ABSA
Today, tomorrow, together.

Risk management report

31 December 2012

Member of
BARCLAYS

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Overview

Overview

Introduction

Following the events of recent years, risk and its mitigation have become even more of a priority in the financial services industry. With the effects of the global financial crisis still evident and the current unsettled sovereign debt crisis creating uncertainties in both the local and global economies, it has become increasingly important to understand and manage risks to create sustainable returns for shareholders. In this light, we continue to uphold and strengthen our commitment to manage risks. Consequently, proactive risk management is a key pillar of our One Absa strategy. Linked to this is our board-approved principal risks policy (PRP). The PRP provides an integrated risk management framework designed to meet the challenges of the changing risk environment and to ensure that business growth plans are properly supported by effective risk management.

Responsibility for risk management resides at all levels in Absa Group Limited and its subsidiaries (the Group), from the board and executive level committees down to each business unit manager and their risk specialists. This contributes to instilling a strong risk culture in the Group, making risk everyone's business. We believe this is a core imperative of risk management. The delegation of risk management responsibilities is structured to ensure risk-reward decisions are enacted at the most appropriate level in line with business objectives, subject to robust and effective review as well as challenge processes. Strategic business decisions are taken in accordance with a board-approved risk appetite with the executive and risk committees closely monitoring risk profiles against this appetite.

At the beginning of the current reporting period, the PRP was updated to identify the four principal risks we regard as our most significant potential exposures. The update to the PRP reflects a change in the way we group the risk categories and does not have any impact on the underlying risk types.

The four principal risks are:

- credit risk;
- market risk (includes traded and non-traded market risk and insurance risk);
- operational risk; and
- funding risk (includes liquidity risk and capital management).

In this report, we focus on the above four principal risks and provide a review of these risks for the reporting period ended 31 December 2012.

2012 in review

During the reporting period, impairment losses on loans and advances reflected significant growth, driven by an increase in provisions required on the Home Loans legal book and higher impairment losses on loans and advances in Business Markets, primarily attributable to the Commercial Property Finance (CPF) debt.

Management action focused on the reduction in the loss given default (LGD) and non-performing loan (NPL) management. Emphasis was also placed on the key drivers of LGD such as insolvencies, cures and voluntary sales. In conjunction with this, process changes in the collections environment resulted in an enhanced control environment.

Overall, our executive committees were closely involved in important risk management strategies that focused particularly on preserving appropriate levels of capital and liquidity as well as effectively managing the risk portfolios. In addition, we closely monitored key areas such as market conditions, the global banking industry, the Basel Capital Accord (Basel) II.5 and Basel III requirements (Basel requirements) and anticipated demands relating to future business growth.

Two changes to our risk management processes were introduced at the beginning of the reporting period. We commenced reporting under the new Basel II.5 framework required by the Banks Act, No. 94 of 1990 (Banks Act). In addition, the wholesale book and statutory reserve and liquid asset portfolio were moved to the advanced internal ratings-based (AIRB) approach. These changes resulted in risk-weighted assets (RWA) increasing by 3,2% during the reporting period, which was less than anticipated.

2012 was a year in which:

- a strong capital position was maintained above board-approved target ranges;
- a strong liquidity risk position was maintained;
- impairment losses on loans and advances of Retail and Business Banking (RBB) increased significantly, with higher coverage required on the Home Loans legal and CPF portfolios;
- the Corporate, Investment Banking and Wealth (CIBW) wholesale portfolio continued to perform steadily against a backdrop of global economic uncertainty; and
- fraud and transaction operations remained the main drivers of operational risk losses.

We maintained our strong capital adequacy position, placing the Group in a healthy position to deal with the implementation of Basel III requirements. Capital levels remained above target ranges for both the Group and Absa Bank Limited and its subsidiaries (the Bank), with the Group's Core Tier 1 capital adequacy ratio remaining stable at 13% and the Bank's Core Tier 1 capital adequacy ratio improving by 40 basis points (bps). The acquisition of the Edcon Proprietary Limited (Edcon) portfolio changed the Group's risk profile, with a resultant increase in RWA. Optimisation remains a key focus area, as it lowers the potential need to raise additional capital that may be required in future under Basel III regulations. R1,5 billion of subordinated debt, qualifying as Tier 2 capital, was called at the first optional redemption date in September 2012. Subsequently, we issued R5 billion of subordinated debt. The issuance is the largest listed Tier 2 subordinated debt raising on a single day in the South African market.

2012 in review *(continued)*

We also reviewed our brand and reputation risk control framework, governance structures and escalation protocols during the reporting period.

We continued to focus on liquidity risk management and maintained a strong liquidity position to achieve compliance within the timeframes required by Basel III. Progress was made during the reporting period regarding compliance with the liquidity coverage ratio (LCR), in particular following the South African Reserve Bank (SARB) announcement in May 2012 that a committed liquidity facility (CLF) will be made available to South African banks to help address the shortfall of high quality liquid assets in the South African market, combined with the announcement made early in January 2013 by the Basel Committee on Banking Supervision (BCBS) that the implementation timeframes relating to the LCR would be relaxed, with full compliance required only by 2019. The phasing-in approach now proposed in respect of the LCR is more in line with proposals relating to capital requirements and takes into account the need to balance the implementation of global liquidity standards with economic growth. The net stable funding ratio (NSFR) remains a challenge, given the structural features of the South African economy. This will remain a key focus area.

Conditions remained challenging during the course of the reporting period, as signs of the expected economic recovery were less evident than at the end of the previous reporting period. In addition, in the wholesale environment, the disappointing supply-side growth momentum observed in the second half of the previous reporting period continued into the current reporting period. Headline consumer price inflation remained stable, though this has not been sufficient to positively sway corporate confidence, which remained flat. Impairment performance for the majority of retail portfolios was in line with expectations, but impairment losses on mortgage advances increased significantly during the reporting period due to the higher coverage required on the legal portfolio. Impairment losses on loans and advances in Business Markets were a key focus area for the reporting period, and various reasonableness tests, deep dives, collateral revaluations and policy changes resulted in a significant increase in the impairment charge for the current reporting period.

We continued to maintain our structural hedging programme during the reporting period. This contributed positively to the net interest margin and cash flow hedging reserve, against a backdrop of historically low interest rates.

Priorities for 2013

A sustained focus will be placed on enabling strong proactive risk management in the business and strengthening the effectiveness of the business control activities. This is in line with our drive to embed a risk-aware culture that balances commercial intent and control in our business. Enhancing the level of controls in important business processes on an end-to-end basis will also receive emphasis.

Retail Markets will continue to focus on value and balance sheet optimisation, balanced with prudent risk management practices. We will remain focused on the quality and profitability of new business and will continue to be selective in the type of business written in the retail portfolios. There will also be a sustained focus on operating model optimisation, model monitoring and validation processes.

Business Markets will continue to reduce exposure on the early warning list (EWL) and to monitor the portfolio composition. The risk and control framework will be further enhanced and AIRB principles will be firmly embedded in the business.

We are working on maintaining an optimal mix of high quality capital, while continuing to generate sufficient capital to support economically profitable growth opportunities.

Basel III was implemented on 1 January 2013 and its potential impacts have been included in our capital models. As a result of our strong capital position, we will remain adequately capitalised after implementation.

A strong liquidity position will be maintained. We will continue to work with industry forums and the SARB to ensure the optimal implementation of the Basel III liquidity framework. We are well positioned for future growth and will continue to monitor the economic and regulatory environments and enhance risk management processes while exploiting value-adding opportunities.

Our approach to risk management

We employ the following five-step process in terms of our risk management approach:

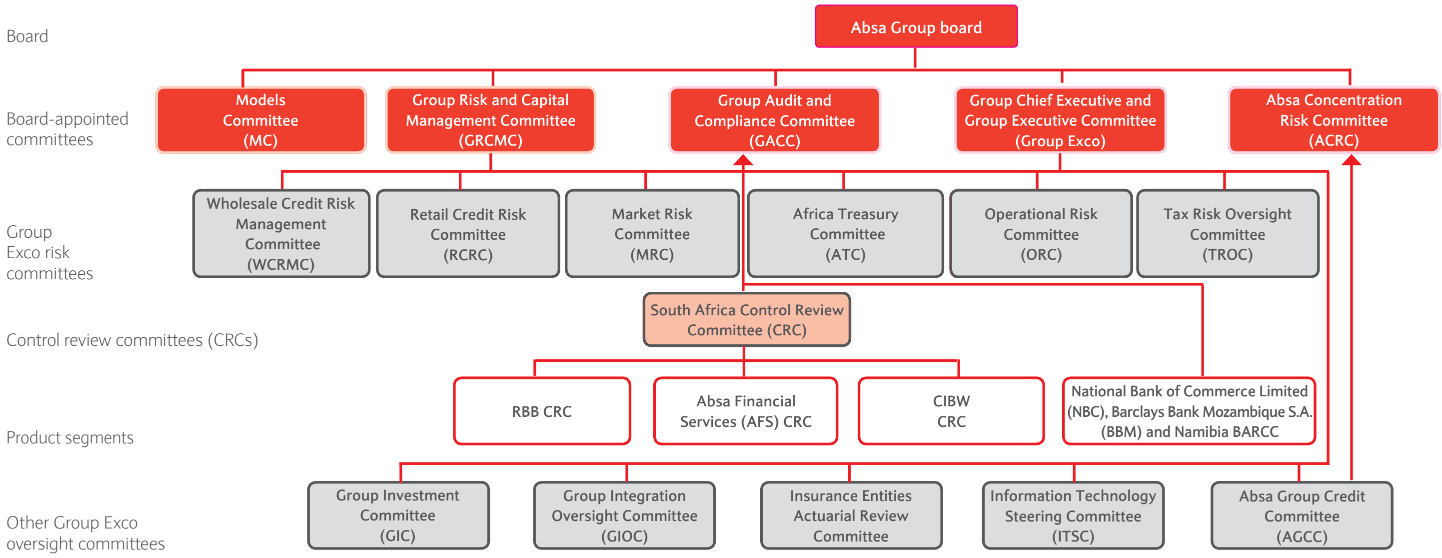
Risk management process	
Identify	→ Understand the principal risks fundamental to achieving our strategy. → Establish the risk appetite. → Establish and communicate the risk management framework including responsibilities, authorities and key controls.
Assess	→ Establish the process for analysing business-level risks. → Agree and implement measurement and reporting standards and methodologies.
Control	→ Establish key control processes and practices, including limit structures, provisioning requirements and reporting standards. → Monitor controls and adherence to risk direction and limits. → Ensure that risk management practices and conditions are appropriate for the business environment.
Report	→ Interpret and report on risk exposures, concentrations and risk-taking outcomes. → Interpret and report on sensitivities and key risk indicators. → Agree and operate early warning reporting processes that are used to highlight issues at a Group and business unit level. → Ensure that processes are in place to operate appropriate reporting and controls to ensure that the risk profile is maintained within risk appetite/tolerance.
Manage/challenge	→ Review and challenge all aspects of our risk profile. → Assess new risk-return opportunities. → Advise on ways to optimise our risk profile. → Review and challenge risk management practices.

Risk oversight

Oversight of overall Group risk resides primarily with two board committees, the Group Risk and Capital Management Committee (GRCMC) and the Group Audit and Compliance Committee (GACC). The newly implemented combined assurance model, owned and managed by Group Risk, covers each principal risk and business area. The aim is to provide a coordinated approach to all assurance activities enabling the board and management to assess whether the significant risks facing the Group are adequately covered.

The Group Chief Executive (GCE) grants authority and responsibility to the Chief Risk Officer (CRO) to ensure the principal risks are properly managed under appropriate control frameworks, and to advise on risk appetite and the Group's risk profile. A description of the GRCMC and its activities follow.

Absa's risk governance structure



The Group Risk and Capital Management Committee

The GRCMC assists the board in fulfilling its responsibilities in managing risk and complying with the relevant requirements of the Banks Act. The GRCMC determines and recommends the Group's risk appetite to the board and then reviews and monitors the risk profile against the risk appetite. The GRCMC also approves control frameworks for various principal risks and assists in determining capital and liquidity target ranges and monitoring capital and liquidity levels.

The GRCMC meets on a quarterly basis.

GRCMC meetings during the current reporting period were attended by the GCE, Deputy GCE, Group Financial Director, CRO, Head of Compliance and Regulatory Affairs and Group Treasurer. Internal and external auditors also attended the meetings in accordance with our governance processes.

The meetings were convened under the mandate contained in the terms of reference of the GRCMC, and in accordance with applicable regulations. The GRCMC was provided with required representations and information by management at each meeting, which enabled the committee to properly review and monitor the various risks and, in so doing, effectively comply with its mandate. Adequate training is conducted annually to ensure members effectively discharge their duties.

The Chairman of the GRCMC is a member of the GACC and attended all meetings of the GACC. He met with the CRO and executive management on a regular basis and reported to the board after each committee meeting.

Absa's risk governance structure *(continued)*

The Group Risk and Capital Management Committee *(continued)*

Core activities of the Group Risk and Capital Management Committee

During the current reporting period, the GRCMC's activities and key decisions included:

- recommending Absa's risk appetite to the board for approval and monitoring the actual risk against the board-approved appetite;
- assisting the board in executing its duties with respect to risk and capital management as required by the Banks Act;
- monitoring our emerging risk profiles and reporting findings to the board;
- monitoring the level of available capital, both current and projected, and reporting to the board on the adequacy of available capital relative to the emerging risk profile of the Group;
- reviewing the adequacy and effectiveness of the PRP, the completeness of principal risks coverage and the ongoing effectiveness of the framework as implemented by the Group;
- assessing our risk management approach and practices in light of the global financial crisis;
- liaising with the GACC to ensure appropriate oversight of key controls and, in turn, considering and acting on concerns raised by the GACC;
- oversight of risk matters relating to information technology (IT);
- ensuring the appropriate disclosure of our risk and capital management status and activities;
- setting our liquidity risk appetite and monitoring our liquidity position over the current reporting period; and
- undertaking a number of deep dives on key areas of focus, including impairments, to further evaluate underlying risks.

The GRCMC is satisfied that the risk management processes and systems provide comprehensive and adequate oversight over the Group's risk exposure. The GRCMC is satisfied that management was able to effectively respond to, and manage, the risks that arose during the reporting period.

The Group Audit and Compliance Committee

The GACC assists the board with regard to reporting financial information, selecting and properly applying accounting principles and policies, monitoring Absa's internal control systems and various compliance-related matters. Other aspects for which the GACC is responsible include business continuity and the management and governance of our relationship with the external auditors.

Risk management related activities of the Group Audit and Compliance Committee

The GACC performs the following activities in terms of risk management:

- dealing with any matters referred to it by the GRCMC; and
- ensuring that the combined assurance model is applied by internal and external assurance providers and management.

For further information on the GACC, refer to the Group's corporate governance statement.

The principal risks policy

The board-approved PRP sets out the scope of the risks facing Absa and creates clear ownership and accountability for risks. The policy was updated during the current reporting period and covers the four principal risks (as discussed earlier) as well as the 22 key risks (as detailed in the table to follow).

The CRO appoints a Group Principal Risk Owner (PRO) for each principal risk. Within each principal risk there are individual key risks for which the CRO appoints a Group Key Risk Owner (KRO). Group PROs are responsible for ensuring that appropriate risk control frameworks exist for each key risk and for ensuring the appropriate reporting of those risks.

The principal risks policy *(continued)*

Group KROs are responsible for designing, recording and communicating their risk control frameworks. They further monitor the management of the key risk exposures throughout the Group in accordance with the framework using the five step process to risk management. Group Exco risk committees meet on a regular basis to assess and monitor the key risks.

Principal risk	Key risks	Group Exco risk committees
Credit risk	➜ Retail credit risk ➜ Wholesale credit risk[1]	➜ RCRC ➜ WCRMC
Market risk	➜ Traded risk ➜ Interest rate risk in the banking book[2] ➜ Pension risk[2] ➜ Insurance risk	➜ MRC
Operational risk	➜ External supplier risk ➜ Financial reporting risk ➜ Fraud risk ➜ Information risk ➜ Legal risk ➜ Product risk ➜ Payment process risk ➜ People risk ➜ Premises and security risk ➜ Regulatory risk ➜ Tax risk ➜ Technology risk ➜ Transaction operations risk	➜ ORC (except for tax risk via the TROC)
Funding risk	➜ Liquidity risk ➜ Capital management ➜ Structural risk	➜ ATC

Our risk appetite

Our risk appetite is defined as the level of risk we are willing to accept in planning and achieving our business objectives. The risk appetite framework is embedded in key decision-making processes and supports the implementation of Absa's strategy. We use this to maximise returns without exposing Absa to levels of risk above our appetite. In particular, the risk appetite framework assists in protecting our financial performance, improves management responsiveness and debate regarding the risk profile, assists executive management in improving the control and coordination of risk-taking across business units and identifies available risk capacity in pursuit of profitable opportunities.

The risk appetite framework is developed using a formal quantitative method and is set by the board. Risk appetite outcomes are subjected to stress testing, (i.e. validated by estimating Absa's sensitivity to adverse changes in the business environment). This framework then forms the basis for setting business unit targets and risk-taking limits across the Group.

Our risk appetite can be categorised into four broad areas namely:

- earnings volatility in comparison to targets;
- capacity to absorb unexpected losses;
- capital ratio targets; and
- capacity to grow.

Notes

[1]Equity investment risk is reported under wholesale credit risk.

[2]This is reported together with foreign exchange risk and asset management structural risk as non-traded market risk.

Our risk appetite *(continued)*

Stress testing

Stress testing is embedded in our risk management and is a key focus area in strategic planning processes. Through stress testing and scenario analysis, we are able to assess the performance of our portfolios under potentially adverse economic conditions.

Stress tests simulate the effects on the business units' financial position across the Group by analysing the impact on profits and the ability to maintain appropriate capital ratios and liquidity levels. Insights gained are integrated into the management process covering the medium to long term. Stress testing also forms an integral part of evaluating our risk appetite for reasonableness under specifically designed scenarios. Stress tests are regularly discussed with the regulators.

Risk appetite key indicators and triggers

We aim to manage our risk profile in a proactive way. To support this, key indicators and triggers have been developed to act as early signals in the event that one of the scenarios or stress situations may materialise. The forward-looking indicators include, *inter alia*, economic indices directly correlated with risk measures and financial indicators. The indicators and triggers are monitored routinely and considered by the GRCMC.

Risk disclosure approach

Our approach to the disclosure of risk management includes the required disclosures under International Financial Reporting Standards (IFRS) and Basel Pillar 3 disclosure requirements and represents a holistic view of our risks.

Risk disclosures contained in this report form part of the disclosures required in the Group's financial statements. Where relevant these disclosures have been indicated as audited by means of a blue line:

Principal risk	Pages audited
Credit risk	➜ 19 – 20, 24 – 26, 42 – 47, 51 – 54, 57 – 59, 62, 68 and 70
Market risk – traded and non-traded	➜ 73, 75 – 78, 82 – 86 and 88
Market risk – insurance	➜ 89, 92 – 98
Operational risk	➜ 102
Funding risk – liquidity risk	➜ 109, 110 and 116 – 118
Funding risk – capital management	➜ 120 and 122

All other disclosures in this report relate to Basel Pillar 3 requirements, which are unaudited. Any reference to a note in the sections that follow refers to the applicable note in the Group's financial statements for the reporting period ended 31 December 2012.

Regulatory and statutory accounting treatment may differ for certain entities. Where a different treatment is applied, the following approach is followed.

Entity	Statutory accounting treatment	Basel III regulatory treatment
Subsidiaries engaged in insurance activities.	Consolidated	Excluded from the calculation of the capital adequacy ratio.
Associates, joint ventures and participation in businesses that are financial in nature.	Equity-accounted	Deducted from qualifying capital or proportionately consolidated.
Associates, joint ventures and participation in businesses that are not financial in nature.	Equity-accounted	Included in equity investment risk capital.

Changes to comparative numbers

This report includes regulator-approved changes in approach in accordance with Basel II.5, Pillar 3. In many cases, the change in the treatment of credit risk portfolios from the foundation internal ratings-based (FIRB) to the AIRB approach and the move of our statutory reserve and liquid asset portfolio from the standardised approach to the AIRB approach, caused material restatements of comparative numbers.

Basel II.5 has resulted in increased reporting requirements for which comparatives cannot always be provided, especially in terms of more granular data disclosures.

Furthermore, our corporate customers and products were transferred from Business Markets (previously known as Absa Business Bank) to CIBW (previously known as Absa Capital) for which comparatives have been reclassified.

Credit risk – retail

Key performance indicators

	Group 2012 %	Group 2011 %
Growth in loans and advances	3,00	0,85
NPLs as a percentage of gross loans and advances to customers	7,10	9,20
Impairment losses ratio	1,89	1,23
Total impairment losses on loans and advances as a percentage of total gross loans and advances to customers	3,06	2,84

Definition

Loss to the Group arising from the failure of a customer or counterparty to fulfil payment obligations.

Strategy

- Support the achievement of sustainable asset and revenue growth in line with our risk appetite.
- Simplify risk management processes.
- Invest in skills and experience.
- Operate sound credit granting processes.
- Monitor credit diligently.
- Use appropriate models to assist decision-making.
- Improve forecasting and reduce variability.
- Continually improve collection and recovery.
- Optimise the control environment.

2012 in review

- Impairment losses on mortgage advances increased significantly due to the higher coverage required on the legal portfolio. Contributing factors included high inflows into the legal portfolio, a rapid change in the portfolio composition, with high concentrations of vintage accounts reaching the write-off stage and operational issues pertaining to collections. Deteriorating under-recovery rates on distressed property sales and high property management costs compounded the impact and resulted in an increased LGD.
- Emphasis was placed on the workout of the legal inventory. Measures taken included new workout strategies and raised impairment losses on loans and advances to provide more appropriate coverage. We became increasingly proactive in encouraging voluntary sales for customers unable to recover financially, thereby improving collections. After workout of the legal inventory, the portfolio stabilised and the quality of new portfolio inflows is good. This resulted in a reduction in NPL stock and flow as well as early cycle delinquencies.
- We conducted a collections review and have since optimised the operating model for collections. We enhanced our operational risk performance indicators on key LGD performance drivers and we are currently optimising key processes and systems. We implemented a new LGD model for Home Loans (including the review of monitoring and validation processes) and we are reviewing our impairment forecasting models. In parallel, we have enhanced our end-to-end controls to incorporate any lessons learnt.
- A sustained focus on performance and responsible lending resulted in early delinquencies continuing to improve in all portfolios.
- We also engaged with the SARB regarding unsecured lending.
- We acquired the Edcon portfolio for R9,6 billion (gross receivable). The book was successfully migrated to Absa on 1 November 2012.

Priorities for 2013

- We will continue to focus on value and balance sheet optimisation, supported by a strong risk management culture. Our aim is to increase portfolio growth by defining acceptable risk pockets/products and to improve decision-making processes by continuously assessing market conditions and understanding the impact of economic shifts on the various portfolios.
- We will remain focused on the quality and profitability of new business written. We will continue to be selective in the type of business written in the Home Loans portfolios.
- We will continue to place emphasis on reducing NPLs (especially in the secured portfolios) by optimising potential value when disposing of assets.
- We will be further refining our operating model, and improving our forecasting and control of impairment losses on loans and advances. We have reviewed our forbearance policy and are applying stringent affordability criteria.
- We will continue to support the business with pricing optimisation to effectively manage portfolio risk and maximise profitability.
- As the market conditions change, we will continue to monitor the composition of our legal portfolio and adjust our treatment strategies effectively.
- We will continue to apply prudent lending practices in unsecured lending. Our risk appetite has been focused on higher income/lower risk segments. Stress testing indicates that our unsecured portfolios will remain profitable, even under severe stress scenarios.

Summary of risks
31 December

Credit risk – wholesale

Key performance indicators

	Group 2012 %	2011 %
Growth in loans and advances	**7,51**	0,43
NPLS as a percentage of gross loans and advances to customers	**3,66**	2,85
Impairment losses ratio	**1,17**	0,50
Total impairment losses on loans and advances as a percentage of total gross loans and advances to customers	**1,96**	1,63

Definition

Loss to the Group arising from the failure of a customer or counterparty to fulfil payment obligations.

Strategy

- Invest in skills and experience.
- Operate sound credit granting processes.
- Monitor credit diligently.
- Use appropriate models to assist decision-making.
- Continually improve collection and recovery.

2012 in review

- Significant volatility in the rand represented an increased risk in all rand-based positions in the trading book, resulting in an increase in the quantum of credit exposure.
- Notwithstanding increased exposure, overall CIBW limits across the wholesale portfolio remained fairly flat, largely owing to weak corporate demand for credit.
- The increase in impairment losses on loans and advances in Business Markets relates primarily to the CPF portfolio. The Commercial and Commercial Asset Finance (CAF) portfolios also experienced higher impairment losses on loans and advances.
- The increase in impairment losses on loans and advances was the result of improved rigour and revised valuation assumptions applied to accounts on the EWL rather than the degradation of the underlying risk profile of the portfolio.
- Exposure on the EWL demonstrated no material change compared with the previous reporting period. However, a noticeable migration in risk categories was observed from low-risk to higher-risk buckets. Concomitant negative trending on the impairment losses ratio became apparent later in the reporting period.

Priorities for 2013

- Given recent trends in impairment losses on loans and advances in Business Markets, the application of more conservative assumptions around legal realisation periods in these portfolios will continue to receive focus.
- We will also place emphasis on enhancing our risk and control framework and embedding AIRB principles firmly in the business.
- We will continue to focus on coverage ratios across segments, benchmarked against our peers and counterparties exposed to the eurozone.

Securitisation and equity investment risk

Key performance indicators

	Group 2012 %	2011 %
Securitisation RWA (Rm)	**1 037**	1 716
Equity investments RWA (Rm)	**22 735**	22 168

2012 in review

- In line with our securitisation strategy, we reduced the securitisation portfolio. However, our note holdings in relation to HOMES Series 1 securitisation increased from R37 million in July 2012 to R1 231 million at the reporting date. This increase is related to the 19 July 2012 HOMES Series 1 note redemption and subsequent purchase of the note.
- We successfully exited selected assets in our equity investment portfolio.
- The CPF equities portfolio decreased due to downward adjustments in fair value and a conscious effort to balance the equity portfolio in line with our risk appetite.

Priorities for 2013

- We will continue to reduce the level of on-statement of financial position securitisation exposures.
- We will refinance the current note holding during 2013.
- In future, we will continue to balance the portfolio composition in line with our risk appetite, which may include exiting appropriate assets.

Summary of risks

31 December

Market risk – traded and non-traded

Key performance indicators

	Group 2012	Group 2011
Average traded market risk – daily value at risk (DVaR) (Rm)	**18,87**	23,73
Traded market risk regulatory capital (RC) (at 9,5% of RWA) (Rm)	**1 308**	794
Banking book annual earnings at risk (AEaR) for a 2% interest rate shock (percentage of Group net interest income)	**<7%**	<5%

Definition

The risk that our earnings, capital or ability to meet business objectives will be adversely affected by changes in the level or volatility of market rates or prices such as interest rates, foreign exchange rates, equity prices, commodity prices and credit spreads.

Strategy

- Ensure traded market risk resides solely in CIBW.
- Facilitate business growth.
- Minimise non-traded market risk.
- Ensure a higher degree of net interest margin stability over an interest rate cycle in the banking book.

2012 in review

Traded market risk

- Our trading exposures were carefully managed to ensure efficient use of trading capital with returns above return on average risk-weighted assets (RoRWA) hurdles.
- The risk platform and control framework in our Africa operations were expanded to support a broader product range.

Non-traded market risk – interest rate risk in the banking book

- In the low interest rate environment, our structural interest rate hedge programme mitigated the negative endowment impact on equity and structural deposits by contributing positively to the interest margin.
- Cash flow hedging reserves remained strong and will be released to the statement of comprehensive income on an accrual basis over the life of the programme, should market rates remain at current levels.
- We remained exposed to prime-Johannesburg Interbank Agreed Rate (JIBAR) basis risk arising from the difference between predominantly prime-linked assets being funded with liabilities that are primarily JIBAR-linked, after hedging.

Priorities for 2013

Traded market risk

- We will respond to regulatory and capital change, while continuing to make efficient use of RWA.
- We will continue to challenge and improve our risk management model based on business and regulatory trends.

Non-traded market risk – interest rate risk in the banking book

- With interest rates expected to remain low, we will focus on the risk of margin compression and the efficient maintenance of our structural hedge programme.

Market risk – insurance

Key performance indicators

	Group 2012 %	Group 2011 %
Short-term loss ratio	**69,9**	67,4
Life new business margin	**9,3**	7,4

Definition

The risk that future experience relating to claims, expenses, policyholder behaviour and investment returns differs from the assumptions made when setting premiums or valuing policyholder liabilities.

Strategy

- Pursue profitable growth opportunities.
- Balance exposure between life and short-term insurance to allow for better diversification.
- Grow risk exposures outside of South Africa.

2012 in review

- All of our insurance risk types remained well within set risk appetite limits.
- We stayed abreast of developments and continued with preparations to adopt the Solvency Assessment and Management (SAM) legislation requirements, once promulgated.
- We launched Barclays Life Zambia in August 2012.
- Short-term and life insurance underwriting risk utilisation varied in accordance with expectations and in line with underlying business growth and changes in forecasts.
- Although not considered material, an increase was seen in our agricultural and personal business claims. Affected lines of business remained profitable.

Priorities for 2013

- We will continue with the development of the capital model for the short-term insurance environment.
- We will continue to diversify risk between business lines and South African and non-South African risks.
- We will enhance our monitoring and reporting to maintain good oversight of new non-South African insurance exposures.
- We will assess risk management frameworks and governance structures in preparation for SAM legislation.
- We will challenge existing processes, practices and offerings to ensure alignment with the Treating Customers Fairly (TCF) principles.

Operational risk

Key performance indicators

	Group 2012	Group 2011
Total number of events	↓	↓
Total loss value	↑	↓

Definition

Direct or indirect losses resulting from inadequate or failed internal processes or systems, human error or external events. Operational risk exists in the natural course of business activity.

Strategy

- Further embed an operational risk-aware culture throughout the Group.
- Enhance controls, using automated solutions as far as possible.
- Set and monitor an appropriate operational risk appetite and tolerance levels.
- Continue to strengthen follow-up and recovery actions for unexpected operational risk and boundary events.
- Meet regulatory requirements.
- Manage and mitigate key operational risks.

2012 in review

- Our total losses decreased in volume, but increased in value due to a single significant unexpected event – the financial restatement at NBC, Tanzania.
- Fraud and transaction operations remained the main drivers of our expected losses. The growth in debit card fraud is a concern.
- A strategic renewal programme was initiated to replace ageing core technology platforms. The restructuring within technology, which was necessary to streamline and improve the effectiveness of key IT processes, has been completed.
- We implemented several control improvement projects during the reporting period, aimed at reducing operational risk and consequent losses. We also placed emphasis on making our customers' lives easier through enhancements to our control environment.
- An accelerated organisational restructure in the first half of the reporting period resulted in an elevated people risk profile. This was offset by close change management across Absa to provide stability and targeted action plans to address concerns in specific businesses and functions.

Priorities for 2013

- While we will continue to embed fraud prevention processes and controls to limit increases in losses, fraud is expected to remain the key operational risk impacting expected losses.
- We will continue to invest in technology and use this advantage to further promote our risk management capabilities.
- Cognisant of our obligation to protect our customers and thereby reduce the risk of significant losses, we will continue to prioritise enhancements to measure and improve the customer experience.
- We plan to undertake significant investments, including the streamlining of back- and middle-office processes, improving customer onboarding processes, strengthening proactive fraud monitoring and integrating the Edcon portfolio.

Funding risk – liquidity risk

Key performance indicators

	Group 2012 %	Group 2011 %
Long-term funding ratio	**26,2**	26,8
Loans-to-deposits ratio	**90,2**	88,4

Definition

Failure to meet our payment obligations when they fall due and to replace funds when they are withdrawn. The consequences of this may be the failure to meet obligations to repay depositors and to fulfil commitments to lend. It is the risk that we will be unable to continue operating as a going concern due to a lack of funding.

Strategy

- Grow and diversify the funding base.
- Lengthen our funding profile.
- Maintain surplus liquid asset holdings to meet Basel III.
- Lower the weighted average cost of funding.

2012 in review

- Slow growth in the South African economy reduced our requirement to lend, leaving us in a strong liquidity position. In this climate, we sought to maintain surplus liquid asset reserves, a strong funding tenor position and growth of the deposit base.
- We successfully issued senior unsecured debt in March 2012 and Tier 2 subordinated bonds in November 2012, to further extend our funding terms and diversify the funding base. The Tier 2 issuance was the largest listed Tier 2 subordinated debt raising on a single day in the South African market.
- We maintained our position of reduced reliance on the wholesale money market. The cost of liquidity experienced upward pressure during the first three quarters of the reporting period, but eased towards the end of the reporting period.
- The appetite for term funding in money markets dampened during the first half of the reporting period as asset managers rebalanced their fund profiles. In the second half of the reporting period, the position was alleviated following an amendment to the Collective Investment Schemes Act that relaxed the average duration restrictions applicable to money market funds from 90 days to 120 days.
- In May 2012, the SARB announced it had approved a CLF to assist banks in meeting the LCR under Basel III. It was further confirmed that statutory cash reserves may be included in the calculation of the LCR. Conditions were set by the SARB regarding the size of the committed facility, collateral requirements and pricing.
- Our liquidity risk position was managed in line with the board-approved liquidity risk appetite.

Priorities for 2013

- Regulators have allowed several years for full implementation of the Basel III liquidity rules. The BCBS announced in January 2013 that the implementation timeframes for the LCR, which is aimed at promoting the short-term resilience of a bank's liquidity risk profile, will be relaxed, with full compliance now only required by 2019. The recently announced changes, combined with the SARB announcement in May 2012 that a CLF will be made available to South African banks, means that significant progress was made during the current reporting period regarding compliance with the LCR. The NSFR remains a challenge given the structural features of the South African economy. This will remain a key focus area.
- A strong liquidity position will be maintained. We will continue to work with industry forums and the SARB to ensure the optimal implementation of the SARB CLF.
- Our liquidity risk appetite, as approved by the board, will continue to drive key decisions relating to liquidity risk.

Funding risk – capital management

Key performance indicators[1]

	Group 2012 %	2011 %
Core Tier 1 capital adequacy ratio	**13,0**	13,0
RoRWA	**2,07**	2,35
Return on average economic capital (RoEC)	**20,8**	23,0
Cost of equity (CoE)[2]	**13,5**	14,0

Definition

Failure to maintain adequate levels of capital and/or losing our investment grade credit rating.

Strategy

- Maximise shareholder value by optimising the level and mix of capital resources.
- Meet capital ratios required by regulators and the target ranges approved by the board.
- Maintain an adequate level of capital resources as cover for economic capital (EC) requirements.
- Deliver RWA efficiency, capital and balance sheet accountability and returns.
- Proactively assess, manage and efficiently implement global regulatory changes to optimise capital usage.
- Maintain a strong credit rating, with Absa's recent upgrade of the national long-term credit rating to AAA (zaf) being higher than that of the peer group.

2012 in review

- We maintained our strong capital adequacy position above the board-approved target range, thereby positioning Absa favourably to deal with the implementation of Basel III. RWA optimisation exercises also improved our understanding of risk, in terms of accuracy of risk measurement, allowing the Group to optimise capital allocation.
- R1,5 billion of subordinated debt, qualifying as Tier 2 capital, was called at the first optional redemption date in September 2012. We subsequently issued R5 billion of subordinated debt at a yield of between JIBAR + 195 bps and JIBAR + 205 bps, optimising our capital mix and taking advantage of the last opportunity to issue 'old style' (excluding the loss absorbency and the point of non-viability requirements) Tier 2 capital prior to the implementation of Basel III.
- We updated our capital models to reflect the current environment, implemented Basel II.5, as well as AIRB for the wholesale credit portfolio, and prepared for the implementation of Basel III on 1 January 2013.

Priorities for 2013

- We aim to maintain a strong, high quality and optimal mix of capital.
- As in the previous and current reporting periods, RWA optimisation remains a key focus area.
- We intend to further optimise the use of capital without jeopardising our ability to comply with expected Basel III regulatory changes. Our board target ranges will meet the minimum capital requirements after the full implementation of Basel III.
- We will continue to support economically profitable asset growth, while actively managing the business portfolio.
- Distribution to shareholders will be considered after due cognisance is given to our capital requirements, growth and business plans, as well as balance sheet integrity.

Notes

[1]Reported ratios include unappropriated profits.

[2]The CoE is based on the capital asset pricing model (CAPM).

Credit risk

Credit risk

Overview

31 December

Key points

- Impairment losses on loans and advances increased by 63% to R8 billion, resulting in a 1,59% impairment losses ratio (2011: 1,01%)
- Significant increase in impairment losses on loans and advances in RBB:
  - Impairment losses on mortgage advances increased considerably due to the higher coverage required on the Home Loans legal portfolio.
  - Large increase in impairment losses on loans and advances in the CPF portfolio.
- Enhanced scorecard development for secured lending origination strategies.
- Improved collection processes and customer arrears.
- Formal approval obtained from the SARB for the use of the AIRB approach in the wholesale portfolio.
- Wholesale portfolio performed steadily against a backdrop of global economic uncertainty.
- Enhanced governance and operational efficiencies.
- Optimised the potential value when disposing of assets.
- Application of prudent lending practices ensured a high quality unsecured lending portfolio.

Key performance indicators

	Group	
	2012 %	2011[1] %
Growth in loans and advances to customers	**4,61**	(0,92)
NPLs as a percentage of gross loans and advances to customers	**5,81**	6,87
Impairment losses ratio	**1,59**	1,01
Total impairment losses on loans and advances as a percentage of total gross loans and advances to customers	**2,58**	2,35
Securitisation RWA (Rm)	**1 037**	1 716
Equity investments RWA (Rm)	**22 735**	22 168

Audited

Introduction

Credit risk is the risk of loss to Absa arising from the failure of a customer or counterparty to fulfil its payment obligations. Credit risk arises mainly from lending and related banking activities, including underwriting, dealing in traded products such as derivative contracts, securities borrowing and lending products. It may also arise when fair values of our exposure to financial instruments decline.

Credit risk is a core component of lending quality and impacts on the risk versus reward model. Credit risk received increased focus due to the current economic conditions and subdued growth as well as increased regulatory requirements under Basel II.5.

Strategy

Our credit risk objectives are:

- supporting the achievement of sustainable asset and revenue growth in line with our risk appetite;
- simplifying risk management processes;
- investing in skills and experience;
- operating sound credit granting processes;
- monitoring credit diligently;
- using appropriate models to assist decision-making;
- improving forecasting and reducing variability;
- continually improving collection and recovery; and
- optimising the control environment.

Note

[1]Previous reporting period figures have been reclassified.

2012 in review

Audited

Retail credit risk

Conditions remained challenging during the course of the reporting period, as signs of the expected economic recovery were less evident than at the end of the previous reporting period. Growth proved difficult and the total portfolio experienced marginal growth.

Impairment losses on loans and advances for the majority of portfolios were in line with expectations, but impairment losses on mortgage advances increased significantly during the reporting period due to the higher coverage required on the legal portfolio. A number of factors contributed to the significant increase. These included high inflows into the legal portfolio towards the end of the reporting period, which resulted in high NPLs, high concentrations of vintage accounts reaching the write-off stage (particularly insolvencies, which changed the loss composition of the portfolio) and operational issues pertaining to collections, which affected portfolio performance. Deteriorating under-recovery rates on distressed property sales and high property management costs compounded the impact and resulted in an increased LGD.

In this challenging environment, we acted appropriately by raising additional impairment losses on loans and advances and the current coverage is at an appropriate level.

Emphasis was placed on the workout of the legal inventory. Measures taken included new workout strategies and raised impairment losses on loans and advances to provide more appropriate coverage. We optimised the secured collections strategy by focusing on improved voluntary sales strategies to ensure higher recovery rates for customers who, despite our best efforts to make payment arrangements, were unable to recover financially. After workout of the legal inventory, the portfolio stabilised and the quality of new portfolio inflows is good. This resulted in a reduction in NPL stock and flow as well as early cycle delinquencies.

Due to the materiality of impact on the mortgage loan portfolio, a review of collections was undertaken. This resulted in the optimisation of the operating model for collections. Key actions in this regard included enhancing our operational risk indicators on key LGD performance drivers, optimising key process and systems, implementing a new LDG model for Home Loans, reviewing impairment forecasting models, and enhancing our end-to-end controls to incorporate lessons learnt during the reporting period.

A sustained focus on performance and responsible lending resulted in early delinquencies continuing to improve in all portfolios.

We are confident that we understand the extent of the issues in the mortgage loan portfolio. We have taken appropriate measures to address these. Constant attention was and will continue to be placed on portfolio performance across all products. We have reviewed all affordability rules to ensure that they are appropriate in the current environment. In addition, we continued to perform stress testing over our portfolio to ensure that returns are sustainable.

We acquired the Edcon portfolio during the reporting period for R9,6 billion (gross receivable). The book was successfully migrated to Absa in November 2012.

Wholesale credit risk

The disappointing supply-side growth momentum observed in the second half of the previous reporting period continued into the current reporting period. Headline consumer price inflation remained stable though this was not sufficient to positively sway corporate confidence, which remained flat. Although corporate credit extension increased compared with the previous reporting period, this has largely been restricted to working capital facilities rather than asset backed finance, suggesting a lack of corporate appetite for long-term capital investment. This was confirmed by an increase in corporate savings to 7% of gross domestic product, well above the long-term average of 4%.

Internationally, European sovereign debt fears continued to affect market confidence, particularly against a backdrop of a slowing and volatile global economy. While our direct exposure to European banks is modest and largely collateralised, concerns persist regarding the impact of continued European volatility on international economic growth prospects. This combination of local and international uncertainty has manifested in volatility in local equity markets during the reporting period, which in turn has led to a marginal degrading of credit quality across sectors in the wholesale portfolio. Notwithstanding this, the performance of our wholesale book during the reporting period was reasonably steady.

