	**63 710**	**6 052**	40 481
Securitisation exposure	**9 207**	**381**	**9 588**	**911**	4 580
Other	**–**	**12 904**	**12 904**	**1 226**	31 911
Total credit risk	**272 159**	**45 690**	**317 849**	**30 196**	258 589
Operational risk*	**58 114**	**14 849**	**72 963**	**6 931**	63 649
Market risk	**12 511**	**3 357**	**15 868**	**1 507**	17 311
Equity investment risk**	**40 640**	**–**	**40 640**	**3 861**	20 605
Other assets	**–**	**24 148**	**24 148**	**2 294**	25 036
Total RWA	**383 424**	**88 044**	**471 468**	**44 789**	385 190
– Pillar 1 (8%)				**37 717**	30 814
– Pillar 2a (1.5%)				**7 072**	5 778
Total capital requirement				**44 789**	36 592

* *Exposures subject to the basic indicator approach are included under the standardised method.*

** *Effective 1 July 2011, all exposures are subject to the simple risk weighted method (previously non-bank entities were on the standardised approach).*

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

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

Composition of qualifying capital and capital ratios for the Bank

	FirstRand Bank*			
R million	**2012**	**%**	2011	%
Ordinary shareholders equity as per IFRS**	**45 956**		37 965	
Less: non-qualifying reserves**	**(364)**		(333)	
– Cash flow reserve**	**753**		452	
– Available-for-sale reserve**	**(695)**		(443)	
– Share-based payment reserve**	**(422)**		(342)	
Ordinary shareholders equity qualifying as capital	**45 592**		37 632	
– Ordinary share capital and share premium**	**15 308**		11 459	
– Reserves	**30 284**		26 173	
Less: total impairments	**(2 526)**		(3 295)	
– Excess of expected loss over eligible provisions (50%)	**(400)**		(907)	
– First loss credit enhancements in respect of securitisation structures (50%)	**(45)**		(71)	
– Qualifying capital in branches	**(1 732)**		(1 732)	
– Intangibles	**(332)**		(268)	
– Other impairments	**(17)**		(317)	
Total Core Tier 1 capital	**43 066**	**11.8**	34 337	11.4
NCNR preference share capital**	**3 000**		3 000	
Total Tier 1 capital	**46 066**	**12.6**	37 337	12.4
Upper Tier 2 instruments	**1 045**		1 042	
Tier 2 subordinated debt instruments	**6 392**		5 349	
Less: total impairments	**(445)**		(978)	
– Excess of expected loss over eligible provisions (50%)	**(400)**		(907)	
– First loss credit enhancements in respect of securitisation structures (50%)	**(45)**		(71)	
Total Tier 2 capital	**6 992**	**2.0**	5 413	1.8
Total qualifying capital and reserves	**53 058**	**14.6**	42 750	14.2

* *Reflects solo supervision, i.e. FirstRand Bank excluding foreign branches.*
** *Audited.*

Risk and capital management report continued

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

RWA and capital requirements

	FirstRand Bank*				
	2012				2011
	RWA†				
R million	Advanced approach	Standardised approach	Total	Capital requirement#	RWA
Credit risk					
Corporate, banks and sovereigns	**108 719**	**–**	**108 719**	**10 328**	92 642
Small and medium enterprises (SME)	**34 134**	**–**	**34 134**	**3 243**	37 584
Residential mortgages	**52 224**	**–**	**52 224**	**4 961**	42 388
Qualifying revolving retail	**12 564**	**–**	**12 564**	**1 194**	9 003
Other retail	**55 311**	**–**	**55 311**	**5 255**	40 481
Securitisation exposure	**9 207**	**–**	**9 207**	**875**	4 580
Total credit risk	**272 159**	**–**	**272 159**	**25 856**	226 678
Operational risk**	**54 099**	**–**	**54 099**	**5 139**	42 659
Market risk	**12 511**	**–**	**12 511**	**1 188**	7 016
Equity investment risk	**10 391**	**–**	**10 391**	**987**	10 460
Other assets	**–**	**15 275**	**15 275**	**1 451**	14 027
Total RWA	**349 160**	**15 275**	**364 435**	**34 621**	300 840
– Pillar 1 (8%)				**29 154**	24 068
– Pillar 2a (1.5%)				**5 467**	4 513
Total capital requirement				**34 621**	28 581

* *Reflects solo supervision, i.e. the FirstRand Bank excluding foreign branches.*

** *Exposures subject to the basic indicator approach are included under the standardised method.*

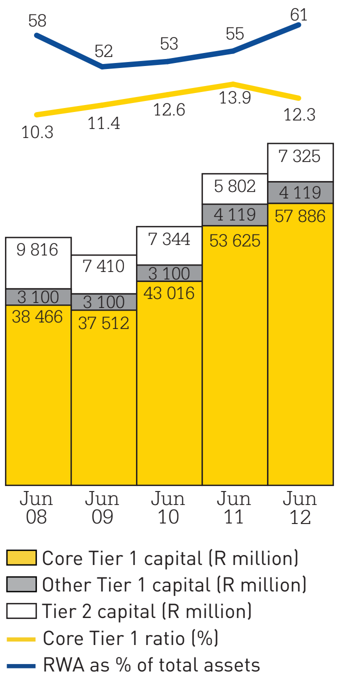
Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.

† *All risk types, except other assets are subject to the advanced approach at the Bank.*

Historical overview of capital adequacy

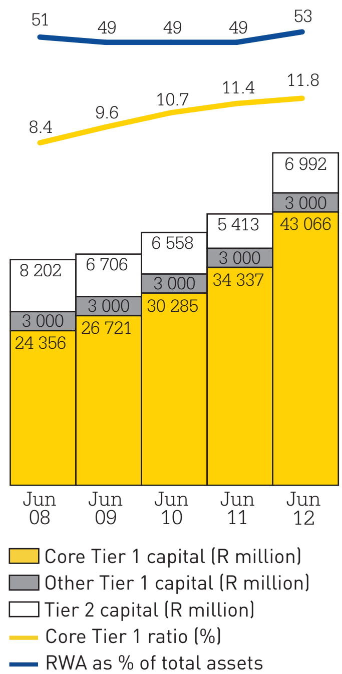
The graphs below provide a historical overview of the capital adequacy for FirstRand and the Bank.

Capital adequacy – FirstRand*



* *Comparative information prior to July 2010 relates to previously regulated entity FirstRand Bank Holdings Limited.*

Capital adequacy – FRB



Risk and capital management report continued

Capital adequacy position for FirstRand and its subsidiaries

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

	FirstRand				
	2012			2011	
	RWA R million	**Tier 1 %**	**Total capital adequacy %**	Tier 1 %	Total capital adequacy %
Basel II					
FirstRand	**471 468**	**13.2**	**14.7**	15.0	16.5
FirstRand Bank South Africa	**364 435**	**12.6**	**14.6**	12.4	14.2
FirstRand Bank London	**6 134**	**17.8**	**18.0**	12.5	12.5
FirstRand Bank India	**1 693**	**30.4**	**30.4**	43.0	43.0
FirstRand Ireland*				24.9	24.9
RMB Australia	**9 288**	**14.2**	**14.2**	24.0	24.0
FNB Namibia**	**13 085**	**11.8**	**17.6**	12.6	16.6
Basel I**					
FNB Botswana	**9 601**	**13.9**	**16.6**	13.7	15.7
FNB Lesotho	**319**	**17.2**	**17.4**	19.7	20.0
FNB Mozambique	**1 011**	**11.1**	**11.9**	11.8	16.6
FNB Swaziland	**1 600**	**28.1**	**29.4**	23.0	24.2
FNB Zambia	**753**	**12.1**	**18.0**	33.0	33.0
FNB Tanzania#	**79**	**77.8**	**77.8**	–	–

* *In the process of voluntary liquidation.*
** *Ratios based on local rules.*
# *Opened offices in July 2011.*

CREDIT RISK

Introduction and objectives

Credit risk is managed as part of the broader balance sheet management process and is aligned with the Group's macro economic view. Activities that give rise to credit risk in the Group include:

- retail loans and advances;
- large corporate credit risk exposures from term lending activities in the RMB Investment bank division (IBD), short-term exposures from overdraft and working capital facilities in Global Transactional Services' (GTS) corporate and transactional banking, and short-term money market exposures in RMB's Fixed income, currency and commodity division (FICC); and
- exposure from financial market activities such as cash placements with other banks, exposure from positive mark-to-market movements on derivatives and reverse repos.

Credit risk management is split into three distinct portfolios, namely retail credit, commercial credit and wholesale credit, which are aligned to customer profiles. Credit risk management includes credit origination strategy, risk appetite, risk quantification and measurement, collection and recovery of delinquent accounts, and extends across the franchises. Activities that give rise to credit risk in each of the portfolios are described below:

Retail credit

Retail credit in FNB comprises three main segments, wealth, personal banking (the consumer segment) and smart solutions (for customers with income below R100 000 per annum). These segments offer similar products but are segmented according to customers income. Retail credit in WesBank is not segmented by customer income.

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

Unsecured products in both FNB and WesBank include:

- personal loans ranging from small short-term loans to larger loans with repayment terms of up to 60 months;
- student loans to finance studies at approved tertiary institutions;
- revolving overdrafts facilities linked to the transactional demand deposit accounts; and
- credit cards with revolving credit limits and either straight or budget period repayment facilities.

Risk and capital management report continued

Commercial credit

The commercial credit portfolio strategy is focused on providing tailored credit products to commercial customers. These credit products are originated under both of the FNB (primary relationship owner) and WesBank (vehicle and asset based finance (VAF)) brands. These products include:

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

Wholesale credit

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

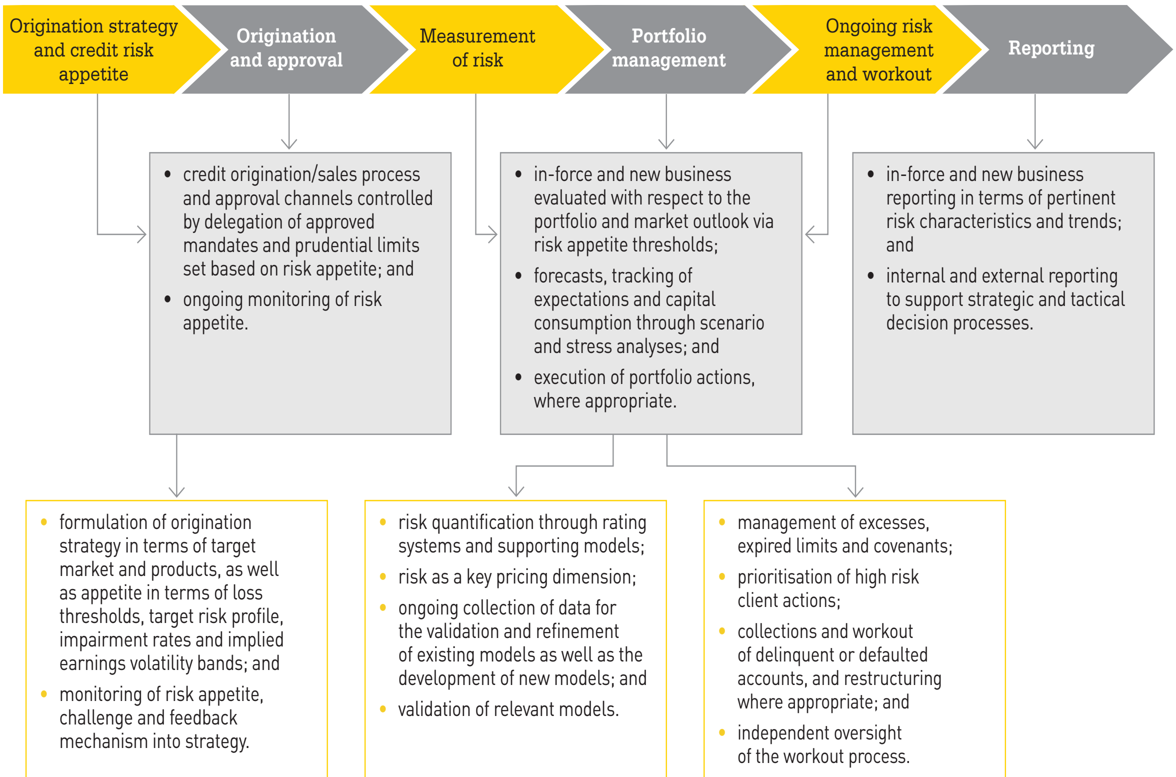
- structured asset finance for client funding requirements in local and cross-border strategic African jurisdictions;
- funding of corporate businesses, government and parastatals through debt capital market instruments;
- all inclusive financing packages for investment banking clients;
- structuring,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

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 the credit risk management practices are two-fold:

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

The scope of credit risk identification and management practices across the Group 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 Excos regularly receive and review reports on the adequacy and robustness of credit risk identification, management and control processes, as well as on the current and projected credit risk profile across the Group. The credit risk management governance structures, related roles and responsibilities as well as lines of accountability are set out in the credit risk management framework (CRMF). Approved by the RCC committee, the CRMF is a policy of the Board and a subframework of the BPRMF (see page 126).

The credit-focused committees, namely the Large exposures committee (a board committee) and the FirstRand Credit risk management committee (subcommittees of the RCC committee) support the RCC committee in its tasks. The Model risk and validation committee (MRVC, also a subcommittee of the RCC committee), also supports the RCC committee in it tasks relating specifically to models. For a description of the roles and responsibilities of these committees refer to the *Governance structure* on page 129.

The Group Credit Risk Management (GCRM) function

The GCRM function in ERM provides independent oversight of credit risk management practices in the deployed risk management functions to ensure an effective credit risk management process. 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;
- aggregation of 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 credit performance;

Risk and capital management report continued

- aggregation and 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;
- management of relationships with external stakeholders such as relevant regulators with respect to credit matters;
- oversight of the credit impairment process;
- consolidated regulatory reporting; and
- the assessment, analysis and reporting of impairments and consolidated credit risk reporting to stakeholders such as the RCC committee.

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 Group treasury and within the constraints of the overall credit risk appetite);
- 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;
- segment ownership of the credit regulatory reporting process;
- maintaining the segment credit governance structure; and
- monitoring of corrective actions.

Assessment and management (audited)

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 and the Banks Act, as well as for addressing business needs.

Credit risk models are widely used 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 AIRB approach requirements and the Bank's model building framework. The Group was granted regulatory approval under Basel 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 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 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 definition of default is consistently applied across all credit portfolios as well as in the recognition of non-performing loans (NPLs) for accounting purposes.

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

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

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 Standard & Poor's. These mappings are reviewed and updated on a regular basis.*

FR rating of 1 references to the lowest PD and a FR rating of 100 to the highest. External ratings have been mapped to the master-rating scale for reporting purposes.

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

- Through-the-cycle (TTC) PD measures reflect long-term, average default expectations over the course of the economic cycle. TTC PDs are 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 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 utilised 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 the economic loss on a particular facility upon default of the counterparty. It is expressed as a percentage of exposure outstanding at the time of default. In most portfolios, LGD is strongly dependent on:

- the type, quality, and level of subordination;
- the value of collateral held compared to the size of 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 requirements. **Rating process:** • rating assignment to corporate credit counterparties is based on a detailed individual assessment of the counterparty's creditworthiness; • this assessment is performed through a qualitative analysis of the business and financial risks of the counterparty and is supplemented by internally developed statistical rating models; • rating models were developed using internal and external data covering more than ten years. Qualitative analysis is based on the methodology followed by international rating agencies; • the rating assessment is reviewed by the Wholesale credit committee 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; and • LGD and EAD estimates are based on the 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 requirements. **Rating process:** • expert judgement models are used in combination with external rating agency ratings as well as structured peer group analyses which form a key input in the ratings process. The analysis is supplemented by internally developed statistical models; • the calibration of PD and LGD ratings is based on a mapping to external default data as well as credit spread market data; • the rating assessment is reviewed by the Wholesale credit committee and the rating (as well as the associated PD) is approved by this committee; and • 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 Basel requirements. **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 Wholesale credit committee and the rating (as well as the associated PD) is approved by this committee; and • 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 requirements. **SME retail rating process:** • the SME retail portfolio is segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, customer behaviour and delinquency status; • PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools; and • LGD and EAD estimates are applied on a portfolio level, estimated from internal historical default and recovery experience. **SME corporate rating process:** • PD: Counterparties are scored using Moody's RiskCalc™, 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 and Basel guidelines; and • EAD: Portfolio level credit conversion factors are estimated on the basis of the Group's internal historical experience and benchmarked against international studies.

