# BIDVEST BANK LIMITED
## RISK MANAGEMENT REPORT
as at 31 December 2010

Bidvest Bank

# Risk Management Report

## Introduction and overview

Bidvest Bank (the Bank) has exposure to the following major risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks
- reputational risk

This report presents information about the Bank's exposure to each of the above-mentioned risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

## Risk management framework

The board of directors of the Bank (the Board) has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Risk and Capital Management Committee, Asset and Liability Committee, and Credit Committee, which are responsible for developing and monitoring the Bank's risk management policies in their specified areas. The Risk and Capital Management Committee comprises non-executive directors, and executives attend by invitation. The Asset and Liability Committee and the Credit Committee each have a non-executive chairman and executives as members.

In addition, an Operational Risk Committee comprises executive members from key business areas in the Bank, and reports quarterly to the Risk and Capital Management Committee.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies are reviewed regularly to reflect changes in strategy and products and services offered. The Bank, through its training and management standards and procedures, aims to maintain a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Risk and Capital Management Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee assesses the appropriateness of risk-related provisions.

## Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers.

### *Management of credit risk*

The Board has delegated responsibility for the management of credit risk to its Credit Committee, which is chaired by a non-executive director. The Credit Committee assesses counterparty credit risk by reviewing published financial statements which are available to the public. A separate Credit Department is responsible for oversight of the Bank's credit risk, including:

- *Formulating credit policies* in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- *Establishing the authorisation structure for the approval and renewal of credit facilities.* All facilities require approval by the Head of Credit, Credit Committee or the Board according to authorisation limits.
- *Reviewing and assessing credit risk.* The Credit Department assesses all credit exposures prior to facilities being committed to customers. Renewals and reviews of facilities are subject to the same review process.
- *Limiting concentrations of exposure* to counterparties, geographies, products and industries.
- *Reviewing compliance* of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to the Credit Committee on the credit quality of portfolios and appropriate corrective action is taken.
- *Providing advice, guidance and specialist skills* to business units to promote best practice throughout the Bank in the management of credit risk.

| *Exposure to credit risk* | Gross maximum exposure | | Loans and advances | | Other financial assets | |
|---|---|---|---|---|---|---|
| | 2010 R'000 | 2009 R'000 | 2010 R'000 | 2009 R'000 | 2010 R'000 | 2009 R'000 |
| *Individually impaired* | | | | | | |
| Gross amount | | | | | | |
| Exceptional credit quality | - | - | - | - | - | - |
| Good credit quality | - | - | - | - | - | - |
| Average credit quality | 689 | 1 588 | 689 | 1 588 | - | - |
| Deteriorated credit quality | 1 010 | 1 504 | 1 010 | 1 504 | - | - |
| Unrated | - | 44 | - | 44 | - | - |
| Total | 1 699 | 3 136 | 1 699 | 3 136 | - | - |
| Allowance for impairment | (1 127) | (1 243) | (1 127) | (1 243) | - | - |
| Carrying amount | 572 | 1 893 | 572 | 1 893 | - | - |
| *Loans and advances collectively impaired* | | | | | | |
| Gross amount | | | | | | |
| Exceptional credit quality | - | 31 663 | - | 31 663 | - | - |
| Good credit quality | 57 771 | 55 689 | 57 771 | 55 689 | - | - |
| Average credit quality | 105 556 | 84 974 | 105 556 | 84 974 | - | - |
| Deteriorated credit quality | 17 468 | 12 848 | 17 468 | 12 848 | - | - |
| Unrated | - | 15 860 | - | 15 860 | - | - |
| Total | 180 795 | 201 034 | 180 795 | 201 034 | - | - |
| Allowance for impairment | (4 624) | (6 939) | (4 624) | (6 939) | - | - |
| Carrying amount | 176 171 | 194 095 | 176 171 | 194 095 | - | - |
| *Neither past due nor impaired* | | | | | | |
| Gross amount | | | | | | |
| Exceptional credit quality | 253 891 | 502 311 | 109 604 | 306 742 | 144 287 | 195 569 |
| Exceptional credit quality (banks) | 535 056 | 639 259 | 8 637 | 18 333 | 526 419 | 620 926 |
| Good credit quality | 462 933 | 129 354 | 153 244 | 9 284 | 309 689 | 120 070 |
| Average credit quality | 7 272 | 94 109 | 7 272 | 94 109 | - | - |
| Carrying amount | 1 259 152 | 1 365 033 | 278 757 | 428 468 | 980 395 | 936 565 |
| Total carrying amount | 1 435 895 | 1 561 021 | 455 500 | 624 456 | 980 395 | 936 565 |
| Less financial instruments not exposed to credit risk | (144 287) | (195 569) | | | | |
| | 1 291 608 | 1 365 452 | | | | |
| Represented by the following statement of financial position items: | | | | | | |
| Balance with banks | 526 419 | 620 926 | | | | |
| Derivative financial assets | 74 174 | 28 695 | | | | |
| Loans and advances | 455 500 | 624 456 | | | | |
| Investment securities | 66 895 | 58 874 | | | | |
| Other assets | 168 620 | 32 501 | | | | |
| | 1 291 608 | 1 365 452 | | | | |