The increase in impairment losses on loans and advances in Business Markets relates primarily to the CPF portfolio. The Commercial and CAF portfolios also experienced higher impairment losses on loans and advances. The increase resulted due to improved rigour and revised valuation assumptions applied to accounts on the EWL rather than the degradation of the underlying risk profile of the portfolio.

Exposure on the EWL demonstrated no material change compared with the previous reporting period. However, a noticeable migration in risk categories was observed from low- to higher-risk buckets. Concomitant negative trending on the impairment losses ratio became apparent later in the reporting period.

2012 in review *(continued)*

Securitisation

In line with our securitisation strategy, we reduced our securitisation portfolio. However, our note holdings in relation to HOMES Series 1 securitisation increased from R37 million in July to R1 231 million at the reporting date. This increase is due to the 19 July 2012 HOMES Series 1 note redemption and subsequent purchase of the note.

Equity investment risk

Selected assets in our equity investment portfolio were successfully exited during the reporting period. In addition, the CPF equities portfolio decreased due to downward adjustments in fair value and a conscious effort to balance the equity portfolio in line with our risk appetite.

Priorities for 2013

Retail credit risk

We will continue to focus on value and balance sheet optimisation, supported by a strong risk management culture. Our aim is to increase portfolio growth by defining acceptable risk pockets/products and to improve decision-making processes by continuously assessing market conditions and understanding the impact of economic shifts on the various portfolios. We will remain focused on the quality and profitability of new business and continue to be selective in the type of business written in the mortgage portfolios.

Emphasis will be placed on reducing NPLs (especially in the secured portfolios) by optimising potential value when disposing of assets. Further refinement of our operating model and improved forecasting and control of impairment losses on loans and advances will receive attention. We have reviewed our forbearance policy and are applying stringent affordability criteria.

We will continue to support the business with pricing optimisation to effectively manage portfolio risk and maximise profitability. As the market conditions change, we will continue to monitor the composition of our legal portfolio and adjust our treatment strategies effectively.

The application of prudent lending practices in unsecured lending will continue to receive attention. Our risk appetite has been focused on higher income/lower risk segments. Stress testing indicates that our unsecured portfolios will remain profitable even under severe stress scenarios.

Wholesale credit risk

Given the recent trends in impairment losses on loans and advances in Business Markets, the application of more conservative assumptions around legal realisation periods will remain a focus area. We will also place emphasis on enhancing our risk and control framework and embedding AIRB principles firmly in the business. Coverage ratios across segments, benchmarked against peers and counterparties exposed to the eurozone, will continue to receive attention.

Securitisation

We will continue to reduce the level of balance sheet (on-statement of financial position) securitisation exposures. We also aim to refinance our current note holding during 2013.

Equity investment risk

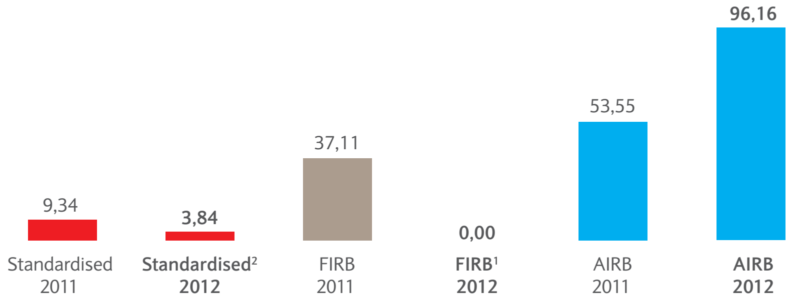
We will continue to focus on balancing the portfolio composition in line with our risk appetite, which may include exiting appropriate assets.

Approach to credit risk

We apply both the standardised and internal ratings-based (IRB) approaches to various portfolios to calculate RC requirements, as illustrated in the table below:

Approaches	Standardised	AIRB[1]
Reporting of balances	➜ African operations ➜ Edcon book	➜ Domestic retail portfolios ➜ Domestic corporate portfolios (including specialised lending portfolios) ➜ Public sector entities ➜ Local government ➜ Municipalities ➜ Sovereign, banks and securities firms ➜ Statutory reserve and liquid asset portfolio
Assessment applied	➜ Standard risk weight percentage as prescribed in the regulations relating to banks	➜ Automated application and behavioural scoring based on statistical models ➜ Statistical, structural and expert based models either developed internally or by external vendors

Exposure at default per Basel approach (%)



Notes

[1]Our wholesale portfolio moved from the FIRB to the AIRB approach with effect from 1 January 2012. This resulted in a decrease in the FIRB portfolio compared with the previous reporting period.

[2]Our statutory reserves and liquid asset portfolio moved from the standardised to the AIRB approach with effect from 1 January 2012, resulting in a decrease in the standardised portfolio for the previous reporting period. The Edcon portfolio is included as part of the standardised portfolio for the current reporting period.

Approach to credit risk *(continued)*

Risk-weighted assets and minimum required capital

	Group			
	2012		2011	
	RWA Rm	Required capital Rm	RWA Rm	Required capital Rm
Banks	7 258	689	9 925	943
Corporate exposure	130 474	12 394	148 297	14 083
Corporate	92 762	8 812	113 161	10 750
SME[1] Corporate	31 719	3 013	27 492	2 611
Specialised lending – income producing real estate	2 266	215	2 986	282
Specialised lending – project finance	3 727	354	4 658	440
Local governments and municipalities	1 717	163	3 054	290
Public sector entities	2 161	205	2 378	226
Retail exposure	150 618	14 308	141 331	13 432
Mortgages (including any home loan equity lines of credit)	65 938	6 264	58 123	5 521
Other	48 167	4 576	48 754	4 631
Unsecured lending ≤ 30 000[2]	16 612	1 578	n/a	n/a
Unsecured lending > 30 000[2]	5 315	505	n/a	n/a
Vehicle and asset finance[2]	26 240	2 493	n/a	n/a
Revolving credit	26 721	2 538	22 078	2 097
Credit cards[2]	24 782	2 354	n/a	n/a
Non-credit cards[2]	1 939	184	n/a	n/a
SME[1]	9 792	930	12 376	1 183
Secured lending[2]	1 892	180	n/a	n/a
Unsecured lending[2]	7 900	750	n/a	n/a
Securities firms	1 035	98	393	37
Sovereign	3 686	350	231	22
Securitisation[3]	1 037	99	1 716	163
	297 986	28 306	307 325	29 196
Standardised approach[4]	23 513	2 233	10 595	1 006
	321 499	30 539	317 920	30 202

Standardised approach

Following approval from the SARB, the statutory reserve and liquid asset portfolio have been moved to the AIRB approach with effect from 1 January 2012. Our African operations as well as the Edcon portfolio are subject to the standardised approach. For capital calculation purposes, these exposures are multiplied by the standard risk-weight percentages as set out in the Banks Act.

Advanced internal ratings-based approach

To assess credit risk under this approach, we analyse this risk into its common components of probability of default (PD), earnings at default (EAD) and LGD, modelled on an exposure specific basis in the case of wholesale exposures and on a portfolio level in the case of retail exposures. These risk components are then used in the calculation of a number of aggregate risk measures such as expected loss (EL), RC and EC. Under the AIRB approach, we can use our own measures of PD, EAD and LGD. Following approval from the SARB, we migrated our wholesale portfolio to the AIRB approach with effect from 1 January 2012.

Notes

[1]Small and medium-sized enterprises as defined by the regulations.

[2]Due to the new Basel II.5 requirements coming into effect on 1 January 2012, numbers at the more granular level for the previous reporting period are not available.

[3]Securitisation was previously reported as part of Retail. This has been revised and is now separately disclosed. Granular asset class disclosure is provided in the securitisation section of this report.

[4]The increase compared to the previous reporting period relates to the acquisition of the Edcon portfolio in November 2012.

Approach to credit risk *(continued)*

Advanced internal ratings-based approach *(continued)*

The assessment of credit risk relies heavily on quantitative models and tools developed internally. These are supplemented by vendor solutions in a number of areas.

We classify all credit models by materiality, based on a combination of measures aimed at assessing the value at stake (VAS) for the Group. The VAS measure used for a specific model is determined by its relevance to the respective portfolio and the risk it is intended to assess.

High materiality models require Equity Models Committee (EMC) approval. All models are monitored on an ongoing basis and validated, at least annually, by an independent validation unit in Group Credit. The monitoring information and validation results are reported to and discussed at the appropriate governance forums.

Audited

Approach to credit modelling/internal ratings

The principal objective of credit risk measurement is to produce the most accurate possible quantitative assessment of credit risk to which we are exposed from the level of individual facilities up to the total portfolio. Integral to this is the calculation of internal ratings that is used in numerous aspects of credit risk management and in the calculation of RC and EC. The key building blocks of this process are:

- PD;
- EAD;
- LGD; and
- maturity.

These parameters are used in a variety of applications that measure credit risk across the entire portfolio and can be calculated to represent different aspects of the credit cycle:

- PD estimates can be calculated on a through-the-cycle (TTC) basis, reflecting the predicted default frequency in an average 12-month period across the credit cycle, or on a point-in-time (PIT) basis, reflecting the predicted default frequency in the next 12 months.
- EAD and LGD estimates can be calculated as downturn measures, reflecting behaviour observed under stressed economic conditions, or as business-as-usual measures, reflecting behaviour under actual conditions.

These parameters can be used in different combinations for a wide range of credit risk measurement and management. Internal ratings are used for the following purposes:

- Credit approval: PD models are used in the approval process in both retail and wholesale portfolios. In high-volume retail portfolios, application and behaviour scorecards are frequently used as decision-making tools. In wholesale and certain retail Home Loans portfolios, PD models are used to direct applications to an appropriate credit sanctioning level.
- Credit grading: to provide a common measure of risk across the Group, wholesale credit grading employs a 26 point scale of default probabilities.
- Risk-reward and pricing: PD, EAD and LGD metrics are used to assess the profitability of deals and portfolios and to allow for risk-adjusted pricing and strategy decisions.
- Risk appetite: measures of EL and the potential volatility of loss are used in our risk appetite framework.
- Impairment calculation: under IAS 39 Financial Instruments: Recognition and Measurement (IAS 39), many of the collective impairment estimates incorporate the use of our PD and LGD models, adjusted as necessary.
- Collections and recoveries: model outputs are used to identify segments of the portfolio where collection and recovery efforts should be prioritised.
- EC calculations: most EC calculations use the same PD and EAD inputs as the RC process. The EC process also uses the same underlying LGD model outputs as used in RC calculations, but does not incorporate the same economic downturn adjustment used in RC calculations.
- Risk management information: Group Risk and the business units generate risk reports to inform senior management on issues such as business performance, risk appetite and consumption of EC. Model outputs are used as key indicators in these reports.

Retail portfolio

Audited

Ratings assigned across each retail portfolio are based on automated application and behavioural scoring systems. The underlying rating is calculated at point of application and updated monthly thereafter and used in decisions concerning underwriting, 'pay/no pay' and assignment of accounts to risk grades used to calculate RC. The methodology and data employed in the risk estimation and the rating processes can be summarised as follows:

- Internal risk estimates of PD, EAD and LGD are grounded in historical experience, incorporating all relevant material and available data, information and methods. Both the historical observation periods and default definitions used are consistent with regulatory requirements.
- For each product, PDs are assigned at account level by calibrating the raw behavioural model scores/ratings to the observed long-run average default rate for each pool.

Audited

Approach to credit risk *(continued)*

Retail portfolio *(continued)*

- For each product, EADs are assigned to each account based on the EAD pool to which the account has been assigned. EAD estimates incorporate all relevant data and information including account balances as well as utilised and unutilised limits, if present.
- LGDs are estimated for each product and assigned at account level, based on the LGD pool to which the account has been assigned. Calibration data on historically defaulted accounts includes observed EADs, recovery streams, cure and write-off rates. The models also make use of suitable risk drivers such as loan-to-value (LTV), which are updated monthly.

The mortgage loan PD model was recalibrated. The recalibrated model will be implemented in the first quarter of 2013. The remaining PD models have been recalibrated and are pending approval. Other models recalibrated and implemented during the current reporting period were:

- EAD models for vehicle and asset financing, credit cards, personal loans and Platinum 1; and
- LGD models for cheques and overdrafts, Platinum 1 and mortgages LGDs.

To ensure the effectiveness of the validation process, an independent review is performed annually. Models are approved by the RCRC and the most material models require approval by the MC.

Models are independently reviewed on an annual basis and when new models have been developed or changes occur to models. In addition, a process is in place to perform post model adjustments as needed or when management applies its discretion.

Retail Markets has, in the past two years, redeveloped its Basel models based on international best practice standards. Methodology and documentation across its retail portfolios have been standardised resulting in improved transparency in the capital allocation process. More specifically they have developed the following:

- new bespoke scorecards, incorporating international input, which replaced the generic scorecards that had been in place since implementation of Basel;
- amended PD methodology based on the variable scalar approach that is used to determine TTC PD estimates; and
- amended LGD methodologies specifically for our retail secured and unsecured portfolios.

Wholesale portfolio

The rating process relies both on internally developed PD rating models and vendor provided solutions. While the rating and credit decision-making process in the retail portfolio is largely automated, this process in the wholesale portfolio relies on quantitative and qualitative assessments on a transactional level. Information used in the calculation of customer ratings includes:

- financial statements;
- projected cash flows;
- equity price information;
- external rating agency grades; and
- behavioural scorecards.

Internal LGD estimates depend on the key drivers of recovery such as collateral value, seniority and costs involved as part of the recovery process, while the EAD models aim to replicate the expected utilisation of a customer's facility should a default occur. Following approval by the SARB, an EAD and LGD model for the wholesale portfolio has been implemented with effect from 1 January 2012.

PD measures based on behavioural scores and equity prices are updated monthly for credit risk management and capital calculation purposes. Other PD models that rely on more static information are updated at least quarterly in a conventional environment or as and when extraordinary circumstances warrant a review of the customer's credit standing.

To ensure the effectiveness of the validation process, an independent review is performed annually. Models are approved at the WCRMC, and the most material models require approval by the MC.

Models are independently reviewed on an annual basis and when new models have been developed or changes occur to models. In addition, a process is in place to perform past model adjustments as needed or when management applies its discretion.

Assessment of credit risk

The assessment of credit risk relies heavily on quantitative models and tools which, to a large degree, have been developed internally and are supplemented by vendor solutions. The following sections provide an overview of the aforesaid concepts and their use in the assessment of credit risk across our portfolios.

Probability of default

PD measures the likelihood of a customer defaulting on its obligations within the next 12 months and is a primary component of the internal risk rating calculated for all customers. We use two types of PDs, namely:

- TTC PD, which reflects our assessment of the borrower's long-run average propensity to default in the next year; and
- PIT PD, which reflects current economic, industry and borrower circumstances.

Both types of PDs are used extensively in our decision-making processes and several types of rating approaches are employed across the Group.

Assessment of credit risk *(continued)*

Audited

Probability of default *(continued)*

For communication and comparison purposes, we map our 21 default grades (DG), which is our internal master rating scale, to the SARB 26 grade PD scale used for regulatory reporting purposes.

Our DG grading represents a TTC view of the distribution of the book at a specific point in time.

An indicative mapping of the DG buckets to the equivalent international rating agency and regulatory PD bands are set out in the table below:

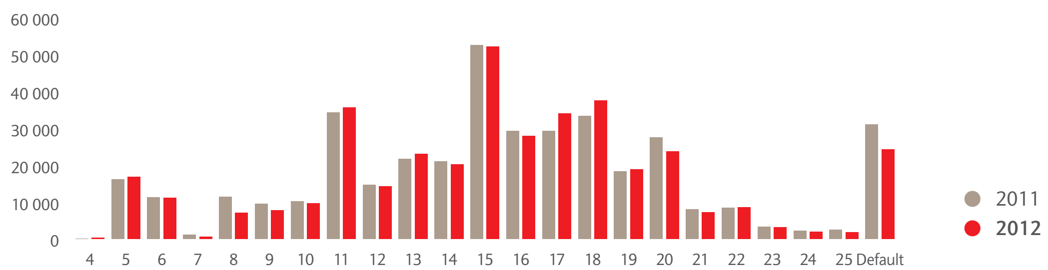
Indicative mapping of DG to PD band, alphanumeric agency grades and regulatory bands

Default grade bucket	Note	Absa DG to PD mapping Min PD (>) %	Max PD (<) %	PD Midpoint %	Alphanumeric scale mapping Standard & Poor's	Moody's	Fitch
1	1	0,0000	0,0200	0,0100	AAA	Aaa	AAA
2		0,0200	0,0300	0,0250	AA	Aa	AA
3		0,0300	0,0500	0,0400	A+	A1	A+
4		0,0500	0,1000	0,0750	A/A–	A2/A3	A/A–
5		0,1000	0,1500	0,1250	BBB+	Baa1	BBB+
6		0,1500	0,2000	0,1750	BBB+/BBB	Baa1/Baa2	BBB+/BBB
7		0,2000	0,2500	0,2250	BBB	Baa2	BBB
8		0,2500	0,3000	0,2750	BBB/BBB–	Baa2/Baa3	BBB/BBB–
9		0,3000	0,4000	0,3500	BBB–	Baa3	BBB–
10	2	0,4000	0,5000	0,4500	BBB–/BB+	Baa3/Ba1	BBB–/BB+
11		0,5000	0,6000	0,5500	BB+	Ba1	BB+
12		0,6000	1,2000	0,9000	BB	Ba2	BB
13		1,2000	1,5500	1,3750	BB/BB–	Ba2/Ba3	BB/BB–
14		1,5500	2,1500	1,8500	BB/BB–	Ba2/Ba3	BB/BB–
15		2,1500	3,0500	2,6000	BB–	Ba3	BB–
16		3,0500	4,4500	3,7500	B+	B1	B+
17		4,4500	6,3500	5,4000	B+/B	B1/B2	B+/B
18		6,3500	8,6500	7,5000	B	B2	B
19		8,6500	11,3500	10,0000	B–	B3	B–
20	3	11,3500	18,6500	15,0000	CCC+	Caa1	CCC+
21		18,6500	100,0000	30,0000	CCC	Caa2	CCC
Default		100,0000	100,0000	100,0000	D	D	D

PD band	Regulatory PD band to PD mapping Lower bound %	Upper bound %
1	0,0001	0,0120
2	0,0121	0,0170
3	0,0171	0,0240
4	0,0241	0,0340
5	0,0341	0,0480
6	0,0481	0,0670
7	0,0671	0,0950
8	0,0951	0,1350
9	0,1351	0,1900
10	0,1901	0,2690
11	0,2691	0,3810
12	0,3811	0,5380
13	0,5381	0,7610
14	0,7611	1,0760
15	1,0761	1,5220
16	1,5221	2,1530
17	2,1531	3,0440
18	3,0441	4,3050
19	4,3051	6,0890
20	6,0891	8,6110
21	8,6111	12,177
22	12,177	17,222
23	17,222	24,355
24	24,355	34,443
25	34,443	100,000
Default	100,000	100,000

The following graphs provide a view of PD migration for wholesale and retail exposures:

Exposure migration across probability of default bands – retail operations (Rm)



Notes

[1]DG 1 – 10: assets falling within these DG buckets are regarded as 'investment grade' and, when converted to a rating agency equivalent, correspond to a BB rating and better.

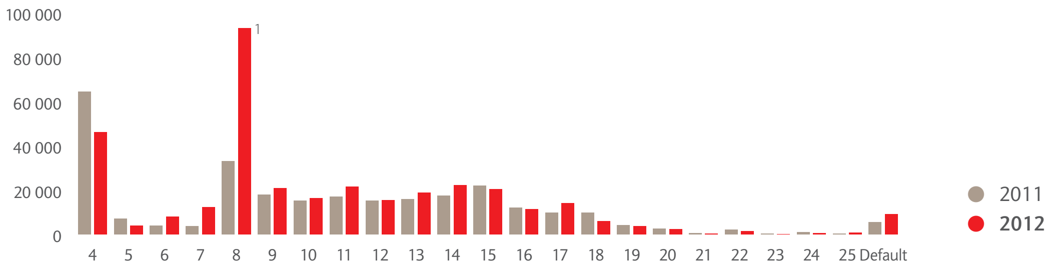
[2]DG 10 – 19: financial assets in these grades typically require more detailed management attention where clear evidence of financial deterioration or weakness exists. Assets in this category, although currently protected, are potentially weaker credits. These assets contain some credit deficiencies.

[3]DG 20 – 21: the PD of financial assets in these grades have deteriorated to such an extent that they are included for regular review. Assets so classified must have well defined weaknesses that exacerbate the PD. These assets are characterised by the distinct possibility that the borrower will default, and should the collateral pledged be insufficient to cover the asset, we will sustain some loss when default occurs.

Assessment of credit risk *(continued)*

Probability of default *(continued)*

Exposure migration across probability of default bands – wholesale operations (Rm)



Expected/predicted versus actual loss analysis

The purpose of the following sections (PD, EAD and EL) is to provide a view of the performance of the Basel models.

Probability of default

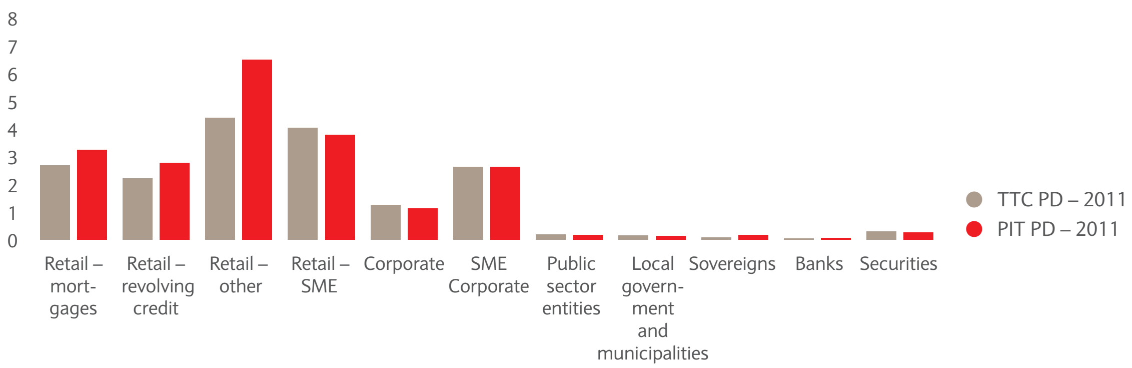
Comparison of probability of default estimates with actual default

The objective of PD backtesting is to compare the accuracy of the PD estimates for regulatory purposes with actual default data.

For each retail and wholesale asset class in terms of Basel II.5, the assigned PD for RC purposes at the previous reporting date is compared to the NPL ratio observed at the current reporting date.

Regulatory PD is TTC while the NPL ratio is observed at a particular point in the cycle (at the current reporting date). To complete the analysis, the observed NPL ratio is also compared to the PIT PD (at the previous reporting date). A comparison between the TTC PD and PIT PD at the previous reporting date for the performing book only (i.e. defaults excluded) is provided below.

Comparison of probability of default estimates (total book) for the performing book (%)[2]



Notes

[1]The increase is as a result of the statutory liquid asset portfolio moving from the standardised to the AIRB approach in the current reporting period.

[2]Woolworths Financial Services, Africa and Edcon are excluded from this analysis.

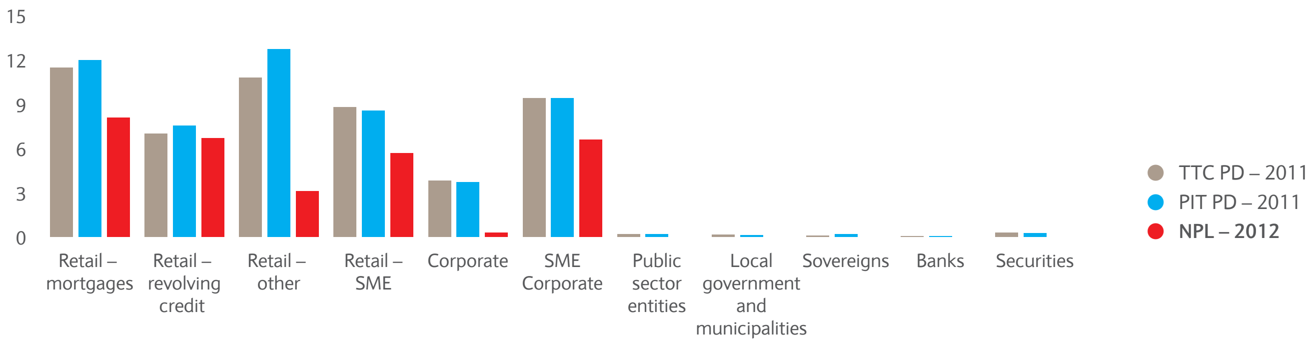
Assessment of credit risk *(continued)*

Expected/predicted versus actual loss analysis *(continued)*

Probability of default (continued)

Comparison of probability of default estimates with actual default *(continued)*

Comparison of probability of default estimates (total book) with non-performing loans[1] (%)



The main conclusions of the analysis are as follows:

- The regulatory or TTC PD at the previous reporting date is above the NPL ratio observed at the current reporting date for all asset classes.
- The PIT PD at the previous reporting date, i.e. the PIT estimates of the model, is above the NPL ratio observed at the current reporting date for all asset classes.
- Except for SME Retail, the overall PIT PD for the retail asset classes is still higher than the TTC PD at the previous reporting date, while it has moved below the TTC PD in the case of wholesale asset classes.

Exposure at default

The EAD denotes the total amount we expect will be outstanding from a particular customer at the time of default. We calculate these estimates for each facility using models incorporating internal and external default data as well as the experience of credit experts in relation to particular products or customer groups.

EAD estimates incorporate both on- and off-statement of financial position exposures resulting in a capital requirement that incorporates existing exposures, as well as exposures contingent on a counterparty's use of an available facility.

Comparison of exposure at default estimates with actual exposure at default

The objective of EAD backtesting is to compare the accuracy of EAD estimates for regulatory purposes with actual EAD.

For each retail and wholesale Basel II.5 asset class, the estimated EAD at the previous reporting date is compared to the actual EAD at the current reporting date.

Recalibrated EAD models for vehicle and asset financing, credit card, personal loans and Platinum 1 were implemented during the current reporting period. The wholesale AIRB EAD model was introduced on 1 January 2012.

Note

[1]Woolworths Financial Services, Africa and Edcon are excluded from this analysis.

Retail and wholesale credit risk
31 December

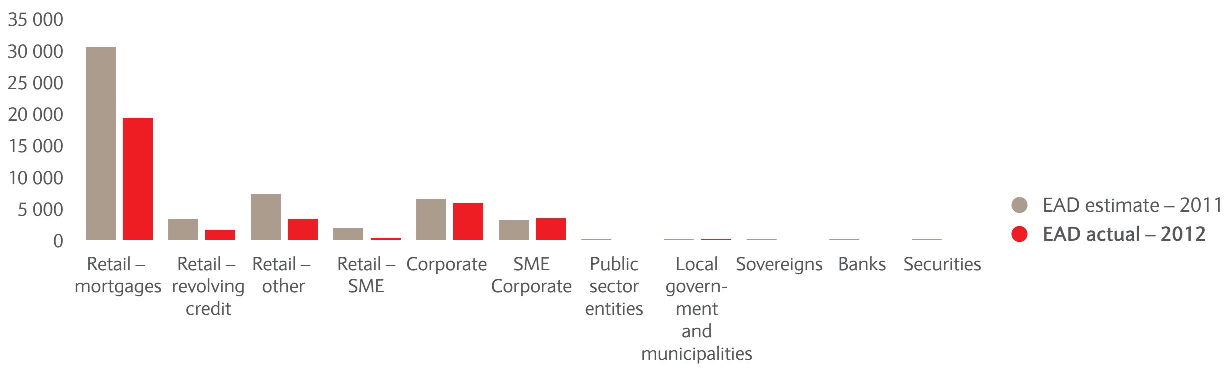
Assessment of credit risk *(continued)*

Expected/predicted versus actual loss analysis *(continued)*

Exposure at default *(continued)*

Comparison of exposure at default estimates with actual exposure at default *(continued)*

Comparison of exposure at default estimates with actual exposure at default (Rm)[1]



The main conclusion of the analysis is as follows:

- The actual EAD at the current reporting date is lower than the estimated EAD at the previous reporting date in all cases except for the SME Corporate asset class where it is marginally higher.

Loss given default

The third major risk component measures the loss expected on a particular credit facility in the event of default and therefore recognises credit risk mitigants we may employ, such as collateral or credit risk derivatives. LGD estimates are calculated as a percentage of EAD using models based on internal and external loss data and the judgement of credit experts, and are primarily driven by the type and value of collateral held. We modify our LGD estimates to distinguish between expected losses over the course of an economic cycle and loss estimates during periods of economic stress (downturn LGD).

Expected loss and capital requirements

The PD, EAD and LGD are components used in a variety of applications that measure credit risk across the entire portfolio. EL is a measurement of loss that enables the application of consistent credit risk measurement across all retail and wholesale credit exposures.

These components are the basis for RC and EC calculations. EL figures are calculated as the product of TTC PD, EAD and downturn LGD and represent our best estimate of losses over the next 12 months based on long-run estimates that span an entire business cycle.

These estimates are also used in a range of applications including pricing, customer and portfolio strategy and performance measurement. EL estimates are compared to impairment losses on loans and advances figures, but it should be noted that while they may be similar, they are calculated on a different basis and for distinctly different purposes and should therefore not be expected to match one another.

EL is a statistical estimate of the average loss for the loan portfolio over the next 12 months, based on a long-term average loss tendency that incorporates at least one business cycle. This type of measure provides a measure of loss independent of the current credit conditions for a particular customer type, and is more stable over time. It is primarily used in capital measurement processes.

Expected losses compared to actual write-offs

The objective of EL backtesting is to compare the accuracy of the EL estimates with actual write-off data.

For each retail and wholesale Basel II.5 asset class, the estimated EL at the previous reporting date is compared to the actual amount written off during the current reporting period.

EL is a function of TTC PD, downturn LGD and EAD (EL = TTC PD x downturn LGD x EAD), i.e. it is a TTC measure adjusted for an economic downturn while the amount written off is observed over the current reporting period.

Recalibrated LGD models for home loans and cheques were implemented during the current reporting period. The wholesale AIRB LGD model was introduced on 1 January 2012.

Notes

[1]Woolworths Financial Services, Africa and Edcon are excluded from this analysis.

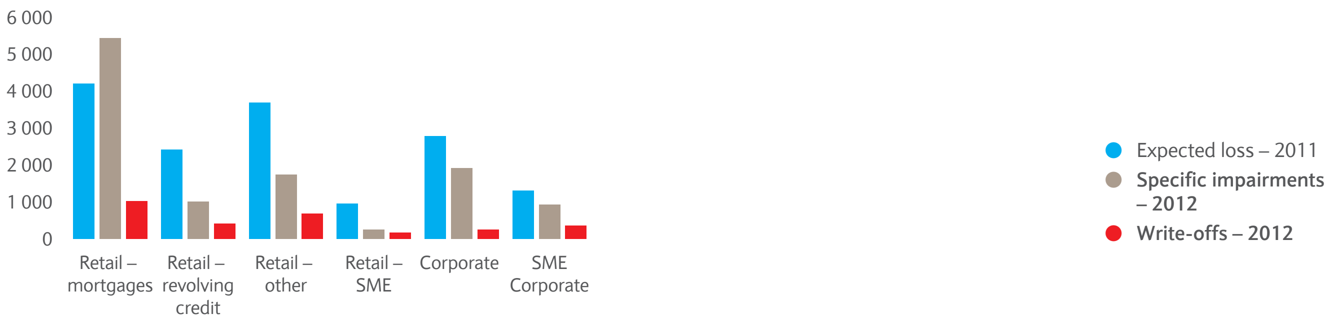
Assessment of credit risk *(continued)*

Expected loss and capital requirements *(continued)*

Expected losses compared to actual write-offs *(continued)*

Comparison of expected loss estimates with actual write-offs

Comparison of expected loss estimates with specific impairments and actual write-offs[1,2] (Rm)



The main conclusions of the analysis are as follows:

- The actual write-offs observed for the current reporting period are below the specific impairment levels (at the current reporting date) and EL estimates (at the previous reporting date) for all asset classes, except in the case of Retail SME where write-offs are marginally higher than specific impairments.
- Except for retail mortgages, specific impairments at the current reporting date are lower than the EL estimates at the previous reporting date.

Trend analysis of expected loss, specific impairments and write-offs:

Expected loss estimates over time (Rm)[2]

The main conclusions of this analysis are as follows:

- The recovery rates on distressed property sales and property management cost remained high during the current reporting period for the retail portfolio, but has improved compared to the previous reporting period.
- Asset values for security purposes remained under pressure for the corporate portfolio. This resulted in a higher LGD compared to the previous reporting period, resulting in a higher EL for the current reporting period.

Notes

[1]The previous reporting period numbers for wholesale are based on FIRB models while current reporting period numbers are based on AIRB models.

[2]No specific impairments and write-offs were reported during the three-year period for the following assets classes; public sector entities, local government and municipalities, sovereigns, banks and securities. These assets classes have been excluded from the graphs.

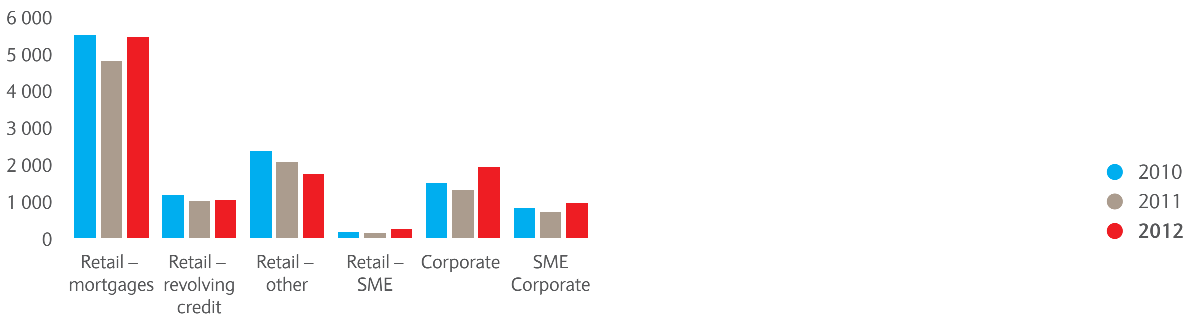
Assessment of credit risk *(continued)*

Expected loss and capital requirements *(continued)*

Expected losses compared to actual write-offs *(continued)*

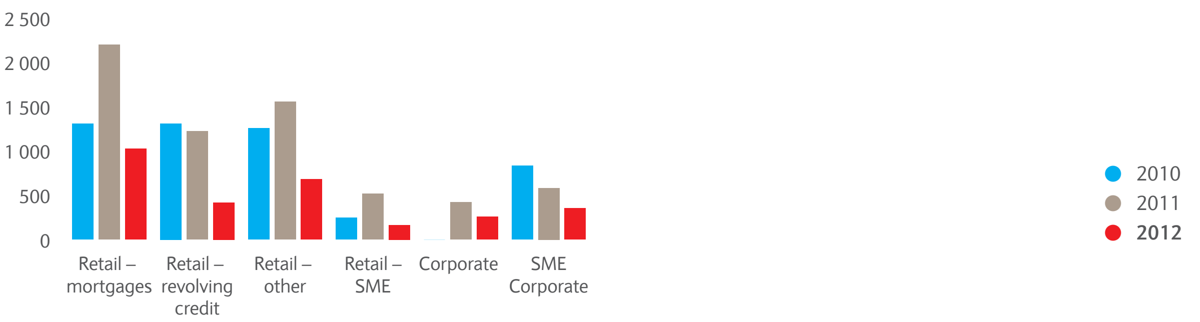
Trend analysis

Specific impairments (Rm)[1]

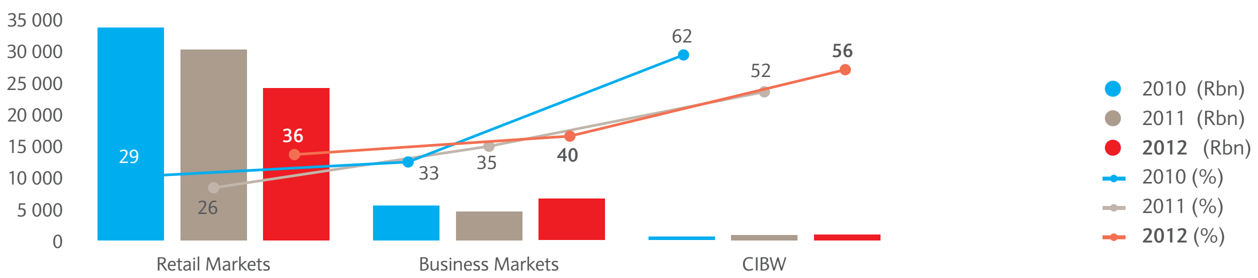


- The overall increase in specific impairments in the retail and corporate portfolios was as a result of our prudent approach.
- Mortgage loan impairments increased significantly in the current reporting period due to higher coverage required on the legal portfolio. We are comfortable with the current coverage levels.

Write-offs over time (Rm)[1]



Non-performing loans and coverage ratios (Rbn and %)



- From the above it is evident that the NPLs of Retail Markets decreased from the previous reporting period with an increase in the coverage ratio. Business Markets experienced an increase in NPLs and coverage ratio.

Note

[1]No specific impairments and write-offs were reported during the three-year period for the following assets classes; public sector entities, local government and municipalities, sovereigns, banks and securities. These assets classes have been excluded from the graphs.

Retail and wholesale credit risk

31 December

Assessment of credit risk *(continued)*

Probability of default, exposure at default and loss given default analysis in terms of regulatory disclosure requirements

AIRB approach – Retail portfolio[1]

2011		Group												
			Mortgages: (including any home loan equity lines of credit)				Other: unsecured lending ≤ 30 000				Other: unsecured lending >30 000			
Risk grade	Average PD %	Average PD %	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm
Non-default	3,05	2,93	13,79	27,34	1 340	239 809	72,46	99,61	201	4 633	72,35	101,41	593	14 303
4	0,03	0,03	10,00	0,92	0	0	52,66	5,21	0	42	83,10	8,61	0	6
5	0,04	0,04	11,01	1,26	1	12 476	72,59	8,42	0	192	76,13	8,83	0	203
6	0,05	0,05	11,29	1,69	1	10 953	—	—	—	—	—	—	—	—
7	0,08	0,09	—	—	—	—	0,00	—	—	—	—	—	—	—
8	0,11	0,11	11,49	3,18	0	1 258	72,07	22,67	0	117	76,71	24,35	0	318
9	0,16	0,16	13,49	5,05	1	5 394	71,33	27,55	0	42	72,80	28,12	0	82
10	0,23	0,23	14,54	6,96	3	9 123	83,10	32,89	0	1	83,06	33,79	0	34
11	0,32	0,32	13,92	8,15	14	33 383	73,23	41,40	0	214	77,35	44,35	2	631
12	0,45	0,45	12,53	9,47	5	8 831	69,96	48,61	0	63	73,87	51,47	0	115
13	0,66	0,66	14,04	14,07	19	20 631	67,71	57,02	1	297	76,53	63,57	4	793
14	0,90	0,90	13,76	17,07	14	11 210	73,07	73,62	1	189	77,67	77,81	4	643
15	1,24	1,24	13,81	20,92	67	39 643	76,47	88,78	8	856	77,93	90,16	26	2 736
16	1,79	1,81	14,10	27,70	45	17 482	70,47	92,10	4	285	69,13	90,59	14	1 103
17	2,52	2,55	14,27	76,72	515	13 433	72,32	102,88	6	342	74,02	105,29	23	1 235
18	3,74	3,79	14,90	43,41	79	14 552	75,41	113,67	10	363	72,44	108,42	35	1 336
19	5,11	5,14	14,12	49,86	92	12 636	74,14	115,63	9	254	74,03	114,91	25	700
20	7,44	7,37	14,86	61,96	192	17 866	76,29	125,23	14	264	75,50	122,14	39	726
21	9,54	9,74	14,51	68,90	64	4 523	75,01	131,49	8	118	76,77	134,45	19	264
22	15,11	14,87	14,36	79,00	44	2 060	66,51	139,63	68	675	60,24	128,04	259	2 746
23	20,84	20,84	15,80	94,80	70	2 121	72,19	175,22	10	68	75,05	181,46	28	178
24	29,01	28,94	14,00	86,47	40	968	75,86	203,14	40	182	76,99	207,22	72	317
25	39,94	40,14	15,40	92,47	74	1 266	72,09	195,77	22	69	73,36	200,48	43	137
Default	100,00	100,00	15,12	2,00	5 432	19 276	76,82	187,69	870	372	73,76	187,99	19	1 121
	10,60	9,02	13,89	25,45	6 772	259 085	72,78	106,16	1 071	5 005	72,45	107,70	612	15 424

Note

[1]Amounts indicated as zero in the above table reflect values less than R1 million.

