Absa Group Limited

Capital and risk management

31 December 2011

Member of the BARCLAYS Group

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Capital and risk management

Introduction

The continuing uncertain economic conditions present a challenge to risk management in the financial services industry. In this context, risk management is a key pillar of the One Absa strategy and is guided by the Principal Risks Policy (PRP), that has been developed and approved by the board. Our structured and disciplined approach to risk management, as well as the enhancements made in the year, position us well to take advantage of sustainable business growth opportunities.

While we identify 14 risk areas related to our business, this report reviews the most important six risks, cross-referencing to a seventh, regulatory risk, which is dealt with in the compliance review. Key areas which receive focus are:

- credit risk management;
- liquidity management;
- maintaining adequate capital buffers; and
- enhancing the level of integration of operational risk management tools and processes.

2011 in review

Capital management is a key strategic pillar supporting the One Absa strategy. Closely related is the management of our liquidity resources in order to meet potential stresses on the financial system. We closely monitor key areas such as market conditions, the global banking industry, Basel II.5 and Basel III requirements and anticipated demands relating to Absa's future asset growth. The environment turned out relatively benign, being largely shielded here in South Africa from the turmoil of international markets. The key challenge going forward will be to sustain this favourable position and to exploit the foundation it provides more aggressively for specific, value-adding opportunities.

2011 was a year in which we:

- consolidated and improved our internal risk management processes, in particular the measurement of risk and the calculation of risk versus return;
- improved our liquidity position;
- experienced an improvement in credit risk exposure;
- improved the internal operational risk management processes and environment; and
- limited market and equity risk exposures.

As a result, we saw a marked improvement in both the level and structure of our capital. Capital levels stayed above target ranges for both the Group and the Bank, with Core Tier 1 capital levels improving by 130 and 140 basis points (bps) respectively.

The regulatory environment continues to shift, necessitating robust engagement with all relevant authorities. The Group has investigated the impact of Basel II.5 and Basel III and is prepared for full implementation within the timelines required. Due to existing strong capital positions, capital management is not expected to be significantly impacted by Basel III, although uncertainties remain. Based on an initial assessment, capital requirements and risk-weighted assets (RWAs) may increase, but overall capital adequacy should remain at levels above the range set by the board. The Core Tier 1 ratio is expected to decrease by 110 bps after taking into account the potential impact of the offset of the implementation of Advanced Internal Ratings Based (AIRB). RWA optimisation is a key focus area. The Group is participating in ongoing discussions with the regulator concerning the local application and discretionary limits of Basel III.

During the year, the Group further improved liquidity risk management in formulating the Group's liquidity risk appetite (measured as the number of days that the Group is expected to survive a defined liquidity stress scenario). We have extended this horizon and now hold sufficient liquidity resources to meet the Group's liquidity risk appetite, which is to be able to survive a severe liquidity stress for a minimum period of 30 days. We will continue to focus on liquidity risk management during 2012 and to strengthen the Group's liquidity position ahead of the implementation of Basel III to achieve compliance within the required timeframes. The Basel III liquidity requirements remain challenging for the Group and other South African banks in spite of the work done in recent years to further strengthen the liquidity position. We look forward to continued engagement with the South African Reserve Bank (SARB) to ensure an appropriate implementation of the Basel III liquidity framework in South Africa.

Risk management will not be significantly impacted by the application of King III in 2012.

Further reviews of the risks we manage are described in the tables following this introduction.

The Group's approach to risk management

The board-approved PRP sets out the scope of the risks facing the Group and who is responsible for managing these risks. Oversight resides with two board committees, the Group Risk and Capital Management Committee (GRCMC) and the Group Audit and Compliance Committee (GACC). A combined assurance model, owned and managed by Group Risk, covers each principal risk and business area. The aim is to provide a co-ordinated approach to all assurance activities enabling the board and management to assess if the significant risks facing the Group are adequately covered and to maximise the value of these activities.

The GRCMC

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 Group's risk profile against the risk appetite on a quarterly basis. The GRCMC also approves control frameworks for various principal risks and assists in determining capital and liquidity target ranges and monitoring the Group's capital and liquidity levels.

Our five-step process to risk management

Risk management process	
Identify	➜ Understand the principal risks fundamental to achieving the Group's 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. ➜ Provide early warning of control or appetite breaches. ➜ 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. ➜ Communicate with external parties.
Manage/challenge	➜ Review and challenge all aspects of the Group's risk profile. ➜ Assess new risk-return opportunities. ➜ Advise on ways to optimise the Group's risk profile. ➜ Review and challenge risk management practices.

The GRCMC consists of six non-executive directors, five of whom are independent directors. The GRCMC meets on a quarterly basis.

GRCMC meetings during the year were also attended by the Group Chief Executive (GCE), Deputy Group Chief Executive, Group Financial Director, Chief Risk Officer and Group Treasurer. Internal and external auditors also attended the meetings in accordance with the Group's governance processes.

The meetings were convened under the mandate contained in its terms of reference 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 attended all meetings of the GACC, met with the Chief Risk Officer and executive management on a regular basis and reported to the board after each committee meeting.

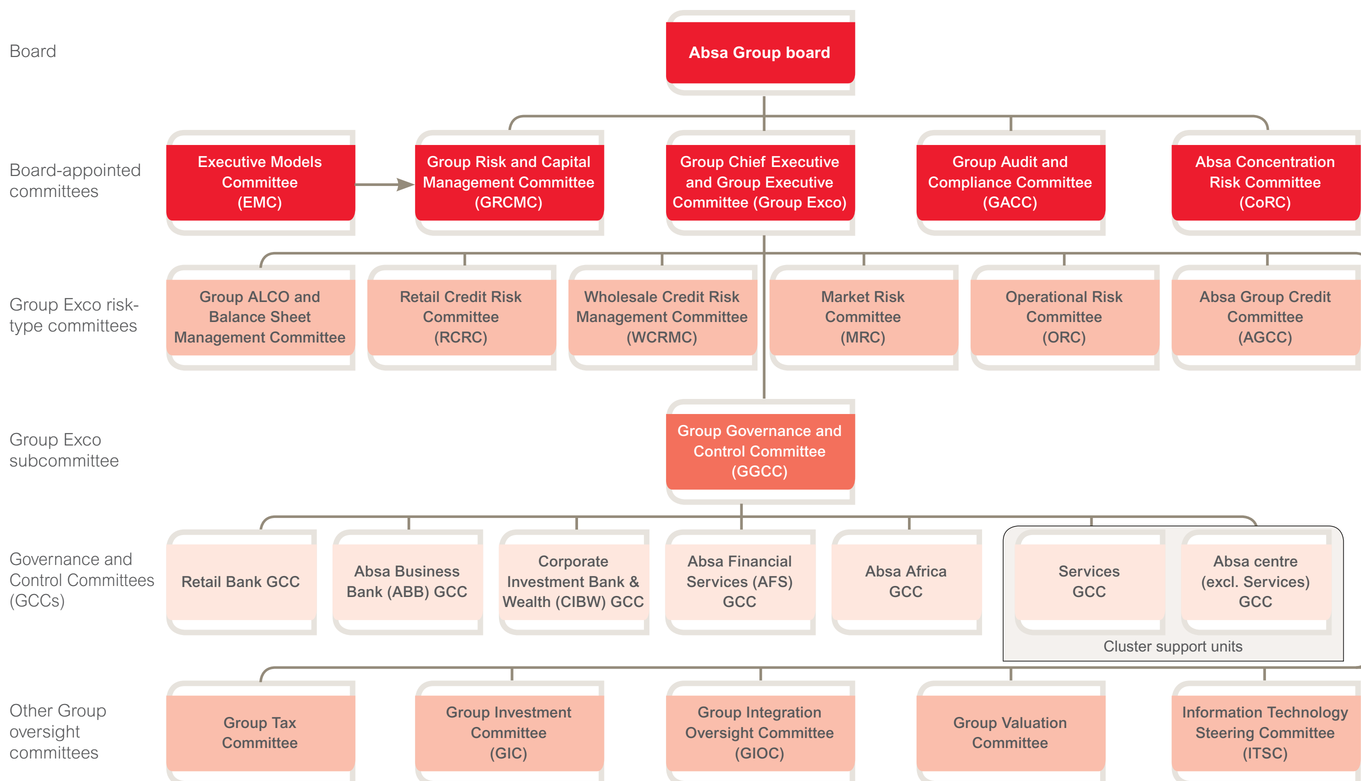
Core activities of the GRCMC

During the year, the GRCMC's activities and key decisions included:

- recommending the Group's risk appetite to the board for approval and monitoring, on a quarterly basis, 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 the Group's emerging risk profiles and reporting its 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 the Group's 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 the risk governance structures and oversight measures for information technology;
- ensuring the appropriate disclosure by the Group of its risk and capital management status and activities; and
- setting the Group's liquidity risk appetite and monitoring the liquidity position of the Group over the year.

The GRCMC is satisfied that the risk management processes and systems provide comprehensive and adequate oversight over the risk exposure of the Group. The GRCMC is satisfied that management was able to effectively respond to, and manage, the risks that arose from time to time.

Absa's risk governance structure



The Group's risk appetite

The Group's risk appetite is defined as the level of risk the Group is willing to accept in fulfilling its business objectives. The Group's risk appetite framework is embedded within key decision-making processes and supports the implementation of the Group's strategy. We use this to maximise returns without exposing the Group to levels of risk above its appetite. In particular, the risk appetite framework assists in protecting the Group's financial performance, improves management responsiveness and debate regarding the Group's risk profile, assists executive management in improving the control and co-ordination of risk-taking across business units (BUS) and identifies unused 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 the Group's sensitivity to adverse changes in the business environment). This framework then forms the basis for setting BU targets and risk-taking limits across the Group.

The Group's 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
- desired dividend payout levels.

Stress testing

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

Stress tests simulate the effects on the business' 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 horizon. Stress testing also forms an integral part of evaluating the Group's risk appetite for reasonableness under specifically designed scenarios. Stress tests are regularly discussed with the regulators. We participated in Barclays group-wide stress testing. This has also included participation in the Barclays submission related to the European Union (EU)-wide annual stress testing conducted by the European Banking Authority (EBA).

Looking forward

The Group is positioning itself for growth, notwithstanding uncertain and (at times) volatile market conditions. We are working to maintain the quality, level and mix of the Group's capital and to generate sufficient capital to support the exploitation of growth opportunities. We will further strengthen our liquidity risk position ahead of Basel III. By focusing on value and balance sheet optimisation, we will ensure optimal capital and funding utilisation. Through responsible lending and rehabilitation practices we are managing credit risk successfully, despite ongoing pressure in both the wholesale and retail environments.

We will continue to monitor the economic and regulatory environment and ensure that we adapt our risk management to deal with the changing demands on all our business ventures.

Risk disclosure approach

The Group's approach to the disclosure of risk management represents the required disclosures under both International Financial Reporting Standards (IFRS) and Basel Pillar 3 disclosure requirements and therefore represents a holistic view of the risks of the Group.

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

- Capital management pages 12 and 13;
- Credit risk pages 21 – 22, 24 – 25, 38 – 43, 46 – 49; 51 – 53 and 56;
- Market risk pages 62, 63 – 64, table on page 65, pages 67 – 69, 70 – 71, 73, 74 – 75 and table on page 77;
- Liquidity risk pages 79, 80 and 85 – 87;
- Operational risk page 90; and
- Insurance risk pages 92 and 95 – 101.

All other disclosures represent regulatory disclosures, which are unaudited. Any reference to a note in the sections that follow refers to the applicable note in Absa Group Limited's annual consolidated financial statements as at 31 December 2011.

Risk report summary table

Capital management	2011 in review	Looking forward

Capital management

Definition

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

KPIs[1]

	2011 %	2010 %
Core Tier 1 capital adequacy ratio	13,0	11,7
Return on average risk-weighted assets (RoRWA)	2,35	1,99
Return on average economic capital (RoEC)	23,0	19,7
Cost of equity[2]	14,0	14,0

Strategy

- Maximise shareholder value by optimising the level and mix of capital resources.

2011 in review

Focus in 2011 included:

- improving capital adequacy levels;
- increasing RoRWAs;
- improving understanding of risk, allowing more accurate allocation of capital and improved returns;
- ensuring capital models were updated to reflect the current environment;
- RWA optimisation; and
- AIRB approach for the wholesale credit portfolio.

Capital levels remain above board-approved target ranges for both the Group and the Bank, with Core Tier 1 capital levels improving by 130 and 140 bps respectively. Proactive capital management, including RWA optimisation, remains a priority.

The Basel III framework, released in December 2010, is expected to have a significant effect on the global banking industry. The framework introduces new and more stringent capital and liquidity requirements which are expected to be phased in over a number of years.

Looking forward

Our focus for 2012 is to maintain a strong level, high quality and optimal mix of capital. We will continue to generate sufficient capital to support economically profitable asset growth, while actively managing the business portfolio. In addition, we intend to further optimise the use of capital without jeopardising its ability to comply with expected Basel III regulatory changes. As in 2011, RWA optimisation remains a key focus, together with implementing the AIRB approach for the wholesale credit portfolio.

We are actively engaging with the SARB to obtain more clarity regarding the application of Basel III in South Africa and local discretionary limits which are still to be determined. The Group deems it prudent to maintain higher capital levels in the interim.

Notes

[1]Reported ratios include unappropriated profits.

[2]The average cost of equity is based on the Capital Asset Pricing Model (CAPM).

Risk report

Credit risk

Definition

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

KPIs

	2011 %	2010 %
Growth in loans and advances to customers	(1,0)	(1,6)
Non-performing loans as a percentage of loans and advances to customers	6,9	7,6
Impairment losses ratio	1,01	1,18
Total credit impairments as a percentage of total gross loans and advances to customers	2,4	2,7

Strategy

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

Securitisation

In seeking to pool debt, spread risk and fund the Group's loan operations, securitisation exposes Absa to the risks of irresponsible lending. This may result from declines in underwriting standards, excessive leverage and the risks inherent in the complexity of securitisation instruments.