The maximum exposure to credit risk is represented by the carrying amount of each financial asset including derivatives in the statement of financial position. Instalment sales and finance lease agreements have been included in the above credit risk analysis.

Where a company has a rating issued by a recognised rating agency, that rating has been applied. If not, an internal risk-based rating process has been applied.

On 1 June 2010, the Bank acquired a 100% interest in a leasing business from The Bidvest Group Limited. At date of acquisition, the exposure to credit risk in the leasing business was warranted by The Bidvest Group Limited. All warranted loans are reflected as unimpaired, good credit quality. No impairment provision has been raised in the financial statements during the period ended 31 December 2010 for any pre-acquisition warranted exposures, as the full carrying value is anticipated to be received.

### *Leased assets*

The leased assets are moveable assets rented to customers under operating leases. This is in the range of 3 – 5 years tenor. The leased assets are depreciated over the shortest period of the lease or the useful life of the asset. The maintenance costs are borne by the Bank and are expensed as they are incurred.

Leased assets are disclosed at fair value, and tested for impairment on a bi-annual basis. The carrying value of leased assets at 31 December 2010 amounted to R1.6 billion (2009: R92 million). The Bank acquired a leasing business with the effective date of 1 June 2010. The financial risk in relation to these leased assets has been adjudicated by the Board.

### *Impaired loans*

An impaired loan is a loan which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan agreement.

### *Impairment policy*

The Bank writes off a loan (and any related allowances for impairment losses) when the Credit Committee determines that the loan is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance loans, impairment decisions generally are based on a product specific past due status.

### *Allowances for impairment*

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

The past due not impaired balance equals R6 136 436 at December 31 2010 (2009: RNil) up to 30 days which relates to loans and advances to customers only. The carrying amount of renegotiated loans at December 31 2010 was R1 310 304 (2009: RNil). Adequate security exists to cover capital and interest and have thus not been impaired.

### *Security held*

The Bank holds financial collateral and other security against loans and advances to customers in the form of mortgage bonds over property, assets financed, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of security assessed at the time of borrowing, and are updated regularly, and are reported on the following page:

## Security value

| | Loans and advances 2010 R'000 | 2009 R'000 |
|---|---|---|
| *Against individually impaired* | | |
| Movable assets | - | 253 |
| Cash, debtors, stock | - | - |
| Property | 24 | 35 |
| Unsecured | 548 | 1 605 |
| Total | 572 | 1 893 |
| *Collectively impaired* | | |
| Movable assets | 68 949 | 51 660 |
| Cash, debtors, stock | 14 356 | 50 704 |
| Property | 44 676 | 42 001 |
| Equity | - | 1 193 |
| Guarantees | 24 439 | 40 297 |
| Unsecured | 23 751 | 8 240 |
| Total | 176 171 | 194 095 |
| *Neither past due nor impaired* | | |
| Movable assets | 43 371 | 75 469 |
| Guarantees | 235 386 | 352 999 |
| Carrying amount | 455 500 | 624 456 |