Retail and wholesale credit risk

31 December

Assessment of credit risk *(continued)*

Probability of default, exposure at default and loss given default analysis in terms of regulatory disclosure requirements *(continued)*

AIRB approach – Retail portfolio[1] *(continued)*

2012															
Other: vehicle and asset finance				Revolving credit: credit cards				Revolving credit: non-credit cards				SME: secured lending			
LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm
38,00	51,41	522	45 612	74,23	67,63	959	33 121	81,84	21,89	46	7 051	20,89	26,63	41	6 535
0,00	0,00	—	—	—	—	—	—	82,53	1,94	0	197	36,50	3,88	0	21
39,59	4,59	0	220	72,87	1,88	0	3	82,03	2,11	1	2 899	39,32	5,13	0	1
—	—	—	—	—	—	—	—	82,66	3,62	0	14	11,23	2,04	0	149
37,69	9,19	0	466	78,49	4,48	0	1	82,03	3,94	0	168	35,38	8,01	0	2
38,26	10,14	0	1 038	70,61	4,88	3	4 328	78,08	5,82	0	2	10,66	2,95	0	6
—	—	—	—	69,20	6,35	2	2 219	78,10	7,14	0	12	14,13	5,39	0	23
42,15	22,01	0	0	78,85	8,92	0	1	81,12	8,97	1	516	18,09	8,43	0	34
37,57	21,73	0	266	77,64	13,41	0	156	82,07	14,85	2	598	24,52	14,01	0	31
38,11	28,31	7	3 899	76,63	17,40	0	15	81,03	17,20	0	43	13,51	9,31	1	1 057
37,74	32,69	1	463	73,95	20,12	0	1	81,58	22,62	2	375	22,56	19,37	0	43
36,84	46,71	13	3 640	74,76	27,33	20	2 930	81,68	30,87	3	446	16,12	16,45	1	922
37,93	45,30	16	3 333	74,88	36,03	7	714	81,79	40,49	10	885	16,20	18,44	3	1 558
38,40	51,29	46	6 515	75,53	44,88	14	1 132	81,31	53,93	3	222	28,31	37,98	2	302
37,79	54,40	128	13 064	76,41	58,86	35	1 899	81,74	66,77	5	228	31,34	45,32	6	771
38,23	59,83	—	4 442	74,37	82,70	440	14 682	81,60	87,03	8	252	26,54	40,23	8	845
38,23	59,99	50	2 526	76,33	98,32	66	1 728	81,71	105,74	3	79	33,63	52,57	3	206
38,38	63,96	80	2 673	77,48	125,88	73	1 304	81,37	132,43	3	57	25,76	42,14	5	279
37,76	66,07	40	1 122	78,05	155,65	52	656	82,01	166,34	5	55	36,00	63,35	3	99
38,49	80,02	71	1 237	78,46	186,84	71	637	79,71	188,48	0	1	17,73	35,55	4	147
39,45	94,32	33	407	78,79	219,37	57	359	81,13	225,98	0	2	30,41	72,24	1	14
39,20	104,17	24	215	79,45	245,06	35	158	81,96	247,22	0	0	37,35	97,86	1	6
40,43	113,10	13	86	79,10	237,79	84	198	81,72	264,52	0	0	39,52	111,24	3	19
61,88	156,22	845	1 786	74,69	167,22	941	1 426	94,96	484,59	73	82	15,67	156,96	197	96
38,90	55,36	1 367	47 398	74,25	71,74	1 900	34 547	81,99	27,18	119	7 133	20,81	28,53	238	6 631

Note

[1]Amounts indicated as zero in the above table reflect values less than R1 million.

Assessment of credit risk *(continued)*

Probability of default, exposure at default and loss given default analysis in terms of regulatory disclosure requirements *(continued)*

AIRB – Retail portfolio[1] *(continued)*

SME: unsecured lending				Total				2011[2]
LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	EAD Rm
65,40	58,88	283	13 074	28,67	38,86	3 985	364 138	369 932
39,85	4,19	0	47	69,08	2,97	0	313	1
81,74	2,34	0	890	28,80	1,68	2	16 884	16 194
81,83	3,71	0	0	11,39	1,70	1	11 116	11 364
82,02	3,95	0	1	49,48	7,79	0	638	1 177
79,46	6,28	0	22	55,66	6,52	3	7 089	11 438
71,97	12,41	0	5	30,47	5,79	3	7 777	9 584
50,90	21,76	0	41	18,48	7,23	4	9 750	10 275
77,54	16,08	1	403	17,72	9,32	19	35 682	34 367
72,90	17,87	1	316	21,90	15,31	14	14 339	14 666
75,31	27,03	2	442	19,65	17,10	29	23 045	21 757
60,13	34,27	1	235	31,49	26,83	57	20 215	21 094
75,89	43,43	24	2 444	24,71	28,74	161	52 169	52 626
66,90	52,22	11	971	27,49	38,18	139	28 012	29 318
63,23	61,91	52	3 153	34,84	66,33	770	34 125	29 307
52,17	68,78	22	1 169	45,34	64,67	602	37 641	35 866
52,84	77,69	19	710	28,05	60,28	267	18 839	18 307
61,11	104,36	29	601	24,93	69,24	435	23 770	27 595
71,21	126,70	28	405	31,09	83,62	219	7 242	8 084
46,38	95,18	66	1 080	45,47	108,92	583	8 583	8 774
71,72	192,29	10	65	31,52	117,07	209	3 214	3 423
77,25	226,36	12	57	40,65	137,12	224	1 903	2 226
80,29	254,91	5	17	31,11	123,47	244	1 792	2 489
72,73	94,75	47	214	26,45	37,39	8 424	24 373	31 265
65,51	59,46	330	13 288	28,53	38,77	12 409	388 511	401 197

Notes

[1] Amounts indicated as zero in the above table reflect values less than R1 million.

[2] During the previous reporting period, the statutory liquid asset portfolio was subject to the standardised approach.

Assessment of credit risk *(continued)*

Probability of default, exposure at default and loss given default analysis in terms of regulatory disclosure requirements *(continued)*

AIRB approach – Wholesale portfolio[1]

		Group												
	2011		Banks				Corporate exposure: Corporate				Corporate exposure: SME Corporate			
Risk grade	Average PD %	Average PD %	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm
Non-default	0,97	0,87	43,51	15,13	11	47 979	38,91	58,27	630	153 630	38,31	66,95	304	42 107
4	0,03	0,03	43,33	10,77	4	32 568	42,37	12,03	2	12 911	55,41	10,92	0	93
5	0,04	0,04	—	—	—	—	43,91	23,27	0	2 127	21,21	9,32	0	95
6	0,06	0,06	43,91	31,67	1	2 401	43,61	14,90	1	5 507	12,40	7,88	0	31
7	0,08	0,09	43,91	18,98	2	5 877	43,55	20,34	2	6 309	42,34	16,15	0	13
8	0,12	0,13	43,91	23,99	3	6 087	39,04	27,75	5	9 775	22,15	18,02	0	33
9	0,16	0,17	43,91	27,80	0	20	37,70	37,45	10	15 768	29,14	29,02	0	272
10	0,23	0,23	43,91	31,63	1	753	42,81	43,51	12	11 337	38,42	32,69	3	3 433
11	0,31	0,31	43,91	40,00	0	21	38,13	52,85	15	12 338	38,85	40,12	6	4 952
12	0,45	0,46	43,91	54,64	0	204	41,09	58,82	17	9 258	38,70	48,14	9	4 831
13	0,62	0,62	43,91	62,17	0	8	39,48	71,08	32	13 618	39,84	56,26	10	4 146
14	0,90	0,88	43,91	74,47	0	3	39,10	77,98	57	17 148	36,38	62,52	15	4 478
15	1,28	1,30	—	—	—	—	30,03	74,73	56	14 638	34,67	62,76	20	4 674
16	1,84	1,80	43,91	93,18	0	1	38,42	93,03	50	7 380	39,40	81,96	23	3 328
17	2,60	2,64	43,91	107,17	0	20	37,77	109,56	81	8 022	39,91	88,82	47	4 924
18	3,64	3,66	43,91	120,07	0	14	38,23	123,85	42	2 977	35,44	87,38	37	2 756
19	5,15	5,12	43,91	133,86	0	1	37,22	129,89	33	1 730	39,42	102,30	39	1 997
20	7,08	7,32	43,91	161,44	0	1	38,74	147,46	34	1 265	45,65	132,61	36	1 147
21	10,03	9,88	43,91	181,80	0	0	36,55	161,83	9	239	50,23	170,75	9	204
22	14,47	14,87	44,17	200,00	0	0	26,74	134,57	5	116	41,24	158,02	28	492
23	19,93	19,95	—	—	—	—	45,39	253,36	3	29	46,51	207,07	6	66
24	29,77	29,89	—	—	—	—	27,55	167,29	33	397	34,13	164,44	12	122
25	39,98	54,03	—	—	—	—	32,68	152,70	131	741	47,20	230,27	4	20
Default	100,00	100,00	—	—	—	—	29,04	71,70	1 903	4 516	31,23	133,17	930	2 650
	2,86	3,02	43,51	15,13	11	47 979	38,63	58,66	2 533	158 146	37,89	70,87	1 234	44 757

Note

[1]Amounts indicated as zero in the above table reflect values less than R1 million.

Assessment of credit risk *(continued)*

Probability of default, exposure at default and loss given default analysis in terms of regulatory disclosure requirements *(continued)*

AIRB approach – Wholesale portfolio[1] *(continued)*

Group															
2012															
Corporate exposure: Specialised lending – income producing real estate				Corporate exposure: Specialised lending – project finance				Local governments and municipalities				Public sector entities			
LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm
23,20	98,37	38	2 180	33,14	72,82	14	5 036	13,11	18,24	9	9 408	24,09	25,41	4	8 503
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	45,00	20,41	0	33	—	—	—	—
—	—	—	—	—	—	—	—	45,00	15,45	0	1	—	—	—	—
—	—	—	—	—	—	—	—	45,00	27,57	0	1	43,90	15,68	0	213
10,00	10,58	0	13	43,91	55,86	0	575	9,04	8,28	2	8 207	17,93	16,00	0	2 120
10,00	13,52	0	21	—	—	—	—	45,00	61,53	0	36	23,67	21,77	1	3 082
18,37	27,06	0	92	43,91	44,36	0	127	34,98	30,98	0	481	12,50	21,01	0	1
11,24	18,87	0	50	22,42	39,18	1	1 838	45,00	81,97	0	4	24,05	28,66	1	2 024
13,04	26,92	0	163	43,91	64,74	1	677	45,00	93,44	0	14	5,15	9,43	0	24
23,22	49,17	0	47	15,00	35,53	0	285	44,63	107,36	0	49	42,73	57,85	2	651
22,26	60,08	0	183	40,00	2 080	0	0	44,34	72,53	0	0	24,94	38,59	0	212
21,74	63,81	1	490	32,36	99,90	2	560	24,74	69,93	0	0	5,01	15,06	0	1
10,00	25,43	0	24	43,91	150,07	6	663	45,01	103,26	0	0	15,00	33,04	0	31
26,43	91,20	1	130	43,91	152,71	4	311	44,93	135,23	7	573	5,00	18,23	0	17
16,61	64,57	1	111	—	—	—	—	44,71	156,84	0	9	14,74	38,82	0	97
20,49	78,10	0	11	—	—	—	—	44,69	181,52	0	0	20,53	83,60	0	30
24,34	113,44	0	18	—	—	—	—	—	—	—	—	—	—	—	—
13,63	70,03	0	1	—	—	—	—	—	—	—	—	—	—	—	—
28,86	168,29	35	826	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	45,00	283,92	0	0	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
5,14	41,21	—	296	43,91	75,82	50	78	4,19	0,52	—	14	—	—	—	—
21,04	91,54	38	2 476	33,31	72,87	64	5 114	13,10	18,22	9	9 422	24,09	25,41	4	8 503

Note

[1]Amounts indicated as zero in the above table reflect values less than R1 million.

Assessment of credit risk *(continued)*

Probability of default, exposure at default and loss given default analysis in terms of regulatory disclosure requirements *(continued)*

AIRB approach – Wholesale portfolio[1] *(continued)*

Securities firms				Sovereigns				Total				2011[2]
LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	EAD Rm
43,91	30,45	3	3 400	5,37	5,40	4	68 264	31,54	40,93	1 017	340 507	272 752
43,91	7,83	0	214	25,33	13,79	0	401	42,93	11,14	6	46 187	64 562
43,91	9,01	0	1 690	5,00	1,11	0	8	43,29	16,77	—	3 953	7 072
—	—	—	—	—	—	—	—	43,58	19,94	2	7 940	3 898
—	300,00	0	0	—	—	—	—	43,72	19,61	4	12 413	3 803
43,91	32,48	0	98	5,00	4,91	4	66 167	12,06	9,45	14	93 075	32 987
43,91	53,50	0	107	15,00	21,72	0	1 672	33,74	33,87	11	20 978	17 994
43,91	71,25	0	243	5,00	—	—	0	41,60	40,67	16	16 467	15 165
43,91	40,53	0	327	—	—	—	—	35,66	46,22	23	21 554	17 039
43,91	50,92	1	262	—	—	—	—	40,20	55,17	28	15 433	15 170
43,91	53,68	0	122	—	—	—	—	39,30	66,76	44	18 926	15 942
43,91	74,21	1	267	—	—	—	—	38,33	74,31	73	22 291	17 566
43,91	88,65	0	40	—	—	—	—	30,98	72,44	79	20 403	21 970
—	—	—	—	—	—	—	—	38,90	92,81	79	11 427	12 164
43,91	94,28	0	0	5,00	12,51	0	0	38,82	103,99	140	13 997	9 854
50,00	100,00	0	0	43,91	122,70	0	16	36,20	104,60	80	5 980	7 288
43,91	129,74	1	30	—	—	—	—	38,25	114,88	73	3 799	4 104
—	—	—	—	—	—	—	—	41,90	140,21	70	2 431	2 486
—	—	—	—	—	—	—	—	42,80	165,76	18	444	496
—	—	—	—	—	—	—	—	32,93	162,04	68	1 434	1 824
—	—	—	—	—	—	—	—	46,17	221,20	9	95	161
—	—	—	—	—	—	—	—	29,09	166,64	45	519	961
—	—	—	—	—	—	—	—	33,06	154,74	135	761	246
—	—	—	—	—	—	—	—	28,98	91,98	2 883	7 554	5 304
43,91	30,45	3	3 400	5,37	5,40	4	68 264	31,49	42,04	3 900	348 061	278 056

Notes

[1]Amounts indicated as zero in the above table reflect values less than R1 million.

[2]In the previous reporting period, the statutory liquid asset portfolio was subject to the standardised approach.

Assessment of credit risk *(continued)*

Gross exposures per Basel II.5 approach and asset class

	Group						
	2012						2011
Standardised approach	Utilised on-statement of financial position exposure Rm	Off-statement of financial position exposure Rm	Repurchase and resale agreements Rm	Derivative instruments Rm	Total credit exposure Rm	EAD[1] Rm	EAD Rm
Banks	1 981	—	—	—	1 981	1 981	1 802
Corporate exposure							
SME Corporate	4 294	2 789	—	—	7 083	5 951	8 137
Local government and municipalities	—	—	—	—	—	—	1
Retail exposure	11 195	13 177	—	—	24 372	17 782	1 232
Mortgages (including any home loan equity lines of credit)	123	—	—	—	123	123	n/a
Other	1 375	—	—	—	1 375	1 373	n/a
Unsecured lending[2] ≤ 30 000	—	—	—	—	—	—	n/a
Unsecured lending[2] > 30 000	—	—	—	—	—	—	n/a
Vehicle and asset finance[2]	1 375	—	—	—	1 375	1 373	n/a
Revolving credit	9 697	13 177	—	—	22 874	16 286	n/a
Credit cards[2,3]	9 639	13 177			22 816	16 228	n/a
Non-credit cards[2]	58	—	—	—	58	58	n/a
Sovereigns	3 686	—	—	—	3 686	3 686	58 843
	21 156	15 966	—	—	37 122	29 400	70 015

Notes

[1]Our statutory reserve and liquid asset portfolio moved from the standardised to the AIRB approach with effect from January 2012 resulting in a decrease compared with the previous reporting period.

[2]Basel II.5 reporting requirement. Previous reporting period comparatives are not available.

[3]The increase on the previous reporting period relates to the acquisition of the Edcon portfolio during November 2012.

Assessment of credit risk *(continued)*

Gross exposures per Basel II.5 approach and asset class *(continued)*

	Group						
	2012						2011
AIRB approach	Utilised on-statement of financial position exposure Rm	Off-statement of financial position exposure Rm	Repurchase and resale agreements Rm	OTC derivative instruments Rm	Total credit exposure Rm	EAD[1] Rm	EAD[1] Rm
Banks[1]	30 499	43 388	7 954	42 501	124 342	47 980	61 571
Corporate exposure[1]	159 790	118 512	6 142	9 205	293 649	210 492	200 947
Corporate	115 784	106 863	6 142	9 062	237 851	158 146	160 385
SME Corporate	37 130	9 120	—	—	46 250	44 756	32 149
Specialised lending – income producing real estate	2 410	285	—	—	2 695	2 476	2 973
Specialised lending – project finance	4 466	2 244	—	143	6 853	5 114	5 440
Local government and municipalities[1]	6 472	8 694	—	—	15 166	9 423	9 505
Public sector entities[1]	4 848	14 759	18	1 438	21 063	8 503	6 720
Retail exposure	350 544	96 560	—	—	447 104	388 509	397 978
Mortgages (including any home loan equity lines of credit)	239 926	55 550	—	—	295 476	259 083	264 883
Other	69 654	1 366	—	—	71 020	67 828	66 244
Unsecured lending[2] ≤ 30 000	14 636	974	—	—	15 610	15 424	n/a
Unsecured lending[2] > 30 000	4 324	392	—	—	4 716	5 006	n/a
Vehicle and asset finance[2]	50 694	—	—	—	50 694	47 398	n/a
Revolving credit	26 567	29 436	—	—	56 003	41 679	46 451
Credit cards[2]	24 996	25 133	—	—	50 129	34 546	n/a
Non-credit cards[2]	1 571	4 303	—	—	5 874	7 133	n/a
SME	14 397	10 208	—	—	24 605	19 919	20 400
Secured lending[2]	6 315	3 619	—	—	9 934	6 632	n/a
Unsecured lending[2]	8 082	6 589	—	—	14 671	13 287	n/a
Securities firms[1]	2 025	8 161	5 394	1 055	16 635	3 400	1 342
Sovereigns[1]	65 358	1 401	—	100	66 859	68 265	1 195
	619 536	291 475	19 508	54 299	984 818	736 572	679 258

Notes

[1]Previous reporting period comparative numbers for these asset classes are reflective of the FIRB approach being used at the time.

[2]Basel II.5 reporting requirements. Previous reporting period comparatives are not available.

Assessment of credit risk *(continued)*

Residual contractual maturity of exposures – all portfolios

Residual contractual maturity of exposures[1]

	Group				
	2012				
			EAD		
	Current to 6 months Rm	6 months to 1 year Rm	1 year to 5 years Rm	More than 5 years Rm	Total Rm
Banks	5 057	27 478	14 621	2 804	49 960
Corporate exposure	3 554	100 013	77 449	35 426	216 442
Corporate	3 119	79 140	57 092	18 794	158 145
SME Corporate	435	20 684	17 794	11 794	50 707
Specialised lending – income producing real estate	—	1	660	1 815	2 476
Specialised lending – project finance	—	188	1 903	3 023	5 114
Local governments and municipalities	31	3 785	1 713	3 894	9 423
Public sector entities	1	3 033	4 298	1 172	8 504
Retail exposures	105 344	10 521	67 642	222 787	406 294
Mortgages (including any home loan equity lines of credit)	36 091	4 161	7 804	211 150	259 206
Other	5 558	2 343	53 881	7 423	69 205
Unsecured lending ≤ 30 000	798	362	2 243	1 604	5 007
Unsecured lending > 30 000	2 267	752	7 440	4 965	15 424
Vehicle and asset finance	2 493	1 229	44 198	854	48 774
Revolving credit	57 379	528	58	—	57 965
Credit cards	50 774	—	—	—	50 774
Non-credit cards	6 605	528	58	—	7 191
SME	6 316	3 489	5 899	4 214	19 918
Secured lending	45	121	2 987	3 478	6 631
Unsecured lending	6 271	3 368	2 912	736	13 287
Securities firms	470	2 477	221	231	3 399
Sovereigns	23 365	134	18 433	30 018	71 950
	137 822	147 441	184 377	296 332	765 972

Note

[1]Basel II.5 reporting requirement. Previous reporting period comparatives are not available.

Assessment of credit risk *(continued)*

Residual contractual maturity of exposures – all portfolios *(continued)*

Residual contractual maturity of exposures[1]

	Group 2011 EAD Current to 6 months Rm	6 months to 1 year Rm	1 year to 5 years Rm	More than 5 years Rm	Total Rm
Banks	343	30	51 892	11 108	63 373
Corporate exposure	56 962	2 414	86 179	63 529	209 084
Corporate	42 923	2 414	77 571	45 613	168 521
SME Corporate	13 628	—	7 959	10 563	32 150
Specialised lending – income producing real estate	—	—	474	2 499	2 973
Specialised lending – project finance	411	—	175	4 854	5 440
Local governments and municipalities	3 475	—	929	5 103	9 507
Public sector entities	419	355	3 991	1 954	6 719
Retail exposure	91 562	2 721	68 317	236 609	399 209
Mortgages	39 207	998	5 052	219 626	264 883
Other	8 439	1 690	48 710	8 637	67 476
Revolving credit	36 215	—	10 236	—	46 451
SME	7 701	33	4 319	8 346	20 399
Securities firms	—	40	1 003	300	1 343
Sovereigns	55 830	—	3 290	918	60 038
	208 591	5 560	215 601	319 521	749 273

Note
[1]Basel II.5 reporting requirement. Previous reporting period comparatives are not available.

Audited

IFRS disclosures

Maximum exposure to credit risk

For financial assets recognised in the statement of financial position, the exposure to credit risk equals the carrying amount.

For the purposes of our disclosures regarding credit quality, the maximum exposure to credit risk of financial assets at the reporting date has been analysed as follows:

	Group				
	2012				
		Neither past due nor impaired			
	Maximum exposure Rm	DG1-11 Rm	DG12-19 Rm	DG20-21 Rm	Total Rm
Balances with other central banks	1 250	1 250	—	—	1 250
Balances with the SARB	12 340	12 340	—	—	12 340
Money market assets	3 815	3 812	—	3	3 815
Cash, cash balances and balances with central banks (refer to note 2)	17 405	17 402	—	3	17 405
Republic of South Africa (RSA) government bonds	51 853	51 853	—	—	51 853
Reverse repurchase agreements	3	3	—	—	3
Treasury bills	11 164	11 164	—	—	11 164
Statutory liquid asset portfolio (refer to note 3)	63 020	63 020	—	—	63 020
Collateralised loans	1 274	1 274	—	—	1 274
Other	34 241	29 609	4 632	—	34 241
Reverse repurchase agreements	9 134	9 134	—	—	9 134
Loans and advances to banks (refer to note 4)	44 649	40 017	4 632	—	44 649
Debt instruments	24 615	24 283	332	—	24 615
Derivative assets	46 695	45 029	1 665	1	46 695
Money market assets	8 766	8 766	—	—	8 766
Trading portfolio assets (refer to note 5)	80 076	78 078	1 997	1	80 076
Derivatives designated as cash flow hedging instruments	3 859	3 825	34	—	3 859
Derivatives designated as fair value hedging instruments	1 580	1 575	5	—	1 580
Hedging portfolio assets (refer to note 5)	5 439	5 400	39	—	5 439
Accounts receivable	7 850	6 441	64	—	6 505
Settlement accounts	4 455	4 155	300	—	4 455
Other assets (refer to note 6)	12 305	10 596	364	—	10 960
Retail Markets	328 684	87 129	203 425	6 013	296 567
Cheque accounts	2 214	400	1 453	4	1 857
Credit cards[1]	31 317	3 432	24 912	785	29 129
Foreign currency loans	4	4	—	—	4
Instalment credit agreements	41 342	5 425	32 232	947	38 604
Loans to associates and joint ventures	6 634	932	5 539	163	6 634
Microloans	1 668	146	888	203	1 237
Mortgages	230 890	73 750	128 979	2 763	205 492
Other advances	4	4	—	—	4
Personal and term loans	13 595	3 036	9 422	1 148	13 606
Wholesale overdrafts	1 016	—	—	—	—
Business Markets	90 960	34 079	47 766	1 589	83 434
Cheque accounts	18 127	7 733	8 256	269	16 258
Commercial asset finance	18 049	5 906	11 548	206	17 660
Commercial property finance	37 763	11 947	21 193	1 009	34 149
Term loans	17 021	8 493	6 769	105	15 367
CIBW	107 907	75 684	30 777	1 119	107 580
Other and intergroup eliminations	640	595	51	—	646
Loans and advances to customers (refer to note 9)	528 191	197 487	282 019	8 721	488 227
Insurance contracts	551	551	—	—	551
Investment contracts	452	452	—	—	452
Reinsurance assets (refer to note 11)	1 003	1 003	—	—	1 003
Debt instruments	5 333	4 504	829	—	5 333
Derivative instruments	41	41	—	—	41
Money market assets	554	554	—	—	554
Investment securities (refer to note 12)	5 928	5 099	829	—	5 928
Total assets subject to credit risk	758 016	418 102	289 880	8 725	716 707
Assets not subject to credit risk	49 923				
Total assets per the statement of financial position	807 939				

Note

[1]The newly acquired Edcon portfolio is included in the DG 12 – 19 neither past due nor impaired category.

Retail and wholesale credit risk

31 December

Group										
2012										
Past due not impaired						Impaired				
Past due up to 1 month Rm	Past due 1-2 months Rm	Past due 2-3 months Rm	Past due 3-4 months Rm	Past due older than 4 months Rm	Total Rm	Original carrying amount Rm	Identified individual impairment Rm	Identified collective impairment Rm	Total Rm	Un-identified impairment Rm
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
265	6	4	—	—	275	1 095	(25)	—	1 070	—
—	—	—	—	—	—	—	—	—	—	—
265	6	4	—	—	275	1 095	(25)	—	1 070	—
—	—	—	—	—	—	42 147	—	(9 417)	32 730	(613)
—	—	—	—	—	—	484	—	(123)	361	(4)
—	—	—	—	—	—	3 676	—	(1 382)	2 294	(106)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	3 717	—	(893)	2 824	(86)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	765	—	(316)	449	(18)
—	—	—	—	—	—	31 579	—	(5 793)	25 786	(388)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	(11)
—	—	—	—	—	—	1 926	—	(910)	1 016	—
941	219	267	168	513	2 108	8 605	(2 964)	—	5 641	(223)
94	37	23	57	133	344	2 150	(538)	—	1 612	(87)
33	5	1	2	—	41	908	(523)	—	385	(37)
588	134	213	62	199	1 196	3 987	(1 510)	—	2 477	(59)
226	43	30	47	181	527	1 560	(393)	—	1 167	(40)
—	—	—	—	14	14	963	(514)	—	449	(136)
—	7	—	—	—	7	132	(145)	—	(13)	—
941	226	267	168	527	2 129	51 847	(3 623)	(9 417)	38 807	(972)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
1 206	232	271	168	527	2 404	52 942	(3 648)	(9 417)	39 877	(972)

Audited

IFRS disclosures *(continued)*

Maximum exposure to credit risk *(continued)*

	Group 2011[1]				
		Neither past due nor impaired			
	Maximum exposure Rm	DG1-11 Rm	DG12-19 Rm	DG20-21 Rm	Total Rm
Balances with other central banks	1 201	1 201	—	—	1 201
Balances with the SARB	12 279	12 279	—	—	12 279
Money market assets	5 624	5 519	—	105	5 624
Cash, cash balances and balances with central banks (refer to note 2)	19 104	18 999	—	105	19 104
RSA government bonds	44 222	44 222	—	—	44 222
Reverse repurchase agreements	3	3	—	—	3
SARB debentures	200	200	—	—	200
Treasury bills	13 048	13 048	—	—	13 048
Statutory liquid asset portfolio (refer to note 3)	57 473	57 473	—	—	57 473
Collateralised loans	3 478	3 478	—	—	3 478
Other	47 282	47 270	12	—	47 282
Reverse repurchase agreements	6 739	6 739	—	—	6 739
Loans and advances to banks (refer to note 4)	57 499	57 487	12	—	57 499
Debt instruments	27 114	26 058	1 056	—	27 114
Derivative assets	45 604	44 395	1 202	7	45 604
Money market assets	6 741	6 741	—	—	6 741
Trading portfolio assets (refer to note 5)	79 459	77 194	2 258	7	79 459
Derivatives designated as cash flow hedging instruments	3 168	2 772	396	—	3 168
Derivatives designated as fair value hedging instruments	1 131	1 059	72	—	1 131
Hedging portfolio assets (refer to note 5)	4 299	3 831	468	—	4 299
Accounts receivable	5 549	4 446	295	31	4 772
Settlement accounts	6 466	6 466	—	—	6 466
Other assets (refer to note 6)	12 015	10 912	295	31	11 238
Retail Markets	318 734	86 185	187 310	5 688	279 183
Cheque accounts	2 564	496	1 999	1	2 496
Credit cards	19 836	3 283	13 763	624	17 670
Instalment credit agreements	37 554	5 238	27 983	956	34 177
Loans to associates and joint ventures	4 836	741	3 959	136	4 836
Microloans	1 573	163	1 032	184	1 379
Mortgages	237 977	73 958	128 746	2 663	205 367
Other advances	11	4	7	—	11
Personal and term loans	14 383	2 302	9 821	1 124	13 247
Business Markets	93 861	27 761	56 391	3 275	87 427
Cheque accounts	14 137	3 232	9 688	355	13 275
Commercial asset finance	17 975	4 469	12 169	1 092	17 730
Commercial property finance	41 460	13 477	22 468	1 253	37 198
Term loans	20 289	6 583	12 066	575	19 224
CIBW	91 889	58 845	31 890	874	91 609
Other and intergroup eliminations	441	431	—	—	431
Loans and advances to customers (refer to note 9)	504 925	173 221	275 591	9 837	458 650
Insurance contracts	469	469	—	—	469
Investment contracts	540	540	—	—	540
Reinsurance assets (refer to note 11)	1 009	1 009	—	—	1 009
Debt instruments	4 870	3 455	1 415	—	4 870
Derivative instruments	29	29	—	—	29
Money market assets	1 059	1 059	—	—	1 059
Investment securities (refer to note 12)	5 958	4 543	1 415	—	5 958
Total assets subject to credit risk	741 741	404 670	280 039	9 980	694 689
Assets not subject to credit risk	44 978				
Total assets per the statement of financial position	786 719				

Note

[1]Comparatives have been reclassified, refer to note 1.27 of the Group's financial statements.

Group

2011[1]

Past due not impaired						Impaired				
Past due up to 1 month Rm	Past due 1-2 months Rm	Past due 2-3 months Rm	Past due 3-4 months Rm	Past due older than 4 months Rm	Total Rm	Original carrying amount Rm	Identified individual impairment Rm	Identified collective impairment Rm	Total Rm	Un-identified impairment Rm
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
6	14	1	9	4	34	774	(31)	—	743	—
—	—	—	—	—	—	—	—	—	—	—
6	14	1	9	4	34	774	(31)	—	743	—
—	—	—	—	—	—	48 612	—	(8 638)	39 974	(423)
—	—	—	—	—	—	218	—	(146)	72	(4)
—	—	—	—	—	—	3 701	—	(1 511)	2 190	(24)
—	—	—	—	—	—	4 777	—	(1 341)	3 436	(59)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	543	—	(326)	217	(23)
—	—	—	—	—	—	37 353	—	(4 435)	32 918	(308)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	2 020	—	(879)	1 141	(5)
1 340	246	373	142	386	2 487	6 324	(2 101)	—	4 223	(276)
51	41	75	13	125	305	990	(379)	—	611	(54)
69	6	6	11	—	92	916	(706)	—	210	(57)
1 094	172	222	68	204	1 760	3 420	(823)	—	2 597	(95)
126	27	70	50	57	330	998	(193)	—	805	(70)
—	—	—	—	20	20	828	(442)	—	386	(126)
1	1	1	1	6	10	125	(125)	—	—	—
1 341	247	374	143	412	2 517	55 889	(2 668)	(8 638)	44 583	(825)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
1 347	261	375	152	416	2 551	56 663	(2 699)	(8 638)	45 326	(825)

Note

[1]Comparatives have been reclassified, refer to note 1.27 of the Group's financial statements.

Audited

IFRS disclosures *(continued)*

Maximum exposure to credit risk *(continued)*

For financial guarantees, the maximum exposure to credit risk is the maximum amount we would have to pay if the guarantee was called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

Credit exposures relating to off-statement of financial position items

	Group	
	2012 Rm	2011 Rm
Financial guarantee contracts	**146**	356
Guarantees	**16 217**	13 226
Irrevocable debt facilities	**46 483**	46 189
Letters of credit	**6 670**	5 190
	69 516	64 961

Financial instruments designated at fair value through profit or loss

The following table represents financial instruments designated at fair value through profit or loss at the reporting date before taking into account collateral held or other credit enhancements.

	Group	
	2012 Rm	2011 Rm
Assets		
Cash, cash balances and balances with central banks (refer to note 2)	**2 507**	3 112
Statutory liquid asset portfolio (refer to note 3)	**800**	804
Loans and advances to banks (refer to note 4)	**9 728**	7 886
Other assets (refer to note 6)	**16**	17
Loans and advances to customers (refer to note 9)	**11 941**	10 198
Investment securities (refer to note 12)	**3 386**	4 290
	28 378	26 307
Liabilities		
Deposits from banks (refer to note 18)	**11 132**	9 673
Other liabilities (refer to note 20)	**8**	16
Deposits due to customers (refer to note 22)	**18 663**	20 500
Debt securities in issue (refer to note 23)	**3 198**	1 762
Liabilities under investment contracts (refer to note 24)	**13 609**	15 233
Borrowed funds (refer to note 26)	**778**	771
	47 388	47 955

We did not use credit derivatives as a mechanism to hedge our exposure to credit risk for financial instruments designated at fair value through profit or loss during the current reporting period.

Audited

IFRS disclosures *(continued)*

Financial instruments designated at fair value through profit or loss *(continued)*

The following table represents the carrying value of financial liabilities designated at fair value through profit or loss and the amount that we are contractually required to pay to the holder of the obligation at maturity.

Contractual obligation at maturity of financial liabilities designated at fair value through profit or loss

	Group			
	2012		2011	
	Carrying value Rm	**Contractual obligation Rm**	Carrying value Rm	Contractual obligation Rm
Liabilities				
Deposits from banks (refer to note 18)	**11 132**	**11 205**	9 673	9 470
Other liabilities (refer to note 20)	**8**	**20**	16	16
Deposits due to customers (refer to note 22)	**18 663**	**25 143**	20 500	23 066
Debt securities in issue (refer to note 23)	**3 198**	**3 371**	1 762	3 758
Liabilities under investment contracts (refer to note 24)	**13 609**	**24 827**	15 233	15 160
Borrowed funds (refer to note 26)	**778**	**768**	771	772
	47 388	**65 334**	47 955	52 242

Decrease in fair value attributable to changes in credit risk during the reporting period

	Group	
	2012 Rm	2011 Rm
Assets		
Loans and advances to customers	**1**	—
Liabilities		
Deposits from banks	**21**	—

Cumulative increase in fair value attributable to changes in credit risk

	Group	
	2012 Rm	2011 Rm
Assets		
Loans and advances to customers	**5**	4
Liabilities		
Deposits from banks	**33**	12

The following approaches are used in determining changes in fair value due to changes in credit risk for loans and advances designated at fair value through profit or loss:

- Internal risk grading approach: the cumulative change in fair value due to changes in credit risk is calculated by assigning each customer an internal risk grading based on the customer's PD. The risk grading determines the credit spread incorporated in the valuation curve. Changes in the risk grading will result in a change in fair value of the loan due to changes in credit risk. The change in fair value is calculated by removing the trading margin from the fixed rate instruments to determine the split between interest and credit movement.
- Constant credit spread approach: the cumulative changes in fair value due to changes in credit risk are calculated by assigning each customer a credit spread based on the contractual credit spread of the loans and advances at the time of origination. The assigned credit spread is incorporated in the valuation curve. Changes are made to the credit spread used only if a change in credit spread for the counterparty is observed externally.

Regulatory disclosures

Credit risk mitigation, collateral and other credit enhancements

We employ a number of techniques to mitigate credit risk, such as:

- strengthening our position as a lender in a range of transactions, from retail mortgage lending to large wholesale financing, and by structuring a security interest in a physical or financial asset (collateral);
- netting of debtor and creditor balances under regulatory and internal policy, which requires a formal agreement with the customer to net the balances and a legal right to set-off (on- and off-statement of financial position); and
- selective hedging through credit derivatives.

In certain circumstances, depending on our assessment of a customer's financial capacity, financing may be granted on an unsecured basis.

Generally one or more forms of security are sought in the credit approval process. The use and approach to credit risk mitigation (CRM) varies by product type, portfolio, customer and business strategy. Minimum standards, as prescribed in the applicable policies and business processes, are applied across the Group and cover:

- general requirements including acceptable risk mitigation types, and any conditions or restrictions applicable to these mitigants;
- the maximum LTV ratios, minimum haircuts or other volatility adjustments applicable to each type of mitigant, including, where appropriate, adjustments for currency mismatch, obsolescence and any time sensitivities on asset values;
- the means by which legal certainty is to be established, including required documentation and necessary steps required to establish legal rights;
- acceptable methodologies for initial and any subsequent valuations of collateral and the frequency with which they are to be revalued;
- actions to be taken in the event of the current value of mitigation falling below required levels;
- management of the risk of correlation between changes in the credit risk of the customer and the value of CRM, for example, any situation where customer default materially impacts the value of a mitigant and applying a haircut or recovery value adjustment, which reflects the potential correlation risk;
- management of concentration risks, for example, setting thresholds and controls on the acceptability of credit risk mitigants and/or lines of business that are characterised by a specific collateral type or structure; and
- collateral management to ensure that CRM is legally effective and enforceable.

Our policies with respect to assessing, acquiring and managing collateral for capital calculation purposes are aligned with regulatory requirements.

The Banks Act and its regulations allow banks to adjust the risk weighting of exposures by taking account of collateral. Eligibility for recognition in the calculation of RC depends on which approach the bank is using.

Regulatory disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

Collateral types grouped by type of asset

The following types of collateral may be held against assets subject to credit risk and are consistent with accepted market practice:

Assets subject to credit risk	Type of collateral[1]
→ Cash, cash balances and balances with central banks → Statutory liquid asset portfolio → Loans and advances to banks → Trading portfolio assets → Hedging portfolio assets → Other assets → Loans and advances to customers → Reinsurance assets → Investment securities	**Guarantees, credit insurance and credit derivatives** → Government guarantees → Guarantees from shareholders and directors → Parental guarantees → Personal and other company guarantees → Suretyships → Bonds and guarantees **Physical collateral** → Listed equities → RSA government bonds → Bonds over properties (commercial and residential) → Charges on properties → Property, equipment and vehicles → Shares **Cash collateral** → Deposits from customers and cession of ring-fenced bank accounts with cash → Cash **Other** → Call options to holding companies → Cession of loan accounts → Debentures → Insurance policies → Life insurance policies → Listed equities → Netting agreements → Pledged securities → Put options from holding companies or other companies in the Group → Assignment of debtors

Note

[1]This list is not exhaustive. There may be other forms of collateral that may be recognised by the Group.

Regulatory disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

Valuation of collateral

Performing book

Security taken as part of the credit decision process is valued according to the applicable credit policies at the time of credit approval and at relevant intervals thereafter. We use a number of approaches for the revaluation of collateral, including physical inspection, statistical indexing and price volatility modelling.

Non-performing book

For the wholesale portfolio, collateral valuations are updated when an account enters the legal/recovery process to ensure an appropriate impairment allowance can be calculated. In the wholesale portfolios these valuations are reviewed regularly to ensure any impairments raised remain at an appropriate level, including potential gains in the valuation of marketable securities and other market-related instruments that may lead to a partial release of the impairment allowance. In the retail portfolio, collateral valuations are updated using statistical indexing, which is available monthly.

The collateral management process is focused on the efficient handling and processing of a large number of cases in the retail portfolio and the lower end of the corporate sector, therefore relying heavily on our collateral and document management systems. For larger wholesale exposures and capital market transactions, collateral is managed jointly between the credit and legal functions as transactions and associated legal agreements are often bespoke in nature, in particular, where credit derivatives or customised netting agreements are used as a risk mitigant. All security structures and legal covenants are reviewed at least annually to ensure they remain fit for purpose and consistent with accepted market practice.

Types of guarantor and credit derivative counterparties

In the commercial, corporate and financial sector, we often place reliance on a third party guarantor, which may be a parent company to the borrower, a major shareholder or a bank. Similarly, credit derivative transactions are often used to hedge specific parts of any single name risk in the wholesale portfolio. For these transactions, the most common counterparties or issuers are banks, non-bank financial institutions, large corporates, parastatals and governments. The creditworthiness of the guarantor or derivative counterparty/issuer is assessed as part of the credit approval process and the value of such a guarantee or derivative contract is adjusted accordingly for the purpose of calculating internal LGD estimates. For RC purposes, risk mitigants are incorporated in either PD, EAD or LGD, depending on the type of mitigant.

Use of netting agreements, International Swaps and Derivatives Association master agreements and collateral support annexures

In line with international market practice, we endeavour to use netting agreements wherever possible. We primarily employ International Swaps and Derivatives Association (ISDA) master agreements as well as collateral support annexures (CSAs) that provide standardised and commonly accepted processes for managing collateral and margin calls over the lifetime of the transaction. CSAs may create an obligation on the Group unrelated to the underlying instruments in the event of a credit downgrade. Only a small number of our agreements make use of such a tiered structure and an instantaneous downgrade by one rating grade from the current AA-rating (Standard and Poor's and Fitch) would not trigger such clauses and create a requirement for us to post additional collateral.

IFRS disclosures

Credit risk mitigation, collateral and other credit enhancements

IFRS disclosures in terms of credit mitigation

Audited

The financial effect and forms of collateral and credit enhancements for each class of financial instrument giving rise to credit risk are disclosed in the table to follow. The accounting policy on how the collateral impacts the impairment provisions to be carried against the financial asset balance is described further in note 1.7.7 of the Group's financial statements.

We offset asset and liability amounts in the statement of financial position when we have the ability and intention to net settle. Amounts disclosed in the maximum exposure category are stated net of these.