2011 in review

Wholesale credit risk

Domestic and international uncertainty reflected in volatile local equity markets, resulting in credit quality (in the form of probability of default (PD)) marginally degrading across the majority of industries within the wholesale portfolio. In spite of this, the performance of the wholesale book in 2011 was steady. The value of exposures on the early warning list (EWL) (the Group's distressed debt list) has decreased, across the board, and particularly in commercial property finance (CPF), and identified and unidentified impairment levels have reduced from 2010 levels.

Retail credit risk

Conditions remained challenging, although signs of the expected economic recovery were in evidence. Growth proved difficult and the total portfolio remained static. The Group reviewed its lending policies on a regular basis to ensure returns were optimised. Impairments improved, but remain a key focus. The mortgage loans business reduced market share in 2011 as the retail strategy focused on value creation by ensuring the optimal return levels were met. Mortgage loans have since reviewed the direct strategy through mortgage originators in order to sustain an acceptable market share. Early delinquencies continued to improve in all portfolios. The lengthy process to resolve the legal book, particularly the secured portfolios, has kept this area under pressure, exacerbated by the debt counselling process and the subdued mortgage market. Although improved collections processes and strategies for the mortgage legal portfolio and properties in possession started to bear fruit, a protracted recovery period remains probable. The reduction in the debt counselling book continued in 2011 and stabilised towards the end of the year as accounts entered the legal process.

Securitisation

In line with the Group's strategy, the securitisation portfolio has reduced during the year. Abacas, Absa's securitisation conduit, was wound up in December 2011, decreasing from R2,53 billion at 31 December 2010 to Rnil and notes held on the statement of financial position decreased from R2,2 billion to R1,6 billion in the same time frame, due to natural amortisation.

Looking forward

Wholesale credit risk

We expect to see continued improvement in wholesale impairment levels, and reduced exposure on the EWL. Focus areas for 2012 include reducing concentrations to perceived higher risk sectors, enhancing the risk and control framework and further embedding the AIRB principles in the business.

Retail credit risk

We will continue to focus on value and balance sheet optimisation. The aim is to increase portfolio growth through defining low risk pockets/products and improving decision-making processes by continuously assessing market conditions and understanding the impact of economic shifts on the various portfolios. We will therefore remain focused on the quality and profitability of new business written and will continue to be selective in the type of business written within the mortgage portfolios.

We will continue to focus on rehabilitating customer arrears in step with affordability.

We will also focus on reducing non-performing loans (especially in the secured portfolios) by optimising the potential value when disposing of assets.

Securitisation

We will continue to reduce the level of on-statement of financial position securitisation exposures. Further, Absa intends to securitise a portion of the CPF portfolio in 2012.

Market risk

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.

KPIs

	2011	2010
Average traded market risk (DVaR) (Rm)	23,73	27,85
Traded market risk regulatory capital (RC) (at 8% of RWAs) (Rm)	669	721
Banking book AEaR for a 2% interest rate shock (% of Group net interest income)	<5%	<5%
Equity investments in the banking book RWAs (Rm)	22 168	25 911

Strategy

- Ensure traded market risk resides mainly in Absa Capital.
- Maintaining a hedge programme encompassing non-traded interest rate risk and equity, towards greater net interest margin stability over a full interest rate cycle
- Apply sound equity investment management principles.

2011 in review

Traded market risk

Despite challenging market conditions, the trading revenue-to-risk ratio remained favourable during the year. The risk profile was adjusted lower in line with increased market volatility and deterioration of traded market liquidity which occurred as a result of the sovereign debt crisis. Average traded market risk daily value at risk (DVaR) decreased by 14,8% from 2010 to 2011, mainly due to lower customer trading activity and lower overnight exposures. The potential impact of increased market volatility was closely monitored through tail risk assessments.

Measurement systems were upgraded to support trading expansion plans and Basel II.5 amendments. Regulatory approval for the Internal Models Approach (IMA) for trading book general position risk was also maintained.

Interest rate risk in the banking book

Interest rate risk in the banking book was managed to low risk appetite levels.

Our hedge programme for structural products and equity remains in place. Cash flow hedge reserves were further bolstered as a result of favourable mark-to-market movements. With South African interest rates at historically low levels during the past 12 months, efficient maintenance of the structural hedge programme was a key focus.

The Group remains exposed to prime-Johannesburg Interbank Agreed Rate (JIBAR) basis risk.

Equity investment risk in the banking book

We have reduced our equity exposures.

Looking forward

Traded market risk

The sovereign debt crisis and spill-over effect into the South African economy remains a concern going into 2012 and will be closely monitored.

From 2012, bank regulations based on Basel II.5 will result in an increase in the Group's traded market risk RC charge primarily due to the introduction of a stressed VaR charge. Traded market risk is expected to return to more normal levels as Basel II.5 implementations become embedded, removing one of the key drivers of uncertainty. Countercyclical enhancements to our traded market risk economic capital model will also result in an increase in internal capital.

The Group will therefore remain focused on risk-adjusted returns and efficient use of risk capital across trading desks and products. Our low capital consuming customer flow, cash equities and prime brokerage businesses remain our key focus areas. We will also continue to focus on customer risk solutions for sub-Saharan Africa markets.

Disclosure enhancements will be introduced in respect of Basel II.5 changes and to improve visibility of the inflation and credit spread asset classes.

Interest rate risk in the banking book

We will continue to manage interest rate risk in the banking book to low levels. Efficient maintenance of the structural interest rate hedge programme will remain a focus area.

Equity investment risk in the banking book

The focus in 2012 for equity investments is to continue to balance the portfolio composition in line with the Group's risk appetite, with further selective exits, as appropriate.

Liquidity risk	2011 in review	Looking forward

Definition

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

KPIs

	2011 %	2010 %
Long-term funding ratio	26,8	25,6
Loans-to-deposits ratio	88,1	92,1

Strategy

- Grow and diversify the funding base.
- Lengthen the Group's funding profile.
- Build surplus liquid asset holdings.
- Lower the weighted average cost of funding.

2011 in review

The Group's liquidity position remained strong as it continued to focus on increasing its surplus liquid asset reserves, extending its funding term and growing its deposit base. Relatively slow growth in the South African economy meant that the supply of liquidity remained strong. The level of surplus liquid assets held by Absa (defined as unencumbered liquid assets held in excess of the amount required to be held in accordance with the regulations) increased during 2011. As at the reporting date, R27 billion of surplus liquid assets were held. Total liquid assets held were R63 billion, an increase of R10 billion on 2010.

The Group successfully issued senior unsecured debt to further extend its funding term and diversify its funding base. The Group also succeeded in reducing its reliance on wholesale money markets funding sources. The cost of liquidity remained high, but reduced from peak levels seen towards the end of 2009 and 2010. The appetite for term funding in the money markets reduced towards the end of the year, driven largely by asset managers rebalancing the duration profiles of their money market funds.

Looking forward

Regulators have allowed several years for full implementation of the Basel liquidity rules. Compliance with the liquidity coverage ratio, aimed at promoting the short-term resilience of a bank's liquidity risk profile, is required by January 2015, whereas compliance with the net stable funding ratio, aimed at promoting resilience over a longer time horizon (one year), is required by January 2018. The Group will continue to focus on liquidity risk to maintain and continuously improve its strong liquidity risk position ahead of Basel III and to ensure full compliance within the required timeframes.

Operational risk	2011 in review	Looking forward

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.

KPIs

	2011	2010
Total number of events	↓	↓
Total loss value	↓	↑

Strategy

- Further embed an operational risk-aware culture throughout the Group.
- Hold a risk-sensitive RC for operational risk under the Advanced Management Approach (AMA).
- Enhance controls using automated solutions as far as possible, specifically relating to fraud and e-fraud.
- Set and monitor appropriate operational risk appetite and tolerance levels.

2011 in review

AMA approval was maintained for the Group subject to the relevant RC floors.

Losses were kept to acceptable levels and remain within appetite.

The implementation of new controls improved the management of fraud risk and resulted in fewer losses for the year compared to 2010. Total losses remained within appetite and were down from 2010, partially due to improved recoveries on losses.

Several control improvement projects were implemented during the year, which included new systems and technological processes to reduce operational risk (including the risk of fraud) and consequent losses.

We improved our risk governance structures and oversight measures for information technology.

The continued focus on control enhancements for financial and violent crime resulted in a decrease in losses.

Looking forward

We will continue to control fraud (the key operational risk within the Group) through further implementation and enhancement of fraud systems.

A key focus area will be to mitigate operational risks arising from new projects and programmes implemented in response to the changing economic and regulatory environments.

Plans to grow the African presence will require continuous assessment of operational risks and a determined response to them. Additional focus will be placed on sound project and programme management going forward to reduce risks arising from ‘change’.

Technology risk management capabilities will be further enhanced.

Given regulatory changes and increasing focus on consumer protection, related risks will be monitored.

Insurance risk	2011 in review	Looking forward

Definition

The risk that future claims and expenses will exceed the allowance for expected claims and expenses in measuring policyholder liabilities and in product pricing.

KPIs

	2011 %	2010 %
Short-term loss ratio	**67,4**	68,5
Life new business margin	**7,4**	9,5
Return on shareholders' assets versus benchmark	**7,3 vs 6,9**	13,8 vs 10,7

Strategy

- Sustainability through risk management and governance.
- Pursue profitable growth opportunities.
- Balance exposure between life and short-term insurance.

2011 in review

All insurance risk types remained well within set appetite limits. We completed a realignment of the Absa Life portfolios with revised asset allocations. This resulted in improved matching between assets and policyholder liabilities, and a decrease in the risk profile of shareholder assets.

We increased our focus on profitability management per product line and implemented corrective measures to ensure products met the required levels of return.

A review of risk management processes indicated the entities are well prepared for the developing solvency assessment and management (SAM) legislation.

Looking forward

We will continue developing the capital model for the short-term insurance environment and maintain focus on driving product profitability by maximising returns on capital allocated to individual product lines.

We will continue with the work required in preparation for the SAM legislation and, in particular, an assessment of the risk profiles of the insurance entities and the capital requirements specific to these profiles.

Focus will also remain on:

- diversifying the risk between business lines and between South African and non-South African risks; and
- enhancing risk reporting and measurement with the aim of improving the monitoring of risk appetites and capital requirements across the insurance businesses, particularly in respect of non-South African insurance exposures.

Highlights

- *Strong level and mix of capital maintained.*
- *Increase in Core Tier 1 capital ratio indicating improved quality of capital.*
- *Strong capital position maintained above board-approved target ranges, incorporating capital buffers above minimum regulatory requirements.*
- *Focused on optimising RWAs.*

Key performance indicators[1]

	Group	
	2011 %	2010 %
Core Tier 1	**13,0**	11,7
Return on average risk-weighted assets (RoRWA)	**2,35**	1,99
Return on average economic capital (RoEC)	**23,0**	19,7
Cost of equity[2]	**14,0**	14,0

	Bank	
	2011 %	2010 %
Core Tier 1	**12,1**	10,7
Cost of equity[2]	**14,0**	14,0

Introduction

Capital management is a key focus area for the Group. The Group's 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 return on regulatory capital (RoRC), 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. The Group continues to monitor and respond pragmatically to market conditions both locally and internationally, while preparing for the forthcoming Basel III legislative environment. In so doing, the Group will ensure adequate capital is available to support future asset growth.

Capital levels remain well above board-approved target ranges for both the Group and the Bank, with Core Tier 1 capital levels improving by 130 and 140 bps respectively. Proactive capital management, including RWA optimisation and equity generation, remains a priority while further improvements in risk management are implemented. The potential impact of proposed regulatory changes are analysed and steps are taken to integrate necessary changes into the business.

The Basel III framework, released in December 2010, is expected to have a significant effect on the global banking industry. The framework introduces new and more stringent capital and liquidity requirements which are expected to be phased in over a number of years. However, the application of Basel III to South Africa and local discretionary items still needs to be determined and the Group is actively engaging with the SARB to obtain more clarity. The Group deems it prudent to maintain higher capital levels in the interim. The Group is also participating in the Basel Committee on Banking Supervision's Quantitative Impact Studies (QIS), to enable it to assess and provide feedback on the expected impact of the new rules. The Group will continue to review its capital position and implement appropriate management action, when necessary, to ensure it remains adequately capitalised at all times. Further detail on Basel III and the Group's response are set out further on in this section.

Strategy

The Group's capital management objectives are:

- meeting the capital ratios required by regulators and the target ranges (stress buffers over regulatory minimum) set by the board;
- maintaining an adequate level of available capital resources as cover for the economic capital (EC) requirements, calculated at a 99,95% confidence level;
- generating sufficient capital to support asset growth; and
- maintaining an investment grade credit rating.

Governance

Capital is managed in terms of the Group's capital risk control framework. This framework, which includes capital management policy, capital target ranges and capital strategy, is set by the Principal Risk Owner (PRO) for capital management, and is approved by the GRCMC. The board approves the capital risk appetite, as well as the three-year capital plan, as recommended by the GRCMC. The PRO sets a capital management limit framework within the context of the approved capital risk appetite.

All capital risks are reported to the GRCMC on a quarterly basis. The Balance Sheet Management and Capital Committee (BSMCC) meets monthly, in support of the quarterly ALCO meeting, to review, approve and make recommendations relating to the capital risk profile including risk appetite, policies, limits and utilisation.

The head of each BU, assisted by an independent business risk management team, is accountable for all its capital risks. Each BU is responsible for identifying, measuring, managing, controlling and reporting capital risk, as detailed in the capital risk control framework.

Notes

[1]Reported ratios include unappropriated profits.

[2]The average cost of equity is based on the Capital Asset Pricing Model (CAPM).

2011 in review

The Group maintained its strong capital adequacy position, increasing its Core Tier 1 ratio and thereby further improving the quality of capital. Key focus areas included:

- improving capital adequacy levels – the Group ended the year with a strong capital adequacy position, placing it in a healthy position to deal with the implementation of Basel III changes; freeing up of capital through RWA optimisation – which lowers the potential need to raise additional capital in the future, both for Basel III and growth;
- increasing RoRWA – through a combination of active RWA optimisation and targeting higher RoRWA business that meets required hurdle rates; and
- improving understanding of risk – many RWA optimisation exercises focused on improving data quality and improving model accuracy, resulting in a more accurate measurement of risk. The importance of risk sensitive capital allocation, together with the metrics used to measure business performance, allows the Group to allocate capital on a more accurate risk-vs-return basis.