## Security valuation

| Type | Tangible value |
|---|---|
| Rand Cash (cession over deposit account) | 100% |
| Foreign cash (cession over CFC account) | 90% |
| Pledge of Shares (JSE top 100)<br>Quarterly statements are obtained from the customer's Broker | 50% |
| Cession of Unit Trusts<br>Monthly statements are obtained from the customer's Broker | 50% |
| Gold coins | 50% |
| Cession of Insurance / Endowment Policy<br>Valued at the time the cession is signed by obtaining surrender values directly from the Assurance company | Extra security, no commercial value |
| Cession of Debtors<br>Valued monthly upon submission of debtor lists to the Bank | 25% excluding arrears, depending on the quality of the book |
| General Notarial Bond over Stock<br>Valued monthly upon submission of stock lists to the Bank | 25% |
| Mortgage Bonds over property<br>Valuation conducted by an independent Valuator approved by the Bank when the deal is initiated | 60% |
| A1 rated bank guarantee | 100% |
| Suretyships | 0% |
| Estimated market values per asset for asset based finance | 100% |

The above table represents the method applied by the Credit Committee in determining the value of security. It would be impractical to disclose the fair value of security based on the type and nature of the security. Guarantees are obtained in the normal course of business in assessing client credit worthiness. The majority of guarantees held are from listed entities with an official agency rating.

## *Credit risk by sector*

The Bank monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown hereafter:

| | Loans and advances | | Investment securities | |
|---|---|---|---|---|
| | 2010 R'000 | 2009 R'000 | 2010 R'000 | 2009 R'000 |
| **Concentration by sector** | | | | |
| Agriculture, Hunting, Forestry & Fishing | **1 942** | - | - | - |
| Manufacturing | **11 318** | 25 564 | - | - |
| Mining & Quarrying | **14 595** | 1 607 | - | - |
| Construction | **16 593** | 13 981 | - | - |
| Wholesale | **160 937** | 320 546 | - | - |
| Transport, storage and communication | **87 303** | 30 943 | - | - |
| Financial intermediation and insurance | **65 970** | 42 606 | **20 813** | 20 711 |
| Real estate | **39 081** | 21 783 | - | - |
| Business services | **26 319** | 145 107 | - | - |
| Community, social and personal services | **10 225** | 14 745 | - | - |
| Private households | **19 559** | 7 574 | - | - |
| Utilities | **448** | - | - | - |
| Other | **1 210** | - | **46 082** | 38 163 |
| Total | **455 500** | 624 456 | **66 895** | 58 874 |
| Of which: | | | | |
| Sovereign (central government and central bank) | **6 699** | 12 622 | - | - |

The Bank also monitors concentrations of credit risk by geographical area and apart from a number of small accounts at foreign banks has exposure in South Africa only.

## *Settlement risk*

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, or other assets as contractually agreed.

## *External credit assessment*

It is the policy of the Bank to only place funds on deposit with A1 rated Banks.

## *Counterparty credit risk*

The Bank nets its exposures with counterparty banks where there are formal legal netting agreements in place.