Portfolio and type of exposures	Description of rating system
Residential mortgages (Retail portfolios in FNB HomeLoans, RMB Private Bank exposures and mortgage exposures in the Mass segment) Exposures to individuals for the financing of residential properties.	The default definition applied in the rating systems is aligned to the requirements of Basel. **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; and • LGD and EAD estimates are based on subsegmentation with reference to the collateral or product type as well as associated analyses and modelling of historical internal loss data. **Additional notes on qualifying revolving retail exposures:** • these exposures are unsecured and therefore only the efficiency of recovery processes impacts on the level of LGD; and • EAD measurement plays a significant role in the assessment of risk due to the typically high level of undrawn facilities that are characteristic of these product types. EAD estimates are based on actual historic EAD, segmented appropriately (e.g. straight versus budget in the case of credit cards).
Qualifying revolving retail exposures (Retail portfolios in FNB Card, FNB Consumer overdrafts and RMB Private Bank) Exposures to individuals providing a revolving limit through a credit card or overdraft facility.	
Other retail exposures (Retail portfolios in FNB Personal loans, Smart products and WesBank Retail auto finance and personal loans)	

Model validation

Rating models are recalibrated and independently validated on an annual basis to ensure validity, efficiency 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 audit team in GIA carries out additional reviews of the independent validation function, as well as sample revalidations. The results of these analyses are reported to MRVC and ultimately approved by the RCC committee (designated model approval committee). As part of this process, extensive documentation covering all steps of the model development lifecycle from inception 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 and deployed credit teams. These frameworks provide guidance, principles and minimum standards which the model development teams are required to adhere to.

Credit risk mitigation (audited)

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

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 assets financed;
- personal loans, overdrafts and credit card exposures are unsecured or secured by guarantees and suretyships;
- FNB Commercial credit facilities are secured by the assets of the SME counterparties and commercial property transactions are supported by the financed property and associated cash flows;

Risk and capital management report continued

- working capital facilities in FNB Corporate are often not secured by claims on specific assets, but risk in structured facilities granted by RMB is mitigated by financial or other collateral such as guarantees or credit derivatives; and
- credit risk in RMB's 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 commencement of the recovery process.

Management of concentration risk (audited)

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

Wholesale credit portfolio:

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

Commercial portfolios:

- 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 (audited)

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.

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.

Retail credit portfolios:

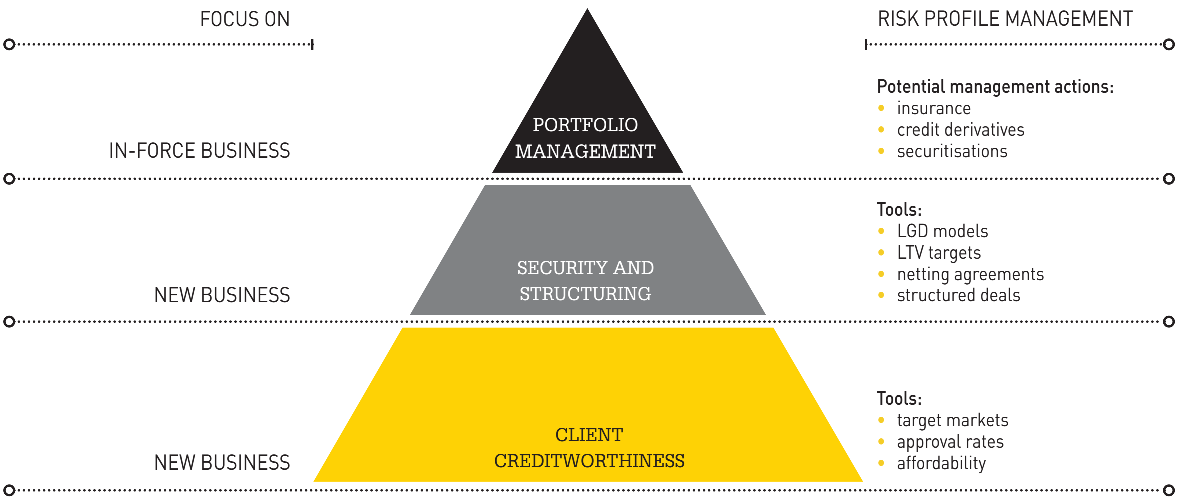
- monitoring on a (homogeneous) portfolio basis;
- restructuring of weak exposures to increase the projected realised value;
- reduction or removal of undrawn facilities in areas such as HomeLoans and Card; and
- revaluation of properties before approval of additional facilities.

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.

Use of credit risk tools and measures (audited)

Credit risk measures are used in a large number of business processes, including pricing and setting impairments, in determining capitalisation levels and business strategy, risk appetite and in 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

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

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 page 176).

Total loans and advances grew strongly during the financial year. Although corporate activity is still subdued, growth in investment banking and commercial loans to the property and agriculture sectors showed improvement. Retail advances benefited from strong growth in the vehicle and asset-based finance (VAF) and unsecured portfolios. Growth in the Africa book is consistent and steady.

The level of NPLs has been trending downwards since the peak in June 2009. Facilitated by the favourable credit environment, incidences of defaults have continued to decline in the retail book. Overall the corporate portfolio experienced a slight decline in NPLs despite an uptick in the investment banking book. Retail NPLs as a percentage of advances continued to decline, however, increases in some unsecured portfolios have materialised, as expected.

Retail credit portfolios

The VAF growth was particularly robust. Residential mortgages growth was flat compared to the prior year with a strong focus on low and medium risk counterparties and appropriate loan-to-value ratios. The strong growth recorded in the unsecured lending portfolios was within the defined credit risk appetite. The most pronounced shifts occurred in personal banking where both overdrafts and loans increased substantially from previous low bases.

The Group's strategies to reduce NPLs continued to yield favourable results. The reduction in NPLs is driven by the slower inflow into NPLs in FNB HomeLoans. Increases in NPLs in most of the unsecured portfolios have been recorded. This is in line with expectations and risk appetite and has been appropriately priced for.

The decreased impairment charge in the retail secured portfolios was supported by the sustained low interest rates, reductions in NPL inflows in FNB HomeLoans and by post write-off recoveries. The retail unsecured portfolios produced increased impairments compared to June 2011 with the exception of FNB Card where the charge was significantly reduced by post write-off recoveries.

Corporate credit portfolios

Strong growth in the RMB core advances book is due to investment banking related lending. Growth in the FNB commercial portfolio is attributed mainly to property term loans and agricultural portfolios.

NPLs in the corporate portfolio declined modestly over the past year, reflecting a reduction in NPLs in the FNB Commercial portfolio, however, RMB's NPLs increased. Impairment charges also showed signs of improvement. Significant reductions in impairment charges were experienced in FNB Commercial and WesBank Corporate compared to the previous June.

Risk and capital management report continued

Credit assets (audited)

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

Credit assets by type and segment

R million	2012	2011
Cash and short-term funds	**33 587**	29 239
– Money at call and short notice	**1 767**	1 371
– Balances with and guaranteed by central banks	**15 434**	15 660
– Balances with other banks	**16 386**	12 208
Gross advances	**533 347**	472 615
– FNB*	**220 638**	206 183
– FNB Retail	**184 992**	174 905
– FNB Commercial**	**35 646**	31 278
– WesBank	**119 389**	102 125
– RMB*	**160 217**	130 862
– GTS*	**2 605**	2 593
– FNB Africa	**25 420**	22 639
– Other	**5 078**	8 213
Derivatives	**52 913**	37 206
Debt investment securities (excluding non–recourse investments)	**82 020**	89 280
Accounts receivable	**6 007**	7 289
Reinsurance assets	**898**	484
Credit risk not recognised on the balance sheet	**104 158**	95 852
– Guarantees	**22 741**	24 727
– Acceptances	**293**	289
– Letters of credit	**7 886**	6 331
– Irrevocable commitments	**69 348**	63 298
– Credit derivatives	**3 890**	1 207
Total	**812 930**	731 965

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

Reconciliation of gross advances to net advances

R million	2012	2011
Gross advances after interest in suspense	**533 347**	472 615
Less: total impairment (refer note 13 of the consolidated financial statements page 274)	**(8 840)**	(8 022)
Net advances (refer consolidated statement of financial position page 237)	**524 507**	464 593

Credit quality (audited)

Advances are considered past due in the following circumstances:

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

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

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

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

Age analysis of advances

	2012					
			Past due but not impaired			
R million	Neither past due nor impaired	Renegotiated but current	One instalment past due	Two instalments past due	Impaired	Total
– FNB Retail	170 853	288	2 604	1 307	9 940	184 992
– FNB Commercial*	33 926	–	38	17	1 665	35 646
FNB	204 779	288	2 642	1 324	11 605	220 638
WesBank	111 680	–	2 612	956	4 141	119 389
FNB Africa	24 467	45	259	174	475	25 420
RMB**	158 400	–	147	17	1 653	160 217
GTS	2 596	–	–	–	9	2 605
Other	5 078	–	–	–	–	5 078
Total	**507 000**	**333**	**5 660**	**2 471**	**17 883**	**533 347**

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

	2011					
			Past due but not impaired#			
R million	Neither past due nor impaired	Renegotiated but current	One instalment past due	Two instalments past due	Impaired	Total
– FNB Retail	153 627	474	8 072	1 359	11 373	174 905
– FNB Commercial*	29 111	–	271	31	1 865	31 278
FNB**	182 738	474	8 343	1 390	13 238	206 183
WesBank	93 879	–	3 790	89	4 367	102 125
FNB Africa	21 824	7	374	64	370	22 639
RMB**	126 656	3 094	19	–	1 093	130 862
GTS**	2 575	–	–	–	18	2 593
Other	8 213	–	–	–	–	8 213
Total	435 885	3 575	12 526	1 543	19 086	472 615

* *Includes public sector.*
** *Certain portfolios have been restated to reflect the current segmentation of the business. Impaired advances for RMB are net of cumulative credit fair value adjustments on the non-performing book.*
# *The past due but not impaired aging analysis has changed to from a day count to an instalment count classification in line with the provisioning methodology.*

Risk and capital management report continued

Renegotiated advances (audited)

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

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

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

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

As part of the risk management and recoveries approach, the Group enters into arrangements with clients where concessions are made on payment terms (for example a reduction in payments for a specified period, changes in the payment profile or debt counselling payment plans). There are formally defined eligibility criteria appropriate for individual products to determine when clients are eligible for such arrangements. These accounts are monitored in a separate portfolio in each product segment and the performance is tracked for management and impairment purposes.

Past due but not impaired (audited)

The classification of advances as past due but not impaired follows the standards set out in applicable accounting policies. Advances past due but not impaired in the tables above include accounts in arrears by one or two full repayments. For the financial year ended June 2011, exposures to technical and partial arrears of R4.1 billion were classified as being one instalment in arrears. In this disclosure, these now form part of the one instalment past due category. However, for the financial year ended 30 June 2012, R5.4 billion in technical and partial arrear exposures have been classified as neither past due nor impaired in accordance with FirstRand provisioning methodology. These balances are primarily driven by retail exposures.

Credit quality of performing advances

	2012							
		FNB						
R million	Total neither past due nor impaired**	Retail	Commercial*	WesBank	RMB	GTS	FNB Africa	Other
FR 1 – 25	**118 874**	**28 979**	**1 625**	**2 999**	**76 868**	**444**	**5 377**	**2 582**
FR 26 – 91	**372 031**	**134 404**	**29 870**	**106 233**	**77 838**	**2 152**	**19 068**	**2 466**
Above FR 92	**16 428**	**7 758**	**2 431**	**2 448**	**3 694**	**–**	**67**	**30**
Total	**507 333**	**171 141**	**33 926**	**111 680**	**158 400**	**2 596**	**24 512**	**5 078**

* *For 2012 total neither past due nor impaired includes renegotiated but current advances.*
** *Includes public sector.*

	2011							
		FNB*						
R million	Total neither past due nor impaired	Retail	Commercial**	WesBank	RMB*	GTS*	FNB Africa	Other
FR 1 – 25	91 993	5 241	480	3 373	74 881	179	224	7 615
FR 26 – 91	320 475	140 540	25 629	82 434	48 739	2 396	20 165	572
Above FR 92	23 417	7 846	3 002	8 072	3 036	–	1 435	26
Total	435 885	153 627	29 111	93 879	126 656	2 575	21 824	8 213

* *Certain portfolios have been restated to reflect the current segmentation of the business.*
** *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 2011 to June 2012 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

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

* *Excludes non-recourse investments.*

	2011				
R million	Debt investment securities*	Derivatives	Cash and short-term funds	Reinsurance assets	Total
AAA to BBB	43 284	10 767	27 745	484	82 280
BB+ to 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.*

Risk and capital management report continued

Impairment of financial assets and NPLs (audited)

Refer to the policy for Impairment of financial assets in the accounting policy section on page 221 and to note 13 Impairment of advances on page 274 of the consolidated annual financial statements for the analysis of the movement in the impairment of advances and NPLs.

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

For amortised cost advances, impairments are recognised through the creation of an impairment reserve and an impairment charge in the income statement. For fair value advances, 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.

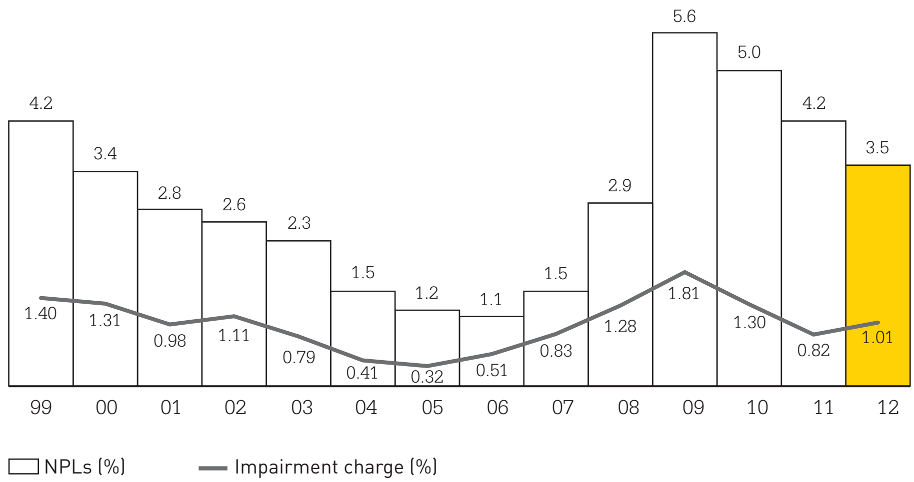
Specific impairments are created for non-performing advances for which objective evidence that an incurred loss event will have an adverse impact on the estimated future cash flows from the asset was identified. Potential recoveries from guarantees and collateral are incorporated into the calculation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

During the year under review a special impairment of R705 million was included in bad debts for unrecovered amounts in FNB's merchant acquiring business. A detailed discussion of the special impairment is included under the heading Boundary event in the *Operational risk* section on page 209.

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

NPLs and impairments history
(%)



Impairment charges are reflected before insurance proceeds where applicable.