The percentage collateral reported is calculated by determining the values of available underlying collateral, limited to the carrying value of the related credit exposure where a loan is possibly over-collateralised, and dividing this value by the maximum exposure, as reported. The percentage reported is calculated independently of other forms of collateral and the assessment of impairment losses on loans and advances.

We may also obtain collateral in the form of floating charges over receivables and inventory of corporate and other business customers. The value of this collateral varies from period to period depending on the level of receivables and inventory. It is impractical to provide an estimate of the amount (fair value or nominal value) of this collateral and the value of this collateral is not reported.

Guarantees, credit insurance and credit derivatives

We, in some cases, hold guarantees and/or letters of credit from third parties that enable us to claim settlement from them. This form of enhancement is typically held for lending to groups of companies but may be obtained in other limited circumstances for other forms of lending.

We make use of credit default swaps and credit insurance to manage our overall credit risk with major counterparties. These enable us to claim in the event of a deterioration in the credit quality of borrowers and counterparties.

Notional value of the guarantees held by the Group, as issued by corporate and financial institutional counterparties, are disclosed in this report. In addition, we take guarantees from personal customers in respect of personal loans and smaller business loans. These are not quantified in the aforesaid table.

Physical collateral

We have the ability to call on collateral in the event of default of the borrower or other counterparty. This collateral takes a number of forms:

- mortgages: a fixed charge over domestic property in the form of houses, flats and other dwellings;
- wholesale and corporate lending: a fixed charge over commercial property in various forms;
- reverse repurchase agreements and securities borrowing transactions: typically the highly liquid securities that have been legally transferred to the Group subject to an agreement to return them for a fixed price;
- finance lease receivables: typically we retain legal ownership of the leased asset and have the right to repossess the asset on the default of the borrower; and
- for finance lease receivables, the collateral value is dependent on the state of the vehicle at inception of the lease. For new vehicles the collateral value is the cost of the new vehicle, while for used vehicles it is the retail value.

Where the required thresholds for property sales are not achieved, we have a property buy-in strategy. There is a clearly defined policy around collateral not easily convertible to cash and strategies are designed to achieve specific benchmark recovery rates on the portfolio. We have been reducing the stock of the repossessed properties (PIP) portfolio over the current reporting period with differentiated strategies to manage the inflows and back-book. Although the main objective is to break even in the portfolio, sales have exceeded sales targets against valuations and buy-in amounts. This is due to an optimised strategy and business processes.

Cash collateral

We may hold cash as security against loans granted, or for derivative trades entered into with certain counterparties. This collateral type includes deposits from customers and ring-fenced bank accounts.

Other

This includes master netting agreements and when derivatives are capable of being net settled, reducing our exposure to counterparties on derivative asset positions. The reduction in risk is the amount of the liability held.

This category also includes put options from holding companies or cession of loan accounts.

Audited

IFRS disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

IFRS disclosures in terms of credit mitigation *(continued)*

Collateral held against maximum exposure

	Group					
	2012					
	Maximum exposure Rm	Guarantees, credit insurance and credit derivatives %	Physical collateral %	Cash collateral %	Other %	Unsecured %
Balances with other central banks	1 250	—	—	—	—	100
Balances with the SARB	12 340	—	—	—	—	100
Money market assets	3 815	—	—	—	—	100
Cash, cash balances and balances with central banks (refer to note 2)	17 405					
RSA government bonds	51 853	—	—	—	—	100
Reverse repurchase agreements	3	—	—	—	—	100
Treasury bills	11 164	—	—	—	—	100
Statutory liquid asset portfolio (refer to note 3)	63 020					
Collateralised loans	1 274	—	—	—	—	100
Other	34 241	—	—	—	6	94
Reverse repurchase agreements	9 134	—	—	—	71	29
Loans and advances to banks (refer to note 4)	44 649					
Debt instruments	24 615	—	—	—	1	99
Derivative assets	46 695	—	—	7	85	8
Money market assets	8 766	—	—	—	—	100
Trading portfolio assets (refer to note 5)	80 076					
Derivatives designated as cash flow hedging instruments	3 859	—	—	—	—	100
Derivatives designated as fair value hedging instruments	1 580	—	—	—	—	100
Hedging portfolio assets (refer to note 5)	5 439					
Accounts receivable	7 850	—	—	—	—	100
Settlement accounts	4 455	—	—	—	—	100
Other assets (refer to note 6)	12 305					
Retail Markets	328 684					
Cheque accounts	2 214	—	—	—	—	100
Credit cards	31 317	—	—	—	—	100
Foreign currency loans	4	—	—	—	—	100
Instalment credit agreements	41 342	—	92	—	—	8
Loans to associates and joint ventures	6 634	—	—	—	—	100
Microloans	1 668	—	—	—	—	100
Mortgages	230 890	—	90	—	—	10
Other advances	4	—	—	—	—	100
Personal and term loans	13 595	—	—	—	—	100
Wholesale overdrafts	1 016	—	—	—	—	100
Business Markets	90 960					
Cheque accounts	18 127	1	44	8	—	47
Commercial asset finance	18 049	—	72	—	—	28
Commercial property finance	37 763	—	95	—	—	5
Term loans	17 021	1	42	2	—	55
CIBW	107 907	2	16	1	—	81
Other and intergroup eliminations	640	—	46	—	—	54
Loans and advances to customers (refer to note 9)	528 191					
Insurance contracts	551	—	—	—	—	100
Investment contracts	452	—	—	—	—	100
Reinsurance assets (refer to note 11)	1 003					
Debt instruments	5 333	—	—	—	—	100
Derivative instruments	41	—	—	—	—	100
Money market assets	554	—	—	—	—	100
Investment securities (refer to note 12)	5 928					
Total	758 016					

Audited

IFRS disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

IFRS disclosures in terms of credit mitigation *(continued)*

Collateral held against maximum exposure *(continued)*

	Group 2011[1]					
	Maximum exposure Rm	Guarantees, credit insurance and credit derivatives %	Physical collateral %	Cash collateral %	Other %	Un-secured %
Balances with other central banks	1 201	—	—	—	—	100
Balances with the SARB	12 279	—	—	—	—	100
Money market assets	5 624	—	—	—	—	100
Cash, cash balances and balances with central banks (refer to note 2)	19 104					
RSA government bonds	44 222	—	—	—	—	100
Reverse repurchase agreements	3	—	—	—	—	100
SARB debentures	200	—	—	—	—	100
Treasury bills	13 048	—	—	—	—	100
Statutory liquid asset portfolio (refer to note 3)	57 473					
Collateralised loans	3 478	—	—	—	—	100
Other	47 282	—	—	—	7	93
Reverse repurchase agreements	6 739	—	—	—	57	43
Loans and advances to banks (refer to note 4)	57 499					
Debt instruments	27 114	—	—	—	—	100
Derivative assets	45 604	1	—	9	90	—
Money market assets	6 741	—	—	—	—	100
Trading portfolio assets (refer to note 5)	79 459					
Derivatives designated as cash flow hedging instruments	3 168	—	—	—	—	100
Derivatives designated as fair value hedging instruments	1 131	—	—	—	—	100
Hedging portfolio assets (refer to note 5)	4 299					
Accounts receivable	5 549	—	—	—	—	100
Settlement accounts	6 466	—	—	—	—	100
Other assets (refer to note 6)	12 015					
Retail Markets	318 734					
Cheque accounts	2 564	—	—	—	—	100
Credit cards	19 836	—	—	—	—	100
Instalment credit agreements	37 554	—	84	—	—	16
Loans to associates and joint ventures	4 836	—	—	—	—	100
Microloans	1 573	—	—	—	—	100
Mortgages	237 977	—	88	—	—	12
Other advances	11	—	—	—	—	100
Personal loans	14 383	—	—	—	—	100
Business Markets	93 861					
Cheque accounts	14 137	1	58	14	—	27
Commercial asset finance	17 975	—	69	—	—	31
Commercial property finance	41 460	—	100	—	—	—
Term loans	20 289	—	36	1	—	63
CIBW	91 889	5	8	10	—	77
Other and intergroup eliminations	441	—	31	—	—	69
Loans and advances to customers (refer to note 9)	504 925					
Insurance contracts	469	—	—	—	—	100
Investment contracts	540	—	—	—	—	100
Reinsurance assets (refer to note 11)	1 009					
Debt instruments	4 870	—	—	—	—	100
Derivative instruments	29	—	—	—	—	100
Money market assets	1 059	—	—	—	—	100
Investment securities (refer to note 12)	5 958					
Total	741 741					

Note

[1]Comparatives have been reclassified, refer to note 1.27 of the Group's financial statements. In certain instances the underlying collateral data was recalibrated.

Audited

IFRS disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

IFRS disclosures in terms of credit mitigation *(continued)*

Enforcement of collateral

The following table represents the carrying value of assets at the reporting date as a result of the enforcement of collateral:

	Group 2012 Rm	Group 2011 Rm
Residential properties		
Balance at the beginning of the reporting period	731	449
Acquisitions	143	617
Disposals	(532)	(335)
Balance at the end of the reporting period	342	731

Absa has been reducing the stock of the repossessed properties portfolio over the current reporting period with optimised sales strategies to manage the inflow and back-book. This has resulted in a portfolio reduction compared with the previous reporting period. It must further be noted that 78% of the current inventory has been sold pending registration, which means that the current inventory available for sale is less than R100 million. New inflows have stabilised to around R15 million per month.

Regulatory disclosures

Credit risk mitigation, collateral and other credit enhancements

Credit risk mitigation in terms of regulatory disclosure requirements

Credit risk mitigation

IRB approach	Group 2012 Original credit and counterparty exposure Rm	2012 Effects of netting agreements Rm	2012 Net exposure after netting and credit risk Rm	2012 Eligible financial collateral Rm	2012 Other eligible IRB collateral Rm	2012 CRM affecting LGD estimates Rm	2011 CRM mitigation affecting LGD estimates Rm
Banks	124 342	37 403	86 939	2 729	6	2 735	3 441
Corporate exposure	293 649	5 041	288 608	6 133	67 977	74 110	94 874
Corporate	237 851	5 040	232 811	2 543	41 077	43 620	69 773
SME Corporate	46 250	—	46 250	3 590	24 812	28 402	20 882
Specialised lending – income producing real estate	2 695	—	2 695	—	2 088	2 088	4 219
Specialised lending – project finance	6 853	1	6 852	—	—	—	—
Local government and municipalities	15 167	—	15 167	945	124	1 069	1 071
Public sector entities	21 063	728	20 335	5	22	27	712
Retail	447 103	—	447 103	2 571	604 495	607 066	622 214
Mortgages (including any home loan equity lines of credit)	295 476	—	295 476	959	527 451	528 410	542 896
Other	71 019	—	71 019	273	65 624	65 897	62 456
Unsecured lending[1] ≤ 30 000	4 716	—	4 716	107	11	118	n/a
Unsecured lending[1] > 30 000	15 609	—	15 609	136	14	150	n/a
Vehicle and asset finance[1]	50 694	—	50 694	30	65 599	65 629	n/a
Revolving credit	56 004	—	56 004	1 338	6	1 344	n/a
Credit cards[1]	50 130	—	50 130	—	—	—	n/a
Non-credit cards[1]	5 874	—	5 874	1 338	6	1 344	n/a
SME	24 604	—	24 604	1	11 414	11 415	16 862
Secured lending[1]	9 934	—	9 934	—	9 061	9 061	n/a
Unsecured lending[1]	14 670	—	14 670	1	2 353	2 354	n/a
Securities firms	16 634	370	16 264	605	—	605	501
Sovereigns	66 860	100	66 760	374	3	377	444
	984 818	43 642	941 176	13 362	672 627	685 989	723 257

No CRM is taken into consideration for the standardised approach.

Note

[1]Basel II.5 reporting requirement. Previous reporting period comparatives are not available.

Regulatory disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

Credit risk mitigation in terms of regulatory disclosure requirements *(continued)*

Counterparty credit risk

Counterparty credit exposure arises from the risk that parties are unable to meet their payment obligations under certain financial contracts, such as derivatives and securities financing transactions (e.g. repurchase agreements). Unlike credit risk, counterparty credit risk implies the bilateral risk of loss.

For allocation of EC to over-the-counter (OTC) derivative exposures, EAD estimates are treated as mark-to-market (MTM) loan equivalents, where the amount of capital allocated to a particular transaction is driven by the:

- borrower's netting arrangements;
- borrower's TTC PD;
- trade's residual maturity;
- nature of each trade; and
- net EAD and corresponding LGD.

For RC calculation purposes, the current exposure method (CEM) is applied to OTC derivative exposures. We mainly rely on cash, government bonds and negotiable certificates of deposits as collateral for derivative contracts.

We intend to apply for permission to use the Internal Model Method (IMM) in the calculation of our RC requirements for these portfolios once the AIRB approach for wholesale credit exposures has been embedded. However, during the current reporting period, all calculations were based on the CEM. Our policies for establishing impairment allowances for counterparties of traded products are based on applicable accounting requirements.

Credit derivatives

The following table provides an overview of the outstanding amount of exposure held in respect of our credit derivative positions used in managing our credit portfolio, broken down by product type, indicating whether protection was bought or sold:

Exposure by instrument bought or sold

	Group							
	2012				2011			
	Intermediation portfolio				Intermediation portfolio			
	As protection buyer		As protection seller		As protection buyer		As protection seller	
	Banking Rm	Trading Rm	Banking Rm	Trading Rm	Banking Rm	Trading Rm	Banking Rm	Trading Rm
Credit derivative product type								
Credit-default swaps	—	4 169	1 504	10 190	—	6 987	—	10 494
Other	7 809	1 705	163	—	8 813	—	690	—
Total notional exposure to credit derivative transactions	7 809	5 874	1 667	10 190	8 813	6 987	690	10 494

Regulatory disclosures

Credit risk mitigation, collateral and other credit enhancements *(continued)*

Credit risk mitigation in terms of regulatory disclosure requirements *(continued)*

Credit derivatives *(continued)*

This book is volatile and derivative exposures are driven by MTM movements due to changes in the underlying instrument during the current reporting period. The implementation of Basel III, commencing 1 January 2013, will result in an increase in credit RWA specifically on the trading book.

Breakdown of OTC and credit derivative exposure

	Group						
	2012						
	Gross positive fair value Rm	**Current netting benefits Rm**	**Current exposure Rm**	**Expected positive exposure (CEM) Rm**	**Expected positive exposure netting (CEM) Rm**	**EAD Rm**	**Notional value Rm**
Commodities	**614**	**433**	**181**	**447**	**158**	**470**	**4 028**
Credit derivatives	**110**	**99**	**11**	**1 274**	**591**	**694**	**16 421**
Equity derivatives	**1 478**	**739**	**739**	**1 658**	**658**	**1 739**	**26 964**
Foreign exchange derivatives	**10 951**	**9 254**	**1 697**	**15 260**	**8 077**	**8 880**	**778 897**
Interest rate derivatives	**38 496**	**32 164**	**6 332**	**10 831**	**5 753**	**11 410**	**3 398 199**
	51 649	**42 689**	**8 960**	**29 470**	**15 237**	**23 193**	**4 224 509**

	2011						
	Gross positive fair value Rm	Current netting benefits Rm	Current exposure Rm	Expected positive exposure (CEM) Rm	Expected positive exposure netting (CEM) Rm	EAD Rm	Notional value Rm
Commodities	267	171	96	172	46	222	1 657
Credit derivatives	151	144	7	1 394	687	714	17 883
Equity derivatives	1 190	744	446	2 338	960	1 824	37 145
Foreign exchange derivatives	20 620	17 045	3 575	14 054	7 384	10 245	695 789
Interest rate derivatives	30 944	26 433	4 511	12 322	6 660	10 173	4 006 935
	53 172	44 537	8 635	30 280	15 737	23 178	4 759 409

Regulatory disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements *(continued)*

Credit risk mitigation in terms of regulatory disclosure requirements *(continued)*

Credit derivatives *(continued)*

Credit rating downgrade

We enter into derivative contracts with rated and unrated counterparties. To mitigate counterparty credit risk, we stipulate credit protection terms, such as limitations on the amount of unsecured credit exposure we will accept, collateralisation in the event of a MTM credit exposure exceeding the current amount and collateralisation and/or termination of a contract when certain credit events occur. Such events might include a downgrade of the counterparty's public credit rating.

Certain counterparties may require us to provide similar credit protection terms, to which we may agree from time to time, on a restrictive basis. Rating downgrades as a collateralisation or termination event are generally only conceded to highly rated counterparties, and whenever possible, on a reciprocal basis.

The impact on the Group in terms of the additional amount of collateral required in the event of a credit downgrade is determined by the negative MTM value on derivative contracts. Where the impact on our liquidity is deemed to be material, the potential exposure is taken into account in model stress testing. Generally, the extent of legal commitments resulting in additional collateral requirements caused by a rating downgrade is not material and would not adversely affect our financial position.

As at the reporting date, additional collateral of R28,9 million for a one-notch downgrade, R131,6 million for a two-notch downgrade and R87,5 million for a three-notch downgrade would have been required.

Audited

IFRS disclosures

Impairments: relevant accounting impairment policy versus expected loss regulatory policy

IFRS govern reporting practices of banks and, in part, overlap with the requirements of regulation 43 of the Banks Act (commonly known as Pillar 3). IFRS 7 Financial Instruments: Disclosures prescribes disclosure requirements pertaining to financial instruments for accounting purposes and, as such, is based on a similar set of data used for Pillar 3 reporting purposes. Regulation 43 requires banks to disclose certain accounting definitions and information, in particular, with respect to impairments, past due loans and advances and charge-offs. We regularly reconcile the data used for both financial (IFRS) and regulatory (Pillar 3) disclosures.

Impairment methods of assessment and use of allowance accounts

We establish, through charges against profit, an impairment allowance for the incurred loss inherent in the lending book. Under IFRS, impairment allowances are recognised where there is objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition of the asset, and where these events had an impact on the estimated future cash flows of the financial asset or portfolio of financial assets. To determine if a loss event has occurred, historical economic information similar to the current economic climate, overall customer risk profile, payment record and the realisable value of any collateral, are taken into consideration.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to our attention, which may include the following loss events:

- significant financial difficulty of the issuer or borrower;
- a breach of contract, such as a default or delinquency in interest and/or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider, such as restructuring;
- it becomes probable that the borrower will enter insolvency or other financial reorganisation proceedings;
- the disappearance of an active market for a financial asset, as a result of financial difficulties;
- observable data indicating a measurable decrease in the estimated future cash flows from a group of financial assets following the initial recognition of those assets, although the decrease cannot yet be identified with individual financial assets in the group, including:
  - adverse changes in the payment status of borrowers in the group; or
  - national or local economic conditions that correlate with defaults on the assets in the group.

Impairments in respect of assets that are individually significant or have been flagged as being in default, are measured individually. Where a portfolio comprises homogeneous assets and appropriate statistical techniques are available, it is measured collectively. The amount of loss is measured as the difference between the asset carrying amount and the present value of estimated future cash flows (excluding future credit losses), discounted at the financial asset's original effective interest rate. Two key aspects in the cash flow calculation are the valuation of all security and the timing of all asset realisations, after allowing for all collection and recovery costs.

For the purpose of a collective evaluation of impairment, financial assets are allocated to groups, based on similar risk characteristics, asset type, industry, geographical location, collateral type, past due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for such groups of assets, being indicative of the counterparty's ability to pay amounts due under the contractual terms of the assets.

Audited

IFRS disclosures *(continued)*

Impairments: relevant accounting impairment policy versus expected loss regulatory policy *(continued)*

Impairment methods of assessment and use of allowance accounts (continued)

Unidentified impairment allowances are raised when observable data indicates a measurable decrease in the estimated future cash flows from a group of financial assets since their original recognition, even though the decrease cannot yet be linked to individual assets in the group. The unidentified impairment calculation is based on the asset's probability of moving from the performing portfolio to the defaulted portfolio as a result of a risk condition that has already occurred, but will only be identifiable at a borrower level at a future date.

An emergence period concept is applied to ensure that only impairments that exist at the reporting date are captured. The emergence period is defined as the time lapse between the occurrence of a trigger event (unidentified impairment) and the impairment being identified at an individual account level (identified impairment). The emergence periods, based on actual experience, vary across businesses and are reviewed annually. The PD for each exposure class is based on historical default experience, scaled for the emergence period relevant to the exposure class. This PD is then applied to all exposures in respect of which no identified impairments have been recognised. Where total EL of all credit risk assets exceeds total impairments, the difference is deducted from eligible capital. In the instance that total impairments exceed total EL, the difference is added to eligible capital, subject to a maximum of 0,6% of total RWA.

The impairment allowance also takes into account the expected severity of loss at default, or the LGD, which is the amount outstanding that is written off and is therefore not recoverable.

Recovery varies by product and depends, for example, on the level of security held in relation to each loan as well as our position relative to other claimants. LGD estimates are based on historical loss experience. Historical loss experience data is adjusted to add current economic conditions into the data set, which conditions did not exist at the time of loss experience and/or to remove the effects of conditions in the historical period that do not currently exist.

The replacement of IAS 39 with IFRS 9 Financial Instruments (IFRS 9) will have a significant impact on banks' financial statements, the biggest impact being the calculation of impairments. IFRS 9 will replace the current incurred loss model with the requirement to calculate expected losses. Final agreement has not been reached on the exact approach to be followed and another exposure draft is expected within the next few months. It is expected that the new rules will be mandatory from January 2015, with comparative numbers for 2014 to be published at the same time.

Identified impairments on financial assets

According to our credit policy, the following are key indicators of default:

- the borrower is unlikely to pay its credit obligation in full, without recourse by the Group to actions such as realising security held; and/or
- the borrower is overdue.

A retail identified impairment is triggered when a contractual payment is missed. The impairment calculation is based on a roll-rate approach where the percentage of assets moving from the initial delinquency state to default is derived from statistical probabilities, based on experience. The PD is calculated within a certain outcome period. The outcome period is defined as the timeframe within which assets default. Recovery amounts and contractual interest rates are calculated using a weighted average for the relevant portfolio.

Future cash flows for a group of financial assets, which are collectively evaluated for impairment purposes, are estimated based on the contractual cash flows of the assets in the group and the historical loss experienced for assets with similar credit risk characteristics to those in the group.

In the retail portfolio, the identified impairment is calculated on a collective basis. For accounting purposes, these accounts are considered to be identified collective impairments.

In the wholesale portfolio, the identified impairment is calculated on accounts reflected on management EWLs (category 3), and accounts currently going through the legal process. An identified impairment is raised on an individual basis and is the difference between the outstanding capital and the present value of future cash flows.

Write-offs

Once an advance has been identified as impaired and an impairment allowance has been raised, circumstances may change and indicate that the prospect of further recovery does not exist. Write-offs will occur when, and to the extent that, the debt is considered irrecoverable.

A write-off policy, based on an age-driven concept, drives the timing and extent of write-offs. A write-off can also be triggered by a specific event, such as the conclusion of insolvency proceedings or other formal recovery actions making it possible to quantify the extent of the advance that is beyond a realistic prospect of recovery. Nonetheless, impaired loans and advances are reviewed at least quarterly, ensuring irrecoverable loans and advances are written off in a timely and systematic way and in compliance with local regulations.

Assets are only written off once all necessary procedures have been completed and the amount of loss has been determined. Recoveries of amounts previously written off are reversed and accordingly decrease the amount of the reported impairment charge in the statement of comprehensive income.

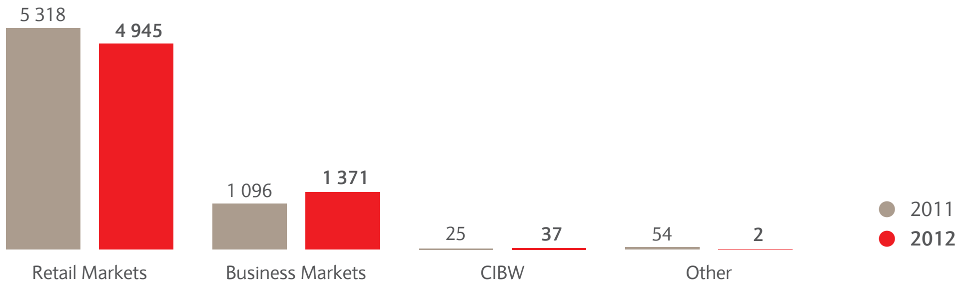
Audited

IFRS disclosures *(continued)*

Impairments: Relevant accounting impairment policy versus expected loss regulatory policy *(continued)*

Write-offs (continued)

Write-offs per cluster (amounts written off) (Rm)



Net present value unwind on non-performing book

The impairment allowance contains a net present value adjustment that represents the time value of money of expected cash flows. Such time value of money reduces as the point of cash flow is approached. The time-based reduction in time value of money is recognised in the statement of comprehensive income as interest received on impaired assets.

Reconciliation of total impairment losses on loans and advances to customers (identified and unidentified)

	Group						
	2012						
	Opening balance Rm	Net present value unwind on non-performing book Rm	Exchange differences Rm	Amounts written off Rm	Identified impairments raised Rm	Unidentified impairments raised/ (released) Rm	Closing balance Rm
Retail Markets	**9 061**	**(934)**	**(2)**	**(4 945)**	**6 657**	**193**	**10 030**
Business Markets	**2 376**	**(83)**	**(5)**	**(1 371)**	**2 319**	**(49)**	**3 187**
CIBW	**569**	**(5)**	**3**	**(37)**	**106**	**14**	**650**
Other	**125**	**4**	**—**	**(2)**	**18**	**—**	**145**
	12 131	**(1 018)**	**(4)**	**(6 355)**	**9 100**	**158**	**14 012**

	2011[1]						
	Opening balance Rm	Net present value unwind on non-performing book Rm	Exchange differences Rm	Amounts written off Rm	Identified impairments raised Rm	Unidentified impairments raised/ (released) Rm	Closing balance Rm
Retail Markets	10 789	(1 048)	—	(5 318)	4 649	(11)	9 061
Business Markets	2 642	(125)	—	(1 096)	1 061	(106)	2 376
CIBW	471	(5)	1	(25)	131	(4)	569
Other	—	5	—	(54)	174	—	125
	13 902	(1 173)	1	(6 493)	6 015	(121)	12 131

Note

[1]Comparatives have been reclassified to align with our segment changes in the current reporting period. Refer to note 59.1 of the Group's financial statements.

Regulatory disclosures

Concentrations of credit risk

A concentration of credit risk exists when a number of counterparties are located in a geographical region, and/or are engaged in similar activities and/or have similar economic characteristics such that their ability to meet contractual obligations is similarly affected by changes in economic or other conditions. The analyses of credit risk concentrations presented below are based on the location of the counterparty or customer or the industry in which they are engaged.

Measuring exposures and concentrations

Loans and advances to customers provide the principal source of credit risk to the Group although it can also be exposed to other forms of credit risk through, for example, loans to banks, loan commitments and debt securities. Group risk management policies and processes identify and analyse risk, set appropriate risk appetite limits and controls and monitor the risks and adherence to limits by means of reliable and timely data. One particular area of review is concentration risk.

Diversification is achieved through setting maximum exposure guidelines to individual counterparties. Excesses are reported to the Group Risk Oversight Committee and the Board Risk Committee. Mandate and scale limits are used to limit the stock of current exposures in a loan portfolio and the flow of new exposures into a loan portfolio. Limits are typically based on the nature of the lending and the amount of the portfolio meeting certain standards of underwriting criteria.

Due to the composition of our business portfolios, a certain degree of risk concentration in the collateral portfolios is evident. We manage these risks through mandate and scale limits that differ across the individual portfolios, for example:

- vehicle and asset finance: limits are placed on the tenure of loans;
- mortgages: limits are placed on property values and LTV ratios; and
- commercial property finance limits are placed on the type of asset (e.g. industrial or retail) and geographical area.

Due to the structure of South African financial markets, a certain level of concentration with derivative counterparties is also to be expected. We manage this type of concentration risk through mandate and scale limits, sophisticated, simulation-based exposure models that support a rigorous credit analysis, ongoing monitoring of these counterparties and our MTM exposure.

Breakdown of gross exposures by geographical area

	Group							
	2012							
	Asia Rm	**Europe[1] Rm**	**North America Rm**	**Other African countries Rm**	**Other Rm**	**South Africa Rm**	**South America Rm**	**Total Rm**
AIRB approach	**2 411**	**78 414**	**7 441**	**5 662**	**2 059**	**888 831**	**—**	**984 818**
Standardised approach[2]	**—**	**—**	**—**	**14 306**	**—**	**22 816**	**—**	**37 122**
	2 411	**78 414**	**7 441**	**19 968**	**2 059**	**911 647**	**—**	**1 021 940**

	2011							
	Asia Rm	Europe Rm	North America Rm	Other African countries Rm	Other Rm	South Africa Rm	South America Rm	Total Rm
IRB approach	2 081	80 629	8 260	6 366	1 298	784 224	1	882 859
AIRB approach	—	—	—	—	—	443 417	—	443 417
FIRB approach	2 081	80 629	8 260	6 366	1 298	340 807	1	439 442
Standardised approach	—	—	—	14 345	—	55 831	—	70 176
	2 081	80 629	8 260	20 711	1 298	840 055	1	953 035

Notes

[1]The majority of exposures for Europe relate to Barclays Bank PLC.

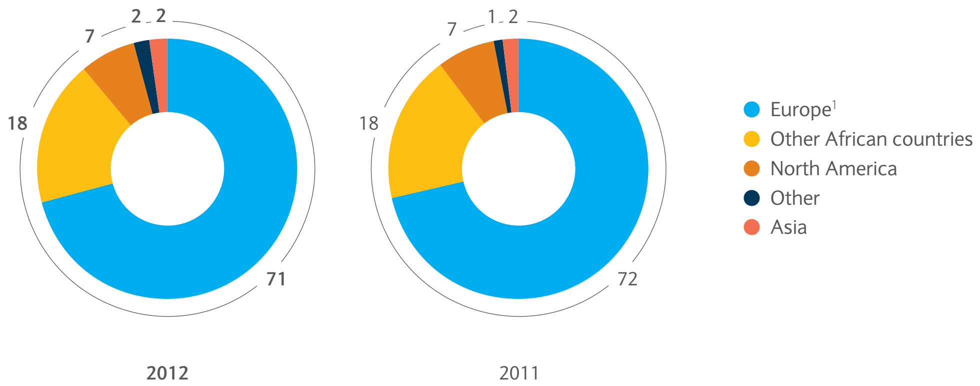
[2]The Bank's liquid asset portfolio moved to the AIRB approach with effect from 1 January 2012. The Edcon book acquired is reported under the standardised approach.

Regulatory disclosures *(continued)*

Concentrations of credit risk *(continued)*

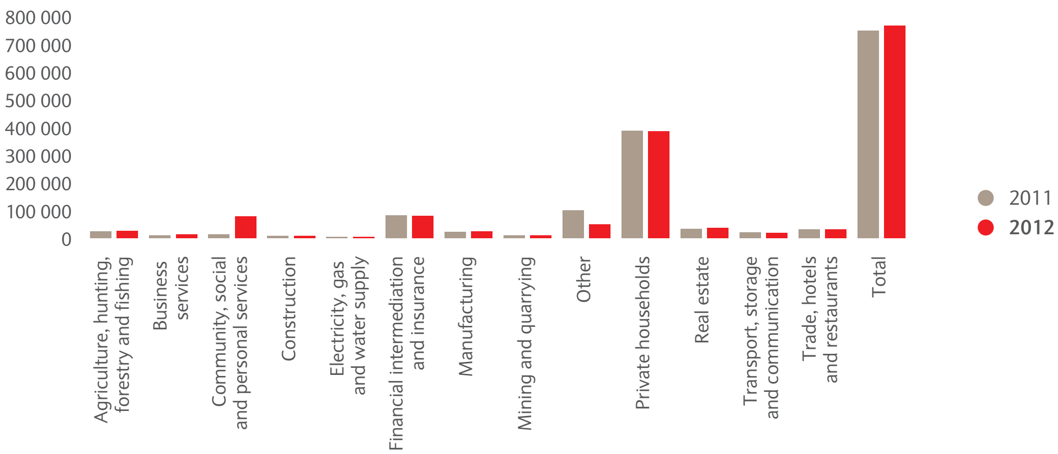
Measuring exposures and concentrations *(continued)*

Breakdown of gross exposure by geography – outside of South Africa (%)



Breakdown of exposure per industry

Industry exposure at default (all approaches) (Rm)



Note

[1]The majority of exposures for Europe relate to Barclays Bank PLC.

Audited

IFRS disclosures

Concentrations of credit risk

IFRS disclosures in terms of credit concentration

Geographical concentration of risk

	Group				
	2012				
	Asia, Americas and Australia Rm	Europe[2] Rm	Rest of Africa Rm	South Africa Rm	Total Rm
On-statement of financial position exposure					
Cash, cash balances and balances with central banks	3	—	1 710	15 692	17 405
Statutory liquid asset portfolio	—	—	—	63 020	63 020
Loans and advances to banks	3 459	23 768	1 641	15 781	44 649
Trading and hedging portfolio assets	784	28 552	693	55 486	85 515
Other assets	11	2 289	391	9 614	12 305
Loans and advances to customers	641	3 783	8 554	515 213	528 191
Reinsurance assets	151	197	129	526	1 003
Investment securities	—	—	793	5 135	5 928
Subject to credit risk	5 049	58 589	13 911	680 467	758 016
Off-statement of financial position exposures					
Financial guarantee contracts	—	37	—	109	146
Guarantees	425	—	1 295	14 497	16 217
Irrevocable debt facilities	—	3 761	312	42 410	46 483
Letters of credit	—	—	861	5 809	6 670
Subject to credit risk	425	3 798	2 468	62 825	69 516

	2011[1]				
	Asia, Americas and Australia Rm	Europe[2] Rm	Rest of Africa Rm	South Africa Rm	Total Rm
On-statement of financial position exposures					
Cash, cash balances and balances with central banks	—	—	2 264	16 840	19 104
Statutory liquid asset portfolio	—	—	22	57 451	57 473
Loans and advances to banks	1 629	48 255	1 709	5 906	57 499
Trading and hedging portfolio assets	3 170	24 132	389	56 067	83 758
Other assets	—	615	255	11 145	12 015
Loans and advances to customers	676	1 808	8 464	493 977	504 925
Reinsurance assets	143	306	51	509	1 009
Investment securities	—	—	722	5 236	5 958
Subject to credit risk	5 618	75 116	13 876	647 131	741 741
Off-statement of financial position exposures					
Financial guarantee contracts	—	46	231	79	356
Guarantees	—	—	1 306	11 920	13 226
Irrevocable debt facilities	545	2 024	950	42 670	46 189
Letters of credit	—	—	630	4 560	5 190
Subject to credit risk	545	2 070	3 117	59 229	64 961

Notes

[1]Comparatives have been reclassified, refer to note 1.27 of the Group's financial statements.

[2]The majority of exposures for Europe relate to Barclays Bank PLC, refer to note 1.27 of the Group's financial statements.

Regulatory disclosures

Wrong-way risk

Wrong-way risk is another form of concentration risk and arises when there is a strong correlation between the counterparty's PD and the MTM value of the underlying transaction. We distinguish between two types of wrong-way risk:

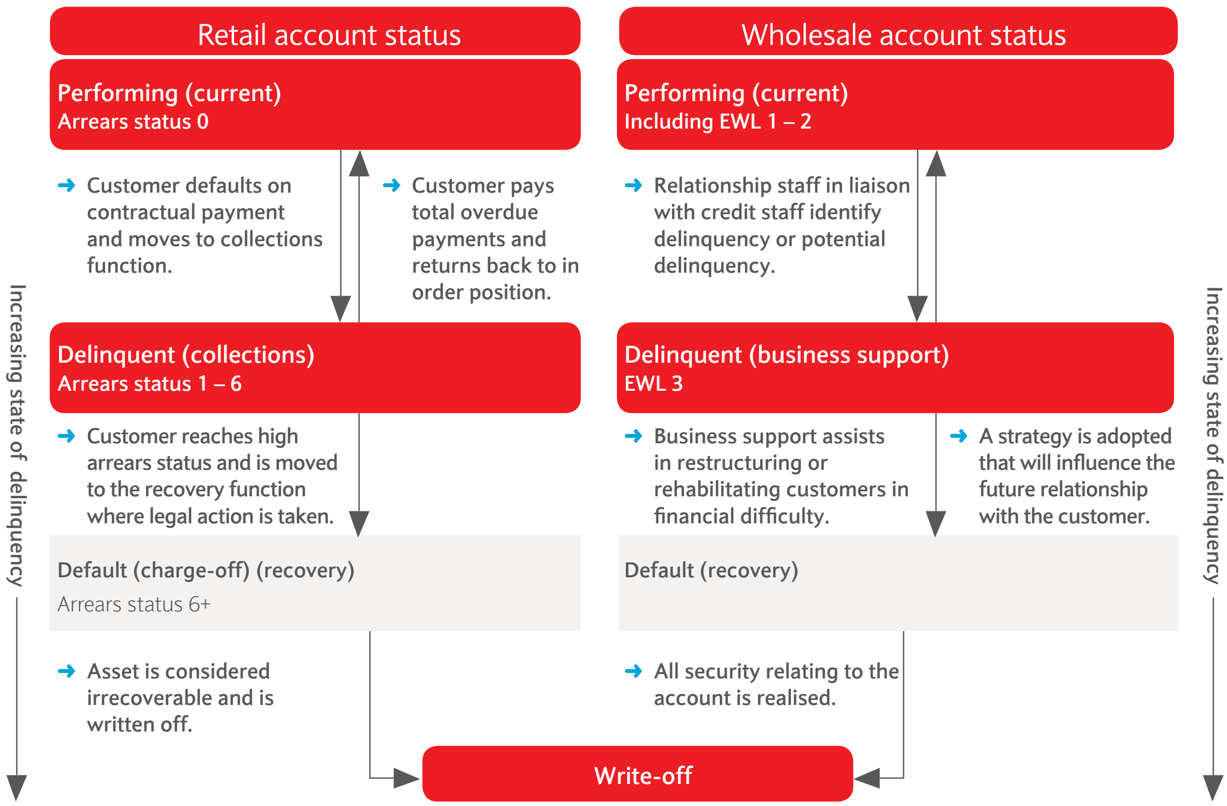
- Specific wrong-way risk, which may arise in transactions with certain structural features, such as the collateralisation of a loan with the borrower's or a related party's shares.
- General or conjectural wrong-way risk, which may arise where the credit quality of the counterparty is related to the value of the transaction for non-specific reasons such as, where both the credit quality of the counterparty and the value of the derivative are strongly related to a macroeconomic variable.

We aim to limit both these risk types. However, we recognise the need to engage in certain transactions that could expose the Group to specific wrong-way risk, such as funding broad-based black economic empowerment transactions.

Monitoring weaknesses in portfolios

Corporate accounts deemed to contain heightened levels of risk are recorded on EWLs. These are updated monthly and circulated to relevant risk control points. Once an account is included on an EWL, exposure is carefully monitored and, where possible, a reduction of the exposure is effected. The lists are graded in line with the perceived severity of the risk attached to the loan. Corporate customers are escalated through three categories of increasing concern. When an account becomes impaired, it would normally but not necessarily, have passed through all three categories, which reflects the need for increased monitoring and control. Where a borrower's financial health presents grounds for concern, it is immediately placed into the appropriate category. All borrowers are subject to a full review of all facilities on at least an annual basis. Interim reviews may be performed if necessary.

Within the Retail Markets portfolios, which tend to comprise homogeneous assets, statistical techniques allow the impairment to be monitored on a portfolio basis. It is consistent with our policy to raise an impairment allowance as soon as objective evidence of impairment is identified as a result of one or more loss events that occurred, subsequent to initial recognition. Models in use are based upon customers' personal and financial performance information over recent periods, which serve as a predictor for future performance. The models' output are regularly reviewed against actual performance and, where necessary, amended to optimise their effectiveness.



Approach to securitisation

Securitisation transactions, used as part of our credit portfolio, are primarily focused on the effective management of funding requirements. Planned securitisation transactions, market appetite and potential marketing and placement strategies are governed by a delegated mandate from the Board Finance Committee and assessed with the assistance of the MRC and ATC. There are two main types of securitisation:

- traditional securitisation transactions where an originating bank transfers a pool of assets it owns to a special purpose entity on an arm's length basis; and
- synthetic securitisation transactions where the originating bank transfers only the credit risk associated with an underlying pool of assets, through the use of credit-linked notes or credit derivatives, while retaining legal ownership of the pool of assets.

All securitisation transactions entered into at the reporting date involved the sale of the underlying assets to the securitisation vehicle. We have not originated any synthetic securitisation transactions. Nonetheless, we calculate appropriate capital charges in respect of the risk assumed through the provision of liquidity facilities and retained exposures, as per the Basel II.5 securitisation framework.

As at the current reporting date, we had securitised our own assets relating to the Home Loans portfolio. For the Homes securitisation, we apply the look through approach hence transfer of credit risk does not take place. In addition to credit risk, liquidity and interest rate risk are also considered regularly. The origination of transactions based on other asset classes, such as CPF are considered on an ongoing basis.

We do not enter into any resecuritisation transactions.

Our securitisation activities

Securitisation transactions have been used as a means of raising long-term funding. We apply the IRB approach in the assessment of our securitisation exposures for RC purposes and use Fitch, Moody's and Standard and Poor's as external credit assessment institutions (ECAIs).

Apart from originating and sponsoring securitisation transactions, the Group also acts as an investor, a service provider, a liquidity provider and credit enhancer to a number of securitisation transactions. Absa invests directly in the securitisation schemes.

The following table provides a breakdown of our role in each transaction during the current reporting period:

Roles played by the Group in securitisation schemes

	Originator	Sponsor	Investor (Absa)	Liquidity provider	Service provider	Credit enhancement/ subordinated loan
Blue Granite 1 Proprietary Limited			√			
Grayston Conduit Proprietary Limited				√		
Home Obligors Mortgage Enhanced Securities Proprietary Limited	√	√	√		√	√
Nitro 4				√		
Nqaba Finance Proprietary Limited				√		

The following facilities have been redeemed during the current reporting period:

- Vukile Investment Property Securitisation Proprietary Limited;
- Ikhaya 2 RMBS 2 Limited;
- Blue Granite 4 Proprietary Limited;
- Vukile Investment Property Securitisation Proprietary Limited;
- Prime Realty Obligors Packaged Securities Proprietary Limited;
- On the Cards Investment II Proprietary Limited;
- Blue Granite 4 Proprietary Limited; and
- Thekweni Fund 7 Proprietary Limited.