Audited

Approach to capital management

The Group plans and manages its capital to ensure it has sufficient and appropriate capital structures to support its risk appetite and business activities, as well as credit rating and regulatory requirements.

The 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 the Group's strategy, risk management and financial processes. The purpose of the framework is to ensure capital consumption in the BUs has an impact on performance measurement, which in turn translates into management performance assessment, product pricing requirements and the achievement of the Group's desired strategic positioning.

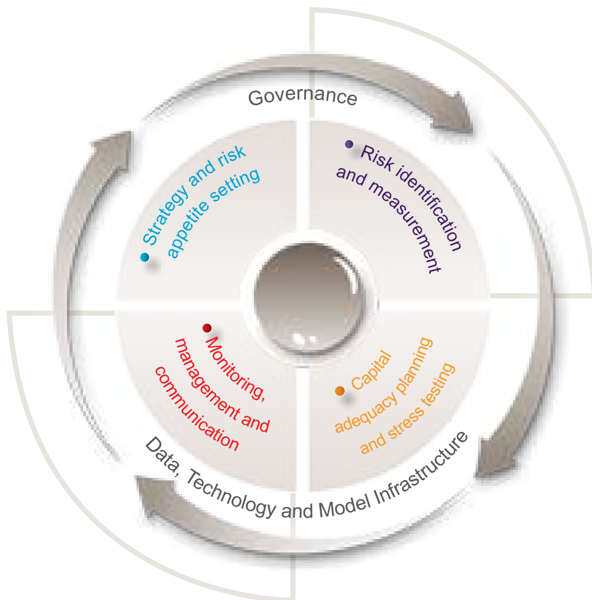
ICAAP

The Group has adopted a building block approach to achieve a robust and integrated capital management framework. EC forms the foundation of this and is the primary means by which the Group assesses the impact of a changing business environment and strategy on its risk profile and the need for capital. EC is a measure of capital required to maintain or achieve a target debt rating. Absa targets a capital level equivalent to an AA rating.

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

While the ICAAP is intended to align with regulatory requirements under Pillar 1 and Pillar 2 of Basel II, the main guiding principle in designing the ICAAP for the Group has been suitability for capital management and other internal applications. The Group considers its ICAAP to be in line with international best practice and is of the opinion that it addresses the core banking principles of Pillar 2 of Basel II.

The building blocks of the Group's ICAAP are as follows:



These processes are conducted within 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 the Group's risk profile. 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 also driven by global events, stress testing has become increasingly important in assessing appropriate levels of capital to ensure the ability to absorb stress events in order to protect our depositors and other stakeholders.

2011 disclosures

The Group maintained its strong position and continued to focus on RWA optimisation and free capital generation.

Capital requirements

The Group manages its 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 (Tier 1 capital plus Tier 2 capital) must sufficiently exceed Basel II 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; and
- in accordance with **board-approved target ranges**: which are derived from the stress testing results, and are set above the minimum regulatory requirements.

Audited

Capital adequacy

The Group sets target capital ranges/levels for regulated entities (as set out below) 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.

The Group monitors capital adequacy and the use of RC by employing techniques based on the guidelines developed by the Basel Committee on Banking Supervision (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 for the Group for the year under review were set by considering the following:

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

	Group			
	2011	2010	Minimum regulatory capital requirements	Board target ranges 2011
Capital adequacy ratios (%)[1]				
Core Tier 1	13,0	11,7	5,25	9,00 – 11,00
Tier 1	14,1	12,8	7,00	10,00 – 12,00
Total	16,7	15,5	9,50	12,00 – 14,00
Capital supply and demand for the year (Rm)				
Free cash flow generated	3 614	2 017		
Qualifying capital	70 780	65 417		
Total RWAs	424 489	422 713		

Note

[1]Reported ratios include unappropriated profits.

Capital management

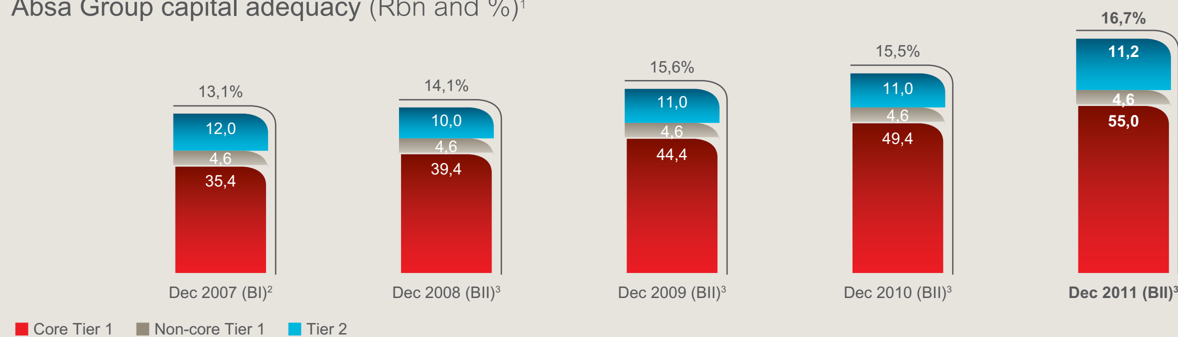
31 December

2011 disclosures *(continued)*

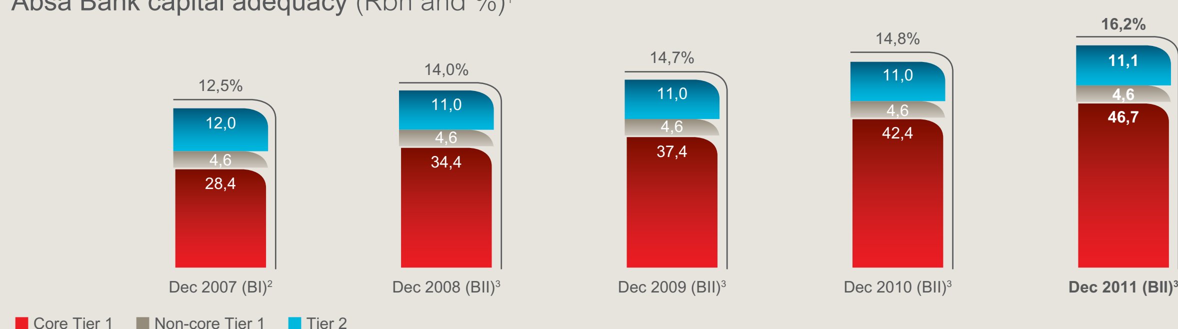
Capital adequacy *(continued)*

	Bank			
	2011	2010	**Minimum regulatory capital requirements**	**Board target ranges 2011**
Capital adequacy ratios (%)[1]				
Core Tier 1	**12,1**	10,7	**5,25**	**8,50 – 10,50**
Tier 1	**13,3**	11,9	**7,00**	**9,50 – 11,50**
Total	**16,2**	14,8	**9,50**	**11,50 – 13,50**
Capital supply and demand for the year (Rm)				
Free cash flow generated	**4 686**	1 532		
Qualifying capital	**62 449**	57 801		
Total RWAs	**384 933**	391 735		

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



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



Notes

[1]Reported ratios include unappropriated profit.

[2]BI: Basel I.

[3]BII: Basel II.

2011 disclosures *(continued)*

Capital adequacy *(continued)*

Target capital ranges/levels were set for the following regulated entities: Absa Group Limited, Absa Bank Limited, Barclays Bank Mozambique S.A. (BBM), National Bank of Commerce (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.

Absa Group – local, foreign banking and insurance entities

		2011			2010			2011	
								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[1] %
Local entities (South Africa)									
Absa Group	SARB								
Including unappropriated profits		70 780	14,1	16,7	65 417	12,8	15,5		12,00-14,00
Excluding unappropriated profits		62 489	12,1	14,7	62 770	12,2	14,9	9,50	
Absa Bank	SARB								
Including unappropriated profits		62 449	13,3	16,2	57 801	11,9	14,8		11,50-13,50
Excluding unappropriated profits		56 409	11,8	14,7	56 890	11,6	14,5	9,50	
Foreign banking entities									
BBM[2]	Banco de Mozambique	158	8,0	8,0	230	17,1	17,1	8,00	15,00
NBC[2]	Bank of Tanzania	734	13,0	13,0	655	13,0	13,0	12,00	14,00
Insurance entities									
Absa Life Limited	FSB[3]	1 198	n/a	2,9 x CAR[4]	1 388	n/a	3,5 x CAR[4]	1,0 x CAR[4]	2,0 x CAR[4]
Absa Insurance Company Limited	FSB[3]	1 716	n/a	60,7% x NWP[5]	1 438	n/a	53,7% x NWP[5]	25% x NWP[5]	45% x NWP[5,6]
Absa *idirect* Limited	FSB[3]	114	n/a	97,5% x NWP[5]	105	n/a	60,1% x NWP[5]	25% x NWP[5]	25% x NWP[5,7]

New disclosure requirements from the SARB require a breakdown of the minimum required capital into the Pillar 1 (minimum Basel II ratio) and Pillar 2a (systemic risk add-on) components.

	2011 Total	Pillar 1	Pillar 2a
Minimum required capital (%)	9,50	8,00	1,50
Absa Group (Rm)	40 326	33 959	6 367
Absa Bank (Rm)	36 569	30 795	5 774

	2010 Total	Pillar 1	Pillar 2a
Minimum required capital (%)	9,50	8,00	1,50
Absa Group (Rm)	40 158	33 817	6 341
Absa Bank (Rm)	37 215	31 339	5 876

Notes

[1]The board approved the following capital target ranges for 2012:

	Total	Core Tier 1
Absa Group	12,50% – 14,00%	9,50% – 11,00%
Absa Bank	12,00% – 13,50%	9,00% – 10,50%

[2]Basel I regulatory ratios and regulatory requirements.

[3]FSB: Financial Services Board.

[4]Capital adequacy requirement (CAR): actuarial calculation of value at risk on insurance liabilities. 2,0 times (2010: 2,0 times) being the required capital level determined by Absa Life Limited.

[5]NWP: net written premiums.

[6]45% (2010: 45%) of NWP, being the required capital level determined by Absa Insurance Company Limited.

[7]Quota share reinsurance is used to maintain capital adequacy at a level sufficiently in excess of the regulatory minimum.

2011 disclosures *(continued)*

Regulatory capital

Risk-weighted assets (RWAs)

RWAs are determined by applying the following:

- AIRB approach for retail credit;
- Foundation Internal Ratings Based (FIRB) approach for wholesale credit;
- AMA for operational risk[1];
- in respect of traded market risk, IMA for general position risk, and Standardised Approach (SA) for issuer specific risk;
- Internal Ratings Based (IRB) market-based simple risk-weighted method for equity investment risk in the banking book; and
- Standardised Approach (SA) for credit risk in all African entities.

Absa Group RWAs and minimum required capital

	Group			
	2011		2010	
	RWAs Rm	**Minimum[2] required capital Rm**	RWAs Rm	Minimum[2] required capital Rm
Basel II measurement approach				
Credit risk	**317 920**	**30 202**	316 967	30 112
Portfolios subject to the AIRB approach	**147 585**	**14 021**	167 618	15 924
Portfolios subject to the FIRB approach	**159 740**	**15 175**	140 802	13 376
Portfolios subject to the Standardised Approach	**10 595**	**1 006**	8 547	812
Equity investment risk				
Market-based approach (simple risk-weight approach)	**22 168**	**2 106**	25 911	2 462
Market risk	**8 357**	**794**	9 013	856
Standardised Approach	**3 828**	**364**	2 752	261
IMA	**4 529**	**430**	6 261	595
Operational risk[1]				
AMA	**59 460**	**5 649**	54 317	5 160
Non-customer assets	**16 584**	**1 575**	16 505	1 568
	424 489	**40 326**	422 713	40 158

Absa Bank RWAs and minimum required capital

	Bank			
	2011		2010	
	RWAs Rm	**Minimum[2] required capital Rm**	RWAs Rm	Minimum[2] required capital Rm
Basel II measurement approach				
Credit risk	**289 949**	**27 545**	294 136	27 943
Portfolios subject to the AIRB approach	**136 786**	**12 995**	155 841	14 805
Portfolios subject to the FIRB approach	**153 163**	**14 550**	138 285	13 137
Portfolios subject to the Standardised Approach	**—**	**—**	10	1
Equity investment risk				
Market-based approach (simple risk-weighted approach)	**24 555**	**2 333**	28 670	2 724
Market risk	**8 357**	**794**	9 013	856
Standardised Approach	**3 828**	**364**	2 752	261
IMA	**4 529**	**430**	6 261	595
Operational risk[1]				
AMA	**51 067**	**4 851**	48 819	4 638
Non-customer assets	**11 005**	**1 046**	11 097	1 054
	384 933	**36 569**	391 735	37 215

Notes

[1]AMA for operational risk, except for an immaterial portion of the Group that uses the BIA, or Standardised Approach.

[2]The required capital is the regulatory minimum excluding the bank specific (Pillar 2b) add on.

2011 disclosures *(continued)*

Capital supply

The Group increased its total qualifying capital supply by R5,4 billion (2010: R5,4 billion).