Fair value sensitivity of wholesale advances due to credit risk

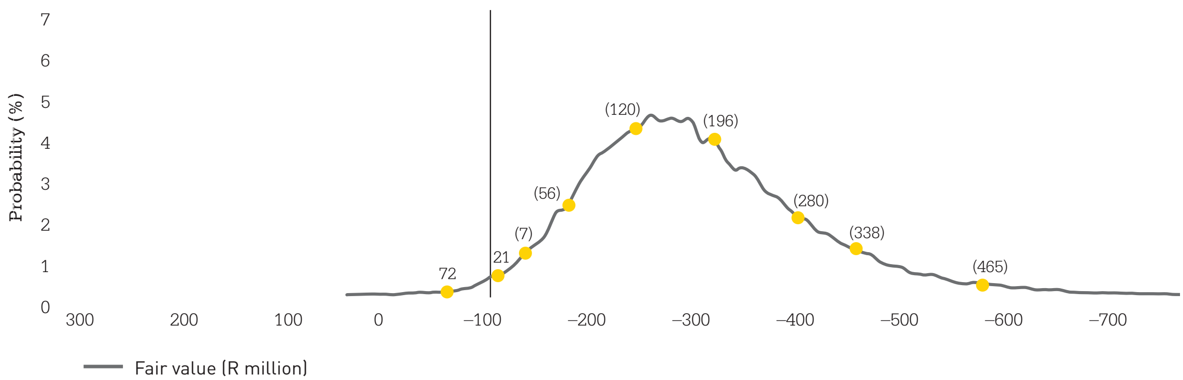
The Investment Banking division within RMB recognises a significant portion of the wholesale advances at fair value through profit or loss. The fair value adjustments made to these advances directly impact the income statement and the value of advances. For risk management purposes a migration matrix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

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

- 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 (for example long-term, downturn).

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 R120 million. The fair value at the 75th percentile (i.e. there is a probability of 25% to exceed this value) of the distribution is a loss of approximately R196 million.

Distribution: Fair value impact – long-term scenario

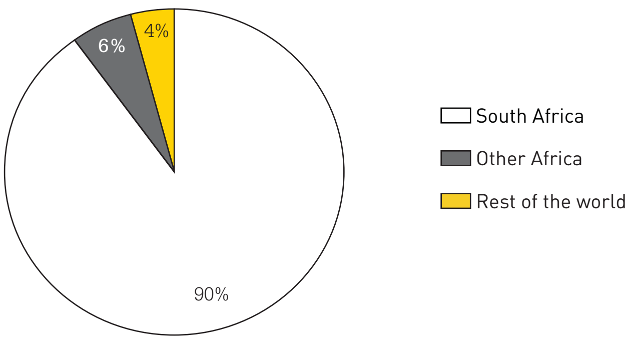


Risk and capital management report continued

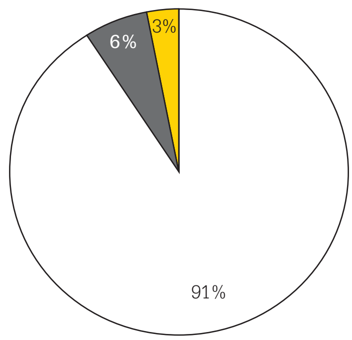
Geographic and industry concentration risk (audited)

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

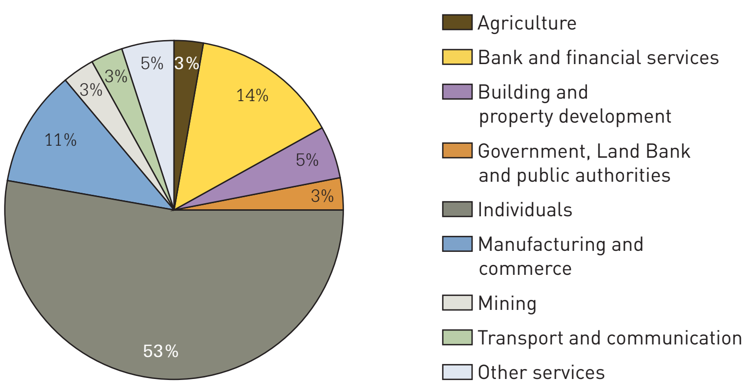
Geographical split by exposure 2012



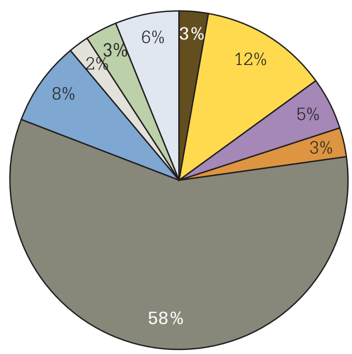
Geographical split by exposure 2011



Industry split by exposure 2012



Industry split by exposure 2011



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

Concentration of significant credit exposure (audited)

	2012							
R million	**South Africa**	**Other Africa**	**United Kingdom**	**Other Europe**	**North America**	**South America**	**Other#**	**Total**
Advances	**478 204**	**31 271**	**15 747**	**2 266**	**284**	**102**	**5 473**	**533 347**
Derivatives	**33 808**	**88**	**11 925**	**5 568**	**1 424**	**–**	**100**	**52 913**
Debt investment securities*	**71 152**	**5 456**	**1 525**	**–**	**1 636**	**–**	**2 251**	**82 020**
Guarantees, acceptances and letters of credit**	**23 912**	**5 674**	**–**	**529**	**7**	**2**	**796**	**30 920**
Irrevocable commitments**	**63 073**	**4 941**	**814**	**148**	**66**	**–**	**306**	**69 348**

* *Excludes non-recourse investments.*
** *Significant off-balance sheet exposures.*
# *Other includes Australasia and Asia.*

	2011							
R million	South Africa	Other Africa	United Kingdom	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**	26 913	3 204	–	546	–	16	668	31 347
Irrevocable commitments**	56 901	5 192	363	794	9	–	39	63 298

* *Excludes non-recourse investments.*
** *Significant off-balance sheet exposures.*
# *Other includes Australasia and Asia.*

Average advances per major risk type (unaudited)

R million	**2012**	2011
Retail credit	**315 417**	289 963
Africa	**24 722**	21 096
Wholesale credit	**146 197**	132 274
Commercial credit	**33 299**	29 263

Segmental analysis of advances (audited)

The following table provides a breakdown of credit exposure by FirstRand segments.

R million/%	2012 Advances	NPLs	NPL as a % of advances	Total impairment charge	Impairments as % of average advances
FNB*	220 638	11 605	5.26	2 329	1.09
– FNB Retail	185 132	9 940	5.37	2 064	1.15
– Residential mortgages	158 784	8 763	5.52	885	0.56
– FNB HomeLoans (Consumer segment)	107 694	5 584	5.19	523	0.49
– Wealth	40 721	2 734	6.71	297	0.73
– Affordable Housing (Mass segment)	10 369	445	4.29	65	0.70
– Credit Card	11 946	271	2.27	40	0.35
– Personal banking	8 780	272	3.10	416	6.22
– overdrafts	2 450	72	2.94	102	5.51
– loans	6 330	200	3.16	314	6.49
– Mass (Secured and unsecured)	5 622	634	11.28	723	15.18
– FNB Commercial**	35 646	1 665	4.67	166	0.50
– FNB Other	(140)	–	–	99	(42.49)
WesBank	119 389	4 141	3.47	1 100	0.99
– WesBank asset backed finance	113 488	3 828	3.37	836	0.79
– WesBank Retail	72 601	2 621	3.61	362	0.55
– WesBank Corporate	31 621	1 134	3.59	377	1.20
– WesBank International	9 266	73	0.79	97	1.26
– WesBank loans	5 901	313	5.30	264	4.84
RMB*	160 217	2 436	1.52	89	0.06
GTS*	2 605	9	0.35	(28)	(1.08)
FNB Africa	25 420	475	1.87	121	0.50
Corporate centre	5 078	–	–	749	11.27
Total	533 347	18 666	3	4 360	0.87
Special impairments#	–	–	–	705	0.14
Total	533 347	18 666	3	5 065	1.01

* *Certain portfolios have been restated to reflect the current segmentation of the business.*
** *Includes public sector.*
\# *Special impairments relate to FNB Commercial (R405 million) and GTS (R300 million).*

2011				
Advances	NPLs	NPL as a % of advances	Total impairment charge	Impairments as % of average advances
206 183	13 238	6.42	2 435	1.21
175 231	11 409	6.51	1 934	1.12
155 974	10 515	6.74	1 216	0.79
106 864	7 335	6.86	740	0.69
40 913	2 796	6.83	405	1.03
8 197	384	4.68	71	0.98
10 758	446	4.15	149	1.39
4 593	132	2.87	178	4.66
1 251	44	3.52	62	5.36
3 342	88	2.63	116	4.36
3 906	316	8.09	391	11.37
31 278	1 865	5.96	334	1.12
(326)	(36)	11.04	167	(>100)
102 125	4 367	4.28	1 291	1.33
97 124	4 025	4.14	1 141	1.23
59 865	2 492	4.16	607	1.07
31 109	1 490	4.79	452	1.47
6 150	43	0.70	82	1.48
5 001	342	6.84	150	3.35
130 862	1 798	1.37	(25)	(0.02)
2 593	18	0.69	9	0.42
22 639	370	1.63	64	0.30
8 213	(1)	(0.01)	4	0.08
472 615	19 790	4.19	3 778	0.82
–	–	–	–	–
472 615	19 790	4.19	3 778	0.80

Risk and capital management report continued

Basel disclosure

Credit rating systems and processes

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

The following table provides a breakdown of credit exposure by type, segment and Basel 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 approach

		AIRB	Standardised approach	
R million	**2012**	FirstRand Bank (SA)	Regulated bank entities within FNB Africa	Other subsidiaries
Cash and short-term funds	**33 587**	27 195	3 191	3 201
– Money at call and short notice	**1 767**	1 664	91	12
– Balances with and guaranteed by central banks	**15 434**	12 396	2 243	795
– Balances with other banks	**16 386**	13 135	857	2 394
Gross advances	**533 347**	486 537	25 420	21 390
– FNB	**220 638**	220 540	–	98
– FNB Retail	**184 992**	184 894	–	98
– FNB Commercial*	**35 646**	35 646	–	–
– WesBank	**119 389**	106 088	–	13 301
– RMB	**160 217**	152 226	–	7 991
– GTS	**2 605**	2 605	–	–
– FNB Africa	**25 420**	–	25 420	–
– Other	**5 078**	5 078	–	–
Derivatives	**52 913**	52 237	2	674
Debt investment securities (excluding non-recourse investments)	**82 020**	70 831	5 624	5 565
Accounts receivable	**6 007**	3 209	529	2 269
Loans due by holding company and fellow subs	**–**	22 954	3 303	(26 257)
Reinsurance assets	**898**	–	1	897
Credit risk not recognised on the balance sheet	**104 158**	95 015	7 277	1 866
– Guarantees	**22 741**	20 029	2 210	502
– Acceptances	**293**	293	–	–
– Letters of credit	**7 886**	7 295	591	–
– Irrevocable commitments	**69 348**	63 508	4 476	1 364
– Credit derivatives	**3 890**	3 890	–	–
Total	**812 930**	757 978	45 347	9 605

* *Includes public sector.*

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

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

FNB Africa exposures by risk bucket

Risk bucket	Exposure R million
0%	91
10%	–
20%	4 476
35%	9 707
50%	3 056
75%	3 569
100%	24 221
Specific impairments	227
Total	45 347

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 Bank uses EAD-weighted PDs based on the FirstRand master-rating scale (see page 149) 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) as well as comparatives for the prior year. The EAD weighted downturn LGD and the EAD weighted PD for the performing and total book 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.

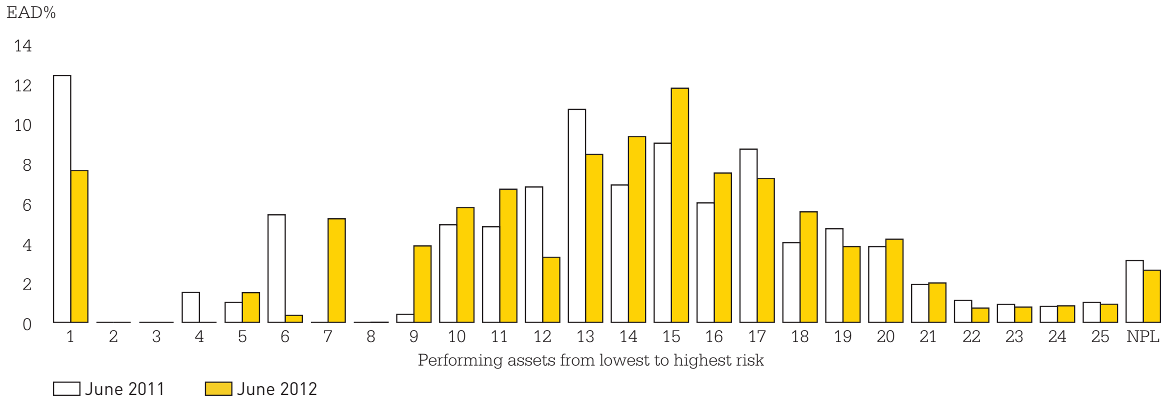
The majority of the retail portfolios exhibited significant positive risk migration for the period under review. This was, however, negated by model recalibrations implemented during the financial year, incorporating further defaults after the peak of the economic downturn.

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

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 and capital management report (continued)

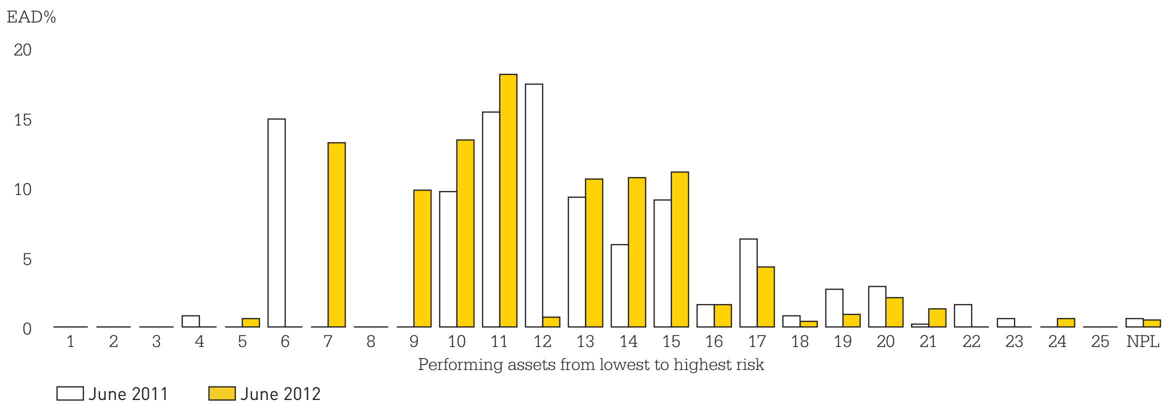
Risk profile for FRB: EAD% distribution per Basel risk buckets



Average performing PD %	3.20%	Average total book PD %	6.16%
Average performing LGD %	28.42%	Average total book LGD %	28.72%
Performing book EL/EAD	0.91%	Total book EL/EAD	1.77%

The distributions above are reflective of PDs on the entire FRB book as at June 2011 and June 2012. The movements are analysed per subportfolio under the following graphs.

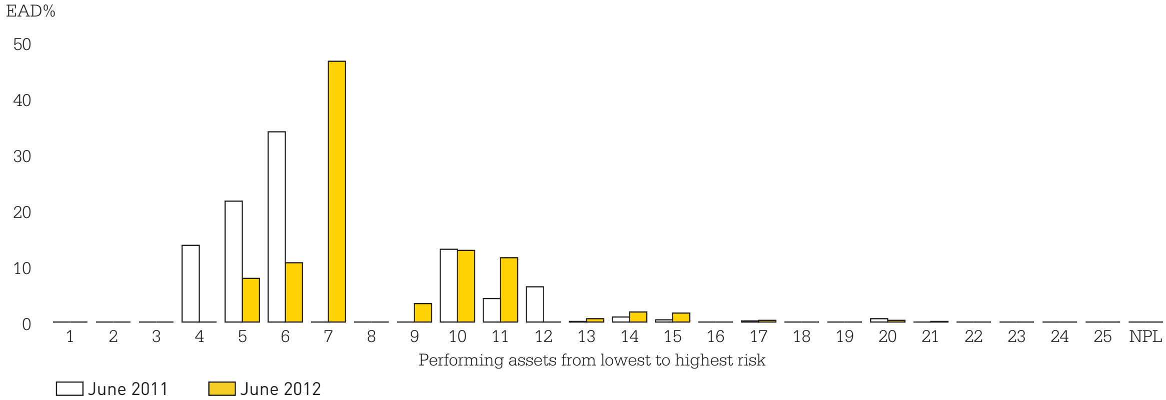
Risk profile for corporate exposures: EAD% distribution per Basel risk buckets



Average performing PD %	1.35%	Average total book PD %	1.87%
Average performing LGD %	35.13%	Average total book LGD %	35.23%
Performing book EL/EAD	0.47%	Total book EL/EAD	0.66%

There are a number of significant movements observed on the corporate portfolio. The reason driving most of this is the recalibration of PDs. As a result, many counterparties have been reallocated to different PD bands. In addition, through the re-rating process, a number of counterparty ratings have changed.