### Carrying value (gross less impairment) of banking and other advances for which collateral is held

| 2010 | Gross R'000 | (Impairment) R'000 | Net R'000 | Guarantees & suretyship R'000 | Pledge of assets and other R'000 | Total collateral R'000 | Carrying value for which no collateral is held R'000 | Net R'000 |
|---|---|---|---|---|---|---|---|---|
| Not past due | 459 552 | (4 624) | 454 928 | 165 671 | 265 506 | 431 177 | 23 751 | 454 928 |
| Past due 0-30 days | 26 | - | 26 | - | - | - | 26 | 26 |
| Past due 31-180 days | 609 | (63) | 546 | - | 24 | 24 | 522 | 546 |
| Past due 181-365 days | 1 064 | (1 064) | - | - | - | - | - | - |
| Total | 461 251 | (5 751) | 455 500 | 165 671 | 265 530 | 431 201 | 24 299 | 455 500 |

| 2009 | Gross R'000 | (Impairment) R'000 | Net R'000 | Guarantees & suretyship R'000 | Pledge of assets and other R'000 | Total collateral R'000 | Carrying value for which no collateral is held R'000 | Net R'000 |
|---|---|---|---|---|---|---|---|---|
| Not past due | 629 502 | (6 939) | 622 563 | 301 114 | 313 209 | 614 323 | 8 240 | 622 563 |
| Past due 0-30 days | 932 | (558) | 374 | - | 288 | 288 | 86 | 374 |
| Past due 31-180 days | 1 104 | (208) | 896 | - | - | - | 896 | 896 |
| Past due 181-365 days | 1 100 | (477) | 623 | - | - | - | 623 | 623 |
| Total | 632 638 | (8 182) | 624 456 | 301 114 | 313 497 | 614 611 | 9 845 | 624 456 |

Capital requirements for credit risk are calculated by making use of daily average balances for all overdraft, corporate, money market and overnight loan exposures as required in terms of Regulation 23(3) of the Regulations relating to Banks. The gross month end exposures reflected above are representative of these average balances.

## Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities.

### *Management of liquidity risk*

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The daily liquidity position is monitored daily. All liquidity policies and procedures are subject to review and approval by the Asset and Liability Committee (ALCO). Daily reports cover the liquidity position of the Bank and are submitted regularly to ALCO. The maturities of financial liabilities are presented to ALCO on a regular basis.

### *Residual contractual maturities of financial liabilities*

| | Carrying amount R'000 | Less than 1 month R'000 | 1-3 months R'000 | 3 months to 1 year R'000 | 1-5 years R'000 |
|---|---|---|---|---|---|
| **31 December 2010** | | | | | |
| *Non-derivative liabilities* | | | | | |
| Intergroup loan | **(325 400)** | **-** | **-** | **-** | **(325 400)** |
| Other liabilities | **(345 937)** | **(345 937)** | **-** | **-** | **-** |
| Deposits | **(1 200 361)** | **(749 194)** | **(190 708)** | **(260 459)** | **-** |
| *Derivative liabilities* | | | | | |
| Trading: outflow (liabilities) | **(66 889)** | **(26 043)** | **(33 355)** | **(7 491)** | **-** |
| Trading: inflow assets | **74 174** | **20 103** | **34 875** | **19 196** | **-** |
| | **(1 864 413)** | **(1 101 071)** | **(189 188)** | **(248 754)** | **(325 400)** |
| 31 December 2009 | | | | | |
| *Non-derivative liabilities* | | | | | |
| Other liabilities | (117 080) | (117 080) | - | - | - |
| Deposits | (931 305) | (743 664) | (135 077) | (52 342) | (222) |
| *Derivative liabilities* | | | | | |
| Trading: outflow (liabilities) | (23 680) | (6 745) | (10 354) | (6 581) | - |
| Trading: inflow assets | 28 695 | 6 738 | 12 251 | 9 190 | 516 |
| | (1 043 370) | (860 751) | (133 180) | (49 733) | 294 |

The aforementioned table shows the carrying value of cashflows on the Bank's financial liabilities on the basis of their earliest possible contractual maturity.

## Market risks

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Overall authority for market risk is vested in ALCO. The Risk Department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation.