Movements in qualifying capital

	Group		Bank	
	2011 Rm	2010 Rm	**2011 Rm**	2010 Rm
Balance at the beginning of the year (excluding unappropriated profits)	**62 770**	57 916	**56 890**	51 201
Share capital, premium and reserves	**37**	4 232	**(175)**	4 963
Non-controlling interest – ordinary shares	**238**	(84)	**—**	—
Tier 2 subordinated debt issued	**—**	1 000	**—**	1 000
Tier 2 subordinated debt matured	**—**	(1 500)	**—**	(1 500)
General allowance for credit impairments: Standardised Approach	**3**	(53)	**—**	—
Regulatory deductions	**(559)**	1 259	**(306)**	1 226
Balance at the end of the year (excluding unappropriated profits)	**62 489**	62 770	**56 409**	56 890
Add: unappropriated profits	**8 291**	2 647	**6 040**	911
Qualifying capital including unappropriated profit	**70 780**	65 417	**62 449**	57 801

Breakdown of Absa Group's qualifying capital

	Group			
	2011 Qualifying capital Rm	**%[1]**	2010 Qualifying capital Rm	%[1]
Tier 1 capital (primary capital)	**51 329**	**12,1**	51 414	12,2
Core Tier 1	**46 685**	**11,0**	46 770	11,1
Ordinary share capital	**1 434**	**0,3**	1 433	0,3
Ordinary share premium	**4 676**	**1,1**	4 590	1,1
Reserves[2]	**42 314**	**10,0**	42 364	10,1
Non-controlling interest – ordinary shares	**1 453**	**0,3**	1 215	0,3
Deductions	**(3 192)**	**(0,7)**	(2 832)	(0,7)
Goodwill	**(568)**	**(0,1)**	(572)	(0,1)
50% of financial and insurance entities not consolidated	**(122)**	**(0,0)**	(61)	(0,0)
50% of amount by which expected loss exceeds eligible provisions	**(1 352)**	**(0,3)**	(1 214)	(0,3)
Other deductions	**(1 150)**	**(0,3)**	(985)	(0,3)
Non-core Tier 1	**4 644**	**1,1**	4 644	1,1
Preference share capital and premium	**4 644**	**1,1**	4 644	1,1
Tier 2 capital (secondary capital)	**11 160**	**2,6**	11 356	2,7
Subordinated redeemable debt	**12 611**	**2,9**	12 611	3,0
General allowance for credit impairment, after deferred tax – SA	**23**	**0,0**	20	0,0
Deductions	**(1 474)**	**(0,3)**	(1 275)	(0,3)
50% of financial and insurance entities not consolidated	**(122)**	**(0,0)**	(61)	(0,0)
50% of amount by which expected loss exceeds eligible provisions	**(1 352)**	**(0,3)**	(1 214)	(0,3)
Total qualifying capital (excluding unappropriated profits)	**62 489**	**14,7**	62 770	14,9
Qualifying capital (including unappropriated profits)				
Tier 1 capital	**59 620**	**14,1**	54 061	12,8
Core Tier 1 (excluding unappropriated profits)	**46 685**	**11,0**	46 770	11,1
Unappropriated profits	**8 291**	**2,0**	2 647	0,6
Non-core Tier 1	**4 644**	**1,1**	4 644	1,1
Tier 2 capital	**11 160**	**2,6**	11 356	2,7
Total qualifying capital (including unappropriated profits)	**70 780**	**16,7**	65 417	15,5

Notes

[1]Percentage of capital to RWA.

[2]Reserves exclude unappropriated profits.

2011 disclosures *(continued)*

Capital supply *(continued)*

Breakdown of Absa Bank's qualifying capital

	Bank			
	2011 Qualifying capital Rm	%[1]	2010 Qualifying capital Rm	%[1]
Tier 1 capital (primary capital)	**45 299**	**11,8**	45 669	11,6
Core Tier 1	**40 655**	**10,6**	41 025	10,4
Ordinary share capital	**303**	**0,1**	303	0,1
Ordinary share premium	**11 465**	**3,0**	11 465	2,9
Reserves[2]	**30 959**	**8,0**	31 134	7,9
Deductions	**(2 072)**	**(0,5)**	(1 877)	(0,5)
50% of amount by which expected loss exceeds eligible provisions	**(1 501)**	**(0,4)**	(1 389)	(0,4)
Other deductions	**(571)**	**(0,1)**	(488)	(0,1)
Non-core Tier 1	**4 644**	**1,2**	4 644	1,2
Preference share capital and premium	**4 644**	**1,2**	4 644	1,2
Tier 2 capital (secondary capital)	**11 110**	**2,9**	11 221	2,9
Subordinated redeemable debt	**12 611**	**3,3**	12 611	3,3
Deductions	**(1 501)**	**(0,4)**	(1 390)	(0,4)
50% of amount by which expected loss exceeds eligible provisions	**(1 501)**	**(0,4)**	(1 390)	(0,4)
Total qualifying capital (excluding unappropriated profits)	**56 409**	**14,7**	56 890	14,5
Qualifying capital (including unappropriated profits)				
Tier 1 capital	**51 339**	**13,3**	46 580	11,9
Core Tier 1 (excluding unappropriated profits)	**40 655**	**10,6**	41 025	10,4
Unappropriated profits	**6 040**	**1,5**	911	0,3
Non-core Tier 1	**4 644**	**1,2**	4 644	1,2
Tier 2 capital	**11 110**	**2,9**	11 221	2,9
Total qualifying capital (including unappropriated profits)	**62 449**	**16,2**	57 801	14,8

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.

The Group 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, the Group is not aware of any material impediments to the prompt transfer of capital resources or repayment of intragroup liabilities when due.

Economic capital requirements

The Group assesses EC requirements by measuring its risk profile using both internally and externally developed models. The Group assigns EC primarily within six risk categories: retail credit risk, wholesale credit risk, traded and non-traded market risk, operational risk, fixed assets risk and equity investment risk in the banking book.

The Group regularly enhances its EC methodologies and benchmarks outputs to external reference points. The credit EC methodologies reflects default probabilities during average credit conditions (through-the-cycle (TTC) effect), rather than those prevailing at the reporting date (point-in-time (PIT)), therefore removing cyclicality from the EC calculation.

EC for wholesale credit risk includes counterparty credit risk arising as a result of credit risk on traded market exposures. EC for market risk covers both traded and non-traded market risk. The methodology also adjusts EC to reflect time horizon, correlation of risks and risk concentrations.

Notes

[1]Percentage of capital to RWA.

[2]Reserves exclude unappropriated profits.

2011 disclosures *(continued)*

Economic capital resources

Economic capital requirements *(continued)*

EC is allocated on a consistent basis across all of the Group's businesses and risk activities. A single cost of equity is applied to calculate the cost of risk. The total average EC required by the Group, as determined by risk assessment models and after considering the Group's estimated portfolio effects, is compared with the supply of EC to evaluate EC utilisation.

The resources available to meet EC requirements are calculated as the average available shareholders' equity after adjustment and including preference shares, but excluding other non-controlling interests. The Group's EC calculations form the basis of the Group's submission for the Basel II ICAAP.

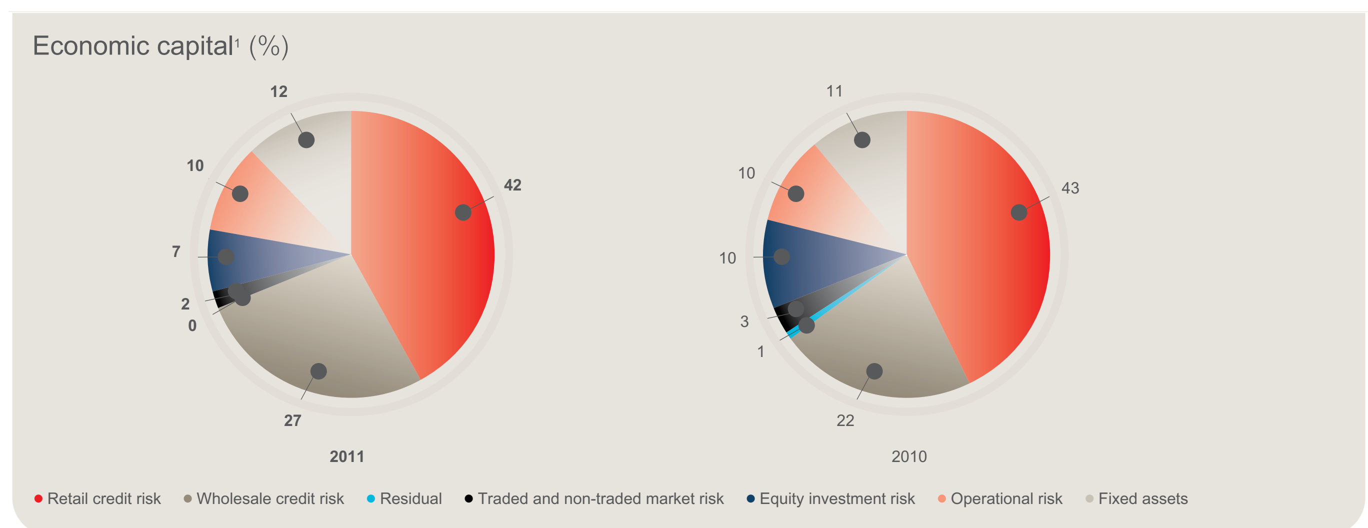
Funds available for EC are impacted by a number of factors that have arisen from the application of IFRS and these are adjusted for in calculating available funds for EC. EC supply includes:

- 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 the Group undertakes 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: the Group has 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;
- goodwill;
- other perpetual debt, preference shares and subordinated debt; and
- tertiary capital.

EC allocations reflect varying levels of risk. 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. Further, other risks included in EC are an add-on for concentration risk within the credit portfolio and country transfer risk.



Note

[1]Excludes insurance due to difference in confidence level in terms of insurance regulation

2011 disclosures *(continued)*

Credit ratings

	November 2011 Moody's[1] Absa Bank	December 2011 Fitch ratings Absa Bank	Absa Group
National			
Short-term	Prime-1.za	F1+ (zaf)	F1+ (zaf)
Long-term	Aa1.za (RFD[2])	AA+ (zaf)	AA+ (zaf)
Outlook	—	Stable	Stable
Local currency			
Short-term	Prime-1	—	—
Long-term	A1 (RFD[2])	A–	A–
Outlook	—	Stable	Stable
Foreign currency			
Short-term	Prime-2	F2	F2
Long-term	A3 (Negative outlook)	A–	A–
Outlook	—	Stable	Stable
Bank's financial strength	C-	C	C
Baseline Credit Assessment[3]	Baa1	—	—
Viability Rating[4]	—	bbb+	bbb+
Outlook	Stable	Stable	Stable
Support	—	1	1

Basel III

The finalised Basel III framework was released on 16 December 2010. The framework focuses on the following areas:

- stringent new liquidity requirements through the creation of two ratios: liquidity coverage ratio and net stable funding ratio;
- higher and better quality capital, including the creation of conservation and counter cyclical buffers;
- improved trading risk coverage; and
- leverage ratio caps with a minimum of 3%, now also incorporating off-statement of financial position exposures.

The Group is expected to remain adequately capitalised following the implementation of Basel II.5 and Basel III. However, it is anticipated that the new rules will increase the Group's capital requirements. Management actions have been identified to mitigate the impact of this anticipated increase in capital requirements.

There is remaining uncertainty regarding the implementation of certain Basel III rules, particularly the National Discretion items, and the Group is actively engaging with the SARB in this regard. The Group has deemed it prudent to maintain higher capital levels until clarity is obtained.

The BCBS is monitoring the potential impact of Basel III by initiating QIS exercises by local regulators worldwide. The Group is participating in the QIS, which covers capital, liquidity and leverage considerations. The QIS will be repeated every six months to refine the expected effects and to investigate the impact of different parameters.

The Group will continue to review its capital position in light of the Basel III rules and will implement appropriate management actions when necessary.

Strategic focus for 2012

Capital management is a key focus area of the Group. The Group's strategic focus for 2012 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, the Group intends to further optimise the use of capital without jeopardising the Group's ability to comply with expected Basel III regulatory changes. As in 2011, RWA optimisation remains a key focus area, together with the implementation of the AIRB approach for the wholesale portfolio.

Notes

[1]With regards the Bank's European Medium Term Note (EMTN) programme, the provisional (p) A1 ratings for senior unsecured debt and (p) A2 rating for subordinated debt have been placed on review for downgrade (RFD). Baa1 (stable outlook) for junior subordinated debt under the EMTN programme has remained unaffected.

[2]On review for downgrade (RFD).

[3]The baseline credit assessment reflects what the local currency deposit rating of the bank with the given Bank Financial Strength Rating would be without any assumed external support from a government or third party.

[4]Fitch introduced a Viability rating on financial institutions around the globe, with effect from July 2011, which represents Fitch's primary assessment of the intrinsic (standalone) creditworthiness of these institutions.

Highlights

- *Continued focus on rehabilitating customer arrears and reducing impairments.*
- *Improved use of data to optimise management of risk vs reward.*
- *Enhanced gover nance and operational efficiencies.*
- *Optimising the potential value when disposing of assets.*

Key performance indicators

	Group	
	2011	2010
	%	%
Growth in loans and advances to customers	**(1,0)**	(1,6)
Non-performing loans as a percentage of loans and advances to customers	**6,9**	7,6
Impairment losses ratio	**1,01**	1,18
Total credit impairments as a percentage of total gross loans and advances to customers	**2,4**	2,7

Audited

Introduction

Credit risk is the risk of loss to the Group 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, and securities borrowing and lending products. It may also arise when fair values of the Group's exposure to financial instruments decline.

Credit risk is a core component of lending quality and impacts on the risk versus reward model. Credit risk has received increased focus due to the current economic conditions and subdued growth.

Strategy

The Group's credit risk management objectives are:

- maintaining an appropriate credit risk structure through continued investment in skilled and experienced staff;
- operating under a sound credit-granting process, using the flexibility of industry leading systems;
- maintaining an appropriate credit administration, measurement and monitoring process;
- ensuring adequate and operationally effective controls over credit risk;
- optimising the use of available credit bureau data to make informed decisions and to build robust models (risk and reward);
- proactively managing credit risk through the economic cycle and ensuring the desired return/economic profit is maintained;
- managing credit risk and the mitigation thereof within the risk appetite boundaries of the Group;
- measuring credit risk inherent in the portfolios using models which are relevant and accurately calibrated; and
- continuing focus on enhancing Absa's collection and recovery process.

Governance

Credit risk is managed in terms of the Group's credit risk control framework. This framework, which provides structures within which credit risk is managed and which defines the responsibilities of stakeholders in the credit risk management process, is set by the PRO for credit risk, and is approved by the GRCMC. During the year, the PRO revised the credit risk control framework. The board approves the credit risk appetite, on the recommendation of the GRCMC. The PRO also sets a credit risk limit framework within the context of the approved credit risk appetite.

All credit risks are reported to the GRCMC on a quarterly basis. The Retail and Wholesale Credit Risk Committees meet every quarter to review, approve and make recommendations relating to the credit risk profile. Regular reporting also takes place to Governance and Control Committees to ensure appropriate management of controls and risk trends.