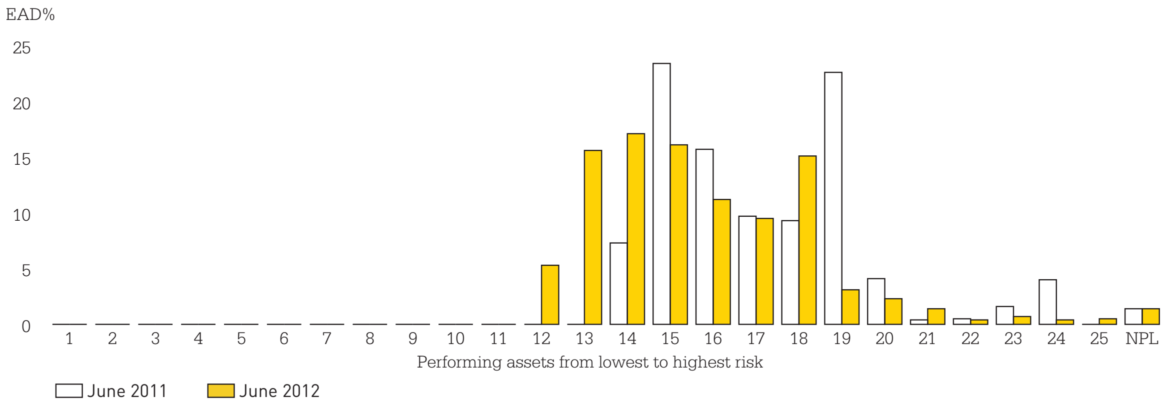
Risk profile for banks exposures: EAD% distribution per Basel risk buckets



Average performing PD %	0.21%	Average total book PD %	0.21%
Average performing LGD %	31.92%	Average total book LGD %	31.92%
Performing book EL/EAD	0.07%	Total book EL/EAD	0.07%

As in the corporate portfolio, there are a number of significant movements observed on the banks portfolio. The reason driving most of this is the recalibration of PDs for this portfolio. As a result, many counterparties will have been reallocated to different PD bands. In addition, through the re-rating process a number of counterparty ratings will have changed.

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

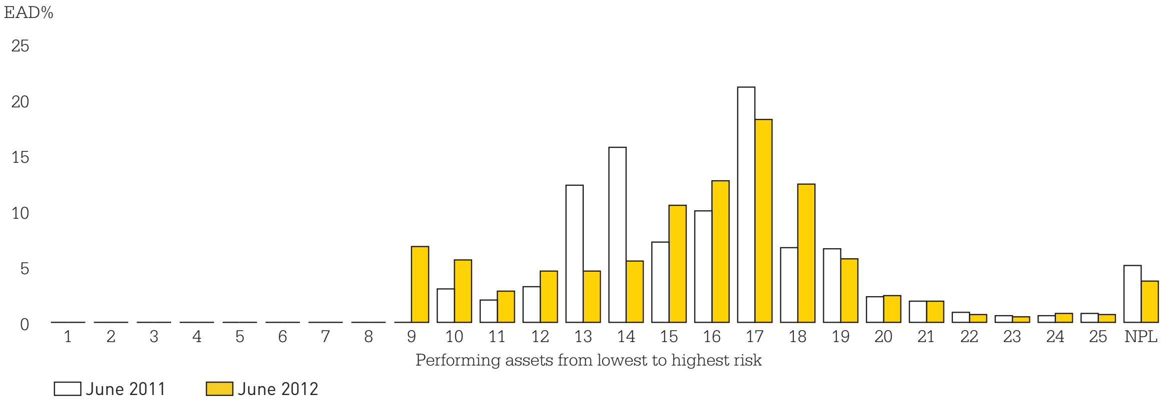


Average performing PD %	2.48%	Average total book PD %	5.39%
Average performing LGD %	28.24%	Average total book LGD %	28.61%
Performing book EL/EAD	0.70%	Total book EL/EAD	1.54%

The movements observed on the SME corporate portfolio are as a result of a recalibration of the PD model. The previous model was too conservative with actual defaults consistently lower than expected defaults, therefore, the recalibration provides lower PDs, which are more in line with expectations.

Risk and capital management report continued

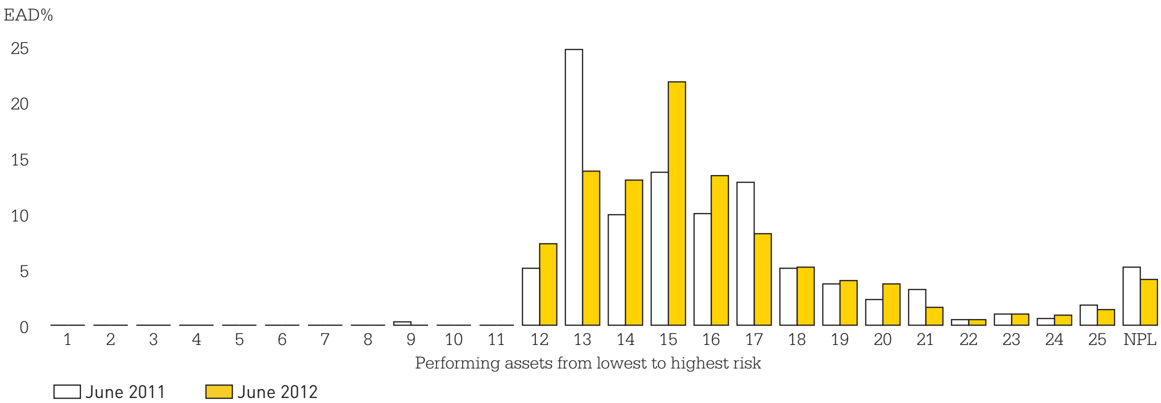
Risk profile for SME retail exposures: EAD% distribution per Basel risk buckets



Average performing PD %	4.37%	Average total book PD %	11.30%
Average performing LGD %	18.97%	Average total book LGD %	19.64%
Performing book EL/EAD	0.83%	Total book EL/EAD	2.22%

The distributions above indicate no significant movements in PD from June 2011 to June 2012.

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



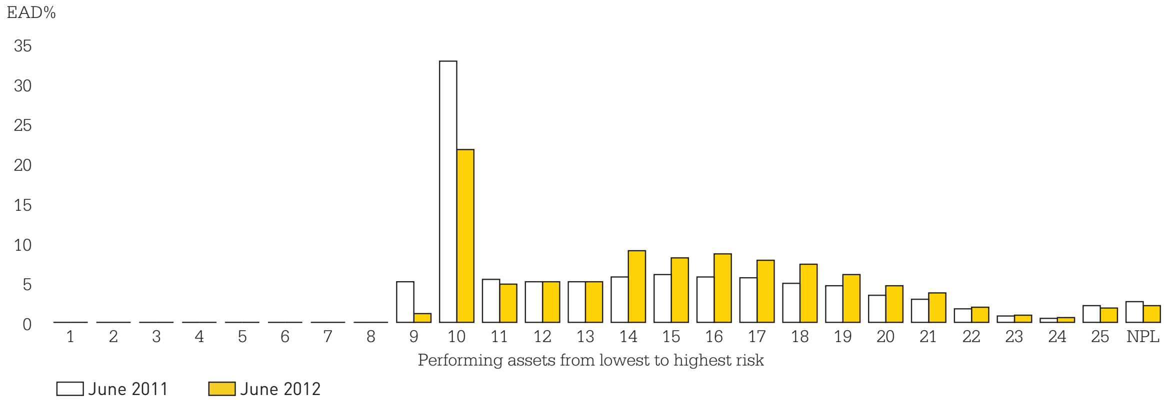
Average performing PD %	3.53%	Average total book PD %	9.38%
Average performing LGD %	14.65%	Average total book LGD %	14.94%
Performing book EL/EAD	0.52%	Total book EL/EAD	1.40%

The distributions above indicate no significant movements in PD from June 2011 to June 2012. This is after improvements in PDs over the previous year as a result of:

- a low interest rate environment positively impacting the existing portfolio; and
- stricter lending criteria resulting in higher quality new business being written,

both of which continue to reflect in the PD distribution.

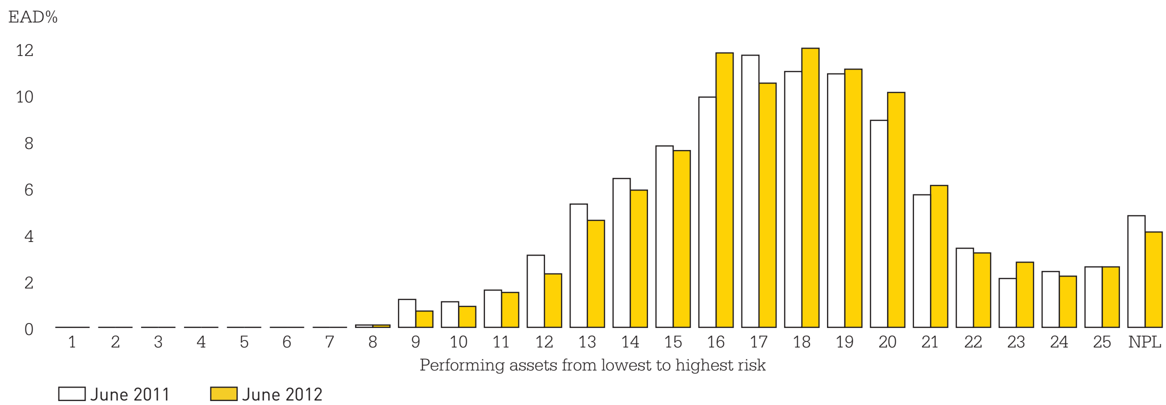
Risk profile for retail revolving exposures: EAD% distribution per Basel risk buckets



Average performing PD %	3.86%	Average total book PD %	6.07%
Average performing LGD %	66.27%	Average total book LGD %	66.50%
Performing book EL/EAD	2.56%	Total book EL/EAD	4.03%

The minor deterioration in the risk profile in the chart above is as a result of a recalibration of the Consumer Overdrafts models, resulting in higher PDs.

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



Average performing PD %	8.98%	Average total book PD %	13.41%
Average performing LGD %	34.24%	Average total book LGD %	35.38%
Performing book EL/EAD	3.07%	Total book EL/EAD	4.75%

A significant proportion of the other retail asset class is made up of VAF, which is secured by the underlying asset. As such, the LGD is lower than what would be expected for unsecured other retail portfolios. The minor deterioration in the risk profile above is a result of increased lending in the unsecured space including to the mass market.

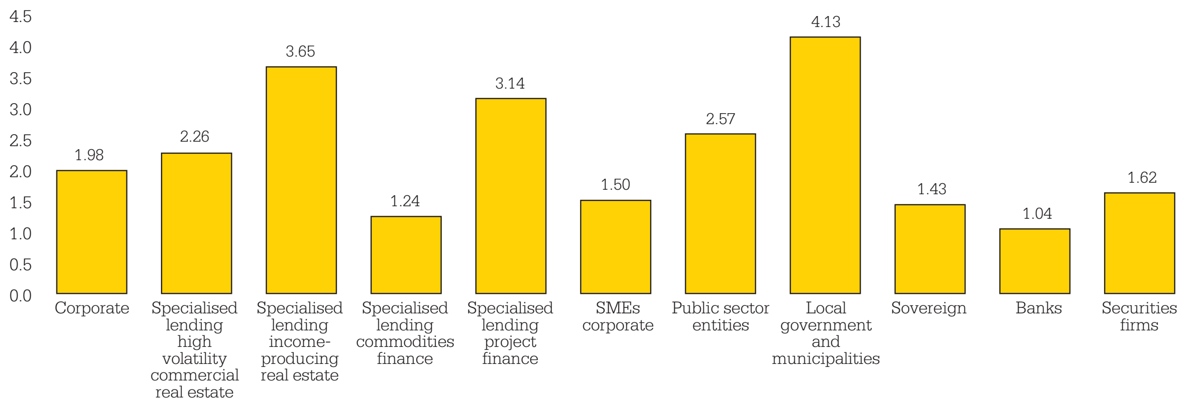
Risk and capital management report continued

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. For deals with longer terms, greater uncertainty is inherent and these also attract a greater 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 2012
(Maturity in years)



Actual versus expected loss analysis

To provide a meaningful assessment of the effectiveness of internal ratings-based models, expected loss is compared against 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 period consist of both the level of specific impairments at the start of the year (1 July 2011), and the net specific impairment charge recorded through the income statement for the period 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 impairments raised for exposures which defaulted during the year, but which did not exist at 30 June 2011. 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 versus expected loss per portfolio segment for the Bank

R million	2012 Expected loss	2012 Actual loss
Corporate (corporate, banks and sovereigns)	**1 621**	**313**
SME (SME corporate and SME retail)	**1 146**	**1 094**
Residential mortgages	**2 674**	**2 961**
Qualifying revolving retail	**1 126**	**808**
Other retail	**1 718**	**1 990**
WesBank	**2 780**	**3 371**
Total	**11 065**	**10 537**

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

R million	2011 Expected loss	2011 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 impairment charges being available on business unit level as opposed to AIRB asset class level.

R million	2010 Expected loss	2010 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

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

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 2011. The models currently applied have since incorporated further details 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 versus 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 period under review.

Expected values are based on regulatory capital models applied as at 30 June 2011. For PDs, this is applied to the total performing book as at 30 June 2011. 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 2011 to June 2012. 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 one 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 2012 calendar year) to the actual nominal exposure at default for the same accounts. A ratio above 100% indicates an overestimation.

Risk and capital management report continued

Risk parameters used to determine regulatory expected loss for the Bank

	2012				
	PD		LGD		Estimated EAD to actual EAD ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
SME corporate	**4.85**	**2.33**	**26.97**	**28.98**	**144.33**
SME retail	**3.21**	**2.96**	**28.83**	**20.87**	**113.27**
Residential mortgages	**3.57**	**2.92**	**15.30**	**11.53**	**104.43**
Qualifying revolving retail	**3.02**	**2.46**	**72.37**	**68.53**	**98.94**
Other retail	**5.99**	**5.07**	**45.99**	**43.66**	**102.91**
Total	**2.72**	**1.96**	**30.55**	**27.52**	**107.98**

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

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

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

	2010				
	PD		LGD		Estimated EAD to actual EAD ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate	1.55	–	37.73		
Banks	0.15	–	31.00		
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

PDs used for regulatory capital purposes are based on long-run experience (i.e. TTC PDs) and are expected to underestimate defaults at the top of the credit cycle and overestimate defaults at the bottom of the credit cycle. Comparisons between current and prior PDs show that there have not been significant changes and this is in line with the expected stability of the Bank's book. These PDs are based on all performing counterparties at the start of the period.

Differences in the latest actual and expected LGDs as compared to previous years are primarily as a result of the actual and expected LGD being based only on counterparties which have defaulted during the respective periods in question. Differences in the characteristics of defaulted accounts can change quite significantly over time, particularly in the wholesale and commercial space where defaults are sparse, and this is evident from the numbers presented above. Another point evident in the latest figures is the increase in actual and expected LGDs on the other retail asset class. This is a result of the increased contribution of unsecured lending to defaulted exposures which is natural given the increase in unsecured lending. This increase then also flows through to the total actual and expected LGDs.