Approach to securitisation *(continued)*

Summary of applicable accounting policies

At the start of a securitisation transaction, assets are sold to the securitisation vehicle at par value and no gains or losses are recognised. The transactions are treated as sales (rather than financing) and for financial reporting purposes the respective vehicles are consolidated at a Group level.

Any retained interest in the securitisation vehicle is valued on the basis of the respective asset's performance. Key valuation assumptions for retained interests of this nature include spreads to discount rates, default and recovery rates and prepayment rates that may be observable or unobservable. Where we act as a service provider, normal impairment policies are applied and retained tranches are ultimately written off once sufficient capital losses accumulate.

Securitisation exposures

The following table provides a breakdown of the total funding raised through securitisation at the reporting date as well as the ECAIs used in the various asset classes.

Portfolio securitised

	Group			
	2012		2011	
	Amount securitised Rm	**ECAI**	Amount securitised Rm	ECAI
Mortgage advances	**5 057**	**Moody's, Fitch and Standard and Poor's**	5 057	Moody's, Fitch and Standard and Poor's

Mortgage advances remained consistent during the current reporting period.

No securitised assets existed at the reporting date that related to instalment finance.

We originated securitisation transactions that performed according to expectations. No triggers were breached.

Outstanding securitisation balances

	Group	
IRB exposure	**2012 Rm**	2011 Rm
On-statement of financial position		
Retail – mortgages	**4 632**	4 958
Total IRB exposures	**4 632**	4 958
Of which notes issued		
Investment grade	**4 019**	4 019
Sub-investment grade[1]	**1 038**	1 038

Note
[1]BBB and below.

Approach to securitisation *(continued)*

Securitisation exposures *(continued)*

Past due securitisation exposures

Originator	Group 2012 Amount securitised Rm	Group 2012 Past due Rm	Group 2011 Amount securitised Rm	Group 2011 Past due Rm
Mortgage advances[1]	**5 057**	**1**	5 057	69

Retained or purchased securitisation exposures per asset class

Exposure type – Retail	Group 2012 Retained Rm	Group 2012 Purchased Rm	Group 2012 Total Rm	Group 2011 Retained Rm	Group 2011 Purchased Rm	Group 2011 Total Rm
Mortgages	**923**	**21**	**944**	946	1 100	2 046
Other	**—**	**—**	**—**	—	368	368
SME	**—**	**—**	**—**	—	150	150
	923	**21**	**944**	946	1 618	2 564

Retained or purchased securitisation exposures by risk weight band

Risk weight band (%)[2]	Group 2012 Retained Rm	Group 2012 Purchased Rm	Group 2011 Retained Rm	Group 2011 Purchased Rm
11 – 19	**—**	**—**	—	437
20 – 49	**—**	**21**	—	1 126
100	**—**	**—**	—	55
250	**—**	**—**	23	—
1 250 or deducted	**923**	**—**	923	—
	923	**21**	946	1 618

Rated securitised exposures in terms of the IRB approach

(Excluding deductions and investors interest in respect of schemes with early amortisation features)

IRB exposures – Retail	Group 2012 Total senior exposure rated BBB or better Rm	Group 2012 Total base risk weight exposure rated BBB or better Rm	Group 2012 Total exposure rated BBB or below Rm	Group 2012 Total Rm	Group 2011 Total senior exposure rated BBB or better Rm	Group 2011 Total base risk weight exposure rated BBB or better Rm	Group 2011 Total exposure rated BBB or below Rm	Group 2011 Total Rm
Instalment sales and leasing	**1**	**—**	**—**	**1**	3	—	—	3
Mortgages	**32**	**60**	**—**	**92**	35	108	—	143
Other	**8**	**—**	**—**	**8**	8	6	—	14
SME	**—**	**—**	**—**	**—**	—	2	5	7
	41	**60**	**—**	**101**	46	116	5	167

Note

[1]No recognised losses were recorded in the current or previous reporting period.

[2]The following risk weight bands had no retained or purchased securitisation exposures in the current or previous reporting period 7 – 10; 50 –99 and 350 – 1 250.

Approach to securitisation *(continued)*

Risk-weighted assets and capital deductions (IRB)

	Group			
	2012		2011	
IRB exposures – Retail	RWA Rm	Required capital Rm	RWA Rm	Required capital Rm
Instalment sales and leasing	11	1	29	3
Mortgages	941	90	1 467	139
Other	85	8	145	14
SME	—	—	75	7
	1 037	99	1 716	163

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Approach to equity investment risk

Equity investment risk refers to the risk of adverse changes in the value of listed and unlisted equity investments. These investments are longer-term investments held in the banking book for non-trading purposes.

Our equity investment risk objective is to balance the portfolio composition in line with our risk appetite, with selective exits as appropriate.

Our governance of equity investments is based on the following key fundamental principles:

- a formal approval governance process;
- key functional specialists reviewing investment proposals;
- adequate monitoring and control after the investment decision has been implemented; and
- ongoing implementation of best practice standards based on current market trends, hurdle rates and benchmarks.

Criteria considered for new investments and investment reviews cover a comprehensive set of financial, commercial, legal (and technical, where required) matters. The performance of these investments is monitored relative to the objectives of the portfolio.

The majority of our equity investments are held in CIBW and Business Markets. Equity and other investments held by our insurance entities are addressed in the insurance risk section of this report.

The CPF equities portfolio decreased during the current reporting period due to fair value revaluations and planned sell-downs in line with our equity investment strategy.

Relevant accounting policies

IAS 39 requires all equity investments to be fair valued. Accounting policies relating to subsidiaries and investments in associates and joint ventures are discussed separately in note 1.3 of the Group's financial statements.

The fair value of equity investments is determined using appropriate valuation methodologies which, depending on the nature of the investment, include discounted cash flow analyses, enterprise value comparisons with similar companies and price-earnings comparisons.

Listed and unlisted investments are either designated at fair value through profit or loss or as available-for-sale. Investments in entities that form part of our venture capital and similar activities have been designated at fair value through profit or loss. The designation has been made in accordance with IAS 39, based on the scope exclusion that is provided in IAS 28 Investments in Associates (IAS 28) and IAS 31 Interest in Joint Ventures. The relevant accounting policies for equity investments are discussed in note 1.7 of the Group's financial statements.

Risk measurement

Equity investment risk is monitored monthly in terms of regulatory and EC requirements and is complemented by a range of additional risk metrics and stress testing. The equity investment risk profile is further tracked across a range of dimensions such as geography, industry and currency. Risk monitoring is done in accordance with a risk appetite, mandate and scale limits framework.

We have adopted the market-based simple risk weight approach to calculate RWA and RC for equity risk in the banking book. According to this approach, RWA are calculated using weightings of 300% and 400% for listed and unlisted equity investments respectively. Amended Basel regulations effective January 2012 prescribe a scaling factor of 1,06. Consequently, RWA are calculated using weightings of 318% and 424% for listed and unlisted equity investments respectively. RC requirements in respect of investments in associates and joint ventures, defined as financial companies in the regulations relating to banks, are calculated with reference to either the pro rata consolidation methodology or the deduction approach.

EC for equity investment risk in the banking book is based on investment type and portfolio risk modelling and varies from 35,2% to 100%.

Approach to equity investment risk *(continued)*

Analysis of equity investment risk in the banking book (regulatory definition)

The equity portfolio falling within the ambit of Regulation 31 of the Regulations to the Banks, excludes third-party equity investments under management for which we do not bear the risk. These include selected associates treated under the pro rata consolidation methodology, and equity investments held by insurance entities (as these entities are regulated separately, and addressed in the insurance risk section of this report).

The size, composition, RWA component and EC requirement of our equity investments in the banking book are reflected in the following table after recognition of guarantees. At the reporting date, the statement of financial position value of such investments amounted to R5 478 million (December 2011: R5 747 million). Of the R5 478 million investment exposure at the reporting date, R5 428 million (December 2011: R5 384 million) is held for capital gains purposes and the remainder for strategic and other purposes.

The increase in the equity exposure from the previous reporting period is mainly due to positive revaluations and draw-downs on current investments.

Equity investments in the banking book

	Group	
	2012 Rm	2011 Rm
Statement of financial position	**5 478**	5 747
Exchange-traded investments, associates and joint ventures[1]	**272**	694
Privately held traded investments, associates and joint ventures[2]	**5 206**	5 053
Fair value of exchange-traded investments, associates and joint ventures[3]	**272**	694
Risk-weighted assets	**22 776**	22 168
Exchange-traded investments, associates and joint ventures[1]	**864**	2 083
Privately held traded investments, associates and joint ventures[2]	**21 912**	20 085
Economic capital	**2 820**	3 007
Exchange-traded investments, associates and joint ventures[1]	**211**	544
Privately held traded investments, associates and joint ventures[2]	**2 609**	2 463

Realised and unrealised gains for equity investments in the banking book as per the specific Pillar 3 disclosure requirements of the SARB are reflected in the following table:

Realised and unrealised gains on equity investments

	Group	
	2012 Rm	2011 Rm
Cumulative realised gains arising from sales and liquidations	**54**	64
Total unrealised gains recognised directly in the statement of comprehensive income	**(4)**	34

Notes

[1]Does not include significant minority financial investments deducted from net qualifying RC in the current and previous reporting periods.

[2]Includes significant minority financial investments deducted from net qualifying RC, amounting to R32 million (2011: R26 million).

[3]To address the specific Pillar 3 requirements of the SARB for equity risk in the banking book relating to the value of investments. It should be noted that the difference between the statement of financial position value and fair value of associates and joint ventures amounts to Rnil (2011: Rnil). There are no differences between the fair value and market value of exchange traded investments, associates and joint ventures.

Approach to equity investment risk *(continued)*

Analysis of equity investment risk in the banking book (regulatory definition) *(continued)*

To address the specific Pillar 3 disclosure requirements of the SARB relating to unrealised gains or losses for equity risk in the banking book, it should be noted that:

- we do not have any latent revaluation gains or losses, i.e. unrealised gains or losses that are not recognised in the statement of comprehensive income; and
- we do not have unrealised gains or losses that are recognised in primary or secondary capital and reserve funds without being recognised in the statement of comprehensive income. This is due to an IFRS principle that we have adopted, i.e. all unrealised gains or losses that are not recognised in the statement of comprehensive income cannot be recognised in primary or secondary capital and reserve funds.

Equity sensitivity analysis of investments, including investments of insurance activities

Note 12 of the Group's financial statements provides a breakdown of investment securities. In respect of listed and unlisted equity investments reported in this note, an analysis is provided of the estimated sensitivity impact on pre-tax profit and loss and equity for a reasonably possible 5% variance in equity market values based on the accounting treatment of these investments. Consistent with the previous reporting period, this analysis additionally includes equity investments held by insurance entities and excludes all associates and joint ventures.

With respect to insurance activities' investments:

- for the policyholder portfolio it is policy, where possible, to follow a matched investment strategy in terms of assets backing non-linked policyholder liabilities;
- the shareholders' investments are susceptible to market fluctuations. To manage the equity risk, equity hedge structures have been implemented in terms of which protection is obtained to ensure that the possibility of negative returns is reduced for the reporting period; and
- this analysis should be read in conjunction with the insurance risk section of this report, which addresses life insurance mismatch risk and life and short term insurance investment risk, including investment exposures other than equity investments.

Audited

Equity sensitivity analysis – impact on pre-tax profit and loss and equity after the effect of hedges

	Group									
	2012					2011				
	Impact of a 5% reduction in fair value			Impact of a 5% increase in fair value		Impact of a 5% reduction in fair value			Impact of a 5% increase in fair value	
	Profit and loss Rm	Equity Rm	Fair value Rm	Profit and loss Rm	Equity Rm	Profit and loss Rm	Equity Rm	Fair value Rm	Profit and loss Rm	Equity Rm
Insurance activities' listed and unlisted equity investments[1, 2]	(86)	—	1 724	86	—	(79)	—	758	79	—
Listed equity investments	(83)	—	1 667	83	—	(76)	—	705	76	—
Unlisted equity investments	(3)	—	57	3	—	(3)	—	53	3	—
Group listed and unlisted equity investments, excluding insurance activities' investments[1, 3]	(266)	(8)	5 487	266	8	(273)	(12)	5 712	273	12
Listed equity investments	(25)	(3)	562	25	3	(33)	(4)	743	33	4
Unlisted equity investments	(241)	(5)	4 925	241	5	(240)	(8)	4 969	240	8
Total Group equity investments[1]	(352)	(8)	7 211	352	8	(352)	(12)	6 470	352	12

Notes

[1]Excludes debt instruments.

[2]The above sensitivities were only calculated on shareholder non-linked and policyholder assets (for unit linked policyholder liabilities there is no impact on the sensitivity analysis due to the fact that the asset and liability is 100% matched) and exclude all assets linked to investment and unit linked contracts due to the fact that the asset and liability is 100% matched.

[3]The figures exclude all associates and joint ventures, which account for the differences in fair value compared to that shown in the table titled 'Equity investments in the banking book'.

Market risk

Market risk

Overview

31 December

Key points

- Trading exposures were carefully managed to ensure efficient use of trading capital.
- Continued focus on improvements to the risk management model based on the Basel IV 'fundamental review of the trading book' and Dodd-Frank regulation.
- Interest rate risk in the banking book continued to be managed to low levels.
- The structural hedge programme contributed positively to the interest margin for the current reporting period. The programme was effectively managed through the current reporting period, during which key South African interest rates reached historical lows.
- Cash flow hedging reserves increased as a result of favourable MTM movements.
- We remained exposed to prime-JIBAR basis risk arising from the difference between predominantly prime-linked assets being funded with liabilities that are primarily JIBAR-linked after hedging.

Key performance indicators

	Group	
	2012	2011
Average traded market risk DVaR (Rm)	**18,87**	23,73
Traded market risk RC (at 9,5% of RWA) (Rm)[1]	**1 308**	794
Banking book AEaR for a 2% interest rate shock (percentage of Group net interest income)	**<7%**	<5%

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Introduction

Market risk is the risk that our earnings or capital, or our ability to meet business objectives, will be adversely affected by changes in the level or volatility of market rates or prices such as interest rates, foreign exchange rates, equity prices, commodity prices and credit spreads. The main sources of risk are traded market risk and non-traded interest rate risk. Traded market risk arises in CIBW to support customer trading activity, whereas non-traded interest rate risk arises in the banking book to support customer products.

The Africa Market Risk Committee (AMRC) meets monthly to review, challenge and make recommendations concerning the market risk profile, including risk appetite, policies, limits, risk utilisation and the effectiveness of the control environment.

The Trading Risk Committee, ATC and ATC subcommittees provide oversight of specific market risk.

Strategy

Our market risk management objectives are:

- ensuring traded market risk resides solely in CIBW;
- facilitating business growth;
- minimising non-traded market risk; and
- ensuring a higher degree of net interest margin stability over an interest rate cycle in the banking book.

2012 in review

Trading exposures were carefully managed to ensure efficient use of trading capital with returns above RoRWA hurdles. All exposures were managed within appetite. Trading revenues were underpinned by a strong customer franchise and this was reflected in the number one overall ranking obtained in the 2012 Risk South Africa Rankings and the Spire Awards.

Note

[1]Comparatives for the previous reporting period have been restated at 9,5% to align with the RC disclosures included in the capital management section of this report.

2012 in review *(continued)*

The trading business continued to drive for zero threshold CSAs with institutional customers. Overnight indexed swap discounting was fully implemented and financially provided for during the reporting period. Furthermore, a dedicated team focused on the management of counterparty credit risk and employed the latest technology for this purpose. The business remained close to Dodd-Frank regulatory developments and will leverage the Barclays Bank PLC swaps dealer registration to deal with US persons (as defined by Dodd-Frank) going forward.

Trading systems and the risk and control framework in Africa (outside of South Africa) were expanded to support an extended product range that includes sovereign bonds and derivatives.

The cash equity business benefited from broker rankings, better risk management and volume improving at an accelerated pace. Prime Broking onboarded customers across equity, fixed income and foreign exchange with a strong pipeline in place. The principal model for securities lending allowed greater flexibility in loan management and maximisation of pricing opportunities.

We continued to manage our structural and non-structural banking book interest rate risk to low risk levels during the reporting period.

The structural interest rate hedge programme remained in place during the reporting period and contributed positively to the interest margin to mitigate the negative endowment impact on equity and structural deposits in the low interest rate environment. The structural hedge programme was efficiently maintained over the reporting period during which key South African interest rates reached historically low levels.

Cash flow hedging reserves remained strong during the reporting period and will be released to the statement of comprehensive income on an accrual basis over the life of the programme should market rates remain at current levels.

We remained exposed to prime-JIBAR basis risk arising from the difference between predominantly prime-linked assets being funded with liabilities that are primarily JIBAR-linked after hedging. Prepayment and recruitment risk that may arise from fixed rate product offerings to customers continued to be managed on customer behaviour risk principles.

Priorities for 2013

Our key objective is to respond to regulatory and capital change while continuing to make efficient use of RWA. We will continue to challenge and improve our risk management model based on business and regulatory trends.

With South African interest rates expected to remain low for 2013, we will remain focused on the risk of margin compression and the efficient maintenance of our structural hedge programme.

Traded market risk

31 December

Audited

Approach

Traded market risk results primarily from the facilitation of customer trades in the wholesale market including market making, the provision of hedge solutions, pre-hedging and providing assistance to customers with the execution of large trades. Not all customer trades are hedged immediately or completely, giving rise to traded market risk. Our policy is to concentrate our traded market risk exposure within CIBW.

Market risk is prevalent in both the trading book and the banking book, as defined for regulatory purposes. Interest rate risk in the banking book is subjected to the same rigorous measurement and control standards as the trading book, but the associated sensitivities are reported as part of the interest rate risk in the banking book section.

Risk appetite

The risk appetite for market risk is based on:

- proposed business strategy and growth;
- targeted growth in risk;
- budgeted revenue growth;
- historical risk usage;
- statistical modelling measures; and
- risk equated to capital projection under stress.

Risk measurement

A number of techniques are used to measure and control traded market risk daily. These techniques include:

- Value at risk (VaR) based measures (incorporating tail risk metrics) including both VaR and stressed value at risk (sVaR);
- tail metrics;
- position and sensitivity reporting of non-value at risk (Non-VaR);
- stress testing; and
- standardised specific risk.

Daily value at risk

DVaR is an estimate of the potential loss that may arise from unfavourable market movements if current positions were to be held unchanged for one business day.

We use an internal DVaR model based on the historical simulation method to derive the quantitative market risk measures under normal conditions. The DVaR model utilises a two-year data history of unweighted historical price and rate data and a holding period of one day with a confidence interval of 95%.

The historical simulation methodology can be split into three parts:

- Calculate hypothetical daily profit or loss for each position over the most recent two years, using observed daily market moves.
- Sum all hypothetical profits or losses for day one across all positions, giving one total profit or loss. Repeat for all other days in the two-year history.
- DVaR is the 95th percentile loss selected from the resultant two-year historically simulated strip of daily hypothetical net profit or loss. Daily losses in excess of the DVaR figure are likely to occur, on average, up to 26 times over the observation period.

This internal model is also used for measuring VaR over both a one-day and a 10-day holding period at a 99% confidence level for regulatory backtesting and RC calculation purposes respectively. The VaR internal model has been approved by the SARB to calculate RC for all trading book portfolios. The approval covers general position risk across all interest rate, foreign exchange, commodity, equity and traded credit products. Issuer-specific risk is currently reported in accordance with the regulatory standardised approach. Additionally, any new products, which are awaiting regulatory approval, are capitalised by using the regulatory standardised approach.

DVaR is an important market risk measurement and control tool. Consequently, the performance of the model is regularly assessed for continued suitability. The main technique employed is backtesting, which counts the number of days when daily trading losses exceed the corresponding VaR estimate. The regulatory standard for backtesting is to measure daily losses against VaR assuming a one-day holding period and a 99% level of confidence. Backtesting reports are monitored daily. For our trading book, there were no breaches during the current reporting period.

Audited

Approach *(continued)*

Risk measurement *(continued)*

Daily value at risk *(continued)*

VaR estimates have a number of limitations:

- historical simulation assumes that the past is a good representation of the future, which may not always be the case;
- the assumed time horizon does not fully capture the market risk of positions that cannot be closed out or hedged within this time horizon;
- VaR does not indicate the potential loss beyond the selected percentile;
- VaR is based on positions at the close of business. Consequently intra-day risk (the risk from a position bought and sold on the same day) is not captured; and
- prudent valuation practices are used in the VaR calculation when there is difficulty in obtaining rate/price information.

Tail risk metrics, stress testing and other sensitivity measures are used to complement VaR.

Backtesting

We conduct backtesting of the VaR risk measurement model against:

- the theoretical profit and loss representing the change in the value of the portfolio as computed by the risk system under the assumption that the portfolio holdings remained constant for the holding period; and
- the actual profit and loss representing the actual daily trading outcome.

Tail metrics

Tail risk metrics highlight the risk beyond the percentile selected for DVaR. The two tail risk metrics chosen for daily monitoring, using the current portfolio and two years of price and rate history, are:

- the average of the worst three hypothetical losses from the historical simulation; and
- expected shortfall (also referred to as expected tail loss), which is the average of all hypothetical losses from the historical simulation beyond the 95th percentile used for DVaR.

Non-value at risk

Non-VaR reporting covers non-statistical measures of measuring and monitoring risk sensitivities and exposures as well as gross or notional limits where appropriate. All asset classes and product types have Non-VaR reporting and limit monitoring, as required. These limits are aligned to DVaR limits, but do not bear a direct linear relationship.

Stressed value at risk

We implemented our new regulatory sVaR model to comply with Basel II.5 revisions to the traded market risk capital as per the amended Basel regulations, which became effective on 1 January 2012.

sVaR is an estimate of the potential loss arising from a 12-month period of significant financial stress. Our sVaR model and period selection methodology was approved by the SARB. The SARB has also assigned an sVaR model multiplier to be used for calculations. sVaR uses DVaR methodology based on inputs calibrated to historical data from a continuous 12-month period to replicate a period of significant stress. A regular process is applied to assess the stress period in terms of the approved methodology, which means that the stress period is subject to change.

The sVaR RC requirement is calculated daily and is disclosed for the period under review. sVaR was reported internally for management purposes throughout the previous reporting period and comparative disclosure has been included in the current reporting period.

Audited

Approach *(continued)*

Risk measurement *(continued)*

Stress testing

Stress testing provides an indication of the potential size of losses that could occur in extreme conditions. Stress testing assists in identifying risk concentrations across business lines and assists senior management in making capital planning decisions. We perform two main types of stress/scenario testing. Firstly, risk factor stress testing is carried out, where extended historical stress moves are applied to each of the main risk categories including interest rate, equity, foreign exchange, commodity and credit spread risk. Secondly, the trading book is subjected to multi-factor scenarios that simulate past periods of significant market disturbance and hypothetical extreme yet plausible events. Scenarios are reviewed at least annually.

Stress testing results are monitored against approved limits and triggers. A full revaluation approach is applied to undertake stress testing.

Standardised specific risk

Idiosyncratic risks are capitalised through the Basel/regulatory framework using standardised rules.

Risk control

Risk limits are set and reviewed at least annually to control our trading activities, in line with the defined risk appetite of the Group. The criteria for setting risk limits include relevant market analysis, market liquidity and business strategy.

This limit structure comprises the following types of market risk limits:

- VaR limits (VaR and sVaR);
- position and sensitivity (Non-VaR) limits;
- stress testing limits; and
- management action triggers: reporting of actual losses based on pre-determined tolerance levels.

Valuation control, independent price testing and bid-offer testing are conducted by our product control group and the results are reviewed monthly by the Valuation Governance and Control Committee of CIBW.

The Model Validation function is responsible for validating all valuation models used for accounting and risk. The validation reviews the theoretical approach and its applicability to the product. Focus is on ensuring the implementation of the model is correct, identifying the primary risks, model limitations or uncertainties and recommending provisions to account for such uncertainties.

Risk reporting

Our market risk team produces a number of detailed and summary market risk reports daily and monthly. These reports summarise the positions, risks and top stresses covering interest rate, foreign exchange, equity, commodity and credit spread risks. A risk summary is also presented at the AMRC and other governance committees as required.

Analysis of risk exposure

The following table reflects the DVaR and expected shortfall statistics for our trading book activities as measured by the internal models approach (IMA) for general trading position risk. Our traded market risk exposure, as measured by average total DVaR, decreased to R18,87 million for the current reporting period, which is down 3% compared to the six months ended 30 June 2012 (R19,44 million) and down 20% compared to the previous reporting period (R23,73 million). This was principally due to a decrease in average foreign exchange and commodity exposure combined with lower procyclical volatility. The business model of CIBW is orientated around customer flow and the risk profile is maintained so that it is aligned with the near-term demands of our customers. The model showed resilience in tough trading conditions. Trading revenues showed strong growth and a favourable risk-adjusted return was sustained for the current reporting period.

Audited

Our trading book DVaR summary

	Group							
	2012				2011			
	Average Rm	High[1] Rm	Low[1] Rm	At the reporting date Rm	Average Rm	High[1] Rm	Low[1] Rm	At the reporting date Rm
Interest rate risk[2]	16,99	30,71	8,84	11,87	19,09	36,69	10,67	14,12
Foreign exchange risk	7,30	21,34	2,13	8,23	8,13	25,68	1,89	5,07
Equity risk	5,12	16,72	1,13	1,88	4,76	10,83	2,38	5,18
Commodity risk[2]	0,85	2,92	0,17	1,29	1,87	6,55	0,32	1,30
Inflation risk[2]	7,06	17,95	2,63	8,80	n/a	n/a	n/a	n/a
Credit spread risk	4,05	5,76	1,95	3,69	n/a	n/a	n/a	n/a
Diversification effect	(22,50)	n/a	n/a	(18,21)	(10,12)	n/a	n/a	(7,35)
Total DVaR[3]	18,87	34,38	12,66	17,55	23,73	44,77	15,22	18.32
Expected shortfall	27,46	49,65	17,58	23,84	34,88	60,12	21,57	26,73
Regulatory VaR[3]	32,38	53,67	20,11	31,91	39,64	74,98	24,52	29,30
Regulatory sVaR[4]	44,42	93,58	27,19	40,88	56,21	116,80	25,15	46,90

The following graph shows the daily history of our total trading book DVaR for the previous and current reporting periods, along with the period averages and highs and lows. In comparison with the previous reporting period and continuing the trend, the DVaR for the current reporting period has demonstrated reduced variability, lower average risk levels and a reduction in large DVaR days. We do, on some occasions in the conduct of customer transactions, take on significantly larger than usual market risk. However, this is always undertaken within our market risk governance framework.

Notes

[1]The high and low DVaR figures reported for each category did not necessarily occur on the same day as the high (and low) total DVaR. Consequently, a diversification effect number for the high (and low) DVaR figures would not be meaningful and is therefore omitted.

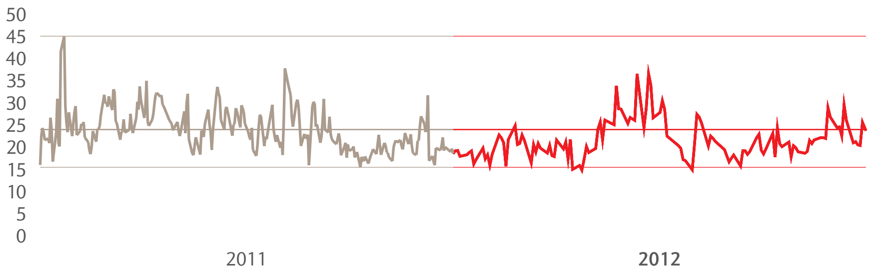
[2]Up to the latter part of the previous reporting period, inflation and credit spread risk were reported together with interest rate risk.

[3]Regulatory VaR is reported with a one-day holding period at a 99% confidence level. Consequently, these figures are not directly comparable to the 95% risk metrics reported in the rest of the table.

[4]sVaR is reported with a one-day holding period at a 99% confidence level. The sVaR for the previous reporting period is an indicative internally-reported comparative. The high and low sVaR figures reported for each category did not necessarily occur on the same day as the higher and lower total sVaR. The sVaR period as required from 1 January 2012 is 1 April 2008 to 31 March 2009. This period is subject to ongoing review for appropriateness.

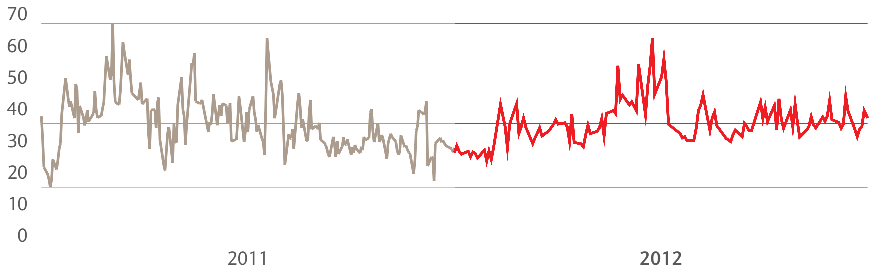
Analysis of risk exposure *(continued)*

Our trading book management daily value at risk (daily values, period average, high and low) (Rm)



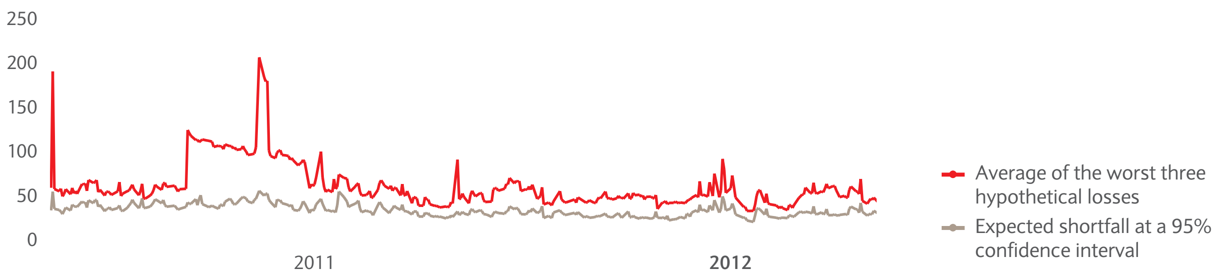
The following graph shows the daily history of the total trading book sVaR for the previous and current reporting periods.

Our trading book management stressed value at risk (daily values, period average, high and low) (Rm)



The following graph shows the daily history of our total trading book tail metrics for the previous and current reporting periods.

Our trading book tail metrics (daily values, period average, high and low) (Rm)

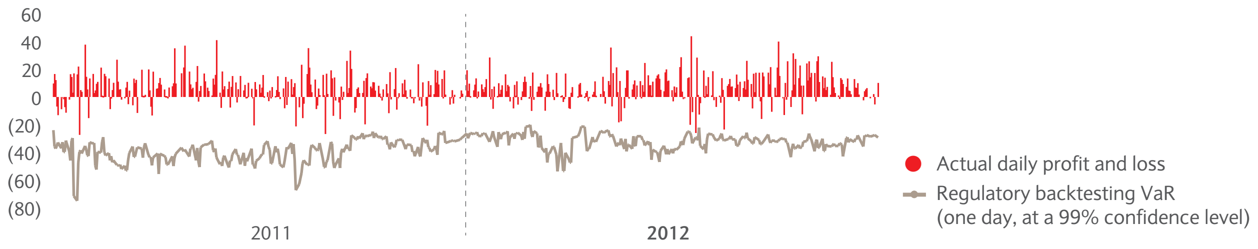


Comparison of value at risk estimates with trading revenues

The following graph compares the total VaR estimates over a one-day holding period at a 99% confidence level with the daily revenues generated by the trading units from the previous and current reporting periods. Revenue as reported here relates to actual trading book revenue only, excluding fees, commissions, bid-ask spreads and net interest income, as required for regulatory backtesting purposes.

Over the 12-months to the reporting date, there were no instances in which an actual daily trading loss exceeded the corresponding VaR estimate, which is the same as in the previous reporting period.

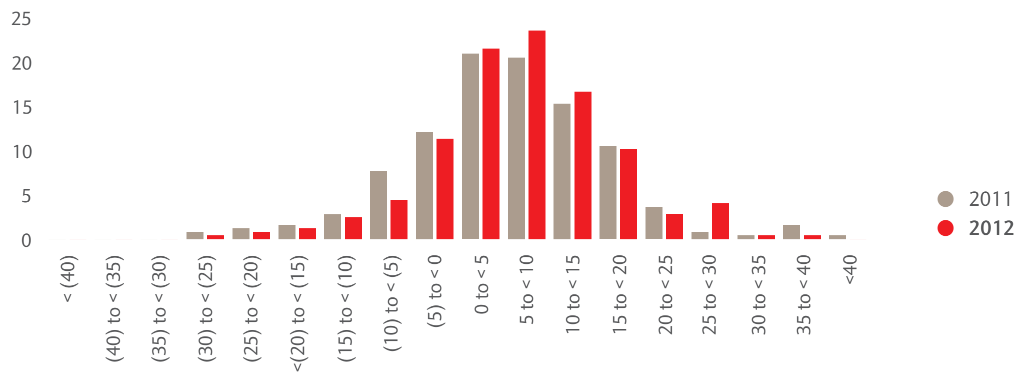
Our daily trading book revenue backtested against regulatory value at risk (Rm)



Analysis of trading revenue

The following histogram depicts the distribution of daily trading revenue for our trading book for the previous and current reporting periods. Revenue includes net trading book income, excluding net fees and commissions. The distributions are skewed to the profit side. The average daily trading revenue for the current reporting period increased compared to that of the previous reporting period. The percentage of positive revenue days increased to 80% in the current reporting period from 74% in the previous reporting period, indicating higher profit days and higher average profit compared to the previous reporting period.

Our daily trading book revenue (Rm) achieved per percentage of business days



Minimum regulatory capital requirement

Our traded market risk minimum RC requirement comprises two elements:

- Trading book positions where the market risk is measured under an internal VaR model approved by the SARB. The capital requirement is calculated based on the internal model with a 10-day holding period at a 99% confidence level and other regulatory 60-day averaging and capital multiplier specifications. This approach currently applies to close to 100% of our general position risk across interest rate, foreign exchange, commodity, equity and traded credit products.
- Trading book positions that have not yet met the SARB or our internal conditions for inclusion within the approved internal model. The capital requirement is calculated using standardised regulatory rules. This approach currently applies to our issuer-specific risk exposures.

The total traded market risk minimum capital requirement increased by 65% or R514 million from the previous reporting date. This increase is mainly due to the introduction of an additional minimum capital requirement based on sVaR from 1 January 2012 under the amended Basel regulations.

Minimum regulatory capital requirement (at 9,5% of RWA) for traded market risk

	Group	
	2012 Rm	2011 Rm
IMA	**956**	430
VaR	**404**	430
sVaR[1]	**552**	n/a
Standardised approach	**352**	364
Interest rate risk	**248**	268
Equity risk	**104**	96
Total traded market risk capital requirement[2]	**1 308**	794

Notes

[1] sVaR for the previous reporting period was restated with the indicative internally-reported comparative of R600 million.

[2] Comparatives for the previous reporting period have been restated at 9,5% in alignment with the RC disclosures included in the capital management section of this report.

Audited

Interest rate risk in the banking book

Approach

Interest rate risk is the risk that our financial position may be adversely affected by changes in interest rate levels, yield curves and spreads. Non-traded interest rate risk arises in the banking book from the provision of retail and wholesale (non-traded) banking products and services, as well as from certain structural exposures in the statement of financial position, mainly due to repricing timing differences between assets, liabilities and equity. These risks impact our earnings and economic value.

Our objective for managing interest rate risk in the banking book is to ensure a higher degree of net interest margin stability over an interest rate cycle. This is achieved by transferring the interest rate risk from the business to the local treasury or Group Treasury, which in turn hedges material net exposures with the external market. As a result of mainly timing considerations, interest rate risk may arise when some of the net position remains with Group Treasury. A limits framework is in place to ensure that retained risk remains within the approved risk appetite.

Risk management strategies considered include:

- strategies regarding changes in the volume, composition, pricing and interest rate risk characteristics of assets and liabilities; and
- the execution of applicable derivative contracts to maintain our interest rate risk exposure within limits.

Where possible, hedge accounting is applied to derivatives that are used to hedge interest rate risk in the banking book. In cases where hedge relationships do not qualify for hedge accounting, mismatches may arise due to different bases used in fair valuing the hedges and the underlying banking book exposure. Applicable accounting rules, as detailed in our accounting policies, are followed.

Structural interest rate risk arises from the variability of income from non-interest bearing products, managed variable rate products and the Group's equity, and is managed by Group Treasury.

Interest rate risk also arises in each of the African subsidiaries' treasuries in the normal course of managing the statement of financial position and facilitating customer activity. The risk is managed by the local treasury functions, subject to modest risk limits and other controls.

Embedded customer optionality risk may also give rise to interest rate risk in the banking book. This risk arises from a customer's right to buy, sell or in some manner alter the cash flow of a financial contract. Embedded customer optionality is distinct from direct optionality, which arises through the underlying product structure (e.g. capped rate loan products). Our policy requires such direct option risk to be hedged explicitly.

Embedded customer optionality risk was not material during the current reporting period.

Prepayment risk arises in relation to transactions where an early settlement option is embedded in the product. This risk most commonly arises in relation to fixed rate loans offered to retail customers, where the customer has an option to repay the loan prior to contractual maturity and where we are unable to collect full market-related compensation. The risk is controlled through book and term limits, funding (hedging) new loans according to the expected behavioural repayment profile and tracking deviations of actual customer behaviour from the expected profile. The risk is monitored monthly.

Recruitment risk arises when we commit to providing a product at a predetermined price for a period into the future. Customers have the option to take up this offer. Controls include campaign rules, pre-funding of anticipated take-up and the management of the resultant residual risk.

Audited

Interest rate risk in the banking book *(continued)*

Approach *(continued)*

Risk measurement

The techniques used to measure and control interest rate risk in the banking book include repricing profiles, AEaR, DVaR, tail metrics, economic value of equity sensitivity (EVE) and stress testing.

Repricing profiles

With the repricing profile, instruments are allocated to time periods with reference to the earlier of the next contractual interest rate repricing date and the maturity date. Instruments that have no explicit contractual repricing or maturity dates are placed in time buckets based on the most likely repricing behaviour. Currently, the contractual profiles of assets are not adjusted for customer prepayment features.

Annual earnings at risk

AEaR measures the sensitivity of net interest income over the next 12 months to a specified shock in interest rates. AEaR is assessed across a range of interest rate scenarios, including parallel and key rate shocks and yield curve twists and inversions as appropriate for each business. The AEaR calculation takes the assumed behavioural profile of relevant structural product balances into account. Currently, the contractual profiles of assets are not adjusted for customer prepayment features.

Daily value at risk

We use a sensitivity-based approach to calculate DVaR at a 95% confidence level for measuring interest rate risk in the banking book. The DVaR is monitored against approved internal limits, and is used as a complementary tool to AEaR. DVaR is also supplemented by tail metrics.

Economic value of equity

EVE sensitivity analysis measures the sensitivity of the present value of the banking book at a specific point in time to a specified shock to the yield curve. Like DVaR, EVE is a present value sensitivity, and is complementary to income sensitivity measures such as AEaR.

Stress testing

Stress testing is carried out by Group Treasury and the risk functions in the African subsidiaries to supplement DVaR and AEaR metrics. Stress testing is tailored to each banking book and consists of a combination of stress scenarios and historical stress movements applied to the respective banking books.

Risk control

Market risk is controlled through the use of DVaR and AEaR limits and supported by monthly monitoring of the risk profiles, EVE sensitivity analysis and stress results. Limits are set at the business level and then cascaded down. The business level limits for DVaR and AEaR are agreed at the AMRC. Compliance with limits is monitored by the respective business market risk team with oversight provided by Group Market Risk.

Risk reporting

DVaR in respect of Group Treasury is reported daily while the DVaR of the African subsidiaries' treasuries is reported monthly. The repricing profiles, AEaR, EVE sensitivity analysis and stress results are reported monthly for both Group Treasury and the African subsidiaries.

Interest rate sensitivity analyses

Three separate interest rate sensitivity analyses for our banking book are set out in the tables that follow, namely, the repricing profile of the book and the potential effect of changes in market interest rates on annual earnings and equity reserves.

Repricing profile

The repricing profile of our domestic, African subsidiaries and consolidated banking books indicates that the consolidated banking book remains asset sensitive, or positively gapped, as interest-earning assets reprice sooner than interest-paying liabilities before and after derivative hedging activities. Accordingly, future net interest income remains vulnerable to a decrease in market interest rates. However, asset sensitivity, as represented by the cumulative 12-month interest rate gap, increased from the previous to the current reporting period.