The head of each BU, assisted by an independent business risk management team, is accountable for all its credit risks. Each BU is responsible for identifying, measuring, managing, controlling and reporting credit risk as detailed in the credit risk policy framework. Various credit cluster committees perform reviews and provide oversight for specific risks in a particular business area.

Credit risk

31 December

Audited

2011 in review

Wholesale credit risk

Locally, the economic recovery of 2010 has given way to disappointing supply-side growth momentum in the second half of 2011, particularly in the mining and manufacturing sectors. Given the structural importance of these sectors to the South African economy as a whole, the slowdown in production has led to a corresponding slowdown in gross domestic product (GDP) growth. The consumption-side of the economy remains the backbone of GDP growth, with robust vehicle sales and positive retail sales momentum continuing to reflect high wage settlements, manageable inflation and low interest rates. This dynamic has flowed through to the commercial property market, which remains subdued apart from pockets of growth in the retail market.

Internationally, European sovereign debt fears continue to affect market confidence. While the Group's direct exposure to European banks is modest and largely collateralised, concerns persist about the impact of continued European volatility on international economic growth prospects.

This combination of local and international uncertainty has manifested in significant volatility in local equity markets during the year, which has resulted in a marginal technical degradation of credit quality (in the form of PD) across the majority of industries within the wholesale portfolio. In spite of this, the performance of the wholesale book in 2011 has been steady. The value of exposures on the EWL (the Group's distressed debt list) has decreased, and specific and portfolio impairment levels have reduced and remained within budget.

Retail credit risk

Conditions remained challenging, although signs of the expected economic recovery were in evidence. Growth proved difficult and the total portfolio remained static. The Group reviewed its lending policies on a regular basis to ensure returns were optimised. Impairments improved, but remains a key focus.

Early delinquencies continued to improve in all portfolios in line with the economic recovery. The lengthy process to resolve legal books, particularly the secured portfolios, has kept this area under pressure, exacerbated by the debt counselling process and the subdued mortgage market. Although improved collections processes and strategies for the mortgage legal portfolio and properties in possession started to bear fruit, a protracted recovery period remains probable.

The reduction in the debt counselling book continued, notwithstanding the moratorium on certain mortgage accounts until March 2011. Many accounts entered the legal process and this continued to place the legal portfolios under pressure.

Securitisation

In line with the Group's strategy, Absa's securitisation portfolio reduced during the year. Abacas, Absa's securitisation conduit, was wound up in December 2011, reducing from R2,53 billion at 31 December 2010 to Rnil, and notes held on-statement of financial position reduced from R2,2 billion to R1,6 billion in the same time frame, due to natural amortisation.

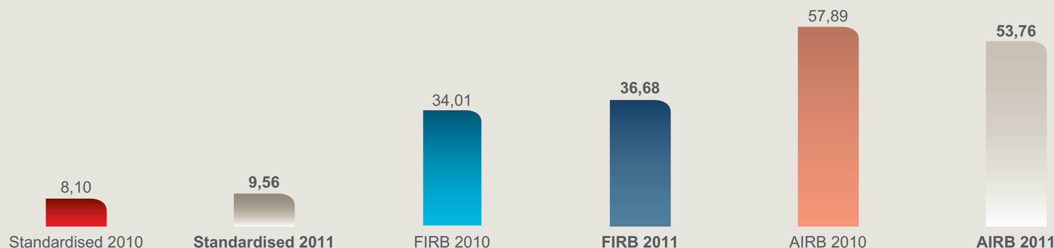
Approach to credit risk

The Group applies both the Standardised and IRB approaches to various portfolios to calculate RC requirements, as illustrated in the table below:

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

Approach to credit risk *(continued)*

EAD per Basel Approach as at December 2011 (%)



RWAs and required capital

	Group			
	2011		2010	
	RWAs Rm	Required capital Rm	RWAs Rm	Required capital Rm
Banks	9 925	943	5 569	529
Corporate exposure	148 297	14 083	125 786	11 950
Corporate	113 161	10 750	106 812	10 147
Small and medium enterprises (SME) Corporate	27 492	2 611	15 413	1 464
Specialised lending – income producing real estate	2 986	282	1 513	144
Specialised lending – project finance	4 658	440	2 048	195
Local governments and municipalities	3 054	290	3 094	294
Public sector entities	2 378	226	6 019	572
Retail	143 047	13 595	167 492	15 912
Mortgages	59 590	5 660	81 900	7 781
Retail – other	48 928	4 648	52 356	4 974
Retail revolving credit	22 078	2 097	21 128	2 007
SME Retail	12 451	1 190	12 108	1 150
Securities firms	393	37	287	27
Sovereign	231	22	173	16
	307 325	29 196	308 420	29 300
Standardised approach	10 595	1 006	8 547	812
	317 920	30 202	316 967	30 112

Standardised approach (SA)

The Group's African operations and the statutory liquid asset portfolios 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 regulations. The statutory liquid asset portfolio has been included in the application to move the wholesale portfolio to the AIRB approach, which was submitted to the SARB during the year.

IRB approach

To assess credit risk under this approach, the Group analyses this risk into its common components of PD, exposure at default (EAD) and loss given default (LGD), modelled on an exposure specific basis in the case of wholesale exposures and 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 both the foundation and the advanced approach, the Group can use its own measure of PD. For the portfolios treated under the foundation approach, the Group estimates LGD and EAD by applying supervisory rules, while these parameters are modelled under the advanced approach.

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

The Group classifies 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 for the respective portfolio as well as the risk the model is intended to assess. The pertinent measures for most credit models are EC and the amount of exposure covered by the model.

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

Audited

Approach to credit risk *(continued)*

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 the Group is exposed from the level of individual facilities up to the total portfolio. Integral to this is the calculation of internal ratings, which are used in numerous aspects of credit risk management and in the calculation of regulatory and EC. The key building blocks of this process are:

- PD;
- EAD; and
- LGD.

Absa Retail 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 Absa Retail has developed the following:

- new bespoke scorecards, incorporating international input, which replaced the existing generic scorecards that had been in place since implementation of the Basel accord;
- amended PD methodology based on the variable scaler approach, which is used to determine through-the-cycle (TTC) PD estimates;
- amended LGD methodologies specifically for Absa's retail secured and unsecured portfolios; and
- a new in-house downturn LGD methodology which was approved by the regulator. This replaced the generic Federal Reserve formula, commonly used in the industry.

Retail portfolios

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, LGD and EAD 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.
- 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 balance, 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.

Further, all retail models have been recalibrated in the year with the exception of the mortgage LGD model which had already been implemented. The remaining recalibrated models will be implemented in the first quarter of 2012.

Wholesale portfolio

The rating process across these portfolios is similar to the retail portfolios and relies both on internally developed PD rating models and vendor provided solutions. Contrary to the largely automated rating and credit decision-making process used for retail portfolios, extensive credit analyses and intuitive assessments are used in the credit decision-making process. Information used in the calculation of customer ratings includes:

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

PD measures based on behavioural scores and equity prices are updated monthly for credit risk management and capital calculation purposes. Other PD models which 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.

2011 disclosures

The assessment of credit risk relies heavily on quantitative models and tools which, to a large degree, have been developed internally and which 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 the Group's portfolios.

Probability of default (PD)

The 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. The Group uses two types of PDs, namely:

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

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

Audited

2011 disclosures *(continued)*

Probability of default (PD) *(continued)*

For communication and comparison purposes, the Group maps its 21 default grades (DG), which is the Group's internal master rating scale, to the SARB 26 grade PD scale, used for regulatory reporting purposes. 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

		Absa DG to PD mapping			Alphanumeric scale mapping			Regulatory PD band to PD mapping		
Default grade bucket	Note	Min PD (>) %	Max PD (<) %	PD Mid-point %	Standard & Poor's	Moody's	Fitch's	PD band	Lower bound %	Upper bound %
1	1	0,0000	0,0200	0,0100	AAA	Aaa	AAA	1	0,0001	0,0120
2		0,0200	0,0300	0,0250	AA	Aa	AA	2	0,0121	0,0170
3		0,0300	0,0500	0,0400	A+	A1	A+	3	0,0171	0,0240
4		0,0500	0,1000	0,0750	A/A–	A2/A3	A/A–	4	0,0241	0,0340
5		0,1000	0,1500	0,1250	BBB+	Baa1	BBB+	5	0,3410	0,0480
6		0,1500	0,2000	0,1750	BBB+/BBB	Baa1/Baa2	BBB+/BBB	6	0,0481	0,0670
7		0,2000	0,2500	0,2250	BBB	Baa2	BBB	7	0,0671	0,0950
8		0,2500	0,3000	0,2750	BBB/BBB–	Baa2/Baa3	BBB/BBB–	8	0,0951	0,1350
9		0,3000	0,4000	0,3500	BBB–	Baa3	BBB–	9	0,1351	0,1900
10		0,4000	0,5000	0,4500	BBB/BB+	Baa3/Ba1	BBB–/BB+	10	0,1901	0,2690
11		0,5000	0,6000	0,5500	BB+	Ba1	BB+	11	0,2691	0,3810
12	2	0,6000	1,2000	0,9000	BB	Ba2	BB	12	0,3811	0,5380
13		1,2000	1,5500	1,3750	BB/BB–	Ba2/Ba3	BB/BB–	13	0,5381	0,7610
14		1,5500	2,1500	1,8500	BB/BB–	Ba2/Ba3	BB/BB–	14	0,7611	1,0760
15		2,1500	3,0500	2,6000	BB–	Ba3	BB–	15	1,0761	1,5220
16		3,0500	4,4500	3,7500	B+	B1	B+	16	1,5221	2,1530
17		4,4500	6,3500	5,4000	B+/B	Ba1/B2	B+/B	17	2,1531	3,0440
18		6,3500	8,6500	7,5000	B	B2	B	18	3,0441	4,3050
19		8,6500	11,350	10,0000	B-	B3	B–	19	4,3051	6,0890
20	3	11,350	18,650	15,0000	CCC+	Caa1	CCC–	20	6,0891	8,6110
21		18,650	100,00	30,0000	CCC	Caa2	CCC	21	8,6111	12,177
Default		100,00	100,00	100,00	D	D	D	22	12,177	17,222
								23	17,222	24,355
								24	24,355	34,443
								25	34,443	100,00
								Default	100,00	100,00

The Group DG grading represents a TTC view of the distribution of the book.

Notes

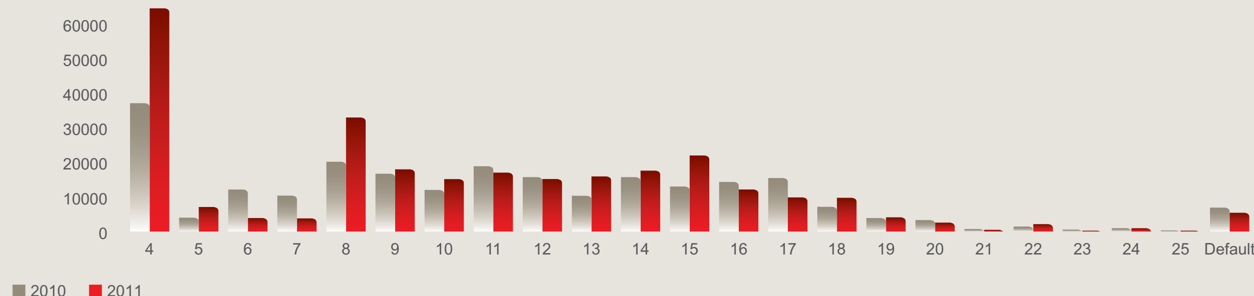
[1]Default grades 1 – 11: assets falling within these DG buckets are regarded as 'investment grade' and, when converted to a rating agency equivalent, correspond to a BB rating and better.

[2]Default grades 12 – 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]Default grades 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, the Group will sustain some loss when default occurs.

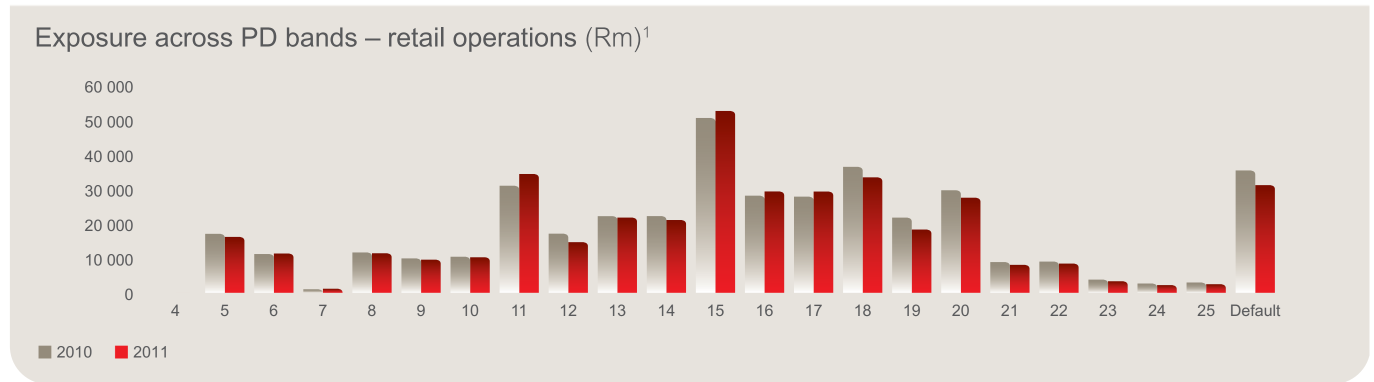
The graphs below provide a view of the year-on-year PD migration for wholesale and retail exposures.