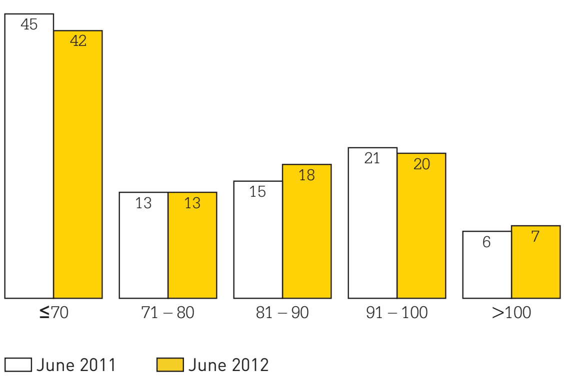
Deviations in the actual versus expected EADs can be seen where the Estimated EAD to actual EAD ratio deviates from 100%. A ratio above 100% indicates an overprediction, and a ratio below 100% indicates an underprediction of EAD. An overprediction of EAD is observed in the corporate, banks and sovereigns, and the SME corporate asset classes. This is as a result of proactive risk management where high risk counterparties are identified prior to default and exposures then actively managed and reduced, where applicable.

Selected risk analysis

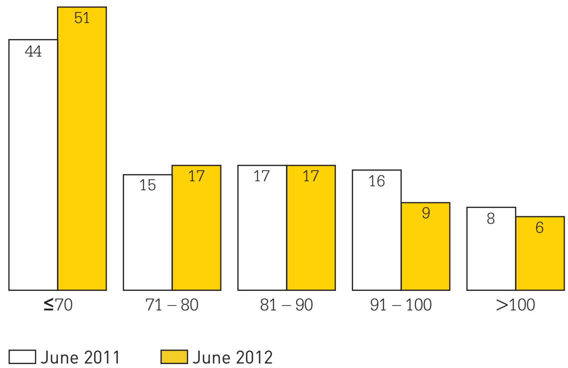
This section provides further information on selected risk analyses that impact the credit portfolios of the Bank.

The graphs below provide the balance-to-value distributions and the ageing of the residential mortgages portfolios. The recent focus on the loan-to-value ratios for new business has resulted in an improvement in the balance-to-original value although the broader strategy is to place more emphasis on the counterparty credit-worthiness as opposed to only on the underlying security.

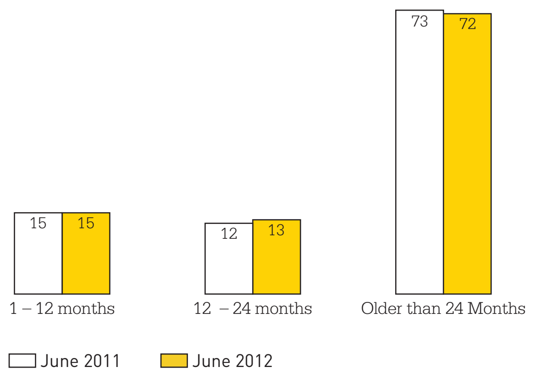
Residential mortgages balance-to-original value (%)



Residential mortgages balance-to-market value (%)



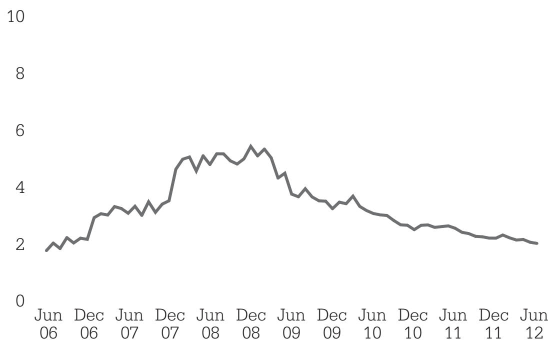
Residential mortgages age distribution (%)



Risk and capital management report continued

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

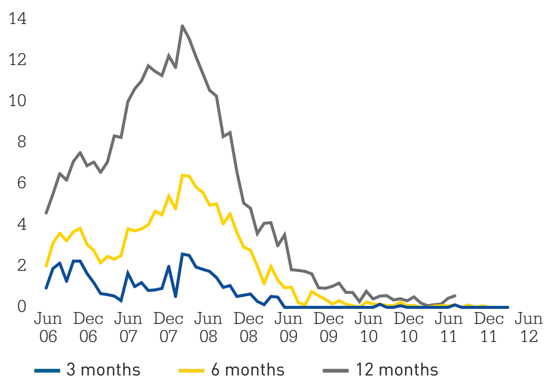
FNB HomeLoans arrears (%)



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

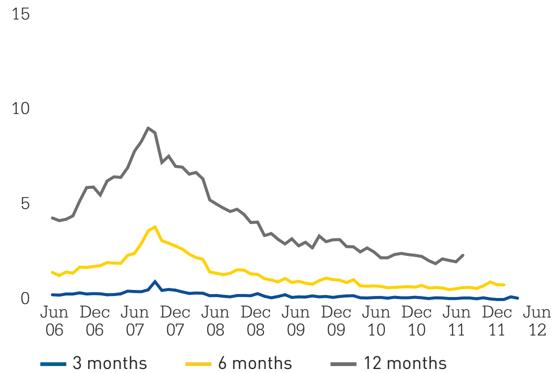
For FNB HomeLoans, the three, six and twelve month cumulative vintage analysis illustrate a marked improvement in the quality of business written since mid-2008 despite further deterioration in macro conditions in the succeeding period. The more recent decreases in the default experience reflect a combination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

FNB HomeLoans vintage analysis (%)



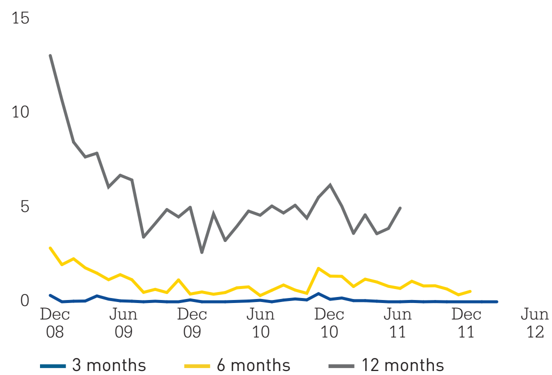
The WesBank retail six and twelve month cumulative vintage analysis continues to show a noticeable improvement in the quality of business written since mid-2007.

WesBank retail vintage analysis (%)

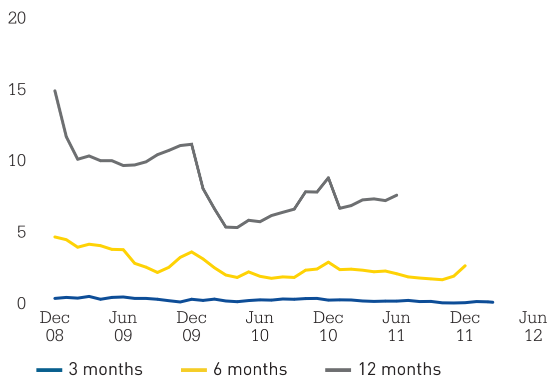


The vintage analyses of FNB and WesBank unsecured portfolios show an uptick in default experience, however, the portfolios remain within risk appetite. Continued actions are undertaken to ensure these portfolios remain within risk appetite.

FNB Card vintage analysis (%)



Unsecured (excluding FNB Card) vintage analysis (%)



The Group's South African repossessed properties are shown below.

Properties in possession

	2012	2011	% change
Number of properties	**594**	1 117	(47)
Value (R million)	**103**	258	(60)

Risk and capital management report continued

SECURITISATIONS AND CONDUITS

Introduction and objectives

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

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

Securitisation transactions for FirstRand

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

* *Does not include cash reserves.*

** *This table includes transactions that have been structured by the Group and therefore excludes third party transactions.*

Rating distribution of retained and purchased securitisation exposures

R million	AAA(zaf)	AA(zaf)	AA–(zaf)	A+(zaf)	A(zaf)
Traditional					
At 30 June 2012	**2 000**	**–**	**–**	**81**	**–**
At 30 June 2011	596	5	–	–	4
Synthetic					
At 30 June 2012	**–**	**–**	**17 839**	**–**	**–**
At 30 June 2011	17 839	–	–	–	–
Third party					
At 30 June 2012	**625**	**–**	**–**	**–**	**51**
At 30 June 2011	188	–	–	–	51

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

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

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

Traditional and synthetic securitisations

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

		Assets outstanding*		Notes outstanding		Retained exposure	
	Assets securitised	**2012**	2011	**2012**	2011	**2012**	2011
	16 423	**7 491**	5 476	**8 130**	5 474	**3 407**	1 260
	3 982	**2 573**	–	**3 007**	–	**1 366**	–
	1 900	**–**	1 164	**–**	1 131	**–**	84
	2 884	**–**	1 625	**–**	1 580	**–**	148
	3 620	**1 487**	2 687	**1 486**	2 763	**1 208**	1 028
	4 037	**3 431**	–	**3 637**	–	**833**	–
	20 000	**20 000**	20 000	**20 000**	20 000	**18 262**	18 262
	20 000	**20 000**	20 000	**20 000**	20 000	**18 262**	18 262
	36 423	**27 491**	25 476	**28 130**	25 474	**21 669**	19 522

	BBB+(zaf)	BBB(zaf)	BB(zaf)	B+(zaf)	Not Rated	Total
	59	**442**	**–**	**–**	**825**	**3 407**
	–	373	–	–	282	1 260
	–	**–**	**180**	**53**	**190**	**18 262**
	–	–	180	53	190	18 262
	–	**–**	**–**	**–**	**–**	**676**
	–	–	–	–	–	239

Risk and capital management report continued

The Group's role in securitisation transactions as at 30 June 2012

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

Third party securitisations

Transaction	Originator	Sponsor	Servicer	Investor	Liquidity provider	Credit enhancement provider	Swap provider
Homes Obligor Mortgage Enhanced Securities					✓		
On the Cards Investment II				✓	✓		
Prime Realty Obligors Packed Securities – Series 2					✓		
Private Residential Mortgages 2					✓		
Superdrive Investments				✓			

Resecuritisations

A resecuritisation exposure is a securitisation exposure in which the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation exposure. The Group has not structured any resecuritisations nor has it acquired any resecuritisation exposures.

Oversight and credit risk mitigation

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

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

The Group does not employ credit risk mitigation techniques to hedge credit risk on retained securitisation tranches. The Group determines the applicable capital requirements for retained exposures according to the Basel securitisation framework, further detail hereon is provided below.

Securitisation accounting policies

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

The securitisation entities are subsequently consolidated into FRIHL for financial reporting purposes. Retained traditional securitisation notes are accounted for as available-for-sale investment securities within the banking book.

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

Summary of securitisation activity

Nitro Securitisation 4 Issuer Trust (Nitro 4)

In August 2011, the Group closed its fourth domestic traditional auto loan securitisation, Nitro 4. Nitro 4 is a cash securitisation of auto loans extended to obligors by WesBank. Nitro 4 was set up as an insolvency remote trust and issued R4 billion of notes rated by Moody's to acquire the asset pool.

The Bank, acting through its RMB division, was the arranger, manager and sponsor for the transaction. The interest rate swap is provided by the Bank with deal administration performed by RMB. The assets will continue to be serviced by WesBank. The following table provides further detail regarding the notes issued.

Nitro 4 notes issued

Tranche	Rating (Moody's)*	Amount (R million)	Credit enhancement (%)	Coupon (bps over 3m JIBAR)
A1	Aa2(sf)/Aaa.za(sf)	345	20.78	12
A2	Aa2(sf)/Aaa.za(sf)	345	20.78	30
A3	Aa2(sf)/Aaa.za(sf)	330	20.78	37
A4	Aa2(sf)/Aaa.za(sf)	320	20.78	44.5
A5	Aa2(sf)/Aaa.za(sf)	314	20.78	52
A6	Aa2(sf)/Aaa.za(sf)	320	20.78	58
A7	Aa2(sf)/Aaa.za(sf)	295	20.78	68
A8	Aa2(sf)/Aaa.za(sf)	150	20.78	73
A9	Aa2(sf)/Aaa.za(sf)	140	20.78	79
A10	Aa2(sf)/Aaa.za(sf)	130	20.78	94
A11	Aa2(sf)/Aaa.za(sf)	115	20.78	104
A12	Aa2(sf)/Aaa.za(sf)	100	20.78	115
A13	Aa2(sf)/Aaa.za(sf)	85	20.78	125
A14	Aa2(sf)/Aaa.za(sf)	180	20.78	130
B	Baa2(sf)/A1(sf)	286	13.63	190
C	Ba2(sf)/Baa1.za(sf)	140	10.13	260
D	NR	281	3.10	425
E	NR	124	0.00	500
Total		4 000		

* *International and national scale ratings provided.*

Structural highlights include:

- a sequential pay waterfall where senior notes are paid down first in order of priority;
- as and when the subordination afforded the Class A tranche is double that at closing, the transaction will redeem capital on all then outstanding notes proportionally;
- excess capital prepayments by obligors will fund the purchase of additional eligible assets;
- first Group transaction to be managed using the ABSSuite™ securitisation administration system; and
- the transaction is compliant with South African securitisation regulations.

The transaction was structured to obtain matched term funding for the Bank and is currently performing in line with expectations.

iKhaya RMBS 1 Limited and (iKhaya 1) iKhaya RMBS 2 Limited (iKhaya 2) maturity

iKhaya 1 was launched on 9 March 2007 with a total note issuance of R1.956 billion. The Class A notes were rated AAA(zaf) with 12.4% subordination provided by mezzanine and junior tranches. The Group retained the first loss subordinated loan of R56 million.

iKhaya 2 was launched on 22 June 2007 with a total note issuance of R3 billion. The Class A notes were rated AAA(zaf) with 16% subordination provided by mezzanine and junior tranches. The Bank retained the first and second loss subordinated loans totalling R116 million.

By September 2011, iKhaya 1 notes to the value of R1.09 billion were outstanding, representing some 57% of the outstanding principal amount of the notes on issue date. From a loss perspective, the

Risk and capital management report continued

transaction had by this time suffered a cumulative loss of 1.2%, all of which was covered by excess spread.

By November 2011, iKhaya 2 notes to the value of R1.55 billion were outstanding, representing some 52% of the outstanding principal amount of the notes on issue date. From a loss perspective, the transaction had by this time suffered a cumulative loss of 2.1%, all of which was covered by excess spread.

A muted housing market and lower-than-expected levels of prepayments leading to lower levels of principal payments meant that although being solvent, the transaction would be unable to meet its targeted maturity date. Structuring features of the vehicle precluded the raising of additional funding and limited the use of liquidity facilities to only covering interest payments and not redemptions.

Consequently, in November 2011, the Bank sought and obtained approval from the SARB and note holders to repurchase the underlying iKhaya 1 and iKhaya 2 assets, on market-related terms. The iKhaya 1 repurchase took place on 9 December 2011 and the iKhaya 2 repurchase took place on 22 March 2012. In both instances the proceeds were utilised for the redemption of the outstanding notes.

Investors in iKhaya 1 and iKhaya 2 were able to realise their investments at the targeted maturity date, without suffering any losses.

Turbo Finance 2 plc, a securitisation of UK auto loan receivables

In March 2012, the Group closed its second UK traditional auto loan securitisation, Turbo Finance 2 plc (Turbo 2). Turbo 2 is a cash securitisation of fixed rate auto loans extended to obligors by MotoNovo Finance (formerly Carlyle Finance), a division of the Bank (London Branch). The note issuance of £319.8 million is rated by both Fitch and Moody's. The following table provides further detail regarding the notes issued:

Tranche	Rating (Moody's/Fitch)	Amount (£ million)	Credit enhancement (%)	Coupon*
A	Aaa(sf)/AAA(sf)	255.00	20.25	1mLibor + 140
B	A1(sf)/A(sf)	38.00	8.37	5.50%
C	NR/NR	21.62	1.60	15.00%
D	NR/NR	5.13	0.00	20.00%
Total		**319.75**		

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

A follow up to last year's Turbo Finance securitisation, Turbo 2 was favourably received by investors. As with Turbo 1, the Group secured additional matched term funding for its UK vehicle finance operations together with a reduction in the cost of funds for asset origination. FirstRand, acting through its London branch, acts as servicer of the transaction.