Audited

Interest rate risk in the banking book *(continued)*

Interest rate sensitivity analyses *(continued)*

Repricing profile *(continued)*

Expected repricing profile

	Group			
	2012			
	On demand – 3 months Rm	4 – 6 months Rm	7 – 12 months Rm	Over 12 months Rm
Domestic bank book[1]				
Interest rate sensitivity gap	126 839	(18 329)	(30 019)	(37 694)
Derivatives[2]	(93 476)	10 633	17 189	65 654
Net interest rate sensitivity gap	33 363	(7 696)	(12 830)	27 960
Cumulative interest rate gap	33 363	25 667	12 837	40 797
Cumulative gap as a percentage of the Bank's total assets (%)	4,4	3,4	1,7	5,3
Foreign subsidiaries' bank books[3]				
Interest rate sensitivity gap	2 281	1 829	110	496
Derivatives[2]	98	1	13	(85)
Net interest rate sensitivity gap	2 379	1 830	123	411
Cumulative interest rate gap	2 379	4 209	4 332	4 743
Cumulative gap as a percentage of foreign subsidiaries' total assets (%)	18,5	32,7	33,6	36,8
Total				
Cumulative interest rate gap	35 742	29 876	17 169	45 540
Cumulative gap as a percentage of the Group's total assets (%)	4,4	3,7	2,1	5,6
	2011			
	On demand – 3 months Rm	4 – 6 months Rm	7 – 12 months Rm	Over 12 months Rm
Domestic bank book[1]				
Interest rate sensitivity gap	120 325	(25 540)	(27 532)	(31 985)
Derivatives[2]	(82 439)	11 087	16 484	54 868
Net interest rate sensitivity gap	37 886	(14 453)	(11 048)	22 883
Cumulative interest rate gap	37 886	23 433	12 385	35 268
Cumulative gap as a percentage of the Bank's total assets (%)	5,1	3,2	1,7	4,8
Foreign subsidiaries' bank books[3]				
Interest rate sensitivity gap	1 974	1 843	(236)	472
Derivatives[2]	111	11	9	(122)
Net interest rate sensitivity gap	2 085	1 854	(227)	350
Cumulative interest rate gap	2 085	3 939	3 712	4 062
Cumulative gap as a percentage of foreign subsidiaries' total assets (%)	17,5	33,1	31,2	34,1
Total				
Cumulative interest rate gap	39 971	27 372	16 097	39 330
Cumulative gap as a percentage of the Group's total assets (%)	5,1	3,5	2,0	5,0

Notes

[1]Includes exposures held in the banking book of CIBW.

[2]Derivatives for interest rate risk management purposes (net nominal value).

[3]Includes NBC and BBM.

Interest rate risk in the banking book *(continued)*

Interest rate sensitivity analyses *(continued)*

Impact on earnings

The following table shows the AEaR from impacts to net interest income for 100 and 200 bps up and down movements in market interest rates for our banking books. Assuming no management action is taken in response to market interest rate movements, a hypothetical, immediate and sustained parallel decrease of 200 bps in all market interest rates would, at the reporting date, result in a pre-tax reduction in projected 12-month net interest income of R1,64 billion (2011: R475 million). A similar increase would result in an increase in projected 12-month net interest income of R1,65 billion. AEaR increased to 6,8% of our net interest income, mainly due to the decrease in the hedging offset in the total banking book. A sensitivity analysis by major currency market interest rates indicates that earnings sensitivity to South African rand (ZAR) market interest rates constitutes 96% of the total earnings at risk at the reporting date (2011: 86%), therefore indicating that we remain primarily exposed to South African market interest rates.

Audited

Annual earnings at risk for 100 and 200 bps changes in market interest rates

	Group			
	Change in market interest rates			
	200 bps decrease	100 bps decrease	100 bps increase	200 bps increase
As at the current reporting date				
Domestic bank book[1] (Rm)	**(1 568)**	**(769)**	**776**	**1 574**
Foreign subsidiaries' bank books[2] (Rm)	**(71)**	**(36)**	**36**	**71**
Total (Rm)	**(1 639)**	**(805)**	**812**	**1 645**
Percentage of the Group's net interest income (%)	**(6,8)**	**(3,3)**	**3,4**	**6,8**
Percentage of the Group's equity (%)	**(2,3)**	**(1,1)**	**1,1**	**2,3**
As at the previous reporting date				
Domestic bank book[1] (Rm)	(411)	(208)	191	400
Foreign subsidiaries' bank books[2] (Rm)	(64)	(32)	32	64
Total (Rm)	(475)	(240)	223	464
Percentage of the Group's net interest income (%)	(1,9)	(1,0)	0,9	1,9
Percentage of the Group's equity (%)	(0,7)	(0,4)	0,3	0,7

Impact on equity reserves

Market interest rate changes may affect equity (capital) in the following three ways:

- higher or lower profit after tax resulting from higher or lower net interest income;
- higher or lower available-for-sale reserves reflecting higher or lower fair values of available-for-sale financial instruments; and
- higher or lower values of derivatives held in the cash flow hedging reserve.

The pre-tax effect of net interest income sensitivity is reported in the preceding sensitivity analysis. The effect of taxation can be estimated using the tax rate for the current reporting period. The equity reserve sensitivities that follow are illustrative, based on simplified scenarios, and consider the impact on the cash flow hedges and available-for-sale portfolios that MTM through reserves. The impact on equity is calculated by revaluing the fixed rate available-for-sale financial assets, including the effect of any associated hedges and derivatives designated as cash flow hedges, for an assumed change in market interest rates. The increase in sensitivity of reserves is due to the increased duration as a result of the low interest rate environment.

Notes

[1]Includes the Bank's domestic banking book, which includes exposures held in the banking book of CIBW.

[2]Includes NBC and BBM. African subsidiaries' interest rate sensitivities are shown on a 100% (rather than actual) shareholding basis.

Audited

Interest rate risk in the banking book *(continued)*

Interest rate sensitivity analyses *(continued)*

Impact on equity reserves (continued)

Sensitivity of reserves to market interest rate movements

	Group					
	2012			2011		
	As at the reporting date Impact on equity Rm	Maximum impact[1] Rm	Minimum impact[1] Rm	As at the reporting date Impact on equity Rm	Maximum impact[1] Rm	Minimum impact[1] Rm
+ 100 bps parallel move in all yield curves						
Available-for-sale reserve	(1 099)	(1 119)	(955)	(1 005)	(1 012)	(793)
Cash flow hedging reserve	(1 746)	(1 799)	(1 671)	(1 664)	(1 758)	(1 652)
	(2 845)	(2 892)	(2 663)	(2 669)	(2 705)	(2 464)
As a percentage of Group equity (%)	(3,9)	(4,0)	(3,7)	(3,9)	(4,0)	(3,6)
– 100 bps parallel move in all yield curves						
Available-for-sale reserve	1 099	1 119	955	1 005	1 012	793
Cash flow hedging reserve	1 746	1 799	1 671	1 664	1 758	1 652
	2 845	2 892	2 663	2 669	2 705	2 464
As a percentage of Group equity (%)	3,9	4,0	3,7	3,9	4,0	3,6

Note

[1]The maximum and minimum impacts reported for each reserve category did not necessarily occur for the same month as the maximum and minimum impact is reported for the total.

Interest rate risk in the banking book *(continued)*

Interest rate sensitivity analyses *(continued)*

Interest return on average balances

Average balances and weighted average effective interest rates were as follows:

Group average statement of financial position

	Group					
	2012			2011[2]		
	Average balance[1] Rm	Average rate[2] %	Interest income/ (expense)[3] Rm	Average balance[1] Rm	Average rate[2] %	Interest income/ (expense)[3] Rm
Assets						
Cash, cash balances and balances with central banks	2 656	6,25	166	3 156	5,04	159
Statutory liquid asset portfolio	58 284	7,27	4 235	51 839	7,52	3 899
Loans and advances to banks and customers	553 178	7,93	43 850	529 446	8,44	44 709
Investment securities	8 540	2,37	202	10 468	3,73	390
Other[4]	—	—	2 313	—	—	1 549
Interest-bearing assets	622 658	8,15	50 766	594 909	8,60	51 191
Non-interest-bearing assets	183 735	—	—	142 652	—	—
Total assets	806 393	6,30	50 766	737 561	6,94	51 191
Liabilities						
Deposits from banks and due to customers	449 045	(4,14)	(18 576)	402 620	(4,23)	(17 048)
Debt securities in issue	112 443	(7,19)	(8 083)	146 216	(6,47)	(9 456)
Borrowed funds	14 117	(9,18)	(1 308)	13 839	(9,47)	(1 311)
Other[4]	—	—	1 312	—	—	1 053
Interest-bearing liabilities	575 744	(4,63)	(26 655)	562 675	(4,76)	(26 762)
Non-interest-bearing liabilities	161 054	—	—	111 086	—	—
Total liabilities	736 798	(3,62)	(26 655)	673 761	(3,97)	(26 762)
Total equity	69 595	—	—	63 800	—	—
Total equity and liabilities	806 393	(3,31)	(26 655)	737 561	(3,63)	(26 762)
Net interest margin on average interest-bearing assets		3,87			4,11	

Notes
[1]The average prime rate for the current reporting period was 8,77% (2011: 9,00%).
[2]Calculated based on daily weighted average balances.
[3]Comparatives have been reclassified, refer to note 1.27 of the Group's financial statements.
[4]Also includes fair value adjustments on hedging instruments and hedging items.

Non-traded market risk

31 December

Audited

Foreign exchange risk

Approach

We are exposed to two sources of foreign exchange risk, namely, transactional and translational risk.

Transactional foreign exchange risk

Transactional foreign exchange risk arises when the banking assets and liabilities are not denominated in the functional currency of the transacting entity. Our policy is for transactional foreign exchange risk to be concentrated and managed within the trading book.

Some transactional foreign exchange risk also arises in the African subsidiaries' treasuries in the course of foreign currency balance sheet management and facilitation of customer activity. This risk is minimised through modest transactional open position and DVaR limits, as approved by the MRC. Foreign exchange risk is monitored daily against these limits. Average foreign exchange DVaR for the current reporting period amounted to R0,3 million (2011: R0,3 million) on an undiversified basis across these treasuries.

In accordance with our policy, there were no significant net open currency positions outside the CIBW trading book at the reporting date that would give rise to material foreign exchange gains and losses being recognised in the statement of comprehensive income or in equity as a result of a foreign exchange rate shock.

Our investments in foreign currency subsidiaries and branches create capital resources denominated in foreign currencies. Changes in the ZAR value of the investments resulting from foreign currency movements are captured in the currency translation reserve. This reserve is currently excluded from qualifying capital under the SARB's rules.

Foreign currency translation sensitivity analysis

The following table depicts the carrying value of foreign currency net investments and the pre-tax impact on equity of a 5% change in the exchange rate between the ZAR and the relevant functional foreign currencies.

Functional foreign currency

	Botswana pula Rm	Mozambican metical Rm	Sterling Rm	Tanzanian shilling Rm	Zambian kwacha Rm	Total Rm
As at the current reporting date						
Foreign currency net investments	**32**	**928**	**2 150**	**321**	**12**	**3 443**
Impact on equity from a 5% currency translation shock	**2**	**46**	**108**	**16**	**1**	**173**
As at the previous reporting date						
Foreign currency net investments	5	556	1 902	432	—	2 895
Impact on equity from a 5% currency translation shock	—	28	95	22	—	145

The impact of a change in the exchange rate between the ZAR and any relevant currencies would be:

- A higher or lower ZAR equivalent value of non-ZAR denominated capital resources and RWA. This includes a higher or lower currency translation reserve within equity, representing the translation of non-ZAR subsidiaries, branches and associates, the impact of foreign exchange rate changes on derivatives and borrowings designated as hedges of net investments.
- A higher or lower profit after tax, arising from changes in the exchange rates used to translate items in the statement of comprehensive income.
- A higher or lower value of available-for-sale investments denominated in foreign currencies, impacting the available for-sale reserve.

Other market risks

We maintain different pension plans with defined benefit and defined contribution structures for current and former employees. In respect of defined benefit plans, the ability to meet the projected pension payments is maintained through investments and regular contributions. Market risk arises when the estimated market value of the pension plan assets decline, their investment returns reduce, or when the estimated value of the pension liabilities increase, resulting in a funding deficit. In these circumstances, we could be required or might choose to make additional contributions to the defined benefit plan.

Asset management risk arises where the fee and commission income earned by asset management products and businesses is affected by a change in market levels, primarily through the link between income and the value of assets under management. The risk is measured in terms of AEaR to reflect the sensitivity of annual earnings to shocks in market rates. Group policy dictates that businesses monitor, report and regularly assess potential hedging strategies relating to this risk. Exposure to this risk currently arises mainly in Financial Services. Asset management risk was not material during the current reporting period.

Insurance risk

31 December

Key points

- A new life insurance entity, Barclays Life Zambia, commenced writing business in August 2012.
- A hedging programme, aimed at improving asset-liability matching, has been implemented for Absa Life Limited's maturity guarantees from 1 July 2012.
- All insurance risk types remained well within the set insurance appetite.
- A review of the retained capital and policyholder asset mandates was conducted during the current reporting period and asset allocation amendments were implemented.
- Absa's South African insurance entities continued with preparations to adopt the SAM legislation requirements, once promulgated.
- Short-term insurance loss ratios only increased marginally notwithstanding a very challenging reporting period, which experienced increased claim frequencies across all business lines.

Key performance indicators

	Group	
	2012 %	2011 %
Short-term loss ratio	**69,9**	67,4
Life new business margin	**9,3**	7,4

Audited

Introduction

Insurance risk is the risk that future experience relating to claims, expenses, policyholder behaviour and investment returns differs from the assumptions made when setting premiums or valuing policyholder liabilities. We recognise four categories of insurance risk, namely short-term insurance underwriting risk, life insurance underwriting risk, life insurance mismatch risk and life and short-term insurance investment risk. These are managed within the different entities in the Group.

Within Financial Services the different risk types are managed through specific committees, as set out below:

- Short-term insurance underwriting risk is managed through underwriting authority mandates and through referral to an Underwriting Review Committee, as and when required. Risk governance is monitored by CRCs, the Actuarial Review Committee and key risk reporting.
- Life insurance underwriting risk is monitored on a monthly basis by an Underwriting Risk Forum, to ensure the risk taken is in line with the risk priced and reserved for. Risk governance is monitored by the CRCs, the Actuarial Review Committee and the reporting of key risks.
- Life insurance mismatch risk is monitored on a monthly basis by the Investment Committee. A quarterly review is conducted by the AFS Capital and Investment Risk Committee and an annual review by the Actuarial Review Committee.
- Life and short-term insurance investment risk is monitored by entity investment risk committees on a monthly basis.

Strategy

Our insurance risk management objectives are:

- pursuing profitable growth opportunities;
- balancing exposure between life and short-term insurance to allow for better diversification; and
- growing risk exposures outside South Africa.

2012 in review

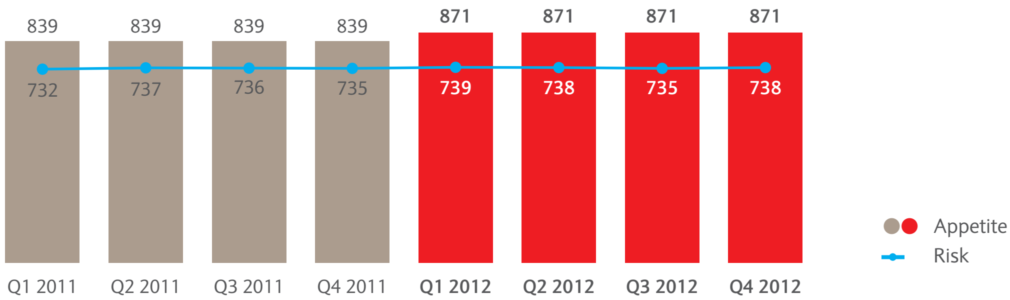
All insurance risk types remained well within set appetite limits. There has been increased focus on profitability management per product line with corrective measures being implemented to ensure products met the required levels of return.

The development of the new regulatory solvency requirements for South African insurance entities, the SAM initiative, is progressing well. Absa's South African insurance entities continue to stay abreast of developments and to prepare for the SAM requirements that are likely to be legislated.

In line with our One Africa strategy, Barclays Life Zambia Limited, a new life insurance company, commenced business in August 2012.

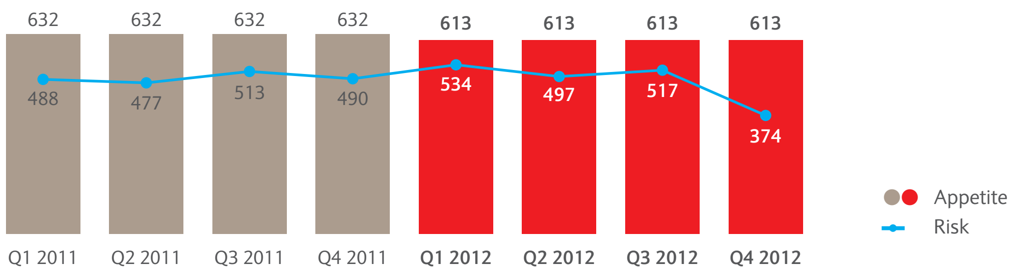
Short-term and life insurance underwriting risk utilisation was monitored on a monthly and quarterly basis against the appetite levels set for the reporting period. The utilisation varied in accordance with expectations and in line with underlying business growth and changes in forecasts. Utilisation for both categories of risk remained within appetite throughout the reporting period. During the reporting period certain short-term insurance business lines were discontinued as they are no longer seen as core to the strategy of the business. These risks are typically derived from niche products and require specialised underwriting skills. This has reduced the volatility of the claims experience. Although not considered material, an increase was seen in agricultural and personal business claims. Affected lines of business remained profitable.

Short-term insurance underwriting risk (Rm)



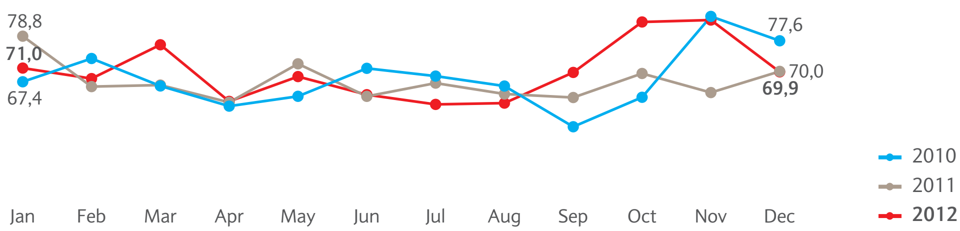
Life insurance underwriting utilisation decreased in the last quarter of the reporting period due to a downward adjustment to the mortality assumptions in line with trends observed in the most recent mortality experience investigations.

Life insurance underwriting risk (Rm)



Short-term loss ratios were slightly higher over the reporting period due to an increase in weather-related claims in the agricultural sector.

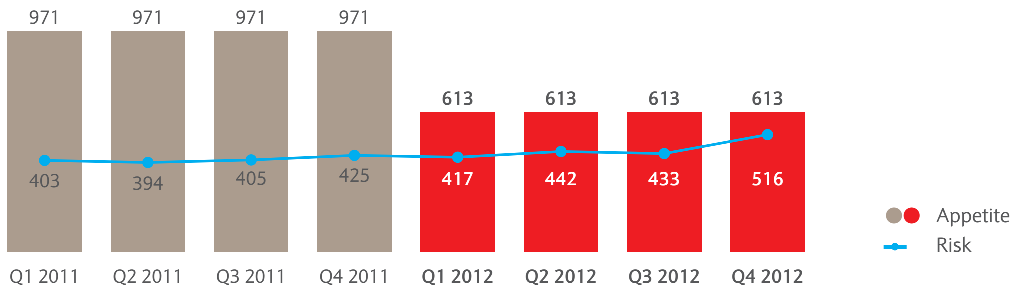
Short-term loss ratios (excluding Absa Manx) (%)



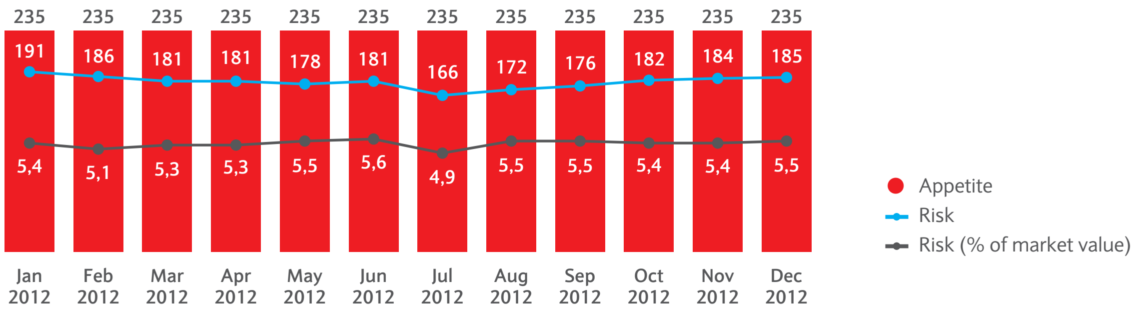
2012 in review *(continued)*

Life insurance mismatch risk remained well within appetite throughout the reporting period although investment conditions were volatile. The sensitivity of reserves in the current low interest rate environment increased risk utilisation in the last quarter of the current reporting period.

Life insurance mismatch risk (Rm)

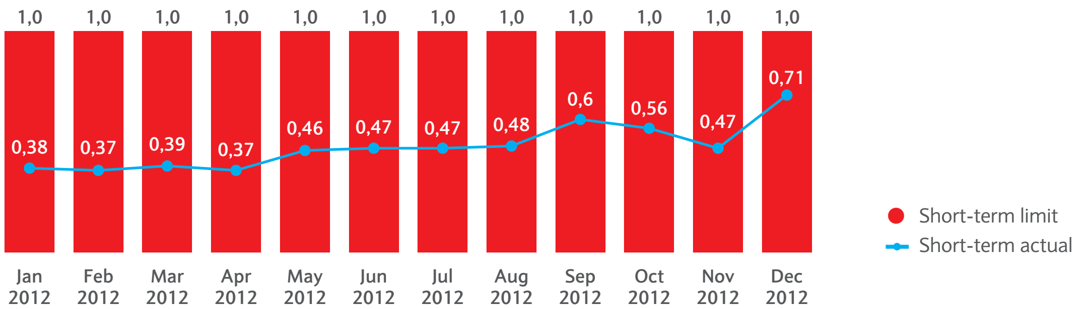


Life and short-term investment risk – position vs appetite (Rm)



The duration of the interest-bearing investments backing short-term insurance policyholder liabilities remained within the limit set.

Short-term insurance duration matching (years)



Priorities for 2013

We will continue to develop the capital model for the short-term insurance environment and will maintain focus on driving product profitability by maximising returns on capital allocated to individual product lines. In preparation for the SAM legislation, an assessment of the risk profiles of the insurance entities and the capital requirements specific to these profiles will be carried out.

Management will continue to focus on diversifying risk between business lines and between South African and non-South African risks. Enhanced monitoring and reporting to maintain good oversight of new non-South African insurance exposure will receive attention.

We will continue to challenge existing processes, practices and offerings to ensure alignment with the TCF principles that were introduced into the insurance industry.

Approach to insurance risk

The four categories of insurance risk recognised in the Group are defined as:

- **Short-term insurance underwriting risk** – the risk associated with underwriting fixed and/or moveable assets, accidents, guarantees and liabilities.
- **Life insurance underwriting risk** – the risk associated with insuring the lives and/or health of individuals or groups of individuals.
- **Life insurance mismatch risk** – the risk that the profile of assets held to back the policyholder liabilities of the life insurance activities is inappropriate to match the profile of these liabilities.
- **Life and short-term investment risk** – the risk associated with changes in asset values and includes interest rate, foreign exchange and equity investment risk.

Short-term insurance underwriting activities are undertaken by Absa Insurance Company Limited (AIC), Absa Insurance Risk Management Services Limited and Absa idirect Limited. Life insurance underwriting activities are undertaken by Absa Life Limited (Absa Life), Absa Life Botswana Proprietary Limited, Barclays Life Zambia Limited and Woolworths Financial Services Proprietary Limited, through an Absa Life Limited cell captive. Global Alliance Seguros S.A. (Mozambique) underwrites both life and short-term insurance business.

Short-term insurance underwriting risk, life insurance underwriting risk, life insurance mismatch risk as well as life and short-term insurance investment risk are core to the business of the insurance entities. The successful management of these risks ultimately determines the success of the entities. The same risk management frameworks and governance structures that enabled the effective management of risks for the South African entities, are implemented and embedded in any new entities established.

Risk management

Short-term insurance underwriting risk

Audited

Management monitors loss ratios on a monthly basis and identifies portions of the business where claims are increasing compared to underlying premiums. In addition, reviews of rates and policy conditions are carried out, when necessary, to determine if any changes are needed. Volumes of business are monitored for increases in volumes out of line with expectations, indicating rates may be low compared to market rates. There are extensive measures in place to control claims, which include assessing claims, checking total potential claims against the sum insured (averaging) and bulk purchase of items required for repair of damaged insured items. The table below summarises risk management measures implemented per short-term insurance product line.

Risk management per short-term insurance product line

Homeowners' comprehensive insurance	Multiple, similar claims make claim rates more predictable in normal circumstances. Assessment and adjustment of potential claims is undertaken. Cover is included in the catastrophe reinsurance purchase.
Personal lines, accident and travel insurance	Scientific pricing using multiple risk factors is used in risk selection and to charge premiums matched to underlying risk. Assessment and adjustment of potential claims is undertaken. Cover is included in the catastrophe reinsurance purchase.
Commercial insurance for small, medium and large companies	In underwriting these risks, significant focus is placed on the quality of fire protection and other risk measures. Assessment and adjustment of potential claims is undertaken. Catastrophe reinsurance is purchased to protect against natural catastrophes, in particular earthquakes, and against large individual losses.
Agricultural insurance	Diversification is sought across crops, seasons and geographical regions. Stop loss reinsurance is in place to protect against excessive claims. Risks are individually underwritten before being taken on. Constant assessment of crop development and adjustment of potential claims is undertaken.
Specialist lines	Risks underwritten by underwriting management agencies are only undertaken with specialists in their respective areas with track records of underwriting and claims control. Reinsurance for relevant risks is included in the main or specific reinsurance treaties.

Life insurance underwriting risk

The number of risks falling outside the ambit of standard underwriting mandates is reviewed on a regular basis to determine whether underwriting rules need to be tightened and/or risk parameters extended. The business relies on annual experience investigations, ongoing studies and analyses of surplus to set pricing and valuation parameters. The non-economic pricing and reserving assumptions (i.e. mortality, morbidity, persistency and expense assumptions) are revised to determine changes in trends that are likely to continue in the future.

Audited

Approach to insurance risk *(continued)*

Risk management *(continued)*

Life insurance underwriting risk *(continued)*

The following table summarises risk management measures implemented per life insurance product line.

Risk management per life insurance product line

Mortgage protection and complex underwritten life business	The main risks are mortality and morbidity. This is the only business that is individually underwritten at the application stage. Premium rates differentiate by gender, age, smoker status, socio-economic class and occupation. Sub-standard risks generally receive additional premium loadings or are declined. Correct pricing and effective underwriting control the mortality and morbidity risks. Exposure in excess of a retention limit for each policy is reinsured to reduce the variability of the claims experience and the exposure to a single life. Most policies have premium guarantee terms that vary from one year (for yearly renewable business) to 25 years (for products that have an investment component attached). For products with an investment component, the overall premium rate is guaranteed; the investment portion is not guaranteed and could be reduced at the discretion of Absa Life. However, when products are priced, it is not the intention to increase premium rates over the policy term. Experience is monitored to confirm that actual experience is in line with pricing assumptions.
Funeral business	The main risk is mortality increased by high Aids rates experienced in the target market. The risk is exacerbated by premium rates that are the same irrespective of the age of policyholders since significant changes in the age profile of customers could impact on experience. Limitation of cover for certain pre-existing conditions for defined time periods (generally two years), applies. Strict experience monitoring limits the risk, combined with the contractual right to increase premiums with a three-month notice period. The intention is not to exercise this right, but we have the option to do so. Reinsurance is not utilised as sums assured per individual life are minor.
Credit life business	The main risks are retrenchment and mortality. Treaty reinsurance arrangements are in place whereby risk is shared with external business partners. The right to change premiums with a 30-day notice period is retained. Premiums generally do not differentiate on the basis of gender, age or smoker status, and demographic shifts could introduce additional insurance risk.
Group life business	The main risk is mortality risk. Treaty reinsurance arrangements are in place whereby risk is shared with external business partners. Contracts and premium rates are reviewed annually. Additional catastrophe reinsurance cover will be considered for an accumulation of losses that may occur due to the geographical concentration of a group.

Life insurance mismatch risk

A mismatch arises if the assets backing non-linked products do not grow sufficiently or materialise timeously to match specified amounts guaranteed on death, disability, critical illness or retrenchments, or on survival to the end of the policy. Mismatch risk is managed through setting asset allocations that appropriately match assets to underlying liabilities. Guaranteed life event benefits and guaranteed maturity benefits are each managed in terms of separate investment strategies.

Life and short-term investment risk

Investment risk relates to the variability in the value of life and short-term shareholder assets, and of assets backing policyholder liabilities in respect of short-term insurance. Interest rate risk relates to the change in investment value of assets due to a change in interest rates. Foreign exchange risk is the risk that a change in the exchange rate could affect the financial results of the insurance entity. A portion of the current foreign exchange exposure, in respect of short-term insurance, relates to a United States dollar denominated investment used to hedge the amount payable to a foreign supplier contracted to develop an administration system. Investment risk is mitigated through diversified asset allocations and investment mandates.

Short-term insurance underwriting risk

Audited

Reinsurance

The impact of large individual short-term insurance claims is limited through the purchase of reinsurance that limits the risk retained on each claim. The accumulation of net retained exposures due to multiple claims is limited through the purchase of catastrophe reinsurance. Catastrophe reinsurance, particularly related to earthquake risk, is purchased to cover losses of up to R3 billion (2011: R3 billion).

Reinsurer credit risk

The credit risk in respect of reinsurance partners is managed by ensuring the entities only transact with reinsurers that have good credit ratings. The creditworthiness of reinsurers is regularly monitored. To qualify as a reinsurance partner, reinsurers must be assigned a minimum 'A' rating by the Standard and Poor's (or equivalent) rating agency. Any exceptions to this policy must be approved by management as well as by the various boards of directors of the insurance businesses. The current reinsurer exposure by Standard & Poor's credit rating is as follows:

	Percentage of premium income (%)
AAA	**0**
AA	**52**
A	**48**

Concentration risk

The main source of concentration risk is exposure to personal property, personal lines and commercial and industrial insurance business. Geographically, the main concentrations are in Pretoria, Johannesburg and the East Rand. Approximately 12,29% (2011: 12,60%) of the total sum insured is concentrated in Pretoria with 10,27% (2011: 11,07%) in Johannesburg and 11,12% (2011: 11,88%) in the East Rand The maximum expected loss for a one in 250-year event is a loss of R3 billion (2011: R3 billion based on one in 250 years). Catastrophe cover is purchased to cover losses up to R3 billion (2011: R3 billion).

Outstanding claims reserves

Outstanding claims reserves are held for claims that have been notified but not yet fully settled. Individual estimates are sourced from claims assessors and are reviewed as and when new information regarding a claim becomes available. The claims provision includes the expected claim cost and any associated handling costs. Claims development patterns are regularly monitored to assess trends and to determine the appropriate level of reserving. The provision at the reporting date amounted to R625 million (2011: R429 million).

Incurred but not reported claims reserves

A stochastic reserving model is applied to calculate the incurred but not reported (IBNR) claim provision for the majority of the exposures. Where detailed data is not available, the provision is based on interim measures proposed by the Financial Services Board. The IBNR provision at the reporting date amounted to R154 million (2011: R122 million).

Sensitivity analysis

The IBNR provision is determined by taking the following factors, per class of business underwritten, into account:

- actual and expected claims experience;
- actual and expected reporting patterns; and
- premium volumes.

These factors affect the sensitivity of the IBNR and are taken into account in setting the level of reserves required.

Changes in assumptions

The IBNR and outstanding claims provisions take historical data, trends and recent experience in claims processing and loss ratios into account. These calculations, together with changes in the underlying risk profile of the business, impact the determination of the final balances.

Life insurance underwriting risk

Reinsurance

A formal reinsurance policy has been approved by the life insurance entities' boards of directors. Reinsurance is used in respect of large individual risks and in respect of risks where Absa Life needs to build knowledge and experience as well as obtain technical assistance from the reinsurers. Catastrophe reinsurance is used as a protection against a large number of simultaneous losses.

Audited

Life insurance underwriting risk *(continued)*

Reinsurer exposure

Reinsurer credit risk is managed by transacting solely with reinsurers in possession of international A credit ratings as well as by holding capital in line with or in excess of regulatory requirements. The following table shows the credit rating of reinsurance assets at the reporting date.

Credit rating of reinsurance assets

	Group		
	Standard and Poor's rating	Description	Parental guarantee
Treaty and facultative reinsurer, 23,3% (2011: 28,3%) of business ceded	AA–	Very strong	No
Treaty and facultative reinsurer, 23,5%% (2011: 25,3%) of business ceded	AA+	Extremely strong	Yes
Treaty and facultative reinsurer, 11,1% (2011: 9,4%) of business ceded	A–	Strong	No
Treaty and facultative reinsurer, 41,3% (2011: 35,6%) of business ceded	AA–	Very strong	No

The individual ratings of the various reinsurers, knowledge of disputes and collection experience are used to determine whether the reinsurance assets should be impaired. The reinsurance assets were unimpaired at the reporting date as none of the reinsurance amounts receivable were past due (2011: none past due).

Concentration risk

The risk of several claims arising simultaneously ('concentration risk') on individual lives is small. The size of individual policies is low, and reinsurance is used to cover larger individual exposures. The following table details the concentration of benefits across three bands of benefits per life assured.

	Group			
	2012			
	Gross of reinsurance		Net of reinsurance	
Benefit band per life assured	**Total benefits assured Rm**	**%**	**Total benefits assured Rm**	**%**
0 – 250	**77 530**	**60**	**71 490**	**67**
250 – 500	**16 217**	**13**	**11 343**	**10**
500+	**35 006**	**27**	**24 492**	**23**
	128 753	**100**	**107 325**	**100**

	2011			
	Gross of reinsurance		Net of reinsurance	
Benefit band per life assured	Total benefits assured Rm	%	Total benefits assured Rm	%
0 – 250	76 205	61	70 215	67
250 – 500	14 913	12	10 661	10
500+	33 240	27	23 844	23
	124 358	100	104 720	100

In the case of the group life business, there is greater risk of geographic concentration since groups of lives, particularly per employer, are insured. In addition to comprehensive quota share reinsurance, catastrophe reinsurance is used to provide protection against an accumulation of losses in respect of risk retained.

Mortality and morbidity risk

We use experienced underwriters to review risk cover applications in excess of specified limits and evaluate them against established standards. Where an applicant requires cover in excess of specified monetary or impairment limits, the excess is reinsured. Mortality and morbidity risks are managed per product line based on underwriting criteria, pricing, reinsurance and experience.

Effective claims management processes ensure that all valid claims are honoured, in time with policy documentation and allowances made with setting premiums or valuing liabilities. Proactive fraud detection capabilities continue to be developed and improved to minimise fraudulent claim payouts.

Audited

Life insurance underwriting risk *(continued)*

Human Immunodeficiency Virus and Aids risk

Absa Life is exposed to Human Immunodeficiency Virus (HIV) and Aids risk where an insufficient allowance has been made in the pricing and valuation bases. To manage risk for the business that is medically underwritten, HIV tests are performed as part of the normal underwriting process. Cover is not provided in instances where the mortality risk is uncertain or is deemed to be too high. For other lines of business, such as funeral and credit life, general pre-existing condition clauses are included in the contract to protect against anti-selection by policyholders. In such an event, a claim will not be paid if it occurs as a result of a condition existing at the inception of the policy or within a certain period (generally 24 months) from inception.

Aids mortality investigations are performed. The results of these investigations assist in setting the premium and mortality basis for life policies. Additional allowances are included in the valuation basis to allow for a worse than expected Aids risk experience.

Lapse risk

Lapse risk is the risk of not recouping expenses such as commission and/or underwriting costs generally incurred at the inception of the policy. In such instances, a loss is incurred if the policy lapses before the costs have been recouped. This risk is managed by entering into 'claw-back' arrangements with financial advisers, whereby the commission or underwriting cost is recouped. Annual investigations of lapse experience are done to ensure our pricing and valuation assumptions are appropriate, relevant and in line with experience.

Expense risk

An allowance for future maintenance and claim expenses, inflated at the assumed expense inflation rate, is included in liability calculations based on the current level of maintenance and claim expenses per policy. The risk of understating and pricing insufficiently for this risk is managed by:

- conducting annual expense investigations based on the most recent operating expenditure incurred;
- monitoring costs monthly to ensure they remain within anticipated levels and identifying trends at an early stage; and
- basing the assumed future inflation rate on observable economic indicators and experience.

Model risk

Model risk is the risk of determining expected future cash flows and liabilities from existing policies using modelling techniques or methodologies that may be incorrect or inappropriate for certain classes of business. This risk is managed by placing the models through rigorous checking procedures to ensure the cash flows projected by the models are reasonable. Experienced and approved external consultants are used in this process. The modelling methodologies used are in line with guidance issued by the Actuarial Society of South Africa (ASSA) or, in the absence of such guidance, generally accepted actuarial methods.

Data risk

Data risk is the risk that the policy data used in the models is not accurate or incomplete, leading to incorrect premiums being set or insufficient reserves being held. This risk is managed by conducting reasonability checks on data and by reconciling the data with the previous valuation data (i.e. a movement analysis) and the financial statements. A new and improved administration system is in the process of being implemented for Absa Life to further mitigate data risk.

Assumption risk

Assumption risk is the risk that the change and effect of the assumptions used in the most recent valuation are not considered. Best estimate assumptions are derived from annual investigations into the demographic experience of the business and economic assumptions are based on observable, actual, consistent economic indicators. Margins are added to best estimate assumptions to allow for variability in the assumptions. These margins include compulsory margins according to the Standard of Actuarial Practice (SAP) 104 – calculation of the value of assets, liabilities and capital adequacy requirements of long-term insurance, issued by the ASSA and further discretionary margins, where considered necessary by the statutory actuary.

The risk discount rate used to discount future profits includes a margin over assumed investment returns to allow for the risk that experience in future years may differ from assumptions. The economic assumptions used are as follows (gross of tax where applicable):

Economic assumptions

	Group	
	2012 %	2011 %
Risk-free rate of return	**6,25**	7,75
Equity return	**9,61**	11,25
Cash return	**4,25**	5,75
Overall investment return	**5,81**	7,31
Risk discount rate	**9,50**	11,00
Expense inflation	**4,25**	4,75

Audited

Life insurance underwriting risk *(continued)*

Assumption risk *(continued)*

Additional allowances are incorporated into the liabilities to mitigate assumption risk. The compulsory margins prescribed in the SAP 104 have been applied in the valuation of liabilities. These margins are summarised in the table below.

Compulsory margins

Assumption	Margin
Mortality	7,5%
Morbidity	10%
Lapse	25%
Surrenders	10%
Expenses	10%
Expense inflation	10%
Charge against investment return	25 bps

The results of the sensitivities set out in the table below show that assumptions regarding future mortality and morbidity experience have a significant impact on the quantum of the actuarial liability. Future developments in mortality and morbidity experience, whether positive or negative, will impact on profits in future years, particularly in areas influenced by Aids infection rates. A further factor to take into consideration is the impact of investment returns. Although a significant portion of the book, such as credit life, is short term, the mortgage protection business increases the duration of the overall business and therefore future investment returns. The business is not sensitive to changes in other assumptions.

Sensitivity analysis

	Group			
	2012		2011	
	Insurance liability Rm	Change %	Insurance liability Rm	Change %
Central value (as published)	**1 650**	**—**	1 357	—
Mortality and morbidity +10%	**1 766**	**7,1**	1 460	7,6
Lapse rate +10%	**1 592**	**(3,5)**	1 315	(3,1)
Renewal and termination expense +10%	**1 687**	**2,2**	1 378	1,6
Expense inflation +1%	**1 682**	**2,0**	1 373	1,2
Investment return -1%	**1 770**	**7,3**	1 435	5,8

Life insurance mismatch risk

Through the use of asset-liability modelling, appropriate investment strategies for the assets backing policyholder liabilities are determined to mitigate mismatch risk as far as possible. These investment strategies are reviewed annually. For guaranteed mortality, morbidity and retrenchment benefits, an asset allocation comprising cash and bonds of various terms to maturity is used. For guaranteed maturity benefits, cash and long-dated bands are used and for policies close to maturity hedging strategies are implemented. Monthly meetings are held with the asset manager to monitor these asset durations and targeted levels.

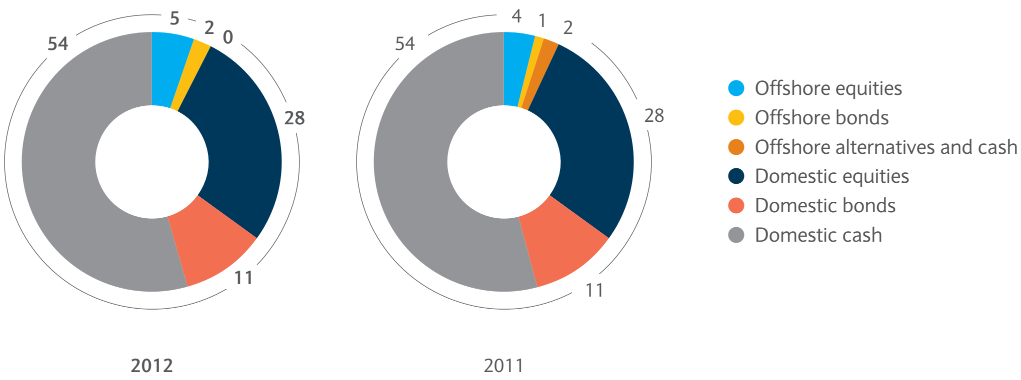
Audited

Life and short-term investment risk

A single investment strategy is maintained for short-term insurance shareholder assets and for assets backing short-term insurance policyholder liabilities. Assets are invested in short dated interest-earning assets and preference shares. The duration of interest-earning assets is monitored against a maximum effective duration.

The insurance shareholder funds of Absa Life are invested in a balanced portfolio. The current mandated asset allocation is as follows:

Absa Life insurance shareholders funds – mandated asset allocation (%)



Domestic assets have a limit on active equity exposures or tracking error taken on by the asset manager versus the underlying equity benchmark.