Exposure across PD bands – wholesale operations (Rm)



2011 disclosures *(continued)*

Probability of default (PD) *(continued)*



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 PD estimates with actual default (all numbers stated are Absa Group numbers)

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

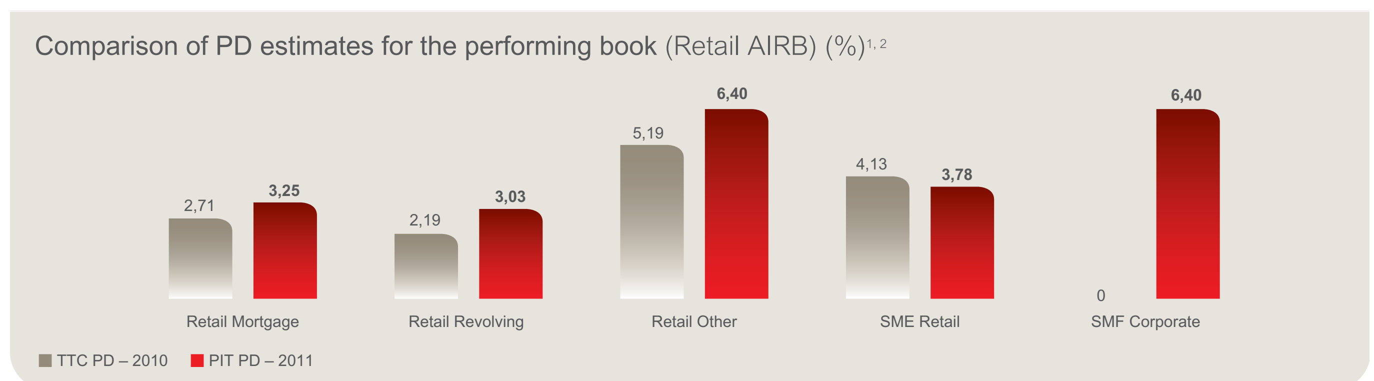
For each Retail and Wholesale Basel II asset class, the assigned PD for RC purposes as at 31 December 2010 is compared to the non-performing loans (NPL) ratio observed in December 2011.

Regulatory PD is TTC while the non-performing loans ratio is observed at a particular point in the cycle (December 2011). To complete the analysis, the observed NPL ratio is also compared to the point-in-time (December 2011) probability of default (PIT PD). A comparison between the TTC PD as at 31 December 2010 and PIT PD as at 31 December 2011 for the performing book only (i.e. defaults excluded) is also carried out.

The main conclusions of the analysis are as follows:

- except for the Retail SME portfolio in wholesale, the regulatory or TTC PD , as at December 2010, is above the non-performing loans ratio observed as at December 2011;
- except for Retail Revolving (Retail – AIRB) and SME Corporate (Wholesale – FIRB), the PIT PD, i.e. the PIT estimates of the model, is above the observed non-performing loans ratio;
- when only the performing book (i.e. excluding defaults) is considered, except for Retail SME, the overall PIT PD as at 31 December 2011 is higher than the TTC PD as at December 2010 for Retail, while it has moved below the TTC PD in the case of wholesale.

It should also be mentioned that new Retail PIT PD and TTC PD models were implemented in December 2010.



Notes

[1]Woolworths Financial Services is excluded from this analysis.

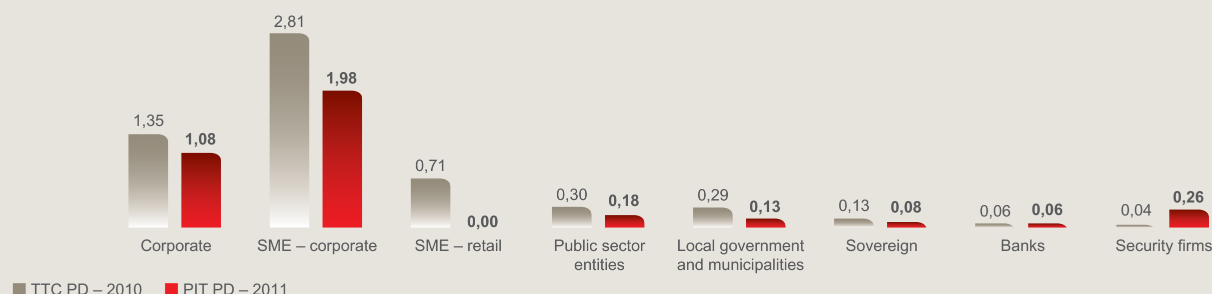
[2]The additional asset class, SME Corporate, reported under AIRB approach for December 2011, is a result of criteria relating to granularity for retail exposures as per SARB circular.

2011 disclosures *(continued)*

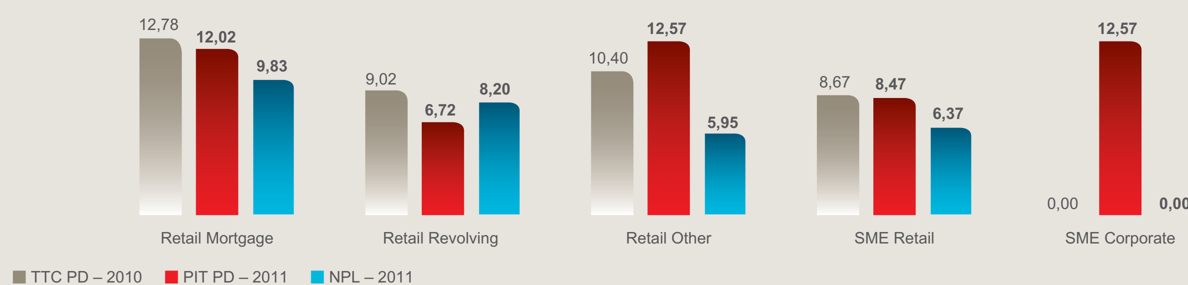
Expected/predicted versus actual loss analysis *(continued)*

Probability of default *(continued)*

Comparison of PD estimates for performing book (Wholesale FIRB) (%)



Comparison of PD estimates (total book) with non-performing loans (Retail AIRB) (%)[1, 2]



Comparison of PD estimates (total book) with non-performing loans (Wholesale FIRB) (%)

Exposure at default (EAD)

The EAD denotes the total amount the Group expects will be outstanding from a particular customer at the time of default. The Group calculates 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 which incorporates existing exposures, as well as exposures contingent on a counterparty's use of an available facility. Standard parameters for credit conversion as prescribed by the local regulator are used for those portfolios on the FIRB approach.

Notes

[1]Woolworths Financial Services is excluded from this analysis.

[2]The additional asset class, SME Corporate, reported under AIRB approach for December 2011, is a result of criteria relating to granularity for retail exposures as per SARB circular.

2011 disclosures *(continued)*

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

Exposure at default (continued)

Comparison of EAD estimates with actual exposure of defaults (all numbers stated are Absa Group numbers)

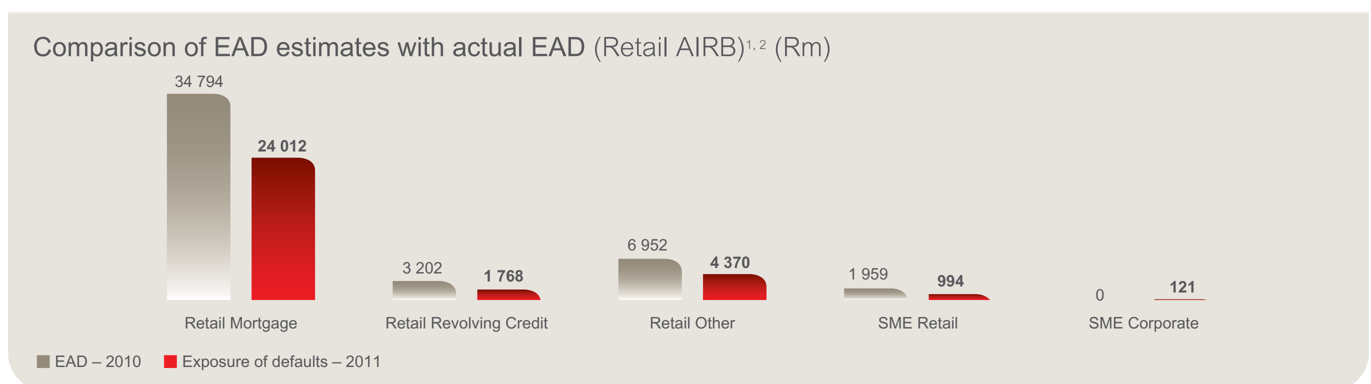
The objective of EAD backtesting is to compare the accuracy of EAD estimates for regulatory purposes with actual exposures at default.

For each Retail and Wholesale Basel II asset class, the estimated EAD (Rm) as at 31 December 2010 is compared to the actual exposures at default (Rm) as at 31 December 2011.

The main conclusion of the analysis is that the actual EAD as at 31 December 2011 is lower than the estimated EAD as at 31 December 2010 in all cases (33% and 35% lower in total for Retail and Wholesale respectively).

It should also be mentioned that new Retail EAD models were implemented in December 2010.

Comparison of EAD estimates with actual EAD (Retail AIRB)[1,2] (Rm)



Comparison of EAD estimates with actual EAD (Wholesale FIRB) (Rm)

Loss given default (LGD)

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 the Group 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. The Group modifies its LGD estimates to distinguish between expected losses over the course of an economic cycle and loss estimates during periods of economic stress (downturn LGD). Standard parameters are used for those portfolios on the FIRB approach, as prescribed by the regulator.

Expected loss (EL) 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 which enables the application of consistent credit risk measurement across all retail and wholesale credit exposures.

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

Notes

[1]Woolworths Financial Services is excluded from this analysis.

[2]The additional asset class, SME Corporate, reported under AIRB approach for December 2011, is a result of criteria relating to granularity for retail exposures as per SARB circular.

2011 disclosures *(continued)*

Expected loss (EL) and capital requirements *(continued)*

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 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 therefore 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 therefore 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 asset class, the estimated EL (Rm) as at 31 December 2010 is compared to the actual amount (Rm) written off for the year ending 31 December 2011.

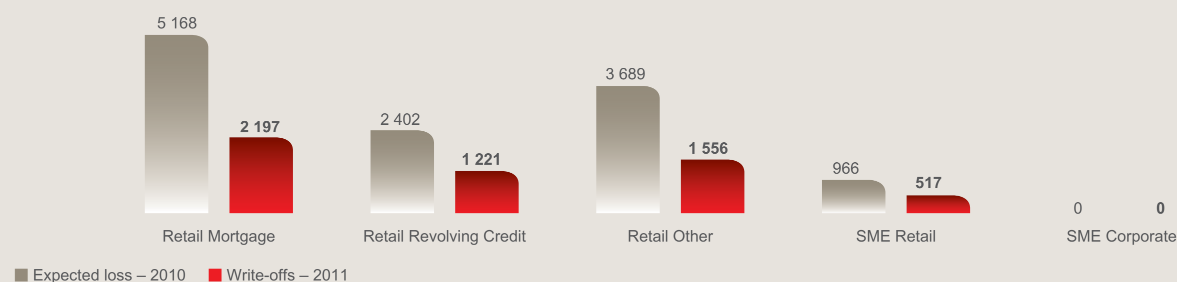
EL is a function of TTC PD, downturn LGD and EAD (EL = TTC PD x downturn LGD x EAD), i.e. it is a TTC measure adjusted for an economic downturn while the amount written off is observed over a 12 month period (January 2011 to December 2011).

The main conclusions of the analysis is that for all asset classes, the EL estimates are clearly above the actual write-offs observed for the year ending 31 December 2011.

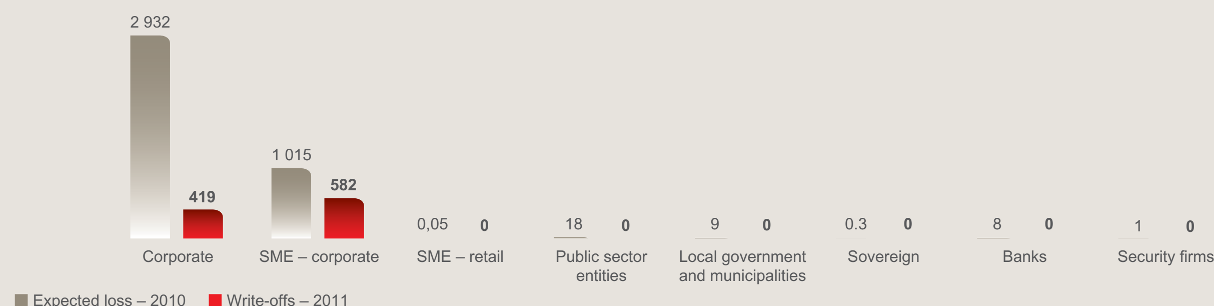
It should also be mentioned that new Retail downturn LGD models were implemented in December 2010.

Comparison of EL estimates with actual write-offs (all numbers stated are Absa Group numbers):

Comparison of EL estimates with actual write-offs (Retail AIRB) (Rm)[1, 2]



Comparison of EL estimates with actual write-offs (Wholesale FIRB) (Rm)



Notes

[1]Woolworths Financial Services is excluded from this analysis.

[2]The additional asset class, SME Corporate, reported under AIRB approach for December 2011, is a result of criteria relating to granularity for retail exposures as per SARB circular.