Rating actions by Fitch Ratings

Fresco 2, which is incorporated under South African law, is a partially-funded synthetic securitisation of a portfolio of South African and international corporate credit exposures originated by the Bank. At closing on 17 July 2007, Fresco 2 entered into a portfolio credit default swap with the Bank, whereby Fresco 2, as the protection seller, provides credit risk protection on an R20 billion portfolio of corporate loans.

Following rating actions on Fresco 2 in November 2010, Fitch placed the Class A1 and A2 tranches on Rating Watch Negative (RWN). On 9 August 2011, Fitch concluded the rating review of Fresco 2 and downgraded the Class A1 and A2 tranches, assigning a Stable outlook. The ratings on tranches B1 to G have been affirmed, while the outlook on tranches C to G has been changed to negative.

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.

The rating actions were as follows:

- Class A1: downgraded to BBB (zaf) from AA- (zaf); RWN removed; assigned outlook stable.
- Class A2: downgraded to BBB (zaf) from AA- (zaf); RWN removed; assigned outlook stable.
- Class B1: affirmed at BB (zaf); outlook stable.
- Class B2: affirmed at BB (zaf); outlook stable.
- Class C: affirmed at B+ (zaf); outlook negative.
- Class D: affirmed at B (zaf); outlook negative.
- Class E: affirmed at B (zaf); outlook negative.
- Class F: affirmed at B (zaf); outlook negative.
- Class G: affirmed at B- (zaf); outlook negative.

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

Conduit programmes and fixed-income funds

The Group's conduit programmes are debt capital market vehicles, which provide investment-grade corporate South African counterparties with an alternative source of funding to directly accessing 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 borrowings or overnight deposits.

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

The conduit programmes have proved resilient during difficult financial market conditions and have experienced a tightening of credit spreads in line with the corporate debt market. Supply of assets and demand for notes issued by the conduits remain healthy.

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

					Non-recourse investments		Credit enhancement	
Transaction R million	Underlying assets	Year initiated	Rating agency	Programme size	**2012**	2011	**2012**	2011
Conduits								
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**6 687**	8 779	**–**	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**4 487**	6 741	**670**	753
Total				30 000	**11 174**	15 520	**670**	753
Fixed income fund								
iNkotha	Overnight corporate loans	2006	GCR	10 000	**2 654**	2 948	**–**	–
Total				10 000	**2 654**	2 948	**–**	–

Rating distribution of conduits and fixed income funds

R million	F1+(zaf)	AAA(zaf)	AA+(zaf)	AA(zaf)	AA–(zaf)	A+(zaf)	A(zaf)	A–(zaf)	Total
Conduits									
At 30 June 2012	**–**	**121**	**730**	**2 628**	**3 778**	**1 071**	**1 765**	**1 081**	**11 174**
At 30 June 2011	–	853	248	4 438	5 074	1 449	2 025	1 433	15 520
Fixed income funds									
At 30 June 2012	**–**	**–**	**–**	**1 097**	**479**	**519**	**–**	**559**	**2 654**
At 30 June 2011	–	–	–	969	652	548	453	326	2 948

Risk and capital management report continued

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

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

All of 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

R million	Transaction type	Exposure 2012	Exposure 2011
Own transactions		**8 157**	12 671
– iNdwa*	Conduit	**4 713**	7 159
– iVuzi	Conduit	**3 444**	5 512
Third party transactions	Securitisations	**558**	1 372
Total		**8 715**	14 043

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 associated capital requirements per risk band. The Group applies a number of methodologies in determining the capital requirements for securitisation and conduit exposures.

For domestic transactions, the Group applies the AIRB approach, using either the ratings based approach, supervisory formula or look-through basis, the choice of which is determined by the most efficient use of capital. For international transactions, the Group uses the standardised approach.

Retained or purchased securitisation exposure and the associated regulatory capital charges

	Exposure		AIRB capital		Capital deduction	
R million	**2012**	2011	**2012***	2011	**2012**	2011
Risk weighted bands						
= <10%	**7 443**	24 322	**55**	183	**–**	–
>10% = <20%	**810**	1 378	**11**	16	**–**	–
>20% = <50%	**1 235**	5 517	**42**	133	**–**	–
>50% = <100%	**81**	4	**6**	–	**–**	–
>100% = <650%	**59**	180	**26**	114	**–**	–
1250%.deduction	**1 457**	415	**46**	–	**1 015**	415
Look through	**22 745**	–	**797**	–	**–**	–
Total	**33 830**	31 816	**983**	446	**1 015**	415

* *Capital is calculated at the Basel II 9.75% requirement and includes a 6% capital scalar.*

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

Deductions arising from securitisation exposures

R million	Corporate receivables	Retail mortgages	Retail: instalment sales and leasing	Total
Traditional	–	–	825	825
Synthetic	190	–	–	190
Total	190	–	825	1 015

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

Introduction and objectives (audited)

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 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 over-the-counter (OTC) derivative and securities financing businesses. The objective of counterparty credit risk management is to ensure that risk is appropriately measured, analysed and reported on, and is only taken within specified limits in line with the Group's risk appetite framework as mandated by the Board.

During the year under review the Group implemented the Basel II standardised approach for the calculation of counterparty credit default risk capital. This measure is more risk-sensitive than the current exposure method (CEM) used previously. The improved risk sensitivity of the measure implies that capital now more accurately reflects the risk profile of the book. In the next financial year the Group will focus on the implementation of the Basel III credit value adjustment (CVA) and asset value correlation (AVC) multiplier capital charges.

FirstRand continues to be an active participant in processes to implement legislative and structural reforms in the local derivatives market. Changes to international regulations as relating to derivative market reforms are monitored.

The risk to bilateral OTC counterparts was reduced by restricting transactions to higher rated counterparts and collateralising all mark-to-market movements. The risk to clients in securities financing was reduced due to improved margining and exposure to higher quality underlying assets.

Organisational structure and governance

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

Counterparty credit risk is managed on the basis of the principles, approaches, policies and processes set out in the credit risk management framework for wholesale credit exposures.

In this respect, counterparty credit risk governance aligns closely with the Group's credit risk governance framework with mandates and responsibilities cascading from the Board through the RCC committee to the respective credit committees and subcommittees as well as deployed and central risk management functions. Refer to the *Risk management framework and governance section*, (page 126), and the *Credit risk governance section* (page 147) for more details.

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

Assessment and management (audited)

Quantification of risk exposure

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

To this end, appropriate quantification methodologies of potential future exposure over the life of a product, even under distressed market conditions, are developed and approved at the relevant technical committees. The two-way credit (and debit) valuation adjustment is calculated and priced on bespoke transactions.

Risk and capital management report continued

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

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

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 Derivative counterparty risk management function. Any remedial actions are agreed amongst these parties and failure to remedy such a breach is reported to the RMB Proprietary board, ERM and 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 credit 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 (ISDA) and International Securities Market Association agreements for the purpose of netting derivative transactions and repurchase transactions respectively. These master agreements as well as associated credit support annexes (CSA) set out internationally accepted valuation and default covenants, which are evaluated and applied on a daily basis, including daily margin calls based on the approved CSA thresholds.

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

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

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

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

While these variables are not quantifiable, the 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 the Group. In aggregate, all of the positive mark-to-market values shown below would need to reverse before the Group would be a net provider of collateral.

Counterparty credit risk profile

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

Composition of counterparty credit risk exposure

R million	2012	2011
Gross positive fair value	**91 924**	114 070
Netting benefits	**(9 315)**	(38 462)
Netted current credit exposure before mitigation	**82 609**	75 608
Collateral value	**(72 470)**	(63 772)
Netted potential future exposure	**3 194**	12 293
Exposure at default*	**21 174**	24 129

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

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

Credit derivatives exposure

	2012			
R million	**Credit default swaps**	**Total return swaps**	**Other**	**Total**
Own credit portfolio				
– protection bought	**19**	**–**	**–**	**19**
– protection sold	**1 900**	**–**	**–**	**1 900**
Intermediation activities				
– protection bought	**3 149**	**–**	**–**	**3 149**
– protection sold	**3 865**	**–**	**–**	**3 865**

	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

MARKET RISK IN THE TRADING BOOK

Introduction and objectives (audited)

Market risk exists in all trading, banking and listed equity 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 Bank is taken and managed by RMB. The relevant businesses within RMB function as the centres of expertise with respect to all trading and market risk-related activities, ensuring that at all times market risk is managed and contained within the risk appetite of the Group.

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.

The Bank implemented the regulatory changes associated with Basel 2.5 in the local trading book, namely the combined incorporation of VaR plus stressed VaR on 1 January 2012. As of January 2012, the performance of market risk-taking activities is measured as the higher of the Bank's internal expected tail loss (ETL) measure (as a proxy for economic capital) or regulatory capital based on VaR plus stressed VaR.

During the year, and as part of a strategic review of its business, RMB decided to cease all outright proprietary trading activities in the trading businesses. This resulted in a reduction in the size of the listed equity trading book. Discontinued positions are in the process of being managed down. However, it should be noted that market risk remains in certain client related activities, such as the provision of client-based hedging solutions and market making.

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 (audited)

Quantification of risk exposures

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

VaR calculations over holding periods of 1 day and 10 days are used as an additional tool in the assessment of market risk. VaR triggers and 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 supplement the above. 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 "what-if" hypothetical and forward-looking simulations. The calibrations of the stress tests are reviewed regularly to ensure that the results are indicative of the possible impact of severely distressed and event-driven market conditions. Stress and scenario analyses are reported to and considered regularly by the relevant governance bodies frequently.

Back testing

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

Regulatory and economic capital for market risk

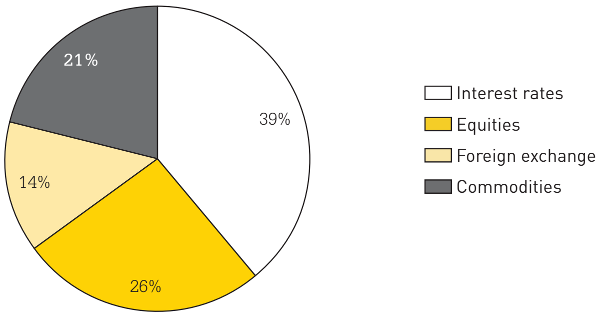
The internal VaR model for general market risk was approved by the SARB for local trading units and is consistent with the methodologies stipulated by the Basel 2.5 framework. For all international legal entities, the standardised approach is used for regulatory market risk capital purposes.

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 2012 based on the VaR methodology.

Composition of VaR exposure per asset class (audited)



VaR analysis by asset class (audited)

The table below reflects the VaR over a 1-day holding period at a 99% confidence level. Results for the year ending 30 June 2012 reflect the de-risking that has taken place with regards to outright proprietary trading, predominantly in the listed equity asset class.

1-day 99% VaR analysis by asset class

	2012				2011**
R million	**Min***	**Max***	**Average**	**Period end**	Period end
Risk type#					
Equities	**30.6**	**84.2**	**55.5**	**30.6**	51.0
Interest rates	**16.8**	**51.9**	**28.4**	**45.8**	22.9
Foreign exchange	**6.4**	**41.7**	**14.4**	**15.8**	6.5
Commodities	**2.8**	**45.1**	**21.0**	**24.6**	32.4
Diversification effect				**(44.2)**	(27.4)
Diversified total	**57.6**	**127.5**	**80.8**	**72.6**	85.4

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

** *The 2011 period end VaR numbers reported last year were based on a 10-day holding period. As 1-day VaR is reported this year, the 2011 period end numbers have been restated to reflect 1-day VaR. In addition, note that the table includes market risk for the trading activities that take place in FRIHL (within RMB Securities (Pty) Limited and RMB Australia Holdings Limited entities). Consequently, the 2011 period end VaR numbers were also restated to include listed equity exposures previously classified as investing activities within the RMB Australia Holdings Limited entity.*

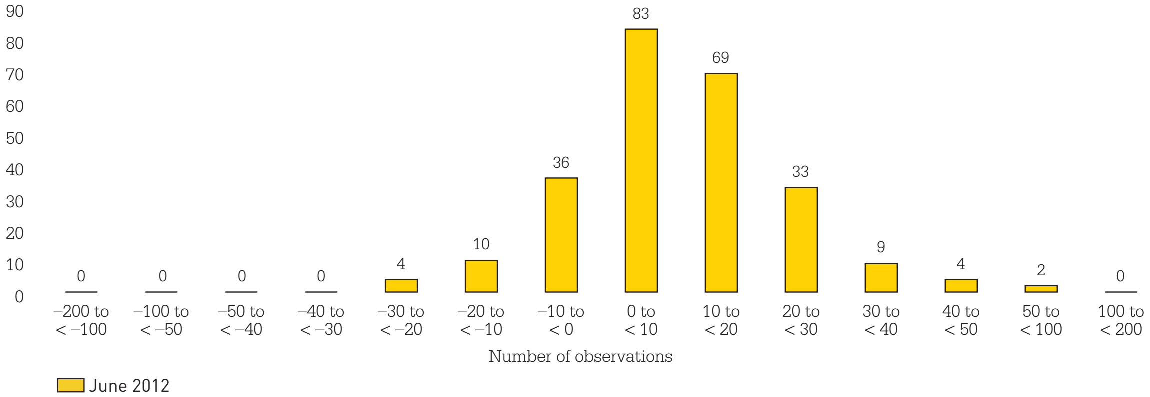
Banking book exposures are managed by Group Treasury and are reported under the banking book interest rate risk section.

Risk and capital management report continued

Distribution of daily trading earnings from trading units

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

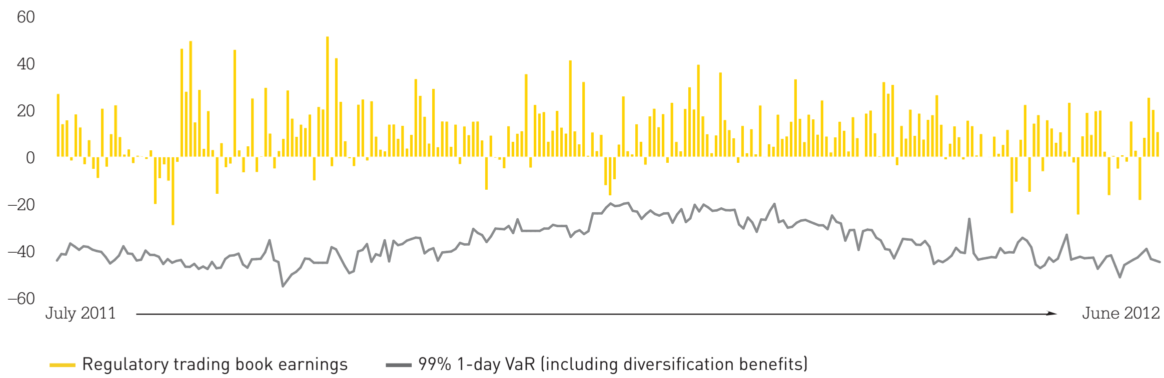
Distribution of daily earnings (unaudited)
Frequency (days in a period)



Back testing: daily regulatory trading book earnings and VaR

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

Back testing: daily regulatory trading book earnings versus 1-day 99% VaR of the Bank (unaudited)
(R million)



During the year 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

RMB Australia Holdings and the Bank's India branch 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. During the year under review, market risk was contained within acceptable limits.

FRIHL

VaR analysis by risk type

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

The table below reflects the de-risking that has taken place with regard to outright proprietary trading in the listed equity asset class, particularly as it relates to RMB Securities Trading (Pty) Limited.

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

	2012				2011
R million	**Min***	**Max***	**Average**	**Period end**	Period end
Diversified total	**27.2**	**74.7**	**43.8**	**27.2**	41.8

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

FNB Africa subsidiaries

Market risk for the African subsidiaries is measured using a stress loss measure per asset class and supplemented with the same VaR/ETL methodology as described above. During the period under review, market risk was contained within acceptable limits and was effectively managed in the FNB African subsidiaries.