Counterparty credit risk in respect of investments is managed by investing with a spread of issuers with F1 or F1+ credit ratings.

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. Liquidity risk is managed in the short-term insurance businesses by investing in short dated interest-earning assets, with limits on investments in less liquid assets such as preference shares and corporate bonds. The life insurance businesses are less exposed to liquidity risks due to the low risk of large cumulative claims. Liquidity risk is managed through close management of potential cash outflow in discussion with the asset managers.

Operational risk

Operational risk

Overview

31 December

Key points

- Advanced measurement approach (AMA) approval by the SARB maintained.
- Increase in value of losses experienced due to a single significant unexpected event.
- Fraud and transaction operations were the core drivers of expected losses, with debit card fraud increasing.
- Continuous improvements in the control environment evidenced by a reduction in the volume of loss events for the current reporting period.
- Processes were enhanced to heighten customer experience, positively impacting on our control environment.

Key performance indicators

	2012	2011
Total number of events	↓	↓
Total loss value	↑	↓

Introduction

Operational risk is the risk of direct or indirect losses resulting from inadequate or failed internal processes or systems, human error or external events. Operational risk exists in the natural course of business activity. Therefore, it is impossible to eliminate all operational risk exposure. Risk events of significance are not frequent and we seek to reduce the likelihood of these in accordance with our risk appetite.

We recognise the significance of operational risk and are committed to enhancing the measurement and management thereof. Within our operational risk framework (ORF), qualitative and quantitative methodologies and tools are applied to identify and assess operational risks and to provide management with information for determining appropriate mitigating measures.

Strategy

Our operational risk management objectives are:

- further embedding an operational risk-aware culture throughout the Group;
- enhancing controls using automated solutions as far as possible, specifically relating to fraud;
- meeting regulatory requirements;
- proactively managing and effectively mitigating key operational risks;
- setting and monitoring appropriate operational risk appetite and tolerance levels; and
- strengthening follow-up and recovery actions for unexpected operational risk and boundary events.

2012 in review

Total losses for the reporting period decreased in volume but increased in value. The increase in value of losses experienced compared with the previous reporting period, was due to a single significant unexpected event relating to the financial restatement at NBC, Tanzania. Fraud and transaction operations remained the main drivers of expected losses. The increasing trend in debit card fraud emerged as an industry concern. We invested in appropriate detection and prevention capabilities. During the reporting period, a strategic review process was initiated to replace ageing core technology platforms. The restructuring within technology, which was necessary to streamline and improve the effectiveness of key IT processes, has been completed.

We implemented several control improvement projects during the reporting period, which included new systems and technological processes to reduce operational risk and consequent losses. Emphasis was placed on making our customers' lives easier, through enhancements to our control environment.

Over the recent years, we strengthened our business continuity management (BCM) capabilities. We have a robust BCM framework underpinned by key business processes and activities.

An accelerated organisational restructure in the first half of the reporting period resulted in an elevated people risk profile. This was offset by close change management across the Group to provide stability and targeted action plans to address concerns in specific businesses/functions.

While strong growth plans will lead to increases in expected losses, improvements and focus on the control environment are expected to offset this, resulting in slower growth in fraud and other losses.

Operational risk

31 December

Priorities for 2013

Fraud will remain a major driver for operational losses, as the growth in card fraud, particularly debit card fraud, is a South African industry concern. We will continue to embed fraud prevention processes and controls through further implementation of fraud systems. This will limit increases in losses, but fraud is nevertheless expected to remain the key operational risk impacting expected losses.

We will ensure that operational risks inherent to the implementation of new projects and programmes are effectively mitigated. Plans to further establish the African presence will require continuous reassessment of capability changes required. While change has not traditionally resulted in operational risk losses, risks related to change will be a constant focus in the positioning of the Group in the changing economic environment. Continued focus will also be applied to meeting the stringent demands of increased regulatory rigour, of changes to current regulation and of new regulations introduced.

Technology is essential to the success of the operations of any financial institution. We will continue to invest in technology advancement, and will further promote our technology risk management capabilities.

Consumerism is not currently causing significant losses but, given regulatory changes and increasing focus on consumer protection, all trends will be monitored. In this regard, we will continue to place our customers at the core and prioritise process enhancements to measure and improve the customer experience. We fully subscribe to the principles and ethos of TCF.

We realise the importance of our human capital and have programmes in place to ensure we remain an employer of choice, including the talent and reward programme aimed at defining a long-term approach to compensation and performance measurement and our culture and values programme, which is aimed at shaping the organisational mind set.

Significant planned investment will have a positive impact on the future control environment and risk profile, including:

- streamlining the back- and middle-office processes to improve efficiency and manage increased volumes;
- improving customer onboarding processes to enhance the customer experience;
- further strengthening pro-active fraud monitoring to curb losses; and
- monitoring and integrating the Edcon portfolio.

Audited

Approach to operational risk

Operational risk is a principal risk managed through an associated ORF, which is underpinned by a taxonomy of key risks. These key risks constitute the risk environment for operational risk and are all owned by relevant senior management with the appropriate expertise. The people key risk is owned by the Group Human Resources Executive, and the technology key risk is owned by the Chief Information Officer. The ORF comprises a number of elements that allow us to manage and measure our operational risk profile and to calculate the amount of operational risk capital that needs to be held to absorb potential losses. The minimum, mandatory requirements for each of these elements are set out in our operational risk policies. These policies are implemented across the Group: vertically, through the organisational structure with all businesses required to implement and operate the ORF that meets, as a minimum, the requirements detailed in these operational risk policies; and horizontally, with the key risk owners required to monitor information relevant to their key risk from each ORF element.

We track boundary events, i.e. operational risk within credit risk. Through root cause analysis of these boundary events, we design and implement appropriate remediation targeted at continuously improving our operational credit management processes.

For the effective management of our brand and external reputation, we reviewed the brand and reputation risk control framework, governance structures and escalation protocols during the current reporting period. The ownership of this risk resides with the legal department. The new framework is managed on a decentralised manner with in-country ownership appointed to the relevant executive committee.

We have two key objectives relating to the management of operational risk:

- To minimise the impact of losses suffered in the normal course of business and to avoid or reduce the likelihood of suffering a large extreme loss.
- To improve the effective management of the Group and strengthen its brand and external reputation.

We are committed to the management and measurement of operational risk and were granted approval to operate an AMA for operational risk under Basel II, which commenced in January 2008. The majority of the divisions in the Group calculates RC using AMA, however, in specific areas we apply the basic indicator approach (BIA) or the standardised approach. In certain joint ventures and associates, we may not be able to apply the AMA.

Approach to operational risk *(continued)*

Operational risk is one of four principal risks in the PRP and comprises a number of specific key risks defined as follows:

- External supplier risk – inadequate selection and ongoing management of external suppliers.
- Financial reporting risk – reporting misstatement or omission in external financial or regulatory reporting.
- Fraud risk – dishonest behaviour with the intent to make a gain or cause a loss to others.
- Information risk – inadequate protection of Absa's information in accordance with its value and sensitivity.
- Legal risk – failure to identify and manage legal risks.
- Product risk – inadequate design, assessment and testing of products/services.
- Payment process risk – failure in operation of payments processes.
- People risk – inadequate people capabilities and/or performance/reward structures, and/or inappropriate behaviour.
- Premises and security risk – unavailability of premises (to meet business demand) and/or safe working environments, and inadequate protection of physical assets, employees and customers against external threats.
- Regulatory risk – failure or inability to comply fully with the laws, regulations or codes applicable specifically to the financial services industry.
- Taxation risk – failure to comply with tax laws and practice that could lead to financial penalties, additional tax charges or reputational damage.
- Technology risk – failure to develop and deploy secure, stable and reliable technology solutions.
- Transaction operations risk – failure in the management of critical transaction processes.

These risks can result in financial and/or non-financial impacts including legal/regulatory breaches or reputational damage.

We operate within a robust system of internal control that enables business to be transacted and risk taken without exposure to unacceptable potential losses or reputational damage.

The prime responsibility for the management of operational risk rests with the business and functional units where the risk arises. Operational risk managers are widely distributed throughout the organisation and support these areas, assisting line managers in understanding and managing their risks. The heads of Operational Risk for each of the product lines are responsible for ensuring the implementation of and compliance with the operational risk policies and the ORF.

The central operational risk function is responsible for establishing, owning and maintaining an appropriate ORF and for overseeing the portfolio of operational risk across the Group. The ORC is the senior executive body responsible for the oversight and challenge of operational risk in the Group. The ORC presents relevant risk profile information to the GRCMC.

In addition, business unit CRCs monitor control effectiveness. The Group CRC receives reports from these committees and considers Group significant control issues and their remediation. The Group CRC presents relevant information to the GACC.

Business units are required to report their operational risks on both a regular and an event-driven basis. The reports include a profile of the material risks to their business objectives and the effectiveness of key controls, control issues of Group-level significance, operational risk events and a review of capital. Operational risk is recorded and reported according to the ORF. Specific reports are prepared on a regular basis for the ORC, Group CRC, GRCMC and GACC.

The objective of the operational risk management methodology is to ensure that we manage operational risks in an optimal and consistent manner, making certain these risks are measured accurately and are adequately capitalised. A further aim is to increase the efficiency and effectiveness of our resources, and to make use of growth opportunities while minimising operational risks.

The ORF has been designed to meet external and internal governance requirements including Basel and the Banks Act. The ORF includes the following elements:

Risk and control assessments

We identify and assess all material risks in the business and evaluate key controls in place to mitigate those risks. Managers in the business use self-assessment techniques to identify risks, evaluate the effectiveness of key controls and assess whether the risks are effectively managed within business risk appetite. The businesses are then able to make decisions on what, if any, action is required to reduce the level of risk. These risk assessments are monitored on a regular basis to ensure that each business continually understands the risks it faces.

Approach to operational risk *(continued)*

Internal risk events

An operational risk event is any circumstance where there is a potential or actual impact to the Group resulting from inadequately controlled or failed internal processes, people and systems or from an external event. The definition includes situations in which we could have made a loss, but in fact made a gain, as well as incidents resulting in reputational damage or regulatory impact only. Thresholds are used across the organisation for reporting risk events and as part of our analysis we seek to identify where improvements are needed to processes or controls, to reduce the recurrence and/or magnitude of risk events. We also use a database of external risk events, which are publicly available and through Barclays who is a member of the operational risk data exchange, a not-for-profit association of international banks formed to share anonymous loss data information. The external loss information is used to support and inform risk identification, assessment, and measurement, and provide management with insight into possible emerging risks.

Key indicators

Key indicators (KIs) are metrics that are used to monitor our operational risk profile. KIs include measurable thresholds that reflect the risk appetite of the business. KIs are monitored to alert management when risk levels exceed acceptable ranges or risk appetite levels and drive timely decision making and actions.

Key risk scenarios

Key risk scenarios (KRSs) are business area level assessments of the material operational risks, or risk themes. By combining data from risk and control assessments, KIs, internal risk events, external risk events, audit findings, expert management judgement and other internal data sources such as control issues, we are able to generate KRSs. These scenarios identify the most significant operational risks across the Group. The KRSs are validated at a product line level as well as at a Group level.

Operational risk appetite

Absa's approach to determining appetite for operational risk combines both quantitative measures and qualitative judgement, in order to best reflect the nature of non-financial risks.

The monitoring and tracking of operational risk measures is supplemented with qualitative review and discussion at senior management executive committees on the actions being taken to improve controls and reduce risk to an acceptable level.

Our operational appetite is aligned to the Group's risk appetite framework.

Basel II measurement elected

We apply the AMA to calculate EC and RC requirements for operational risk. This is subject to the relevant RC floor. However, certain areas are not included in the AMA, namely:

- joint ventures and non-controlling interests where we are unable to dictate the implementation of the ORF or capital methodology; and
- any cross-border legal entities where local regulatory policy/requirements either do not permit the use of or do not support the practical implementation of the AMA framework.

Capital modelling

The model used to determine our operational risk capital is periodically reviewed and approved for continued use. The need for any changes or updates to the model is considered on an ongoing basis to ensure the model is in line with best practice as well as narrowing industry practices and regulatory feedback. Any such changes deemed necessary follow a robust internal process of development and approval prior to being submitted for regulatory approval where relevant.

The AMA follows a key risk scenario-based process. KRSs exist for all of the key risks as detailed in the PRP under operational risk. Currently, the most significant KRSs relate to the fraud, transaction operations, regulatory as well as premises and security key risks. These key risks will also account for the majority of capital.

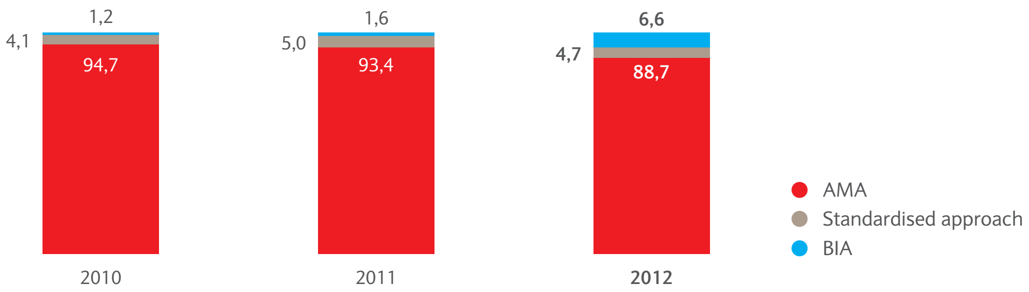
KRSs are the main input to the model and assess our material operational risks on an expected and unexpected basis. The KRSs provide a forward-looking view of operational risk and we believe that this is currently the most effective way to measure unexpected losses. KRSs are also used as a tool in managing operational risk.

For each KRS, a frequency and severity distribution is constructed and aggregated to derive our loss distribution. The modelled RC is measured at a 99,9% confidence level. Once the overall RC for the Group has been established it is allocated to product lines based on a methodology that includes a risk-sensitive component.

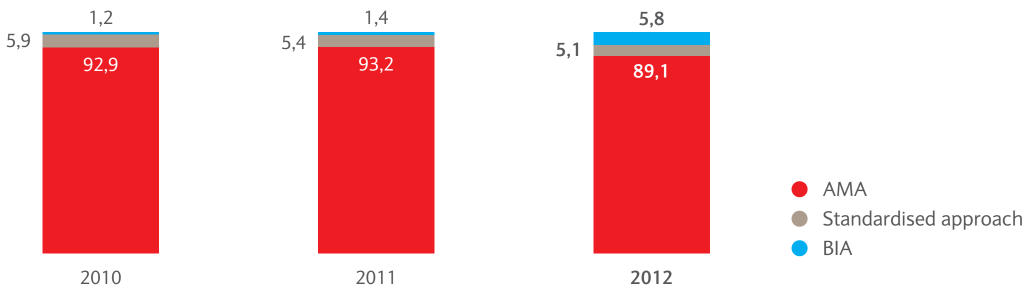
Coverage of the AMA

The AMA is applied across the Group. Each component of the framework provides effective risk management and indirectly also determines the capital that should be held. The resultant capital split is indicated below.

Economic capital (%) by approach for operational risk



Required capital (%) by approach for operational risk



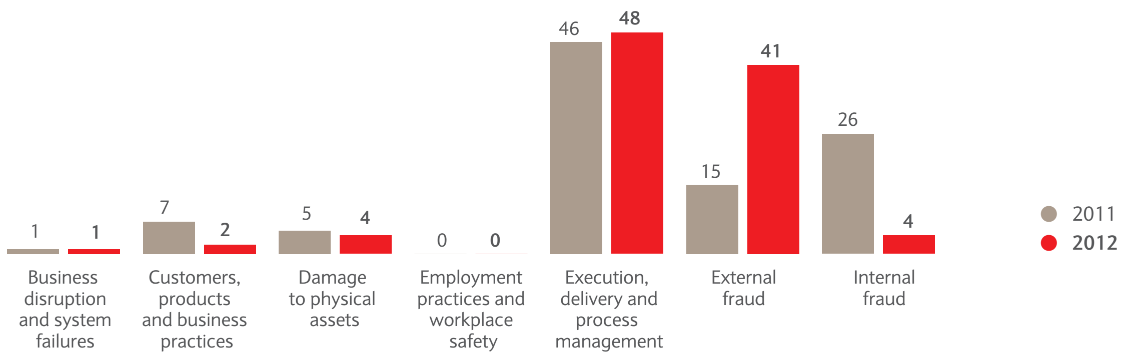
Operational risk profile

We monitor trends in operational risk events by size, product line and internal risk categories (including key risks). For comparative purposes, the analysis below presents Absa's operational risk events by Basel II category. During the current reporting period, improved controls decreased internal fraud events. The highest frequency of events occurred in execution, delivery and process management (40%) as well as external fraud (32%). This pattern is in line with the nature of operational risk and the environment in which we operate.

These two risk categories also account for the highest portion of losses by value. The high impact of execution, delivery and process management is driven by a single significant event, i.e. the overstatement of the interest income for NBC. External fraud is primarily driven by an increase in debit card-related losses, which is an industry concern.

Total risk events by count (%)

Total risk events by value (%)



Insurance in mitigation of operational risk

Insurance is used as a mechanism to mitigate operational risk. The Insurance Committee is responsible for overseeing the principal insurance programmes that mitigate key aspects of our operational risk. The Insurance Committee ensures that these policies are current and remain applicable to the operating environment.

The primary insurance policies in place for the Group are:

- comprehensive crime and electronic crime;
- directors' and officers' liability;
- professional indemnity; and
- various asset policies.

Funding risk

Funding risk

Liquidity risk
31 December

Key points
- Maintained a strong liquidity position ahead of Basel III.
- Continued to hold high levels of surplus liquid assets.
- Sustained strong funding tenor position in challenging market conditions.
- Liquidity risk management process remained robust and comprehensive.
- Successfully issued R5 billion of Tier 2 subordinated bonds, the largest listed Tier 2 subordinated debt raising on a single day.

Key performance indicators

	Group	
	2012 %	2011[1] %
Long-term funding ratio	**26,2**	26,8
Loans-to-deposits ratio	**90,2**	88,4

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Introduction
Liquidity risk is the risk that the Group is unable to meet its payment obligations when they fall due and to replace funds when they are withdrawn. The consequences of this may be the failure to meet obligations to repay depositors and to fulfil commitments to lend. Liquidity risk, more generally, is the risk that the Group will be unable to continue operating as a going concern due to a lack of funding.

Liquidity risk is inherent in all banking operations. Confidence in the organisation, and hence liquidity, can be affected by a range of institution specific and market-wide events including, but not limited to, market rumours, credit events, payment system disruptions, systemic shocks, terrorist attacks and even natural disasters.

The appropriate and efficient management of liquidity risk by banks is of utmost importance in maintaining confidence in the financial markets and in ensuring that banks pursue sustainable business models.

Strategy
Our liquidity risk management objectives are:
- growing and diversifying the funding base to support asset growth and other strategic initiatives;
- lengthening our funding profile in order to improve key liquidity metrics, thereby reducing our liquidity risk exposure;
- maintaining adequate levels of surplus liquid asset holdings in view of the Basel III liquidity requirements; and
- lowering the weighted average cost of funding.

2012 in review
Our liquidity position remained strong as we continued to focus on maintaining our surplus liquid asset reserves, funding tenor position, and growing our deposit base. Relatively slow growth in the South African economy meant the supply of liquidity remained strong as banks were not required to lend as much money as in previous periods of strong economic growth. We successfully issued senior unsecured debt in March 2012, as well as Tier 2 subordinated bonds in November 2012, to further extend our funding term and diversify our funding base. We also managed to maintain our position of reduced reliance on wholesale money market funding sources, which were built up during the previous reporting period. The cost of liquidity experienced upward pressure during the first three quarters of the reporting period with evidence of reductions seen more recently during the fourth quarter. The appetite for term funding in money markets dampened during the first half of the reporting period as a result of asset managers having to rebalance the duration profiles of their money market funds. An amendment made to the Collective Investment Schemes Act subsequently relaxed the average duration restrictions applicable to money market funds from 90 days to 120 days, which helped to alleviate the position during the second half of the reporting period.

Priorities for 2013
Liquidity risk measurement and management has received significant attention worldwide. Regulators have allowed a period of several years for full implementation of the Basel III liquidity rules. The BCBS announced in January 2013 that the implementation timeframes for the LCR, which is aimed at promoting the short-term resilience of a bank's liquidity risk profile, will be relaxed with full compliance now only required by 2019. The phasing-in approach now proposed in respect of the LCR is more in line with the proposals relating to capital requirements and takes into account the need to balance the implementation of the global liquidity standards with economic growth. The press announcement further indicated that certain other requirements relating to the LCR would be relaxed – for instance, the liquidity requirements relating to funding received from the corporate sector will now be subject to less stringent treatment, and it will now be possible to invest in a broader range of liquid assets than was previously the case. These changes, combined with the SARB announcement in May 2012 that a CLF will be made available to South African banks to help address the shortfall of high quality liquid assets in the South African market, means that significant progress was made during the current reporting period at an industry level to facilitate compliance with the LCR. A strong liquidity position will be maintained and we will continue to work with industry and with the SARB to ensure the optimal implementation of the CLF. Compliance with the NSFR, which is aimed at promoting resilience over a longer time horizon (one year), is required by January 2018. The NSFR remains a challenge given the structural features of the South African economy, and this will remain a key focus area.

Note
[1]Previous reporting period figures have been restated.

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Approach to liquidity risk

Our liquidity risk position is managed in line with the board-approved liquidity risk appetite. Group Treasury is responsible for implementing the liquidity risk framework and policy and for ensuring that liquidity risk is adequately managed across the Group. Group Treasury also monitors and manages our liquidity position to ensure full regulatory compliance in respect of liquidity risk management and reporting. As part of this process, Group Treasury takes the contractual and business-as-usual liquidity positions, as well as the stress tested liquidity position into consideration.

Business-as-usual liquidity risk management

Business-as-usual liquidity risk management refers to the management of the cash inflows and outflows of the bank in the ordinary course of business. The business-as-usual environment tends to display fairly high probability, low severity liquidity events and involves balancing our day-to-day cash needs. Group Treasury's approach to managing business-as-usual liquidity focuses on the following key areas:

- managing net anticipated cash flows (between assets and liabilities), within approved cash outflow limits;
- active daily management of the funding and liquidity profile, taking the board-approved liquidity risk metrics into consideration. These metrics were designed to ensure compliance with our business-as-usual liquidity risk tolerance and to position the Group to deal with stressed liquidity events;
- maintaining a portfolio of highly liquid assets as a buffer against any unforeseen interruption to cash flow;
- participating in local money and capital markets to support the day-to-day funding requirements such as refinancing maturities, meeting customer withdrawals and supporting growth in advances;
- monitoring and managing liquidity costs; and
- conducting an ongoing assessment of the various funding sources in order to grow and diversify our funding base and achieve an optimal funding profile.

Key risk metrics used in business-as-usual liquidity management

Risk metric	Purpose of metric
Short-, medium- and long-term funding ratios	Provides a measure of the contractual term of the funding used. For example, the long-term funding ratio shows the proportion of total funding that has a remaining contractual term in excess of six months.
Interbank funding ratio	Provides an indication of the extent to which reliance is placed on funding from other banks.
Short-term maturity cash flow mismatches (at a contractual and behavioural level)	Provides a measure of the extent to which cash flow mismatches occur in the short term (i.e. less than one month).
Cash outflow limits	Measures expected cash outflows against predetermined limits.
Concentration of deposits	Provides a measure of the extent to which reliance is placed on funding from certain customers or market sectors.

Stress liquidity risk management

Stress liquidity risk management refers to the management of liquidity risk during times of unexpected outflows arising from Group specific or systemic stress events. Group Treasury regularly performs liquidity scenario analyses and stress tests to assess the adequacy of our stress funding sources, liquidity buffers and contingency funding strategies in the event of such a stressed scenario. Scenario analysis and stress testing encompasses a range of realistic adverse events which, while remote, could have a material impact on the liquidity of our operations.

Through scenario analysis and stress testing, we aim to manage and mitigate liquidity risk by:

- determining, evaluating and testing the impact of adverse liquidity scenario;
- identifying appropriate rapid and effective responses to a crisis; and
- setting liquidity limits, sources of stress funding and liquidity buffers as well as formulating a funding strategy designed to minimise liquidity risk.

Our overall objective is to ensure that during a liquidity stress event, our stress funding sources and liquidity buffers exceed the estimated stress funding requirements for a period of at least 30 days. Stress testing and scenario analysis are used to evaluate the adequacy of identified sources of stress funding along a continuum of risk scenarios and to formulate and test contingency plans.

A detailed contingent funding and liquidity plan has been designed to protect depositors, creditors and shareholders during adverse liquidity conditions. The plan includes early warning indicators and sets out the crisis response strategy addressing sources of stress funding, strategies for crisis avoidance/minimisation and the internal and external communication strategy. Liquidity simulation exercises are conducted regularly to test the robustness of the plan and to ensure that key stakeholders remain up to date on liquidity matters.

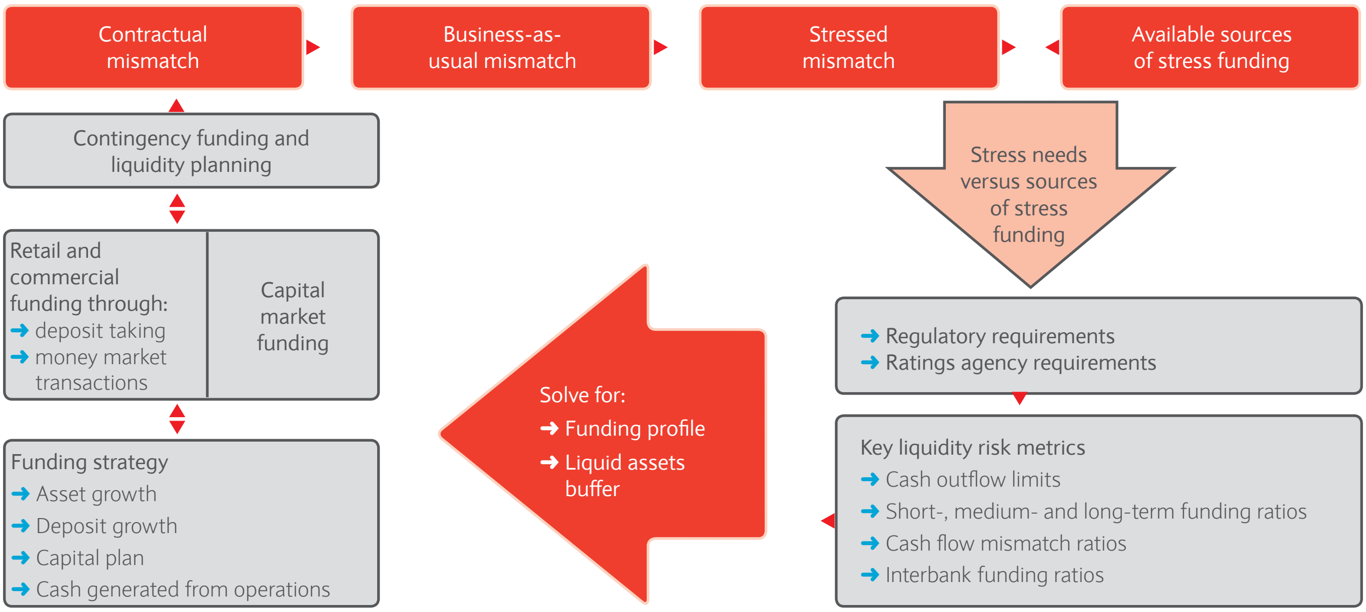
Approach to liquidity risk *(continued)*

Stress liquidity risk management *(continued)*

Key risk metric used in stress liquidity risk management

Risk metric	Purpose of metric
Survival horizon	Provides a measure of the adequacy of the bank's liquidity resources during times of severe stress, measured as the number of days that the bank is expected to survive a defined liquidity scenario.

Our liquidity risk management approach is summarised in the diagram below:



Regulatory changes in 2012

In May 2012, the SARB announced that it had approved a CLF to assist banks in meeting the LCR under Basel III. It was further confirmed that statutory cash reserves may be included in the calculation of the LCR. Conditions were set by the SARB regarding the size of the committed facility, and collateral requirements and pricing were set by the SARB. As outlined earlier in this section, BCBS also announced in January 2013 that the implementation timeframes for the LCR will be relaxed, with full compliance now only required by 2019. It was further stated that certain requirements, such as the liquidity requirements relating to the corporate sector and the range of liquid assets that can be invested in, will be made less onerous. These changes mean that banks could potentially hold less liquid assets and still comply with the requirements of the Basel III LCR, which would hold potential benefits for local banks and the broader economy. Funding that would otherwise have to be deployed to build liquidity buffers can now be used to extend loans to customers, thereby helping to grow the economy. Full compliance with the two key liquidity Basel ratios is required from 2019 for the LCR and 2018 for the NSFR, with the requirements relating to the LCR being phased in from 2015. The SARB will be requiring banks to report their Basel III liquidity positions from January 2013 onwards in order to monitor the progress made by banks towards compliance.

Key metrics under the Basel III liquidity risk framework and timeframes for compliance

Risk metric	Purpose of metric	Implementation timeframes
LCR	To promote the short-term resilience of a bank's liquidity risk profile by ensuring it has sufficient high-quality liquid assets to survive a significant stress scenario lasting for one month.	Requirements phased in from 2015 with full compliance required by 2019.
NSFR	To promote resilience over a longer-time horizon (one year) by creating additional incentives for banks to fund their activities with more stable sources of funding on an ongoing basis.	Compliance required by 2018.

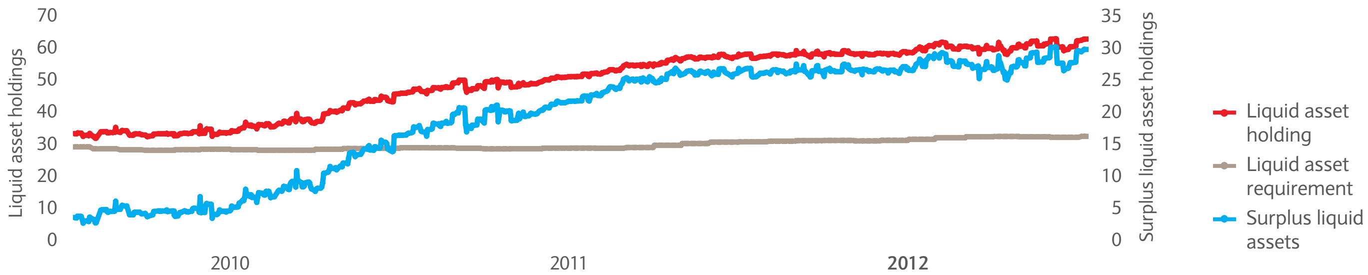
Regulatory changes in 2012 *(continued)*

We maintained our strong liquid assets buffer and the funding tenor position of our wholesale funding book ahead of the timeframes required by the Basel rules outlined in the previous table. Liquidity resources remain sufficient under the liquidity risk appetite framework with surplus liquid assets under a one-month survival horizon. We are currently reassessing our strategy in relation to liquidity buffers in light of the regulatory developments outlined on the previous page to ensure that an optimal approach is followed. Further information on progress made and on the plans for 2013 can be found in the sections that follow.

Surplus liquid assets held

The level of surplus liquid assets held by the Group (defined as unencumbered liquid assets held in excess of the amount required to be held in accordance with the regulations) increased during the current reporting period. As at the reporting date, R30 billion of surplus liquid assets were held, an increase of R3 billion on the amount held at the previous reporting date.

Summary of liquid asset holdings held by Absa Bank Limited (Rbn)

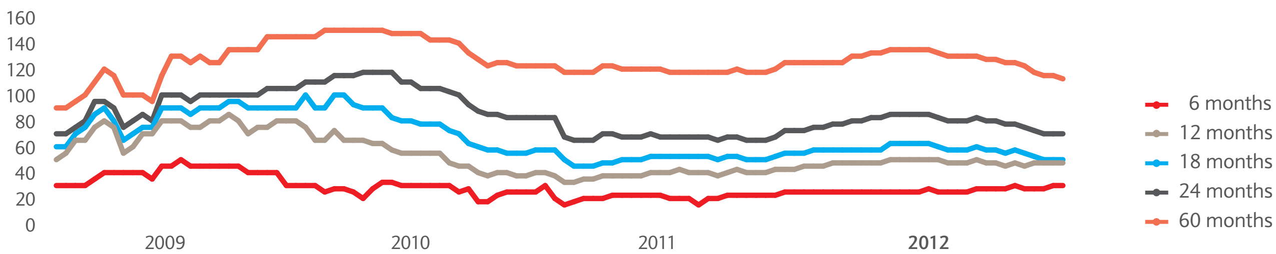


Cost of liquidity

The cost of maintaining the liquidity pool (consisting of liquid assets held to comply with regulatory requirements, plus surplus liquid assets held over and above the minimum regulatory requirements) is a function of the cost of funding used to purchase the liquid assets compared with the return earned on the liquid assets.

The beginning of 2010 saw liquidity premiums (i.e. the excess return or premium demanded by the market to invest funds with banks for longer periods than overnight) at historically high levels. As an example, the liquidity premium for 12-month funding was as high as 80 bps at the beginning of 2010. The graph below indicates that liquidity premiums remained high for most of the current reporting period, with increases evident particularly during the first three quarters of the current reporting period. Reductions in liquidity cost were experienced during the fourth quarter, in particular for longer-term funding.

Liquidity premiums (bps)



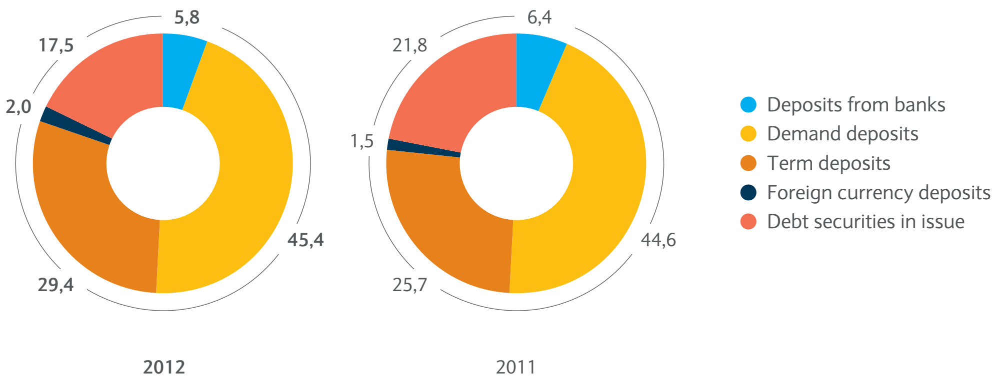
Funding structure

Our funding position has improved during the current reporting period with further increases in term deposits and reduced reliance on wholesale debt securities. Retail Markets remains partly funded by retail deposits, while the corporate business is self-funded under the new corporate structure. We rely on wholesale funding markets for the balance of funding required. CIBW acts as our 'face to the market' for obtaining wholesale funding.

Funding is sourced from a variety of depositors representing a diversity of South African economic sectors, with a wide range of maturities. We have a well diversified deposit base and concentration risk is managed within appropriate guidelines. Sources of liquidity are regularly reviewed to maintain a wide diversity of provider, product and term.

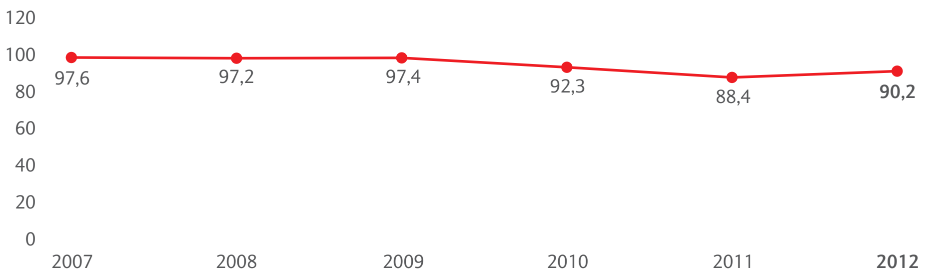
A more detailed breakdown of the loans-to-deposits ratio is provided below:

Funding composition (%)



The progression of our loans-to-deposits ratio is summarised in the following graph. The ratio has remained at healthy levels as a result of continued focus on asset quality and prudent liquidity risk management practices.

Loans-to-deposits ratio (%)



Funding structure *(continued)*

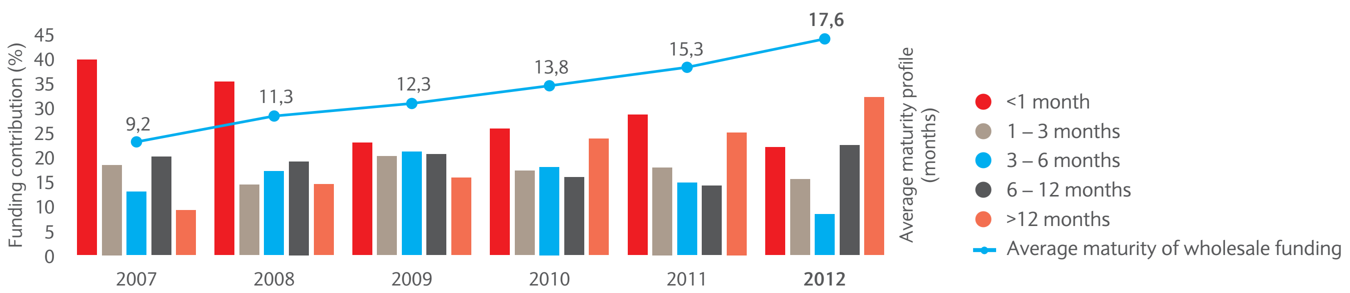
	Group 2012 Rm	2011[1] Rm
Advances		
Loans and advances to customers (refer to note 9)	**528 191**	504 925
Deposits		
Deposits due to customers (refer to note 22)	**477 427**	440 960
Debt securities in issue (refer to note 23)	**108 044**	130 262
	585 471	571 222
Loans-to-deposit ratio (%)	**90,2**	88,4

Maintaining an appropriate funding profile of the Group's funding base is a key strategic aim. Despite structural constraints in the South African economy that limit the extent to which South African banks are able to lengthen their funding profiles, we continued to take steps during the current reporting period to further lengthen the funding profile within these constraints.

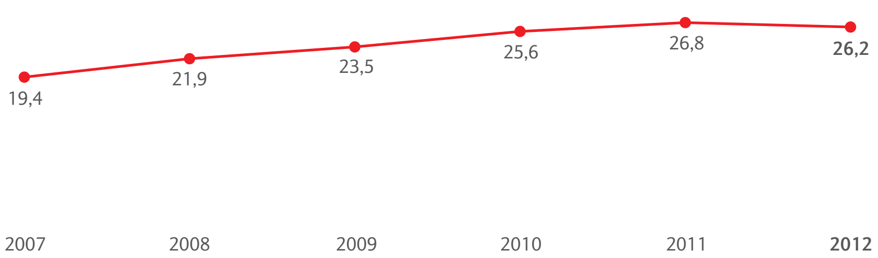
The graph below summarises the extent to which we have been able to extend our wholesale funding profile since 31 December 2006. The weighted average remaining term of wholesale funding increased from approximately six months at 31 December 2006 to approximately 17,6 months as at the reporting date. The proportion of wholesale funding that has a term in excess of 12 months has also seen a marked increase over this period.

A key metric used to track our funding structure is the long-term funding ratio. This ratio reflects the proportion of total funding with an outstanding term in excess of six months. The progression in Absa's long-term funding ratio is shown below. The ratio has remained robust over the current reporting period in spite of challenging market conditions, in particular during the first half of the current reporting period. At the reporting date, the ratio was strong at 26,2%.

Wholesale funding composition of Absa Bank Limited (% and months)



Average long-term funding ratio of Absa Bank Limited (%)



We successfully issued R6,7 billion of senior unsecured debt in March 2012 and R5 billion of subordinated debt in November 2012.

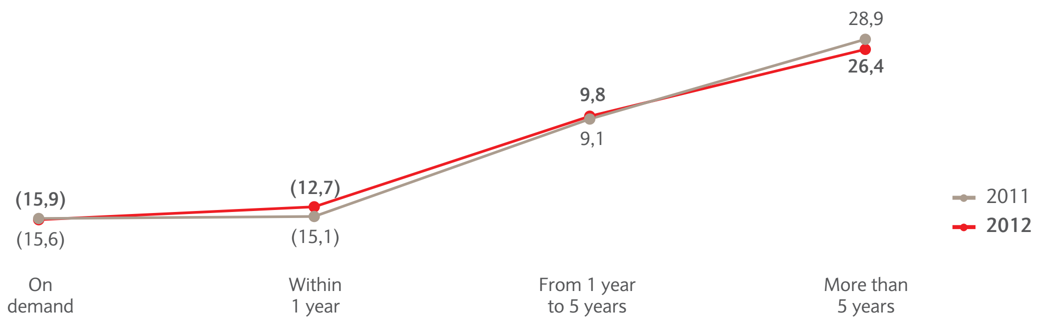
Note
[1]Comparatives have been reclassified.

Contractual and behavioural liquidity mismatch positions

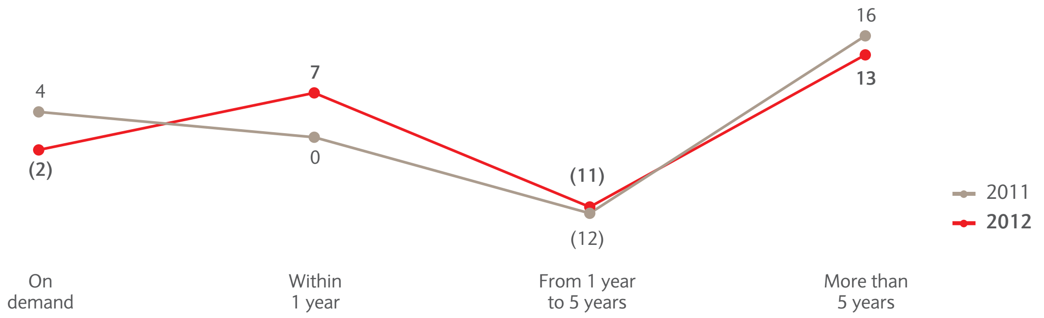
The graph below summarises our contractual mismatch position. The contractual mismatch position over five years improved during the current reporting period as a result of prudent liquidity management practices combined with the maintenance of a strong funding term position, which was achieved by further capital markets issuance, improved product mix and a continued focus on securing longer-dated money markets funding.