2011 disclosures *(continued)*

PD, EAD and LGD analysis in terms of regulatory disclosure requirements

Analysis by PDs, EADs and LGDs by risk grade under the FIRB approach

Group

	2010	2011														
			Corporate				SME Corporate				Specialised lending – income producing real estate				
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	LGD %
Non-default	1,19	0,97	43,31	67,70	753	156 876	43,85	78,19	269	27 198	37,71	100,44	58	2 975	45,00
1	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
2	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
3	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
4	0,03	0,03	44,80	14,39	2	11 306	45,00	14,28	0	69	—	—	—	—	—
5	0,04	0,04	45,00	44,56	1	6 215	45,00	14,00	0	1	—	—	—	—	—
6	0,06	0,06	31,20	14,67	1	3 648	38,35	15,70	0	26	35,83	15,12	0	34	—
7	0,08	0,08	44,98	25,68	1	3 795	40,30	19,78	0	2	35,29	16,51	0	4	—
8	0,12	0,12	42,85	31,42	6	11 436	38,33	23,31	0	52	38,01	27,94	0	44	45,00
9	0,17	0,16	42,14	36,83	11	16 370	42,97	32,44	0	175	35,88	29,43	0	33	—
10	0,22	0,23	43,95	46,49	10	10 246	44,07	37,99	2	1 972	38,21	40,38	0	130	45,00
11	0,31	0,31	43,35	52,88	18	13 357	44,48	45,83	4	2 865	38,04	45,80	0	44	—
12	0,46	0,45	44,38	65,67	21	11 990	43,71	52,81	5	2 657	38,88	52,36	1	346	—
13	0,62	0,62	44,43	75,27	32	11 685	44,19	62,13	7	2 454	38,04	62,85	0	48	45,00
14	0,92	0,90	43,27	85,34	51	13 499	43,69	70,94	13	3 249	37,60	64,91	1	283	45,00
15	1,26	1,28	42,70	95,25	97	17 661	42,81	77,63	17	3 164	38,67	78,99	3	753	45,00
16	1,86	1,84	43,90	109,21	64	7 944	44,38	89,95	21	2 604	40,53	84,45	0	1	45,00
17	2,50	2,60	43,99	120,37	78	6 824	44,18	97,18	33	2 907	39,53	109,55	0	38	—
18	3,61	3,64	44,14	132,52	72	4 540	43,43	104,25	32	2 044	37,92	95,45	4	265	45,00
19	5,23	5,15	43,88	147,35	65	2 875	44,10	117,07	28	1 222	35,65	96,48	0	2	—
20	7,61	7,08	43,62	164,00	49	1 576	43,86	131,14	26	849	37,60	115,55	2	61	—
21	10,05	10,03	43,91	188,78	14	308	44,87	153,70	8	184	39,38	132,23	0	1	—
22	14,30	14,47	42,73	207,93	38	618	41,71	163,37	19	317	36,37	172,11	47	888	—
23	19,88	19,93	43,90	229,82	5	56	44,25	194,18	9	105	—	—	—	—	—
24	29,94	29,77	41,04	226,84	105	861	44,92	210,33	13	100	—	—	—	—	—
25	38,59	39,98	45,00	239,67	12	66	44,97	207,61	32	180	—	—	—	—	—
Default	100,00	100,00	35,76	198,47	1 246	3 508	34,97	97,64	491	1 728	—	—	—	—	45,00
Total	4,02	2,86	43,15	70,56	1 999	160 384	43,32	79,35	760	28 926	37,71	100,44	58	2 975	45,00

Note

Amounts indicated as zero in the above table, reflect values smaller than R1 million.

Group

2011														
Specialised lending – project finance			Public sector entities				Local governments and municipalities				Sovereign			
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
84,75	26	5 372	41,88	35,40	6	6 719	40,53	32,13	5	9 505	28,54	19,36	0	1 195
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—	3,10	1,00	0	470
—	—	—	45,00	18,36	0	0	45,00	14,77	0	5	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	45,00	26,01	0	1	—	—	—	—
34,61	0	848	41,05	29,34	2	5 301	40,25	30,42	5	8 956	45,00	31,01	0	724
—	—	—	45,00	39,51	1	863	45,00	39,54	0	133	—	—	—	—
44,17	0	223	45,00	47,33	0	46	44,89	46,15	0	76	—	—	—	—
—	—	—	45,00	56,59	0	137	45,00	52,96	0	132	—	—	—	—
—	—	—	45,00	64,29	0	33	45,00	65,23	0	65	45,00	66,32	0	0
75,12	4	1 660	45,00	76,12	0	15	45,00	73,20	0	80	—	—	—	—
86,53	2	530	45,00	89,00	0	4	45,00	84,60	0	1	45,00	90,65	0	0
102,20	1	230	45,00	102,75	1	138	45,00	101,43	0	1	—	—	—	—
112,77	12	1 472	45,00	107,21	1	131	45,00	109,48	0	5	—	—	—	—
—	—	—	45,00	123,30	1	46	45,00	119,56	0	31	45,00	124,97	0	0
136,89	7	409	45,00	137,78	0	5	45,00	129,88	0	16	45,00	136,90	0	1
—	—	—	—	—	—	—	45,00	113,96	0	0	—	—	—	—
—	—	—	—	—	—	—	45,00	172,91	0	0	—	—	—	—
—	—	—	—	—	—	—	45,00	162,70	0	2	—	—	—	—
—	—	—	—	—	—	—	45,00	167,55	0	0	—	—	—	—
—	—	—	—	—	—	—	45,00	201,12	0	0	—	—	—	—
—	—	—	—	—	—	—	45,00	248,18	0	0	—	—	—	—
—	—	—	—	—	—	—	45,00	209,46	0	0	—	—	—	—
153,58	50	68	—	—	—	—	45,00	562,50	—	0	—	—	—	—
85,62	76	5 440	41,88	35,40	6	6 719	40,53	32,13	5	9 504	28,54	19,36	0	1 195

Note

Amounts indicated as zero in the above table, reflect values smaller than R1 million.

Credit risk

31 December

Group

2011													2010
Banks				Securities firm				Total					
LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	Average LGD %	Average RWA %	Expected loss Rm	EAD Rm		EAD Rm
42,49	16,12	11	61 571	28,87	29,30	1	1 342	42,88	55,36	1 129	272 752		234 526
—	—	—	—	—	—	—	—	—	—	—	—		—
—	—	—	—	—	—	—	—	—	—	—	—		—
—	—	—	—	—	—	—	—	—	—	—	—		—
43,70	14,03	7	52 624	45,00	14,44	0	93	43,60	14,00	9	64 562		37 118
31,14	12,62	0	851	—	—	—	—	43,33	40,69	1	7 072		4 009
45,00	19,65	0	190	—	—	—	—	31,96	14,92	1	3 898		12 152
45,00	23,41	0	1	—	—	—	—	44,96	25,67	1	3 803		10 380
33,39	25,08	2	5 617	45,00	32,04	0	9	40,34	29,79	15	32 987		20 185
44,74	35,81	0	379	45,00	37,84	0	41	42,36	36,90	12	17 994		16 721
40,06	42,77	2	1 844	45,00	46,80	1	628	43,51	44,86	15	15 165		12 028
45,00	52,54	0	23	—	—	—	481	42,33	50,21	22	17 039		18 891
45,00	66,82	0	12	45,00	64,94	0	67	44,14	63,10	27	15 170		15 738
—	—	—	—	—	—	—	—	44,44	73,19	43	15 942		10 341
45,00	91,78	0	0	45,00	90,65	0	0	43,31	82,39	67	17 566		15 731
—	—	—	—	45,00	103,33	0	23	42,62	92,28	119	21 970		13 027
45,00	111,60	0	7	45,00	110,56	—	0	44,15	105,50	98	12 164		14 342
45,00	123,43	0	8	—	—	—	—	44,04	113,50	112	9 854		15 472
45,00	137,64	0	8	—	—	—	—	43,76	123,49	115	7 288		7 151
45,00	152,78	0	5	—	—	—	—	43,95	138,32	93	4 104		3 895
45,00	175,52	0	0	—	—	—	—	43,55	151,60	77	2 486		3 311
45,00	203,15	0	1	45,00	164,33	0	0	44,27	175,58	22	496		734
45,00	214,58	0	1	—	—	—	—	39,46	182,75	104	1 824		1 447
—	—	—	—	—	—	—	—	44,13	206,52	14	161		561
45,00	248,82	0	0	—	—	—	—	41,44	225,13	118	961		977
—	—	—	—	—	—	—	—	44,98	216,16	44	246		315
—	—	—	—	—	—	—	—	35,62	165,04	1 787	5 304		6 915
42,49	16,12	11	61 571	28,87	29,30	1	1 342	42,74	57,45	2 916	278 056		241 441

Note

Amounts indicated as zero in the above table, reflect values smaller than R1 million.

2011 disclosures *(continued)*

PD, EAD and LGD analysis in terms of regulatory disclosure requirements *(continued)*

Analysis by PDs, EADs and LGDs by risk grade under the AIRB approach

Group

	2010	2011							
		SME Corporate						Mortgages	
Risk grade	Average PD %	Average PD %	LGD %	Exposure weighted average risk weight %	Ex-pected loss Rm	EAD Rm		LGD %	Exposure weighted average risk weight %
Non-default	3,26	3,05	86,95	128,68	148	3 102		13,58	24,13
1	—	—	—	—	—	—		—	—
2	—	—	—	—	—	—		—	—
3	—	—	—	—	—	—		—	—
4	0,03	0,03	—	—	—	—		—	—
5	0,04	0,04	82,78	9,06	0	25		10,93	1,18
6	0,05	0,05	—	—	—	—		11,31	1,61
7	0,08	0,08	—	—	—	—		—	—
8	0,11	0,11	—	—	—	—		11,71	3,06
9	0,16	0,16	—	—	—	—		12,89	4,54
10	0,24	0,23	—	—	—	—		14,21	6,40
11	0,32	0,32	—	—	—	—		13,41	7,43
12	0,45	0,45	42,17	30,58	0	18		12,48	8,97
13	0,66	0,66	—	—	—	—		13,77	13,03
14	0,89	0,90	83,92	77,49	0	42		13,54	15,83
15	1,25	1,24	86,72	97,31	0	28		13,75	19,82
16	1,80	1,79	—	—	—	—		14,08	25,24
17	2,57	2,52	86,17	119,15	0	18		14,13	32,91
18	3,81	3,74	88,25	125,33	88	2 470		14,03	38,42
19	5,67	5,11	88,71	132,44	0	9		13,81	45,98
20	7,48	7,44	82,78	129,74	6	92		14,52	57,66
21	9,50	9,54	—	—	—	—		14,76	65,47
22	15,09	15,11	82,78	165,39	41	320		14,56	75,79
23	21,07	20,84	81,51	183,13	13	80		15,54	87,99
24	29,04	29,01	—	—	—	—		14,62	85,23
25	38,99	39,94	—	—	—	—		14,88	84,13
Default	100,00	100,00	69,69	451,09	94	121		16,60	0,00
Total	11,59	10,60	86,30	140,80	242	3 223		13,85	21,94

Note

Amounts indicated as zero in the above table, reflect values smaller than R1 million.

Credit risk

31 December

Group									
2011									
		SME Retail				Retail revolving credit			
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
928	240 869	53,55	52,71	394	19 404	74,34	45,24	873	44 681
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
—	—	40,00	3,96	0	1	—	—	—	—
0	11 883	88,02	2,21	0	731	88,67	2,15	1	2 959
1	11 139	35,51	6,15	0	215	88,71	3,79	0	10
—	—	68,50	5,70	0	1	88,61	4,02	0	306
0	1 151	85,42	6,94	0	18	69,09	4,51	7	8 845
1	5 238	58,48	12,46	0	5	67,48	5,84	4	4 209
3	9 886	48,11	17,51	0	16	88,63	9,41	1	363
13	32 132	78,27	17,38	1	406	83,81	14,20	2	793
5	8 466	42,24	23,73	3	1 959	83,54	16,99	0	95
18	19 448	66,80	31,03	3	647	88,56	23,21	2	328
14	11 853	42,12	37,45	6	1 492	74,78	25,87	26	4 026
66	38 910	56,19	42,13	29	4 226	80,72	37,36	15	1 463
46	18 369	61,81	53,76	13	1 149	75,97	43,45	19	1 492
41	11 742	49,64	58,59	39	2 945	76,15	54,78	45	2 420
67	13 336	48,80	62,95	39	2 118	72,66	74,41	350	12 464
91	12 813	61,57	84,55	18	546	75,64	92,07	69	1 830
234	21 839	52,42	83,31	38	953	77,23	118,32	71	1 284
78	5 594	62,86	105,61	28	462	78,54	147,80	50	630
49	2 284	49,34	100,25	55	773	78,10	175,39	64	575
73	2 238	61,25	148,23	14	112	78,52	206,17	47	297
49	1 151	76,50	213,44	13	61	79,10	230,12	26	117
79	1 397	41,27	110,26	95	568	78,53	222,64	74	175
4 358	24 012	44,39	216,03	132	994	74,24	105,39	1 112	1 768
5 286	264 881	53,10	60,67	526	20 398	74,34	47,53	1 985	46 449

Note

Amounts indicated as zero in the above table, reflect values smaller than R1 million.

Group

2011								2010
Retail – other				Total				
LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	LGD %	Exposure weighted average risk weight %	Expected loss Rm	EAD Rm	EAD Rm
50,56	64,65	1 421	61 875	29,82	35,83	3 765	369 931	375 498
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	40,00	3,96	0	1	—
64,15	7,05	0	596	30,68	1,63	1	16 194	17 058
78,60	14,14	—	0	11,84	1,70	1	11 364	11 214
58,09	12,03	0	870	66,03	9,94	1	1 177	1 024
50,36	13,75	1	1 424	61,00	5,52	8	11 438	11 670
73,75	26,49	0	132	37,73	5,42	5	9 584	9 951
86,83	35,35	0	10	16,96	6,55	4	10 275	10 429
67,03	36,21	2	1 036	17,41	8,57	18	34 367	30 969
40,35	28,06	8	4 128	24,79	16,39	16	14 666	17 103
64,92	51,29	5	1 334	19,61	16,07	28	21 757	22 169
47,97	46,52	16	3 681	33,40	24,75	62	21 094	22 179
58,89	65,17	58	7 999	25,92	29,03	168	52 626	50 570
44,25	55,50	67	8 308	27,65	35,86	145	29 318	28 097
41,95	56,80	130	12 182	34,43	47,28	255	29 307	27 817
59,94	84,41	122	5 478	48,58	65,39	666	35 866	36 436
51,08	75,48	80	3 108	27,78	56,78	258	18 306	21 748
48,06	75,67	124	3 427	23,14	63,84	473	27 595	29 661
49,51	81,61	65	1 398	28,49	76,97	221	8 084	8 889
57,32	114,23	427	4 822	47,78	108,87	636	8 774	9 030
50,08	113,41	73	696	31,07	107,60	220	3 423	3 816
63,88	161,55	166	897	39,55	127,11	254	2 226	2 687
54,98	142,80	77	349	31,02	108,09	325	2 489	2 981
67,91	200,30	2 192	4 370	28,12	42,57	7 888	31 265	35 393
51,71	73,60	3 613	66 245	29,68	36,36	11 653	401 196	410 891

Note

Amounts indicated as zero in the above table, reflect values smaller than R1 million.