EQUITY INVESTMENT RISK

Introduction and objectives (audited)

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

The Group actively monitors regulatory developments, including amendments to current Basel capital requirements and the anticipated impact of Basel III. Basel III regulations are expected to impact the Group's equity investment portfolio's capital adequacy requirements in January 2013. This is likely to result in the minority interests, intangibles and goodwill of the Group's fully consolidated subsidiaries no longer qualifying as Core Tier 1 capital.

The overall quality of the investment portfolio remains acceptable and is within risk appetite. This year has seen less equity realisations and a number of significant new equity investment acquisitions undertaken as part of a significant portfolio rebuilding drive. This trend is set to continue in the private equity market in the coming year in line with RMB's approved business strategy and risk appetite.

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 large exposures committee, as appropriate;
- the RCC and MIRC committees are responsible for the oversight of investment risk measurement and management across the Group;
- this year saw the formation of a bi-annual investment risk oversight committee. The committee assesses the quality and size of investment business within RMB and reviews movements in light of risk appetite; and
- 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.

Assessment and management (audited)

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 discussed 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 levels.

The Group targets a diversified investment portfolio profile, spread along 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 simple risk weighted (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

Market prices in selected industries continue to present the Group with opportunities to build its private equity portfolio. Unrealised profits for the investment portfolio continue to remain resilient. RMB's strategic business review included a decision to cease outright proprietary trading in the listed equities business. This has resulted in the managing down of listed equity investment risk exposures. At the same time, the private equity portfolio was subject to a significant portfolio rebuilding drive.

Investment risk exposure and sensitivity of investment risk exposure

R million	**2012**	2011
Listed investment risk exposure included in the equity investment risk ETL process*	**687**	1 407
ETL on above equity investment risk exposures*	**377**	616
Estimated sensitivity of remaining investment balances**		
Sensitivity to 10% movement in market value on investment fair value#	**502**	169
Cumulative gains realised from sale of positions in the banking book during the period	**1 642**	972

* *The decline in both exposure and ETL for listed investments from June 2011 to June 2012 was largely due to further run down of the legacy portfolios, de-risking of the listed equity exposures and the allocation of certain exposures from equity investment risk portfolio to the market risk portfolio. The listed investment risk exposure and ETL for June 2011 was restated to reflect the removal of long-term market risk exposure and included in the market risk disclosures.*

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

\# *Audited.*

Risk and capital management report continued

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

Investment valuations and associated regulatory capital requirements

	2012		
R million	**Publicly quoted investments**	**Privately held**	**Total**
Carrying value disclosed in the balance sheet	**2 509**	**10 064**	**12 573**
Fair value*	**2 509**	**13 087**	**15 596**
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	**55**	**44**	**99**
Latent revaluation gains not recognised in the balance sheet**	**–**	**3 054**	**3 054**
Capital requirement#	**715**	**3 824**	**4 539**

* *The fair values of listed private equity investments were not considered to be materially different from the quoted market prices.*
** *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
# *Capital requirement calculated at 9.5% of RWA (excluding the bank-specific Pillar 2b add-on). Effective 1 July 2011, the SARB requested that all equity investment risk exposures be risk weighted under the simple risk weighted method (previously non-bank entities were risk weighted under the standardised approach). This has increased the capital requirement for the Group.*

	2011		
R million	Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	3 236	8 068	11 304
Fair value*	3 236	10 973	14 209
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	49	134	183
Latent revaluation gains not recognised in the balance sheet**	–	2 905	2 905
Capital requirement#	493	1 459	1 952

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

FOREIGN EXCHANGE AND TRANSLATION RISK IN THE BANKING BOOK

Introduction and objectives (audited)

Foreign exchange risk arises from on- and off-balance sheet positions whose valuation in Rand is subject to currency movements. Key activities giving rise to these positions are foreign currency placements, lending and investing activities, 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 net open forward position in foreign exchange (NOFP) are overseen by MIRC, a subcommittee of the RCC committee and mismatch risk is governed through the FirstRand ALCCO and International ALCCO processes. In addition to the committee structures, business units charged with frontline management of these risks have deployed risk managers within their units who assess and report on these risks on an ongoing basis.

Assessment and management (audited)

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 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 US$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 corrective action 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.

FUNDING AND LIQUIDITY RISK

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 liquid 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.

Funding structure

The banking sector in South Africa is characterised by certain structural features, such as a low discretionary savings rate and a higher degree of contractual savings that are captured by institutions such as pension funds, provident funds and providers of asset management services. A portion of these contractual savings translate into institutional funding for banks which has higher liquidity risk than retail deposits. Limited yield incentivisation and corporate liquidity needs mean that South African banks are funding

Risk and capital management report continued

seekers. The structural liquidity risk is therefore higher in South Africa than in most other markets. This risk is however, to some extent mitigated by the following factors:

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

In the light of the structural funding issues focus is currently placed on lengthening and diversifying the funding profile in line with Basel III requirements. New Basel rules for liquidity particularly the LCR and the NSFR, are anticipated to have a significant impact if implemented as currently proposed. The provision of a tiered committed liquidity facility capped at 40% of total available liquidity, and the inclusion of cash reserves as an available source of liquidity have alleviated the structural constraints to LCR compliance.

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

Organisational structure and governance

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

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

The Bank (SA)

Liquidity Risk for FRB SA (RMB, FNB, FirstRand Corporate Centre and WesBank) is centrally managed by a dedicated liquidity and funding team in Group Treasury. Governance is provided by an independent liquidity risk team under the Corporate Centre CRO function responsible for ensuring that the liquidity risk management framework is implemented appropriately.

The Group's liquidity position, exposures and auxiliary information are reported bi-monthly 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 the Corporate Centre risk function also provide regular reports to FirstRand ALCCO.

FNB Africa

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

International subsidiaries

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

FirstRand has been granted renewable dispensation by the Financial Services Authority (FSA) for a waiver on a "Whole-firm 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.

Liquidity risk management

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 to ensure business activities preserve and enhance funding stability. This ensures the Group is able to operate through a period of stress when the access to funding is constrained.

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 across different funding sources; • assessing the impact of future funding and liquidity needs taking into account expected liquidity shortfalls or excesses; • setting the approach to managing liquidity in different currencies and from one country to another; • ensuring adequate liquidity ratios; • ensuring an adequate structural liquidity gap; and • maintaining a funds transfer pricing methodology and processes.	• managing intraday liquidity positions; • managing 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 net daily cash positions; • managing and maintaining market access; and • managing and maintaining collateral.	• managing early warning and key risk indicators; • performing stress testing including sensitivity analysis and scenario testing; • maintaining product behaviour and optionality assumptions; • ensuring that an adequate and diversified portfolio of liquid assets and buffers are in place; and • maintaining the contingency funding plan.

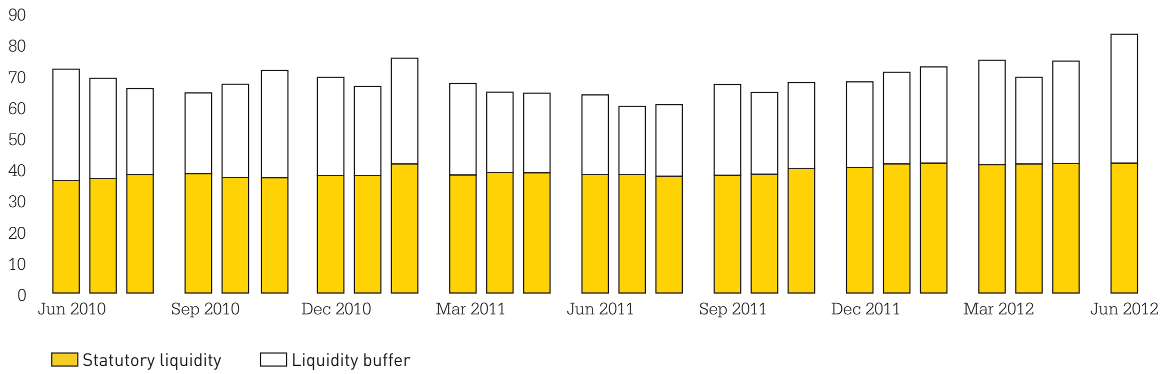
Risk and capital management report continued

Available liquidity

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

The chart below shows the liquidity buffer and statutory liquidity requirements for the Bank.

The Bank's liquidity buffer and statutory liquidity requirements
(R billion)



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

Stress testing and scenario analysis

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

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

Liquidity contingency planning (audited)

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

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

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

- support effective management of liquidity and funding risk under stressed conditions;
- establish clear roles and responsibilities in the event of a liquidity crisis; and
- articulate clear invocation and escalation procedures.

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

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

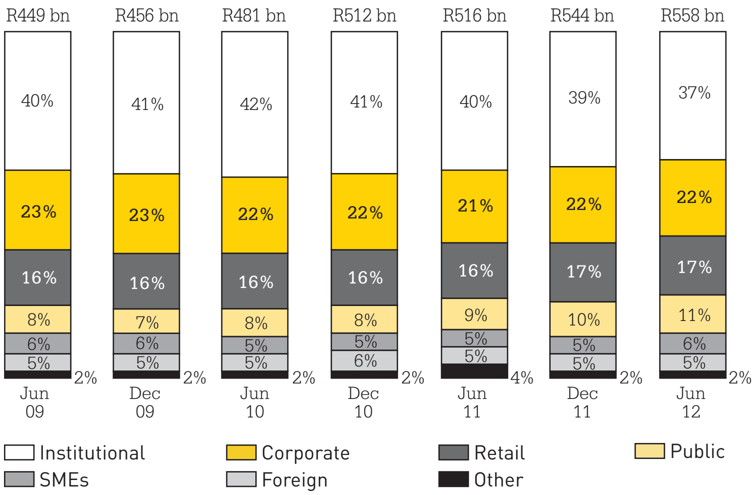
Funding strategy

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

The Group seeks to diversify funding sources across segments, countries, instrument types and maturities. Where structural restrictions exist such as South Africa's reliance on wholesale funding, the risk is mitigated through term profile and liquidity buffers.

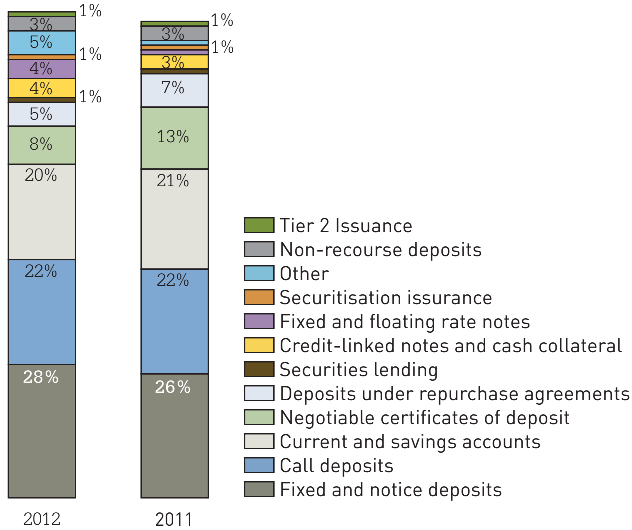
The table below illustrates the Group's sources of funding by counterparty.

FRB's funding analysis by source (%)
and total deposit base (R billion)



The chart below illustrates the Group's funding instruments by instrument type including senior debt and securitisation.

FirstRand's funding instruments by instrument type (%)



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

Liquidity risk profile (audited)

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.

Liquidity cash flows (undiscounted cash flows)

	2012			
		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	**641 809**	**432 128**	**76 444**	**133 237**
Short trading positions	**5 343**	**5 343**	**–**	**–**
Derivative financial instruments	**53 958**	**52 016**	**443**	**1 499**
Creditors and accruals	**9 080**	**8 294**	**521**	**265**
Two-tier liabilities	**10 437**	**13**	**1 346**	**9 078**
Other liabilities	**7 445**	**72**	**825**	**6 548**
Policyholder liabilities under insurance contracts	**1 523**	**339**	**56**	**1 128**
Policyholder liabilities under investment contracts	**71**	**–**	**8**	**63**
Financial and other guarantees	**30 920**	**25 327**	**2 733**	**2 860**
Facilities not drawn	**69 348**	**57 438**	**3 100**	**8 810**

	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	553 091	398 806	68 577	85 708
Short trading positions	12 413	12 413	–	–
Derivative financial instruments	37 028	35 650	884	494
Creditors and accruals	18 306	6 789	2 438	9 079
Long-term liabilities	9 927	–	–	9 927
Two-tier liabilities	10 333	–	399	9 934
Other liabilities	4 176	591	950	2 635
Policyholder liabilities under insurance contracts	1 047	151	308	588
Financial and other guarantees	31 346	25 801	3 175	2 370
Facilities not drawn	63 299	38 616	1 433	23 250

* *During the current year a comprehensive review of the liability disclosure was undertaken by the Group in order to ensure that the Group's presentation was consistent with industry practice and to provide more detailed and useful information in the financial statements. A reclassification was required to bring the comparative numbers in line with the updated presentation.*

Risk and capital management report continued

Contractual discounted cash flow analysis

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

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

Therefore, in addition to the analysis in the 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 for FirstRand

	2012			
		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	**769 765**	**295 061**	**66 046**	**408 658**
Total equity and liabilities	**769 765**	**498 741**	**78 177**	**192 847**
Net liquidity gap	**–**	**(203 680)**	**(12 131)**	**215 811**
Cumulative liquidity gap	**–**	**(203 680)**	**(215 811)**	**–**

	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	697 927	260 517	56 392	381 018
Total equity and liabilities	697 927	476 231	73 356	148 340
Net liquidity gap	–	(215 714)	(16 964)	232 678
Cumulative liquidity gap	–	(215 714)	(232 678)	–

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.

INTEREST RATE RISK IN THE BANKING BOOK

Introduction and objectives (audited)

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

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

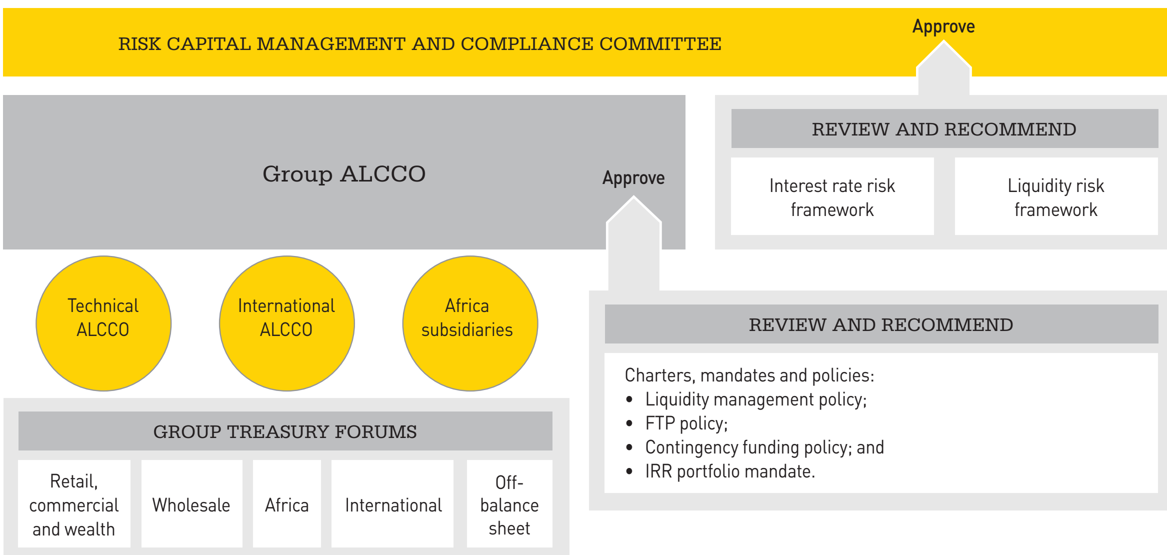
IRRBB originates from the differing repricing characteristics of balance sheet instruments, yield curve risk, basis risk and client optionality embedded in banking book products. It is an inevitable risk associated with banking and can be an important source of profitability and shareholder value. IRRBB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

Organisational structure and governance

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

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

Interest rate risk management and governance structure



Risk and capital management report continued

Assessment and management (audited)

FirstRand Bank

Management and monitoring of the FirstRand domestic banking book is split between the RMB book and the remaining domestic banking book. RMB manages the banking book under its market risk framework, as such, risk is measured and monitored in conjunction with the trading book with management oversight provided by MIRC. The RMB banking book interest rate risk exposure was R79.7 million on a 10-day ETL basis at 30 June 2012 (June 2011 R45.9 million). (Refer to *Market risk* section on page 188) Any reference in future relating to the banking book excludes the RMB book.