A more detailed breakdown of the contractual mismatch position, net of impairments, is provided in the tables that follow.

Contractual mismatch position of the Group at the reporting date, expressed as a percentage of total assets (%)[1]



Behavioural mismatch position of Absa Bank Limited at the reporting date, expressed as a percentage of total liabilities to the public (%)



We manage our behavioural (business-as-usual) mismatches within board-approved limits. The behavioural mismatch position over one year improved during the current reporting period, despite the challenging economic environment.

Note
[1]Comparatives have been reclassified.

Audited

Contractual and behavioural liquidity mismatch positions *(continued)*

Liquidity risk measurement – discounted

	Group				
	2012				
	On demand Rm	Within 1 year Rm	From 1 year to 5 years Rm	More than 5 years Rm	Total Rm
Assets					
Cash, cash balances and balances with central banks	22 990	2 639	538	54	26 221
Statutory liquid asset portfolio	—	22 487	13 817	26 716	63 020
Loans and advances to banks	15 261	23 119	2 552	3 717	44 649
Trading portfolio assets	86 689	—	—	—	86 689
Derivative	46 695	—	—	—	46 695
Non-derivative	39 994	—	—	—	39 994
Hedging portfolio assets	—	374	3 961	1 104	5 439
Other financial assets	1 061	4 317	164	6 763	12 305
Loans and advances to customers	98 437	65 273	146 028	218 453	528 191
Reinsurance assets	179	802	—	22	1 003
Investment securities	1 299	1 449	6 491	11 316	20 555
Financial assets	225 916	120 460	173 551	268 145	788 072
Non-financial assets					19 867
Total assets					807 939
Liabilities					
Deposits from banks	15 143	20 597	19	276	36 035
Trading portfolio liabilities	51 684	—	—	—	51 684
Derivative	46 763	—	—	—	46 763
Non-derivative	4 921	—	—	—	4 921
Hedging portfolio liabilities	—	39	1 320	2 496	3 855
Other financial liabilities	9 926	3 406	220	1 620	15 172
Deposits due to customers	275 847	149 028	29 004	23 548	477 427
Debt securities in issue	147	44 218	46 357	17 322	108 044
Liabilities under investment contracts	423	2 914	5 255	5 017	13 609
Policyholder liabilities under insurance contracts	142	1 233	—	2 175	3 550
Borrowed funds	1 318	1 892	10 851	3 846	17 907
Financial liabilities	354 630	223 327	93 026	56 300	727 283
Non-financial liabilities					7 862
Total liabilities					735 145
Equity					72 794
Total liabilities and equity					807 939
Net liquidity position of financial instruments	(128 714)	(102 867)	80 525	211 845	60 789

Audited

Contractual and behavioural liquidity mismatch positions *(continued)*

Liquidity risk measurement – discounted *(continued)*

	Group				
	2011[1]				
	On demand Rm	Within 1 year Rm	From 1 year to 5 years Rm	More than 5 years Rm	Total Rm
Assets					
Cash, cash balances and balances with central banks	24 744	2 253	—	—	26 997
Statutory liquid asset portfolio	6	27 979	5 926	23 562	57 473
Loans and advances to banks	42 060	11 220	401	3 818	57 499
Trading portfolio assets	84 380	—	—	—	84 380
Derivatives	45 604	—	—	—	45 604
Non-derivatives	38 776	—	—	—	38 776
Hedging portfolio assets	—	79	3 417	803	4 299
Other financial assets	4 196	2 390	1 134	4 295	12 015
Loans and advances to customers	81 163	61 444	133 314	229 004	504 925
Reinsurance assets	158	412	382	57	1 009
Investment securities	515	3 203	6 298	11 166	21 182
Financial assets	237 222	108 980	150 872	272 705	769 779
Non-financial assets					16 940
Total assets					786 719
Liabilities					
Deposits from banks	22 637	11 417	3 532	753	38 339
Trading portfolio liabilities	55 960	—	—	—	55 960
Derivatives	48 703	—	—	—	48 703
Non-derivatives	7 257	—	—	—	7 257
Hedging portfolio liabilities	—	39	638	1 779	2 456
Other financial liabilities	7 498	3 392	1 064	154	12 108
Deposits due to customers	272 949	129 953	23 122	14 936	440 960
Debt securities in issue	—	77 910	42 588	9 764	130 262
Liabilities under investment contracts	257	2 242	8 569	4 165	15 233
Policyholder liabilities under insurance contracts	138	1 461	(211)	1 795	3 183
Borrowed funds	—	1 270	—	12 781	14 051
Financial liabilities	359 439	227 684	79 302	46 127	712 552
Non-financial liabilities					5 762
Total liabilities					718 314
Equity					68 405
Total equity and liabilities					786 719
Net liquidity position of financial instruments	(122 217)	(118 704)	71 570	226 578	57 227

Note
[1]Comparatives have been reclassified, refer to note 1.27 of the Group's financial statements.

Audited

Contractual and behavioural liquidity mismatch positions *(continued)*

Liquidity risk measurement – undiscounted (statement of financial position value with impact of future interest)

	Group					
	2012					
Liabilities	On demand Rm	Within 1 year Rm	From 1 year to 5 years Rm	More than 5 years Rm	Discount effect Rm	Total Rm
On-statement of financial position						
Deposits from banks	15 146	20 773	46	773	(703)	36 035
Trading portfolio liabilities	51 684	—	—	—	—	51 684
Derivatives	46 763	—	—	—	—	46 763
Non-derivatives	4 921	—	—	—	—	4 921
Hedging portfolio liabilities	—	845	2 694	1 772	(1 456)	3 855
Other financial liabilities	9 926	3 406	220	1 620	—	15 172
Deposits due to customers	273 610	157 735	38 668	61 718	(54 304)	477 427
Debt securities in issue	148	45 856	54 715	23 125	(15 800)	108 044
Liabilities under investment contracts	422	3 011	5 431	5 692	(947)	13 609
Policyholder liabilities under insurance contracts	142	1 274	—	2 468	(334)	3 550
Borrowed funds	—	3 460	13 595	7 693	(6 841)	17 907
	351 078	236 360	115 369	104 861	(80 385)	727 283
Off-statement of financial position						
Financial guarantee contracts	58	—	—	88	—	146
Loan commitments[1]	37 903	5 305	3 677	141	—	47 026

	2011					
Liabilities	On demand Rm	Within 1 year Rm	From 1 year to 5 years Rm	More than 5 years Rm	Discount effect Rm	Total Rm
On-statement of financial position						
Deposits from banks	22 641	11 445	4 423	1 385	(1 555)	38 339
Trading portfolio liabilities	55 960	—	—	—	—	55 960
Derivatives	48 703	—	—	—	—	48 703
Non-derivatives	7 257	—	—	—	—	7 257
Hedging portfolio liabilities	—	1 152	1 353	1 298	(1 347)	2 456
Other financial liabilities	7 498	3 392	1 064	154	—	12 108
Deposits due to customers	272 999	133 432	31 182	27 753	(24 406)	440 960
Debt securities in issue	—	81 111	49 599	15 351	(15 799)	130 262
Liabilities under investment contracts	257	2 288	8 971	4 537	(820)	15 233
Policyholder liabilities under insurance contracts	138	1 490	(211)	1 983	(217)	3 183
Borrowed funds	—	1 669	3 227	14 240	(5 085)	14 051
	359 493	235 979	99 608	66 701	(49 229)	712 552
Off-statement of financial position						
Financial guarantee contracts	309	—	47	—	—	356
Loan commitments[1]	43 375	904	1 859	545	—	46 683

Stress and scenario testing

Further steps were taken during the current reporting period to reduce reliance on unsecured wholesale funding sources and to maintain surplus liquid assets. As part of stress and scenario testing, our liquid assets portfolio serves as the main source of liquidity under stress. Liquidity value is also assigned to unsecured funding lines, readily marketable investment securities held and price sensitive overnight loans.

Other funding risks

Per the PRP, structural risk is also reported under funding risk. Structural risk relates to the management of non-contractual risks and predominantly arises from impact on the Group's statement of financial position of changes in primarily interest rates on income or foreign exchange rates on capital ratios.

Note

[1]Includes both irrecoverable debt and equity facilities granted.

Capital management

31 December

Key points

- Strong capital position maintained above regulatory and board-approved target ranges.
- Successful implementation of the AIRB approach in the wholesale portfolio.
- Successful implementation of Basel II.5, with minimal impact on Core Tier 1 capital.
- R1,5 billion of subordinated debt matured and R5 billion Tier 2 capital issuance in November 2012.
- Continued focus on both net generation of equity and RWA optimisation.
- Basel III implementation on track.

Key performance indicators[1]

	Group	
	2012 %	2011 %
Core Tier 1 capital adequacy ratio	**13,0**	13,0
RoRWA	**2,07**	2,35
RoEC	**20,8**	23,0
CoE	**13,5**	14,0

	Bank	
	2012 %	2011 %
Core Tier 1 capital adequacy ratio	**12,5**	12,1
RoRWA	**1,91**	2,20
CoE	**13,5**	14,0

Introduction

Our capital management strategy is to maximise shareholder value by optimising the level and mix of capital resources. Decisions on allocating capital resources are based on a number of factors including RoEC and RoRWA and are part of the internal capital adequacy assessment process (ICAAP).

Proactive risk and capital management is key to balance sheet optimisation, one of the four strategic pillars supporting the One Absa strategy. We continue to monitor and respond pragmatically to market conditions both locally and internationally.

Capital levels remained well above board-approved target ranges for both the Group and the Bank, with the Group's Core Tier 1 capital adequacy ratio remaining stable at 13% and the Bank's Core Tier 1 capital adequacy ratio improving by 40 bps. Proactive capital management, including RWA optimisation and equity generation, remains a priority while further improvements in risk management are implemented. The board-approved target ranges are assessed annually and the 2013 ranges remain consistent with that of the current reporting period. As the market for Basel III compliant capital instruments develops, we will reassess the possibility of using these instruments accordingly. The potential impact of proposed regulatory changes are analysed and steps are taken to integrate necessary changes into the business. We will remain adequately capitalised post the implementation of Basel III, with adequate capital to support future asset growth.

We will continue to review our capital position and implement appropriate management action, when necessary, to ensure we remain appropriately capitalised at all times. Further detail on Basel III and our response are set out further on in this section.

Notes

[1]Reported ratios include unappropriated profits.

[2]The CoE is based on the CAPM.

Capital management

31 December

Strategy

Our capital management objectives are:

- maximising shareholder value by optimising the level and mix of capital resources;
- meeting capital ratios required by regulators and the target ranges approved by the board;
- maintaining an adequate level of capital resources as cover for the EC requirements;
- delivering RWA efficiency, capital and balance sheet accountability as well as returns;
- proactively assessing, managing and efficiently implementing global regulatory changes to optimise capital usage; and
- maintaining a strong credit rating with our recent upgrade of the national long-term credit rating to AAA (zaf) being higher than that of the peer group.

2012 in review

We maintained our strong capital adequacy position above the board-approved target range thereby positioning the Group favourably to deal with the implementation of Basel III. RWA optimisation exercises also improved our understanding of risk in terms of accuracy of risk measurement, resulting in the optimisation of capital allocation.

R1,5 billion of subordinated debt, qualifying as Tier 2 capital, was called at the first optional redemption date in September 2012. We subsequently issued R5 billion of subordinated debt at a yield of between JIBAR + 195 bps and JIBAR +205 bps. This optimised our capital mix and took advantage of the last opportunity to issue 'old style' (excluding the loss absorbency and the point of non-viability requirements) Tier 2 capital prior to the implementation of Basel III.

Our capital models were updated to reflect the current environment. In addition, we implemented Basel II.5 and AIRB for the wholesale credit portfolio and prepared for the implementation of Basel III.

Audited

Approach to capital management

We plan and manage our capital to ensure that we have sufficient and appropriate capital structures to support our risk appetite, business activities, credit rating and regulatory requirements.

Our capital management framework, adopted by the Group, provides the basis for effective capital planning and structuring, capital issuance, Basel alignment, EC utilisation and economic profit. It provides end-to-end integration of our strategy, risk management and financial processes. The purpose of the framework is to ensure that capital consumption in the business units has an impact on performance, which in turn translates into management performance assessment, product pricing and the achievement of our strategy.

Internal capital adequacy assessment process

The board-approved ICAAP process assesses the level of capital required to be held against identified material risks that we are, or may be, exposed to in order to meet the current or future capital needs. The ICAAP and its underlying components form an integral part of our decision-making and business processes. We have embedded risk and capital management tools, processes and activities across our clusters to actively influence management behaviour to align with our risk strategy.

At its most strategic level, the ICAAP is used to inform the board of the ongoing assessment of our risks, how the risks are mitigated and how much current and future capital is considered necessary taking into account mitigating factors.

The ICAAP demonstrates how our strategy is articulated into our risk appetite, financial forecasting and capital planning. It is used to ensure that the minimum capital ratios and board-approved target ranges can be maintained over the period of the medium-term plan, having been subjected to suitably severe stress and scenario analysis. Stress testing is conducted annually to identify market condition changes that could adversely impact the Group. Management actions are identified to mitigate risks on a timely basis.

Furthermore, it ensures that internal systems, controls and management information are in place to enable the board and senior management to track changes in the economic/financial environment, which may require adjustments to the business strategy to remain within the risk appetite on an ongoing basis.

The efficient use of capital is fundamental to ensuring a clear focus on enhancing shareholder value through the careful deployment of capital resources.

We have adopted a building block approach to achieve a robust and integrated capital management framework. The ICAAP is an important element of strategy development and implementation, as is evidenced by the link between the elements such as financial forecasting, risk appetite setting, stress testing and capital planning.

While the ICAAP is intended to align with regulatory requirements under Pillar 1 and Pillar 2 of the regulatory framework, the main guiding principle in designing the ICAAP has been suitability for capital management and other internal applicators. We consider our ICAAP to be in line with international best practice and are of the opinion that it addresses the core banking principles of Pillar 2.

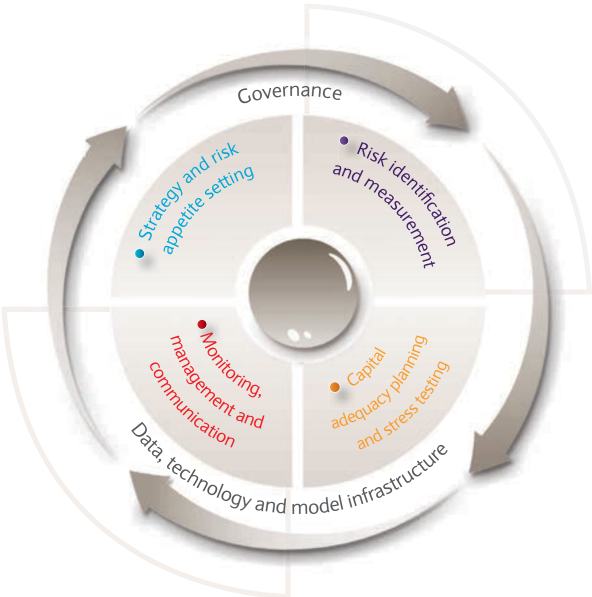
EC is the framework used to set internal capital demand and supply and is used to assess the impact of a changing business environment and strategy on our risk profile and the need for capital. EC is a measure of capital required to maintain or achieve a target investment grade credit rating. We target a capital level equivalent to an AA rating or higher.

Aside from its application in capital management, EC is a key component of Group level and business unit level applications such as capital management, stakeholder communication, risk-adjusted performance measurement, pricing and structuring.

Approach to capital management *(continued)*

Internal capital adequacy assessment process *(continued)*

The building blocks of Absa's ICAAP are as follows:



These processes are conducted in an environment with established governance practices and oversight and are supported by adequate data, technology expertise and model infrastructure.

Stress testing is performed to identify early warning thresholds and risk events that may adversely impact our risk profile, as well to test the robustness of capital. Stress testing is also used to determine adequate capital buffers that are considered sufficient to ensure that both the Group and the Bank do not breach the minimum regulatory ratios under stress scenarios and to formulate appropriate management actions. From an ICAAP perspective, stress testing represents the link between risk management and capital management. As a result of better risk management practices and global events, stress testing has become increasingly important in assessing appropriate levels of capital to ensure that we can absorb stress events in order to protect our depositors and other stakeholders.

Capital transferability

The Group is the primary provider of equity capital to its subsidiaries and capital is held centrally in accordance with the board-approved annual Group capital plan.

Our capital policy stipulates that capital held in Group entities in excess of board-approved target levels/ranges should be repatriated to the Group in the form of dividends and/or capital repatriation, subject to local regulatory requirements, exchange controls and strategic management decisions. Apart from the aforesaid, we are not aware of any material impediments to the prompt transfer of capital resources or repayment of intragroup liabilities when due.

Basel III

We are well equipped for the implementation of the Basel III framework, which is being phased in from 1 January 2013. Basel III focuses on the following areas:

- Stringent new liquidity requirements through the creation of two ratios: LCR and NSFR.
- Higher levels of capital, including capital conservation and countercyclical buffers, as well as additional capital charges for counterparty credit risk.
- Better quality capital, including loss absorbency at the point of non-viability.
- Improved trading risk coverage; and
- Leverage caps with a minimum of 3% internationally, versus the 4% proposed by the SARB.

In preparation for the implementation of Basel III, we participated in the quantitative impact study (QIS) exercises of the BCBS, as well as industry discussions held at the Banking Association of South Africa (BASA) to enable it to assess and provide feedback on the expected impact of the new rules. The QIS covers liquidity, capital and leverage and is conducted biannually. The Group will remain adequately capitalised after the implementation of Basel III, which is expected to reduce the Group's Core Tier 1 capital adequacy ratio by 70 bps.

Priorities for 2013

Our strategic focus for 2013 is to maintain a strong level, high quality and optimal mix of capital, while continuing to generate sufficient capital to support economically profitable asset growth and the active management of the business portfolio. In addition, we intend to further optimise the use of capital without jeopardising our ability to comply with expected Basel III regulatory changes. As in the current reporting period, RWA optimisation remains a key focus area.

Capital requirements

We manage our capital in accordance with the minimum regulatory requirements, EC requirements and the target ranges approved by the board, as follows:

- Regulatory requirements: net qualifying capital must sufficiently exceed Basel minimum capital requirements to provide a buffer for prudence.
- Economic requirements: available capital resources must be sufficient to meet EC requirements over a three-year period.
- Board-approved target ranges: derived from the stress testing results, and are set above the minimum regulatory requirements.

Capital adequacy

Audited

We set target capital ranges/levels for regulated entities to ensure that the objectives of capital management are met. Appropriate capital management actions are taken if these target ranges/levels are at risk of being breached.

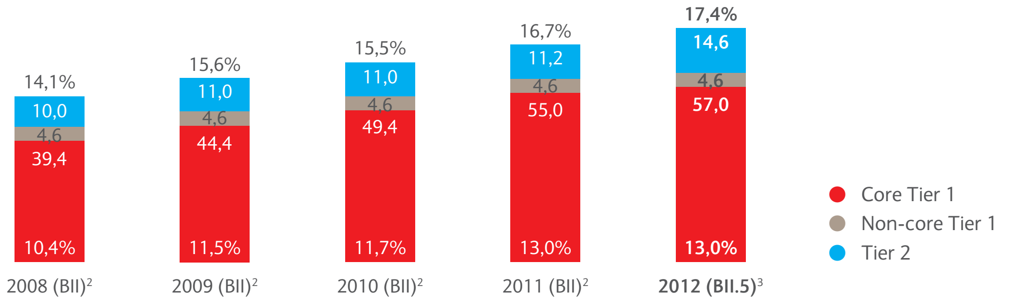
We monitor capital adequacy and the use of RC by employing techniques based on the guidelines developed by the BCBS and implemented by the SARB and other host regulators for supervisory purposes. These techniques include the capital adequacy ratio calculation, which the SARB and other host regulators regard as a key supervisory tool.

Target capital ratios of the Group for the current reporting period were set by considering the following:

- risk appetite;
- the preference of rating agencies for permanent capital;
- stressed scenarios;
- proposed Basel amendments; and
- peer analysis.

	Group			
	2012	2011	Minimum RC requirements	Board target ranges 2012
Capital adequacy ratios (%)[1]				
Core Tier 1	**13,0**	13,0	**5,25**	**9,5 – 11,0**
Tier 1	**14,0**	14,1	**7,00**	
Total	**17,4**	16,7	**9,50**	**12,5 – 14,0**
Capital supply and demand for the reporting period (Rm)				
Free cash flow generated	**1 082**	3 614		
Qualifying capital	**76 298**	70 780		
Total RWA	**438 216**	424 489		

Absa Group capital adequacy (Rbn and %)[1]



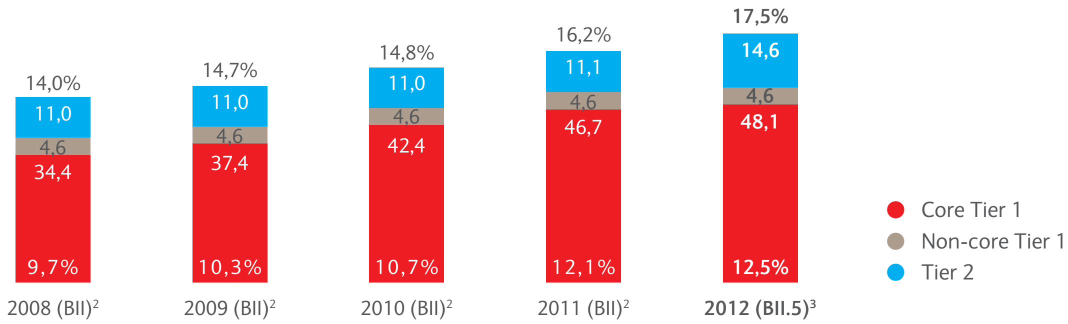
Notes

[1]Reported ratios include unappropriated profit.
[2]BII: Basel II.
[3]BII.5: Basel II.5.

Capital adequacy *(continued)*

	Bank 2012	2011	Minimum RC requirements	Board target ranges 2012
Capital adequacy ratios (%)[1]				
Core Tier 1	**12,5**	12,1	**5,25**	**9,0 – 10,5**
Tier 1	**13,7**	13,3	**7,00**	
Total	**17,5**	16,2	**9,50**	**12,0 – 13,5**
Capital supply and demand for the reporting period (Rm)				
Free cash flow generated	**2 930**	4 686		
Qualifying capital	**67 349**	62 449		
Total RWA	**385 855**	384 933		

Absa Bank capital adequacy (Rbn and %)[1]



The board approved the following target ranges for 2013, which are consistent with those of the current reporting period:

	Core Tier 1 (%)	Total capital (%)
Group	9,5% – 11,0	12,5% – 14,0
Bank	9,0% – 10,5	12,0% – 13,5

Notes
[1]Reported ratios include unappropriated profits.
[2]BII: Basel II.
[3]BII.5: Basel II.5.

Capital adequacy *(continued)*

Target capital ranges/levels were set for the following regulated entities: Absa Group Limited, Absa Bank Limited, BBM, NBC, Absa Life Limited and Absa Insurance Company Limited. Target capital levels for all other entities were at least equal to the minimum regulatory requirements set by the respective regulators.

Local, foreign banking and insurance entities

		Group							
		2012			2011			2012 Total target capital adequacy ratio	
Operations	Regulator	Total qualifying capital Rm	Tier 1 ratio %	Total capital adequacy %	Total qualifying capital Rm	Tier 1 ratio %	Total capital adequacy %	Regulatory minimum %	Board target %
Local banking entities (South Africa)									
Absa Group Limited	SARB								
Including unappropriated profits		76 298	14,0	17,4	70 780	14,1	16,7		12,5 – 14,0
Excluding unappropriated profits		68 652	12,3	15,7	62 489	12,1	14,7	9,5	
Absa Bank Limited	SARB								
Including unappropriated profits		67 349	13,7	17,5	62 449	13,3	16,2		12,0 – 13,5
Excluding unappropriated profits		64 154	12,8	16,6	56 409	11,8	14,7	9,5	
Foreign banking entities									
BBM[1]	Banco de Mozambique	688	29,8	29,8	158	8,0	8,0	8,0	15,0
NBC[1, 2]	Bank of Tanzania	511	8,3	8,7	710	12,6	12,6	12,0	14,0
Insurance entities									
Absa Life Limited	FSB[3]	1 217	n/a	3,0 x CAR	1 198	n/a	2,9 x CAR[4]	1,0 x CAR[4]	2,0 x CAR
Absa Insurance Company Limited	FSB[3]	1 592	n/a	55,8% x NWP	1 716	n/a	60,7% x NWP[5]	27,7% x NWP[5, 6]	45% x NWP
Absa idirect Limited	FSB[3]	131	n/a	136,9% x NWP	114	n/a	97,5% x NWP[5]	26,7% x NWP[5, 7]	45% x NWP

Notes

[1]Basel I regulatory ratios and regulatory requirements.
[2]NBC has obtained dispensation from the Bank of Tanzania for the breach of the minimum regulatory requirements. Appropriate management actions are underway in this regard.
[3]Financial Services Board.
[4]Capital adequacy requirement (CAR): Actuarial calculation of VaR on insurance liabilities. 2,0 times (2011: 2,0 times) being the required capital level determined by Absa Life Limited.
[5]NWP: Net Written Premiums.
[6]48% (2011: 45%) of NWP, being the required capital level determined by Absa Insurance Company Limited.
[7]Quota share reinsurance is used to maintain capital adequacy levels at a level sufficient in excess of the regulatory minimum.

Capital management

31 December

Regulatory capital

RWA are determined by applying the following methods per risk type in accordance with the Basel II.5 revisions, effective 1 January 2012:

- AIRB approach for credit;
- AMA for operational risk[1];
- in respect of traded market risk, IMA for general position risk and the standardised approach for issuer-specific risk;
- IRB market-based simple risk-weighted method for equity investment risk in the banking book; and
- standardised approach for credit risk in our African subsidiaries.

RWA and minimum required capital

	Group			
	2012		2011	
	RWA Rm	Minimum required capital[1] Rm	RWA Rm	Minimum required capital[1] Rm
Basel II.5 measurement approach				
Credit risk	**321 500**	**30 542**	317 920	30 202
Portfolios subject to the AIRB approach	**296 950**	**28 210**	145 870	13 858
Portfolios subject to the FIRB approach	**—**	**—**	159 740	15 175
Portfolios subject to the standardised approach[2]	**23 513**	**2 233**	10 595	1 006
Securitisation[3]	**1 037**	**99**	1 715	163
Equity investment risk				
Market-based approach (simple risk-weighted approach)	**22 735**	**2 160**	22 168	2 106
Market risk	**13 797**	**1 311**	8 357	794
Standardised approach	**3 735**	**355**	3 828	364
IMA	**10 062**	**956**	4 529	430
Operational risk				
AMA[4]	**62 385**	**5 926**	59 460	5 649
Non-customer assets	**17 799**	**1 691**	16 584	1 575
	438 216	**41 630**	424 489	40 326
Pillar 1 requirement (8%)		**35 057**		33 959
Pillar 2a requirement (1,5%)		**6 573**		6 367

Notes

[1]The required capital is the regulatory minimum (9,5%) excluding the bank specific (Pillar 2b) add on.

[2]The increase compared to the previous reporting period relates to Absa acquiring the Edcon portfolio in November 2012.

[3]The separate disclosure of credit risk RWA pertaining to securitisation resulted in a reclassification of comparatives.

[4]AMA for operational risk, except for an immaterial portion of Absa that uses the BIA, or standardised approach.

Regulatory capital *(continued)*

RWA and minimum required capital *(continued)*

	Bank			
	2012		2011	
	RWA Rm	Minimum required capital[1] Rm	RWA Rm	Minimum required capital[1] Rm
Basel II.5 measurement approach				
Credit risk	**292 003**	**27 740**	289 949	27 545
Portfolios subject to the AIRB approach	**278 795**	**26 485**	135 071	12 832
Portfolios subject to the FIRB approach	**—**	**—**	153 163	14 550
Portfolios subject to the standard approach[2]	**12 171**	**1 156**	—	—
Securitisation[3]	**1 037**	**99**	1 715	163
Equity investment risk				
Market-based approach (simple risk-weighted approach)	**14 564**	**1 384**	24 555	2 333
Market risk	**13 768**	**1 308**	8 357	794
Standardised approach	**3 706**	**352**	3 828	364
IMA	**10 062**	**956**	4 529	430
Operational risk				
AMA[4]	**54 045**	**5 134**	51 067	4 851
Non-customer assets	**11 475**	**1 090**	11 005	1 046
	385 855	**36 656**	384 933	36 569
Pillar 1 requirement (8%)		**30 868**		30 795
Pillar 2a requirement (1,5%)		**5 788**		5 774

Notes

[1]The required capital is the regulatory minimum (9,5%) excluding the Bank specific (Pillar 2b) add on.
[2]The increase compared to previous reporting period relates to Absa acquiring the Edcon portfolio in November 2012.
[3]The separate disclosure of credit risk RWA pertaining to securitisation resulted in a reclassification of comparatives.
[4]AMA for operational risk, except for an immaterial portion of Absa that uses the BIA, or the standardised approach.

Capital management

31 December

Capital supply

We increased our total qualifying capital supply by R5,6 billion (2011: R5,4 billion) during the current reporting period.

Movements in qualifying capital

	Group		Bank	
	2012 Rm	2011 Rm	**2012 Rm**	2011 Rm
Balance at the beginning of the reporting period (excluding unappropriated profits)	**62 489**	62 770	**56 409**	56 890
Share capital, premium and reserves	**3 363**	37	**4 700**	(175)
Non-controlling interest – ordinary shares	**(185)**	238	**—**	—
Tier 2 subordinated debt issued	**5 000**	—	**5 000**	—
Tier 2 subordinated debt matured	**(1 500)**	—	**(1 500)**	—
General allowance for impairment losses on loans and advances: standardised approach	**66**	3	**53**	—
Regulatory deductions	**(581)**	(559)	**(508)**	(306)
Balance at the end of the reporting period (excluding unappropriated profits)	**68 652**	62 489	**64 154**	56 409
Add: unappropriated profits	**7 646**	8 291	**3 195**	6 040
Qualifying capital including unappropriated profits	**76 298**	70 780	**67 349**	62 449

Breakdown of qualifying capital

	Group			
	2012 Qualifying capital Rm	**%[1]**	2011 Qualifying capital Rm	%[1]
Core Tier 1	**49 371**	**11,3**	46 685	11,0
Ordinary share capital	**1 435**	**0,3**	1 434	0,3
Ordinary share premium	**4 604**	**1,1**	4 676	1,1
Reserves[2]	**45 749**	**10,4**	42 314	10,0
Non-controlling interest – ordinary shares	**1 267**	**0,3**	1 453	0,3
Deductions	**(3 684)**	**(0,8)**	(3 192)	(0,7)
Goodwill	**(554)**	**(0,1)**	(568)	(0,1)
50% of financial and insurance entities not consolidated	**(162)**	**(0,0)**	(122)	(0,0)
50% of amount by which expected loss exceeds eligible provisions	**(1 401)**	**(0,3)**	(1 352)	(0,3)
Other deductions	**(1 567)**	**(0,4)**	(1 150)	(0,3)
Non-core Tier 1				
Preference share capital and premium	**4 644**	**1,0**	4 644	1,1
Tier 1 capital (primary capital)	**54 015**	**12,3**	51 329	12,1
Tier 2 capital (secondary capital)	**14 637**	**3,4**	11 160	2,6
Subordinated redeemable debt	**16 111**	**3,7**	12 611	2,9
General allowance for impairment losses on loans and advances, after deferred tax – standardised approach	**89**	**0,0**	23	0,0
Deductions	**(1 563)**	**(0,3)**	(1 474)	(0,3)
50% of financial and insurance entities not consolidated	**(162)**	**(0,0)**	(122)	(0,0)
50% of amount by which expected loss exceeds eligible provisions	**(1 401)**	**(0,3)**	(1 352)	(0,3)
Total qualifying capital (excluding unappropriated profits)	**68 652**	**15,7**	62 489	14,7
Qualifying capital (including unappropriated profits)				
Tier 1 capital	**61 661**	**14,0**	59 620	14,1
Core Tier 1 (excluding unappropriated profits)	**49 371**	**11,3**	46 685	11,0
Unappropriated profits	**7 646**	**1,7**	8 291	2,0
Non-core Tier 1	**4 644**	**1,0**	4 644	1,1
Tier 2 capital	**14 637**	**3,4**	11 160	2,6
Total qualifying capital (including unappropriated profits)	**76 298**	**17,4**	70 780	16,7

Notes

[1]Percentage of capital to RWA.

[2]Reserves exclude unappropriated profits.

Capital supply *(continued)*

Breakdown of qualifying capital *(continued)*

	Bank 2012 Qualifying capital Rm	2012 %[1]	2011 Qualifying capital Rm	2011 %[1]
Core Tier 1	44 863	11,6	40 655	10,6
Ordinary share capital	303	0,1	303	0,1
Ordinary share premium	12 465	3,2	11 465	3,0
Reserves[2]	34 659	9,0	30 959	8,0
Deductions	(2 564)	(0,7)	(2 072)	(0,5)
50% of amount by which expected loss exceeds eligible provisions	(1 517)	(0,4)	(1 501)	(0,4)
Other deductions	(1 047)	(0,3)	(571)	(0,1)
Non-core Tier 1				
Preference share capital and premium	4 644	1,2	4 644	1,2
Tier 1 capital (primary capital)	49 507	12,8	45 299	11,8
Tier 2 capital (secondary capital)	14 647	3,8	11 110	2,9
Subordinated redeemable debt	16 111	4,2	12 611	3,3
General allowance for impairment losses on loans and advances after deferred tax – standardised approach	53	0,0	—	—
Deductions				
50% of amount by which expected loss exceeds eligible provisions	(1 517)	(0,4)	(1 501)	(0,4)
Total qualifying capital (excluding unappropriated profits)	64 154	16,6	56 409	14,7
Qualifying capital (including unappropriated profits)				
Tier 1 capital	52 702	13,7	51 339	13,3
Core Tier 1 (excluding unappropriated profits)	44 863	11,6	40 655	10,6
Unappropriated profits	3 195	0,9	6 040	1,5
Non-core Tier 1	4 644	1,2	4 644	1,2
Tier 2 capital	14 647	3,8	11 110	2,9
Total qualifying capital (including unappropriated profits)	67 349	17,5	62 449	16,2

Economic capital requirements

We assess EC requirements by measuring our risk profile using both internally and externally developed models. We assign EC primarily within six risk categories: retail and wholesale credit risk (including residual value risk), traded and non-traded market risk, operational risk, fixed assets risk and equity investment risk in the banking book.

We regularly enhance our EC methodologies and benchmarks outputs to external reference points. Industry benchmarks and best practice are considered and used in our evaluation and enhancement of existing EC methodologies.

The EC methodology incorporates the key credit risk parameters based on average credit conditions (TTC effect), rather than those prevailing at the reporting date (PIT) effect. This seeks to reduce cyclicality from the EC calculation. It also reflects the time horizon, correlation of risks and risk concentrations.

Notes

[1]Percentage of capital to RWA.

[2]Reserves exclude unappropriated profits.

Economic capital requirements *(continued)*

The EC framework covers not only Basel II Pillar 1 risks but also additional economic risks not covered at all, or inadequately covered in Pillar 1 such as interest rate risk in the banking book. A further risk included as an add-on to EC is concentration risk within the credit portfolio.

The total average EC required by the Group, determined by the risk assessment models and considering the Group's estimated portfolio effects, is compared with the available financial resources (EC supply) to evaluate EC utilisation.

Economic capital resources

The resources available to meet EC requirements are calculated as the average available shareholders' equity after adjustment including preference shares, but excluding other non-controlling interests. Our EC calculations form the basis of our submission for the Basel II ICAAP.

Funds available for EC are impacted by a number of factors that have arisen from the application of IFRS.

EC supply includes:

- ordinary shareholders' equity;
- retained earnings, whether appropriated or not; and
- non-redeemable, non-cumulative preference shares.

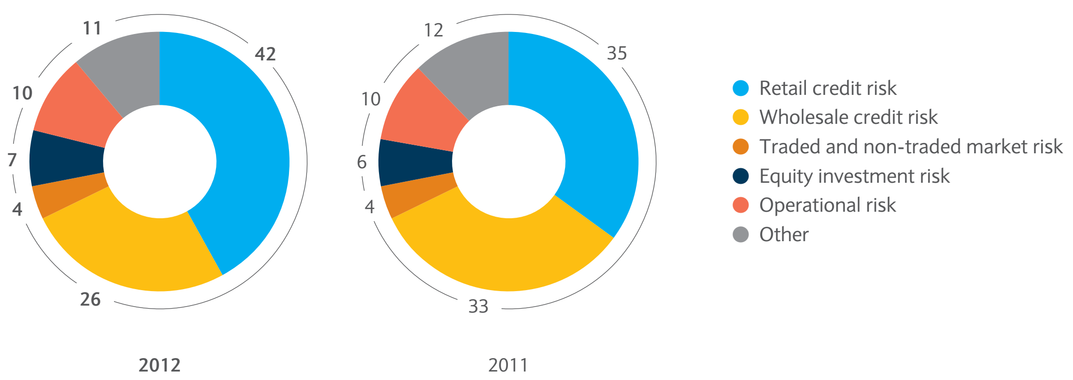
The following equity reserves are excluded from EC resources:

- Cash flow hedging reserve: to the extent that we undertake the hedging of future cash flows, shareholders' equity will include gains and losses that will be offset against the gain or loss on the hedged item when it is recognised in the statement of comprehensive income at the conclusion of the hedged transaction. Given the future offset of such gains and losses, they are excluded from shareholders' equity when calculating EC.
- Available-for-sale reserve: unrealised gains and losses on such securities are included in shareholders' equity until disposal or impairment. Such gains and losses are excluded from shareholders' equity for the purposes of calculating EC.
- Retirement benefit assets and liabilities: we have recorded a surplus with a consequent increase in shareholders' equity. This represents a non-cash increase in shareholders' equity. For the purposes of calculating EC, pension surplus is excluded from shareholders' equity.
- Non-controlling interest.
- Other perpetual debt, preference shares and subordinated debt.
- Tertiary capital.

The following are deducted from EC supply:

- goodwill; and
- intangible assets.

Economic capital[1] (%)



Note

[1]Excludes insurance due to the difference in the confidence level resulting from insurance regulation.

Capital risk

Translation foreign exchange risk

Translational foreign exchange risk arises from capital resources (including investments in subsidiaries and branches, intangible assets, non-controlling interests, deductions from capital and debt capital instruments) and RWA being denominated in foreign currencies. Changes in foreign exchange rates result in changes in the rand equivalent value of foreign currency denominated capital resources and RWA.

Our investments in foreign currency subsidiaries and branches create capital resources denominated in foreign currencies. Changes in the rand value of investments resulting from foreign currency movements are captured in the currency translation reserve, which are currently excluded from qualifying capital resources under the SARB's rules. This will change with the implementation of Basel III when the reserves will form part of qualifying capital.

To minimise volatility of capital ratios caused by foreign exchange rate movements, we aim to maintain an appropriate foreign currency capital structure by maintaining the ratio of foreign currency Core Tier 1, Tier 1 and total capital resources to foreign currency RWA in line with our capital risks. This is primarily achieved by subsidiaries issuing capital or holding retained earnings in local currencies or through the Group issuing debt capital in foreign currency.

Translational foreign currency risk can be mitigated through derivatives or borrowings in the same currency as the functional currency involved, designated as net investment hedges, or through economic hedges. Translational hedging considerations include exchange control regulations, the strategic nature of the investment, materiality of the risk, prevailing foreign exchange rates, market liquidity, cost of hedging and the impact on capital ratios. Based on these considerations, no foreign currency net investment hedges were in place for the current reporting period.

Translational foreign exchange risk is monitored regularly to consider the need for mitigating actions towards minimising material fluctuations. A sensitivity analysis is provided in the market risk section of this document.

Credit ratings

	October 2012	January 2013	
	Moody's[1] Absa Bank Limited	Fitch ratings[2] Absa Bank Limited	Absa Group Limited
National			
Short-term	Prime-1.za	F1+ (zaf)	F1+ (zaf)
Long-term	Aa2.za	AAA (zaf)	AAA (zaf)
Outlook	—	Stable	Stable
Local currency			
Short-term	Prime-2	—	—
Long-term	A3	A–	A–
Outlook	Negative	Stable	Stable
Foreign currency			
Short-term	Prime-2	F2	F2
Long-term	Baa1	A–	A–
Outlook	Negative	Stable	Stable
Bank's financial strength	C-	—	—
Baseline credit assessment	Baa1	—	—
Viability rating	—	bbb	bbb
Outlook	Stable	—	—
Support	—	1	1

Notes

[1]With regard to the Bank's EMTN programme, the provisional foreign-currency senior unsecured debt rating of (P) A3 any issued foreign-currency senior unsecured debt rating of (P) A3, any issued foreign-currency senior unsecured debt rated A3 the provisional foreign-currency subordinated debt ratings of (P)Baa2 and (P)Baa3, respectively, remain unaffected. The outlook for all ratings is negative.

[2]Senior unsecured debt: Long-term foreign currency, rating affirmed at 'A-'; short-term foreign currency affirmed at 'F2'. Senior unsecured notes: National long-term rating upgraded to AAA (zaf) from AA+ (zaf).