### *Exposure to interest rate risk – non-trading portfolios*

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cashflows or fair values of financial instruments because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. ALCO is the monitoring body for compliance with these limits and is assisted by the Risk Department in its day-to-day monitoring activities. A summary of the Bank's interest rate gap position on non-trading portfolios is shown on the following page:

| | Carrying amount R'000 | Less than 3 months R'000 | 3-12 months R'000 | 1-5 years R'000 | More than 5 years R'000 |
|---|---|---|---|---|---|
| **31 December 2010** | | | | | |
| Cash and balances with banks | **670 706** | **670 706** | **-** | **-** | **-** |
| Loans and advances | **455 500** | **198 980** | **146 053** | **94 056** | **16 411** |
| Leased assets | **1 602 311** | **262 661** | **349 124** | **973 939** | **16 587** |
| Investment securities | **66 895** | **20 813** | **44 611** | **1 471** | **-** |
| Other assets | **98 151** | **98 151** | **-** | **-** | **-** |
| Intergroup loan | **(325 400)** | **-** | **-** | **(325 400)** | **-** |
| Deposits | **(1 200 361)** | **(939 902)** | **(260 459)** | **-** | **-** |
| | **1 367 802** | **311 409** | **279 329** | **744 066** | **32 998** |
| 31 December 2009 | | | | | |
| Cash and balances with banks | 816 495 | 816 495 | - | - | - |
| Loans and advances | 624 456 | 378 128 | 50 587 | 185 066 | 10 675 |
| Leased assets | 92 183 | 92 183 | - | - | - |
| Investment securities | 58 874 | 20 711 | 5 062 | 5 283 | 27 817 |
| Deposits | (931 305) | (878 741) | (52 342) | (222) | - |
| | 660 703 | 428 776 | 3 307 | 190 127 | 38 492 |

### *Stress test*

The management of interest rate risk against interest rate gaps is accomplished through monitoring the sensitivity of the Bank's financial assets and liabilities to various standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 200 basis point (bp) parallel fall or rise. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates for a six month period (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

| | 200bp parallel increase R'000 | 200bp parallel decrease R'000 |
|---|---|---|
| **As at 31 December 2010** | | |
| Monthly impact before tax on net interest income | 2 280 | (2 280) |
| As at 31 December 2009 | | |
| Monthly impact before tax on net interest income | 1 101 | (1 101) |

Overall non-trading interest rate risk positions are managed by the Treasury Department, which uses investment securities, advances to banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's non-trading activities.