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

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

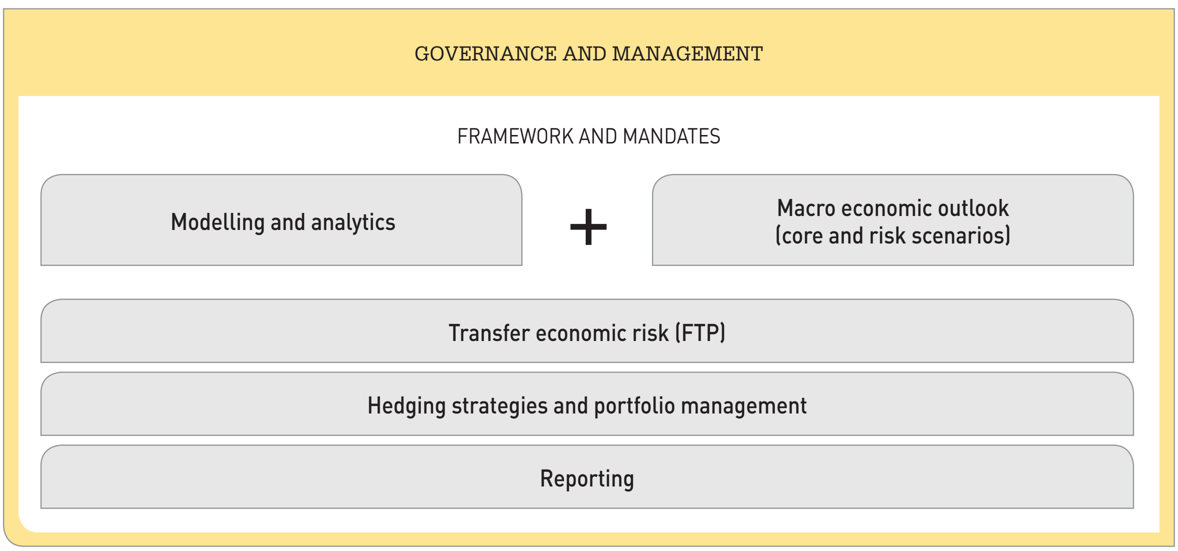
A number of measurement techniques are used to measure IRRBB; these focus on the net interest income (NII) sensitivity/earnings risk and the overall impact on economic value of equity (EVE) and daily PV01 measures.

The interest rate risk from the fixed book is managed to low levels with remaining risk stemming from timing and basis risk. The primary driver of NII sensitivity relates to the non- and low-rate products in the balance sheet, the endowment book. This has an adverse impact on the Group's NII margin in a cutting cycle as the decrease in NII from assets repricing to lower rates is not offset by a corresponding interest saving from liabilities. In the current rate cycle, the average repo rate for the year dropped by 29 bps, resulting in a negative impact to the Bank's margin.

International subsidiaries and branches

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

Interest rate risk management and assessment



Current repricing profile (audited)

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.

In calculating the repricing gap, all banking book assets, liabilities and derivative instruments are placed in gap intervals based on their repricing characteristics. Non-maturing deposits and transmission accounts for which rates are administered by the Group are considered to reprice overnight. No prepayment assumptions are applied.

Repricing schedules for the Group's banking book

	2012				
	Term to repricing				
R million	**< 3 months**	**> 3 but ≤ 6 months**	**> 6 but ≤ 12 months**	**> 12 months**	**Non-rate sensitive**
FirstRand Bank					
Net repricing gap	**23 422**	**(4 164)**	**(5)**	**15 650**	**(34 903)**
Cumulative repricing gap	**23 422**	**19 258**	**19 253**	**34 903**	**–**
FNB Africa					
Net repricing gap	**2 555**	**(1 398)**	**(484)**	**1 558**	**(2 231)**
Cumulative repricing gap	**2 555**	**1 157**	**673**	**2 231**	**–**
Total cumulative repricing gap	**25 977**	**20 415**	**19 926**	**37 134**	**–**

	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	–

This repricing gap analysis excludes the banking books of RMB and the international statement of financial position, both of which are separately managed on ETL and VaR basis.

Risk and capital management report continued

Sensitivity analysis

NII sensitivity

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

The tables below show the 12-month NII sensitivity for a 200 downward parallel shock to interest rates. The decreased sensitivity in June 2012 from June 2011 is attributable to an increase in the use of derivative positions to manage interest rate risk in line with the macro economic outlook. In the prior year, the book was positioned for rate hikes. However, due to the rising threat of a crisis in Europe and growing global growth concerns, hedges have been put in place to provide greater NII margin stability in the event of further rate reductions.

Assuming no change in the balance sheet and no management action in response to interest rate movements, an instantaneous and sustained parallel decrease in interest rates of 200 bps would result in a reduction in projected 12-month NII of R1 755 million, a similar increase in interest rates would result in an increase in projected 12-month NII of R1 801 million.

Sensitivity of the Group's projected NII

	2012		
	Change in projected 12-month NII		
R million	**FirstRand Bank**	**FNB Africa**	**FirstRand**
Downward 200 bps	**(1 514)**	**(241)**	**(1 755)**
Upward 200 bps	**1 562**	**238**	**1 801**

	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

Economic value of equity (EVE)

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

The table below shows the EVE measures for a -200 bps and +200 bps instantaneous, parallel shock to rates on open positions run in Group Treasury. This is shown as a percentage of total Tier 1 and Tier 2 capital for the Group. The change in the current year is attributable to growth in the retail fixed book and the additional hedges put in place to minimise interest rate risk in line with the macro economic outlook.

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

R million/%	**2012**	2011
Downward 200 bps		
Available-for-sale	**1 008**	1 186
Cash flow	**(1 006)**	(1 390)
Total sensitivity	**2**	(204)
As % of Tier 1 and Tier 2 capital	**0.004%**	(0.321%)
Upward 200 bps		
Available-for-sale	**(871)**	(1 044)
Cash flow	**916**	1 315
Total sensitivity	**45**	271
As % of Tier 1 and Tier 2 capital	**0.065%**	0.427%

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

OPERATIONAL RISK

Introduction and objectives (audited)

The Group processes large volumes of simple and complex transactions on a daily basis. The ability to process these transactions effectively is impacted by failure of IT systems and infrastructure, internal or external fraud, litigation, business disruption or process failure. Disruption in power supply, complex systems and inter-connectivity with other financial institutions and exchanges increase the risk of operational failure. Operational risk can also cause reputational damage, and therefore, efforts to identify, manage and mitigate operational risk are equally sensitive to reputational risk as well as the risk of financial loss.

The Group uses a variety of approaches and tools in the assessment, measurement and management of operational risk. ERM, the Group risk management function independent of the revenue-producing units, is responsible for developing and ensuring the implementation of the operational risk management framework (ORMF) and its supporting policies to manage operational risks, and provides regular reports of operational risk exposures to the Board via the Group's risk governance structures. ERM is supported in its tasks by deployed segment and divisional risk managers, using Group-wide control standards endorsed by senior management and through the training of staff in a process of identifying, measuring, monitoring and reporting operational risk.

The year under review has strengthened the Group's view that the management of operational risk is an ongoing process that must be routinely defined, refined and re-examined. Existing policies, methodologies, processes, systems and infrastructure are frequently evaluated for relevance to ensure that the discipline remains at the forefront of operational risk management and in line with regulatory developments and emerging best practices.

The Group recognises that managing operational risk effectively is not only a key capability but also provides a competitive advantage when addressing the balance between risk and reward. Providing and operating within the defined operational risk appetite levels remains a key operational risk strategic objective for the year ahead.

The overall objective of operational risk management is to enhance the level of risk maturity across the Group by implementing and embedding process-based risk and control identification and assessments and integrating the operational risk management advanced measurement approach (AMA) elements for a more comprehensive view of the operational risk profile.

The year under review

An exercise to identify inherent high risk areas and prioritise these for the roll-out of the processed-based risk and control identification and assessment is underway. This assessment aims to provide a comprehensive view of a business' operational risk profile based on end-to-end processes. Work is underway to integrate and automate the Group's operational risk management tools onto a single platform to enhance operational risk management processes. There are, furthermore, a number of Group-wide initiatives focusing on improving the internal control environment.

In order to ensure that the Group's operational risk practices remain in line with global and emerging operational risk management standards, its practices have been benchmarked against the recently issued BCBS's Principles for the Sound Management of Operational Risk and Operational Risk – Supervisory Guidelines for AMA.

The Group's current focus is to refine operational risk appetite levels and to monitor operational risk exposure against the set appetite levels across all the divisions within the Group.

Organisational structure and governance

The Board has delegated its responsibility for the governance and oversight over the management of operational risk to the Operational risk committee (ORC), a subcommittee of the RCC committee. The ORC provides governance, supervision, oversight and coordination of relevant operational risk processes as set out in the board-approved ORMF, a subframework of the BPRMF. Members of the ORC include a non-executive board member and an independent specialist advisory member, franchise heads of operational risk and the head of operational risk of the Group.

In addition, governance committees at all levels of the Group (business unit, segment and franchise) support the ORC and RCC committees in the execution of risk management duties and responsibilities.

Measurement

Basel – advanced measurement approach

FirstRand began applying AMA under Basel 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 the FRIHL Group 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 accurate risk-based measures of capital for all business units on AMA.

Operational risk scenarios (covering key risks that, although low in probability, may result in severe losses) and internal loss data are 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 areas. Scenarios are cross referenced to external loss data, internal losses, risk and control self assessments 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 event types across various internal business lines. Data collection is the responsibility of the respective business units and is overseen by the operational risk management team in ERM.

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

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

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

- changes in the operational risk profile, as measured by the various operational risk tools;
- material effects of expansion into new markets, new or substantially changed products or activities as well as the closure of existing operations;
- changes in the control environment - 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.

Assessment and management

Operational risk assessment and management 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 is responsible for consolidated operational risk reporting, policy ownership and facilitation and coordination of operational risk management and governance processes. GIA, as the third line of control, provides independent assurance of the adequacy and effectiveness of operational risk management processes and practices.

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

Operational risk assessment, management approaches and tools

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

As the PRCIA is rolled out across the Group over a period, it will replace the RCSA to ensure that a comprehensive assessment of risks and controls across end-to-end business processes is conducted.

FirstRand uses an integrated and renowned operational risk system which is well positioned as the core operational risk system and provides a solid platform for automation of all the operational risk tools. The automation and integration of all the operational risk tools on the operational risk system is currently a key focus area for the operational risk management function.

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. external fraud) and are budgeted for appropriately. Business areas minimise these losses through continuously monitoring and improving relevant business and control practices and processes. Operational risk events resulting in substantial losses occur much less frequently and the Group strives to minimise these and contain frequency and severity within its risk appetite 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 processes with meaningful adjustments to risk management.

Boundary event (audited)

During the year under review FNB deployed a new management team into its merchant acquiring business. This unit provides Speedpoint devices at various merchants that accept credit, cheque and debit cards as a form of payment. FNB acquires these transactions and pays the merchant; it then recovers these payments to the merchants from the banks that issue cards to their customers and charges a fee for this process. FNB also settles its own customer transactions through the other banks.

The new team subsequently discovered the deliberate concealment, by certain members of the business unit staff, of payments made to merchants that remained unrecovered from the card issuers. Since 2008 staff had built a complex web of manipulated transactions that proved very difficult to detect by internal and external lines of control. No evidence of personal financial gain had been uncovered and no customers have been negatively impacted by this issue.

In line with best practice the Board and FNB management appointed the services of an independent auditing firm to investigate the issue, including the surrounding operational control environment. This investigation has now been completed and the gross unrecovered amount confirmed at R915 million for the year to 30 June 2012.

Risk and capital management report continued

The Group has written off R705 million of the amount as bad debt. The remaining exposure is expected to be recovered over time. Refer to page 160 Impairment of financial assets and NPLs in the *Credit risk* section of this report.

The Board and management continue to refine the approach of linking key business processes to the operational risk and control environment.

Internal validation

In order to ensure consistency in the application and output of the various operational risk tools, a Group internal validation is undertaken annually. This process involves a robust challenge of all the operational risk tools at all levels within the Group. A report is issued on the final results of the internal validation exercise to the business for action where necessary.

Internal audit findings

GIA acts as the third line of risk control across the Group and provides an independent view on the adequacy 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 management and governance processes and structures.

Risk management processes

Within operational risk, a number of key risks exist in respect of which specialised teams, frameworks, policies and processes have been established and integrated into the broader operational risk management and governance processes as described below.

Business resilience management

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

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

The Group carries out regular reviews of BRM practices and any disruptions or incidents are regularly reported to the relevant risk committees. Over the reporting period, the Group successfully invoked and revoked full disaster recovery with respect to its primary systems.

Legal risk

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

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

Information risk

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

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

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

During the reporting period the Group's IT risk and information security governance structures have been reviewed and restructured to ensure specialised focus on IT risk and information security at the appropriate levels.

The IT risk management tools currently in use are being reviewed to ensure phased integration with the broader operational risk management tools like the PRCIA tool. This integration will ensure that IT risks are identified and managed as part of the management of operational risks in the end-to-end business processes.

Fraud and security risks

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

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

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

Risk insurance

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

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

REGULATORY RISK

Introduction and objectives

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

Non-compliance may have potentially 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. This objective culminates in the maintenance of an effective and efficient regulatory risk management framework with sufficient operational capacity throughout the Group to promote and oversee compliance with legislative and best practice requirements.

It is of paramount importance that the Group ensures compliance with, among others, the provisions of the Banks Act, 1990 (Act No. 94 of 1990 – the Act) and the Regulations relating to Banks and ensures that all compliance issues identified in this context are effectively and expeditiously resolved by senior management with the assistance of RRM. Similarly, compliance with other important legislative and regulatory requirements such as anti-money laundering legislation and the combating of the financing of terrorism standards requires close cooperation with and interaction between RRM, other functions within the Group and the various regulatory authorities.

In order to achieve the Group's regulatory risk management objectives, all staff members are continually made aware of compliance requirements in order to ensure a high level of understanding and awareness of the applicable regulatory framework.

The year under review

The most notable development and focus area in respect of regulatory reforms is the anticipated implementation of a twin peaks model of financial regulation in South Africa and ongoing adjustments to the regulatory framework in terms of the implementation of the Basel III reforms.

The new Regulations relating to Banks became effective on 1 January 2012 and incorporated, among others, amendments and additions to supervisory standards and banking legislation. In addition, as South Africa is following international best practices and standards on financial regulation, supervision and market conduct, it is anticipated that ongoing changes in these areas, which are based mainly on the lessons learnt from the global financial crisis, will be incorporated into the regulatory framework.

Risk and capital management report continued

Organisational structure and governance

Responsibility for ensuring compliance with all relevant laws, related 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, RCC and Audit committees, all of which receive regular detailed reports on the level of compliance and instances of material non-compliance from RRM.

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.

FirstRand has proactively formalised the governance of social and ethics performance through the establishment of a social and ethics committee and is taking steps to ensure the optimal functioning of Group-wide ethics management processes. The FirstRand Group code of ethics is the cornerstone of FirstRand's ethics management framework.

Upon joining the Group all directors are obliged to sign a pledge to adhere to the FirstRand Group code of ethics. This code addresses duties of care and skill, good faith, honesty, integrity and whistle blowing. It also addresses processes for dealing with conflicts of interest and the need to always act in the best interests of the Group. Guidance on political donations and solicitation of gifts is provided in the code of ethics. No issues of impropriety or unethical behaviour on the part of any of the directors were drawn to the attention of the committee during the year.

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

Assessment and management

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

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

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

Public policy and regulatory affairs office

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