### *Foreign exchange rate sensitivities*

| **Currency profile** R'000 | ZAR | GBP | USD | EUR | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| **2010** | | | | | | |
| **Assets** | | | | | | |
| Cash and balances with banks | 530 075 | 39 371 | 41 681 | 43 506 | 16 073 | 670 706 |
| Derivative financial assets | 74 174 | - | - | - | - | 74 174 |
| Loans and advances | 441 949 | - | 13 524 | - | 27 | 455 500 |
| Leased assets | 1 602 311 | - | - | - | - | 1 602 311 |
| Investment securities | 66 895 | - | - | - | - | 66 895 |
| Other assets | 168 620 | - | - | - | - | 168 620 |
| Equipment | 67 788 | - | - | - | - | 67 788 |
| Intangible assets | 31 196 | - | - | - | - | 31 196 |
| | 2 983 008 | 39 371 | 55 205 | 43 506 | 16 100 | 3 137 190 |
| Commitment to purchase forward exchange contracts | - | 68 752 | 1 235 548 | 210 178 | 95 573 | 1 610 051 |
| Total assets | 2 983 008 | 108 123 | 1 290 753 | 253 684 | 111 673 | 4 747 241 |
| 2009 | 1 518 192 | 19 836 | 145 216 | 24 035 | 18 554 | 1 725 833 |
| Commitments to purchase forward exchange contracts | - | 63 076 | 678 133 | 166 127 | 48 013 | 955 349 |
| Total assets | 1 518 192 | 82 912 | 823 349 | 190 162 | 66 567 | 2 681 182 |
| **2010** | | | | | | |
| **Equity and liabilities** | | | | | | |
| Share capital | 1 980 | - | - | - | - | 1 980 |
| Share premium | 435 799 | - | - | - | - | 435 799 |
| Reserves | 686 009 | - | - | - | - | 686 009 |
| Intergroup loan | 325 400 | - | - | - | - | 325 400 |
| Derivative financial liabilities | 66 889 | - | - | - | - | 66 889 |
| Deposits | 853 059 | 62 244 | 196 777 | 64 112 | 24 169 | 1 200 361 |
| Other liabilities | 279 048 | - | - | - | - | 279 048 |
| Taxation | 141 704 | - | - | - | - | 141 704 |
| | 2 789 888 | 62 244 | 196 777 | 64 112 | 24 169 | 3 137 190 |
| Commitments to sell forward exchange contracts | - | 42 994 | 1 090 280 | 193 161 | 94 098 | 1 420 533 |
| Total equity and liabilities | 2 789 888 | 105 238 | 1 287 057 | 257 273 | 118 267 | 4 557 723 |
| 2009 | 1 479 931 | 32 515 | 174 472 | 28 226 | 10 689 | 1 725 833 |
| Commitments to sell forward exchange contracts | - | 51 733 | 646 934 | 165 226 | 49 053 | 912 946 |
| Total equity and liabilities | 1 479 931 | 84 248 | 821 406 | 193 452 | 59 742 | 2 638 779 |

| Net open position | GBP R'000 | USD R'000 | EUR R'000 | OTHER R'000 | TOTAL R'000 |
|---|---|---|---|---|---|
| **31 December 2010** | **2 885** | **3 696** | **(3 589)** | **(6 594)** | **(3 602)** |
| 31 December 2009 | (1 336) | 1 943 | (3 290) | 6 825 | 4 142 |

| Closing spot exchange rate | GBP | USD | EUR |
|---|---|---|---|
| **31 December 2010** | **R10,29** | **R6,65** | **R8,87** |
| 31 December 2009 | R11,90 | R7,38 | R10,63 |

| Average exchange rate | GBP | USD | EUR |
|---|---|---|---|
| **For the period ended 31 December 2010** | **R11,13** | **R7,11** | **R9,42** |
| For the period ended 31 December 2009 | R12,14 | R7,48 | R10,93 |

This currency profile analyses the assets and liabilities in terms of their originating currencies. These totals are then expressed in South African Rand at the closing spot exchange rate.

| Foreign currency sensitivity based on a 10% movement in exchange rate | 2010 R'000 | 2009 R'000 |
|---|---|---|
| GBP | **288** | (134) |
| USD | **369** | 194 |
| EUR | **(359)** | (329) |
| Other | **(658)** | 683 |
| | **(360)** | 414 |

## Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses not part of operational risk with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. The Operational Risk Committee is responsible for oversight of the Bank's operational risks.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Bank standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective

## Reputational risk

The Bank manages reputational risk by an integrated strategy, understanding the correlation between sustainable performance and reputation, and between corporate image and corporate reputation.

The following basic strategies are followed to manage reputational risk:

- fostering a reputation-conscious culture
- linking corporate social responsibility to reputation
- measuring the impact of media coverage, perceptions and stakeholder impressions
- developing plans to develop and protect reputation
- monitoring potential reputation-damaging issues
- proactively exploiting good news and having a crisis communication plan to respond in times of bad news
- transforming potential disasters into opportunities

## Capital management

### *Regulatory capital*

The Bank's regulator, The South African Reserve Bank ("SARB"), sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements the SARB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets, market risk exposure and operational risk exposure. The Bank follows the Standardised approach under Basel II and calculates requirements for market risk in its banking portfolios based upon the Bank's market risk models and uses both external and internal gradings as the basis for risk weightings for credit risk.

The Bank's regulatory capital is analysed into two categories:

- Primary capital, which includes ordinary share capital, share premium and retained earnings.
- Secondary capital, which includes collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-statement of financial position exposures.

The Bank's internal capital adequacy assessment process (ICAAP) is formalised and approved by the Board. The Bank's policy is to maintain a strong capital base so as to maintain investor, credit and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank and its operations have complied with all externally imposed capital requirements throughout the period and previous period.

There have been no material changes in the Bank's management of capital during the period.

The Bank's ICAAP reflects its internal assessment of risk. The ICAAP determines the most suitable level of economic capital, i.e. the capital required to remain solvent under conditions that are extreme in nature. For potential losses arising from risk types that are statistically quantifiable, economic capital reflects the worst case loss taking risk-adjusted returns on capital (RAROC) into account.

The final economic capital level determined through the ICAAP reflects the capital to be held for risks as assessed by management instead of implicated by a prescribed regulatory formula. The economic capital requirement is then compared to the regulatory capital requirement to determine the buffer to be held for uncertainties to ensure adequate capitalisation for the Bank.

Statement of financial position forecasting based on business and strategy planning allows management to ensure that minimum required capital ratios are adhered to.

## Basel III Liquidity Coverage Ratio (LCR)

The Bank currently complies with the Basel III LCR requirement. At 31 December 2010, the Bank's position is:

| | R'000 |
|---|---|
| High quality liquid assets | 135 283 |
| Net cash outflows over the following 30 calendar days | 64 821 |
| LCR | 209% |
| Minimum Basel III LCR requirement | 100% |

## Basel III Net Stable Funding Ratio (NSFR)

The Bank currently complies with the Basel III NSFR requirement. At 31 December 2010, the Bank's position is:

| | R'000 |
|---|---|
| NSFR | 101% |
| Minimum Basel III NSFR requirement | 100% |

The Bank's regulatory capital position at 31 December was as follows:

| Net qualifying capital and reserves | 2010 R'000 | 2009 R'000 |
|---|---|---|
| **Primary capital** | 755 112 | 485 112 |
| Share capital | 1 980 | 1 800 |
| Share premium | 435 799 | 165 979 |
| Appropriated retained earnings | 317 333 | 317 333 |
| Less impairment | (54 220) | (49 010) |
| **Total qualifying capital and reserves** | 700 892 | 436 102 |
| **Non qualifying capital and reserves** | 422 896 | 216 427 |
| Retained earnings not formally appropriated | 368 676 | 167 417 |
| Impairment | 54 220 | 49 010 |
| **Total capital and reserves** | 1 123 788 | 652 529 |

| Risk-weighted exposure | Capital requirement 2010 R'000 | Risk-weighted exposure 2010 R'000 | Capital requirement 2009 R'000 | Risk-weighted exposure 2009 R'000 |
|---|---|---|---|---|
| ***Credit risk*** | | | | |
| Retail bank, corporate bank and central treasury | 65 697 | 677 426 | 205 269 | 2 105 322 |
| ***Market risk*** | | | | |
| Retail bank, corporate bank and central treasury | 1 178 | 12 091 | 1 019 | 10 450 |
| ***Operational risk*** | | | | |
| Retail bank, corporate bank and central treasury | 107 175 | 1 107 169 | 64 376 | 660 263 |
| ***Equity risk*** | | | | |
| Retail bank, corporate bank and central treasury | 3 327 | 17 889 | 157 | 1 611 |
| **Other assets** | 452 528 | 1 903 588 | 7 746 | 79 448 |
| Total | 629 905 | 3 718 163 | 278 567 | 2 857 094 |

| Capital ratios | 2010 | 2009 |
|---|---|---|
| Total capital adequacy ratio | 18,85% | 15,26% |
| Total primary capital adequacy ratio | 18,85% | 15,26% |