2011 disclosures *(continued)*

Gross exposures per Basel approach and asset class

Group

Standardised approach	2011 Utilised (on-balance sheet exposure) Rm	Off-balance sheet exposure Rm	Repurchase and resale agreements Rm	Derivative instruments Rm	Total credit exposure Rm	EAD Rm	2010 EAD Rm
Corporate							
SME Corporate	7 066	1 232	—	—	8 298	8 137	4 895
Banks	1 802	—	—	—	1 802	1 802	1 514
Public sector entities	—	—	—	—	—	—	149
Local government and municipalities	1	—	—	—	1	1	—
Retail	1 232	—	—	—	1 232	1 232	1 362
Sovereign	58 843	—	—	—	58 843	58 843	49 567
Securities firms	—	—	—	—	—	—	—
	68 944	1 232	—	—	70 176	70 015	57 487

FIRB approach	2011 Utilised (on-balance sheet exposure) Rm	Off-balance sheet exposure Rm	Repurchase and resale agreements Rm	OTC derivative instruments Rm	Total credit exposure Rm	EAD Rm	2010 EAD Rm
Corporate	148 047	116 459	921	7 180	272 607	197 724	185 424
Large Corporate	116 184	104 178	921	7 053	228 336	160 385	159 542
SME Corporate	24 431	8 251	—	—	32 682	28 926	21 211
Specialised lending – income producing real estate	2 962	1 558	—	—	4 520	2 973	2 500
Specialised lending – project finance	4 470	2 472	—	127	7 069	5 440	2 171
Banks	43 673	20 962	10 842	42 886	118 363	61 571	31 427
Local government and municipalities	6 181	12 694	—	—	18 875	9 505	7 325
Public sector entities	2 303	9 521	—	1 662	13 486	6 720	14 322
Retail							
SME Retail	—	—	—	—	—	—	14
Sovereign	1 110	1 698	—	40	2 848	1 195	1 026
Securities firms	275	9 422	2 574	992	13 263	1 342	1 903
	201 589	170 756	14 337	52 760	439 442	278 057	241 441

AIRB approach	2011 Utilised (on-balance sheet exposure) Rm	Off-balance sheet exposure Rm	Repurchase and resale agreements Rm	OTC derivative instruments Rm	Total credit exposure Rm	EAD Rm	2010 EAD Rm
Corporate							
SME Corporate	2 829	320	—	—	3 149	3 223	—
Banks	—	—	—	—	—	—	—
Local government and municipalities	—	—	—	—	—	—	—
Public sector entities	—	—	—	—	—	—	—
Securities firms	—	—	—	—	—	—	—
Retail	353 307	86 961	—	—	440 268	397 978	410 891
Mortgages	246 527	50 916	—	—	297 443	264 883	272 267
Other	66 971	2 029	—	—	69 000	66 244	72 378
Revolving credit	24 156	27 085	—	—	51 241	46 451	43 646
SME Retail	15 653	6 931	—	—	22 584	20 400	22 600
Sovereign	—	—	—	—	—	—	—
Securities firms	—	—	—	—	—	—	—
	356 136	87 281	—	—	443 417	401 201	410 891

2011 disclosures *(continued)*

Residual contractual maturity of exposures – all portfolios

Group

Residual contractual maturity of exposures	2011 Exposure at default 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	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 Retail	7 701	33	4 319	8 346	20 399
Securities firms	—	40	1 003	300	1 343
Sovereign	55 830	—	3 290	918	60 038
	208 591	5 560	215 601	319 521	749 273

Residual contractual maturity of exposures	2010 Exposure at default 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	13 868	917	9 744	6 898	31 427
Corporate exposure	63 083	11 661	43 483	67 197	185 424
Corporate	53 129	11 018	42 546	52 849	159 542
SME Corporate	9 520	510	1	11 180	21 211
Specialised lending – income producing real estate	188	127	291	1 894	2 500
Specialised lending – project finance	246	6	645	1 274	2 171
Local governments and municipalities	2 621	1 108	424	3 172	7 325
Public sector entities	1 331	2 041	6 336	4 614	14 322
Retail	47 768	542	—	362 595	410 905
Mortgages	128	—	—	272 139	272 267
Other	6 036	—	—	66 342	72 378
Revolving credit	36 487	—	—	7 159	43 646
SME Retail	5 117	542	—	16 955	22 614
Securities firms	349	—	1 554	—	1 903
Sovereign	283	—	133	610	1 026
	129 303	16 269	61 674	445 086	652 332
Standardised exposures					57 487
					709 819

Audited

2011 disclosures *(continued)*

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 the Group's disclosure regarding credit quality, the maximum exposure to credit risk of financial assetsat the reporting date has been analysed as follows:

	Group				
	2011				
		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	3 411	3 411	—	—	3 411
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)	57 432	57 420	12	—	57 432
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
Initial margin	1 489	1 489	—	—	1 489
Settlement accounts	6 466	6 466	—	—	6 466
Other assets (refer to note 6)	13 504	12 401	295	31	12 727
Retail Banking	318 733	86 185	187 309	5 688	279 182
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	237 976	73 958	128 745	2 663	205 366
Other advances	11	4	7	—	11
Personal and term loans	14 383	2 302	9 821	1 124	13 247
Absa Business Bank	122 250	43 459	68 932	3 476	115 867
Cheque accounts	27 174	11 520	14 432	376	26 328
Commercial asset finance	17 975	4 469	12 169	1 092	17 730
Commercial property finance	41 463	13 477	22 471	1 253	37 201
Term loans	35 638	13 993	19 860	755	34 608
Absa Capital	62 079	41 723	19 352	673	61 748
Other and inter-group eliminations	441	431	—	—	431
Loans and advances to customers (refer to note 9)	503 503	171 798	275 593	9 837	457 228
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	404 668	280 041	9 980	694 689
Assets not subject to credit risk	44 978				
Total assets per the statement of financial position	786 719				

Group										
2011										
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	6 327	(2 104)	—	4 223	(327)
51	41	75	13	125	305	990	(379)	—	611	(70)
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	1 001	(196)	—	805	(105)
—	—	—	—	20	20	825	(439)	—	386	(75)
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)

Audited

2011 disclosures *(continued)*

IFRS disclosures *(continued)*

Maximum exposure to credit risk (continued)

	Group				
	2010				
		Neither past due nor impaired			
	Maximum exposure Rm	DG1-11 Rm	DG12-19 Rm	DG20-21 Rm	Total Rm
Balances with other central banks	859	859	—	—	859
Balances with the SARB	12 912	12 912	—	—	12 912
Money market assets	5 031	5 031	—	—	5 031
Cash, cash balances and balances with central banks (refer to note 2)	18 802	18 802	—	—	18 802
Land Bank bills	50	50	—	—	50
RSA government bonds	34 602	34 602	—	—	34 602
Reverse repurchase agreements	2 685	2 685	—	—	2 685
Treasury bills	10 878	10 878	—	—	10 878
Statutory liquid asset portfolio (refer to note 3)	48 215	48 215	—	—	48 215
Collateralised loans	2 618	2 618	—	—	2 618
Other	19 305	19 294	11	—	19 305
Reverse repurchase agreements	5 572	5 572	—	—	5 572
Loans and advances to banks (refer to note 4)	27 495	27 484	11	—	27 495
Debt instruments	11 694	11 694	—	—	11 694
Derivative assets	43 404	41 111	2 204	89	43 404
Money market assets	1 902	1 889	13	—	1 902
Trading portfolio assets (refer to note 5)	57 000	54 694	2 217	89	57 000
Derivatives designated as cash flow hedging instruments	3 813	3 813	—	—	3 813
Derivatives designated as fair value hedging instruments	849	849	—	—	849
Hedging portfolio assets (refer to note 5)	4 662	4 662	—	—	4 662
Accounts receivable	4 708	4 300	1	—	4 301
Initial margin	895	895	—	—	895
Settlement accounts	4 627	4 447	180	—	4 627
Other assets (refer to note 6)	10 230	9 642	181	—	9 823
Retail Banking	323 427	87 003	187 934	7 351	282 288
Cheque accounts	2 659	816	1 730	1	2 547
Credit cards	18 319	3 154	12 249	545	15 948
Instalment credit agreements	36 738	5 351	26 095	1 108	32 554
Loans to associates and joint ventures	4 827	793	3 870	164	4 827
Microloans	1 662	454	807	220	1 481
Mortgages	245 963	74 083	135 732	2 917	212 732
Other advances	31	31	—	—	31
Personal loans	13 228	2 321	7 451	2 396	12 168
Absa Business Bank	127 792	53 960	61 057	4 224	119 241
Cheque accounts	18 452	7 975	8 734	373	17 082
Commercial asset finance	18 471	3 660	13 052	1 325	18 037
Commercial property finance	46 913	20 947	18 601	1 649	41 197
Term loans	43 956	21 378	20 670	877	42 925
Absa Capital	58 378	38 395	19 556	342	58 293
Other and inter-group eliminations	(817)	(856)	39	—	(817)
Loans and advances to customers (refer to note 9)	508 780	178 502	268 586	11 917	459 005
Insurance contracts	386	386	—	—	386
Investment contracts	474	474	—	—	474
Reinsurance assets (refer to note 11)	860	860	—	—	860
Debt instruments	8 045	6 783	1 262	—	8 045
Derivative instruments	215	215	—	—	215
Money market assets	620	620	—	—	620
Investment securities (refer to note 12)	8 880	7 618	1 262	—	8 880
Total assets subject to credit risk	684 924	350 479	272 257	12 006	634 742
Assets not subject to credit risk	41 033				
Total assets per the statement of financial position	725 957				

Group

2010										
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
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
11	7	33	—	4	55	372	—	(20)	352	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
11	7	33	—	4	55	372	—	(20)	352	—
610	70	55	55	2 153	2 943	48 985	—	(10 339)	38 646	(450)
10	—	—	—	—	10	242	—	(122)	120	(18)
—	—	—	—	—	—	4 559	—	(2 147)	2 412	(41)
—	—	—	—	—	—	5 569	—	(1 342)	4 227	(43)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	588	—	(384)	204	(23)
600	70	55	55	2 153	2 933	35 903	—	(5 290)	30 613	(315)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	2 124	—	(1 054)	1 070	(10)
1 988	348	331	35	313	3 015	8 178	(2 268)		5 910	(374)
210	24	10	—	10	254	1 794	(607)		1 187	(71)
13	29	11	5	5	63	1 129	(694)		435	(64)
1 440	203	288	16	216	2 163	4 275	(675)		3 600	(47)
325	92	22	14	82	535	980	(292)		688	(192)
—	—	—	—	6	6	550	(342)	—	208	(129)
—	—	—	—	—	—	—	—	—	—	—
2 598	418	386	90	2 472	5 964	57 713	(2 610)	(10 339)	44 764	(953)
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—	—
2 609	425	419	90	2 476	6 019	58 085	(2 610)	(10 359)	45 116	(953)

Audited

2011 disclosures *(continued)*

IFRS disclosures *(continued)*

Maximum exposure to credit risk (continued)

For financial guarantees, the maximum exposure to credit risk is the maximum amount the Group 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	
	2011 Rm	2010 Rm
Financial guarantee contracts	**356**	599
Guarantees	**13 226**	11 051
Irrevocable debt facilities	**46 189**	46 495
Letters of credit	**5 190**	4 979
	64 961	63 124

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	
	2011 Rm	2010 Rm
Assets		
Cash, cash balances and balances with central banks (refer to note 2)	**3 112**	2 393
Statutory liquid asset portfolio (refer to note 3)	**804**	3 463
Loans and advances to banks (refer to note 4)	**7 886**	7 548
Other assets (refer to note 6)	**17**	16
Loans and advances to customers (refer to note 9)	**10 198**	10 332
Investment securities (refer to note 12)	**4 290**	6 985
	26 307	30 737
Liabilities		
Deposits from banks (refer to note 18)	**9 673**	1 679
Other liabilities (refer to note 20)	**16**	12
Deposits due to customers (refer to note 22)	**20 500**	16 856
Debt securities in issue (refer to note 23)	**1 762**	1 561
Liabilities under investment contracts (refer to note 24)	**15 233**	13 964
Borrowed funds (refer to note 26)	**771**	739
	47 955	34 811

The Group did not use credit derivatives as a mechanism to hedge its exposure to credit risk for financial instruments designated at fair value through profit or loss.

Audited

2011 disclosures *(continued)*

IFRS disclosures *(continued)*

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

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

	Group			
	2011		2010	
	Carrying value Rm	**Contractual obligation Rm**	Carrying value Rm	Contractual obligation Rm
Liabilities				
Deposits from banks (refer to note 18)	**9 673**	**9 470**	1 679	1 677
Other liabilities (refer to note 20)	**16**	**16**	12	12
Deposits due to customers (refer to note 22)	**20 500**	**23 066**	16 856	21 913
Debt securities in issue (refer to note 23)	**1 762**	**3 758**	1 561	1 941
Liabilities under investment contracts (refer to note 24)	**15 233**	**15 160**	13 964	13 914
Borrowed funds (refer to note 26)	**771**	**772**	739	756
	47 955	**52 242**	34 811	40 213

Decrease in fair value attributable to changes in credit risk during the year

	Group	
	2011 Rm	2010 Rm
Assets		
Loans and advances to customers	**(0)**	(10)

Cumulative increase in fair value attributable to changes in credit risk

	Group	
	2011 Rm	2010 Rm
Assets		
Loans and advances to customers	**4**	4

The following approaches are used by the Group 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 to 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 to each customer a credit spread based on the contractual credit spread of the loan 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.

For financial liabilities designated at fair value through profit or loss, the fair value gain recognised during the year due to change in own credit risk was R12 million (2010: Rnil million).

2011 disclosures *(continued)*

Credit risk mitigation, collateral and other credit enhancements

The Group employs a number of techniques to mitigate credit risk, such as:

- strengthening its 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 the Group's 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.

The Group's 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 whether the bank is using the foundation or advanced approach.

2011 disclosures *(continued)*

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

Collateral types used by the Group, 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 within the Group ➜ Assignment of debtors

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. The Group uses 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 the Group's 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.

Note

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

2011 disclosures *(continued)*

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

Types of guarantor and credit derivative counterparties

In the commercial, corporate and financial sector, the Group often places 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 (NBFIs), 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 EAD, PD or LGD, depending on the type of mitigant.

Use of netting agreements, International Swaps and Derivatives Association (ISDA) master agreements and collateral support annexes (CSAs)

In line with international market practice, the Group endeavours to use netting agreements wherever possible. The Group primarily employs ISDA master agreements as well as CSAs, which provide for 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 the Group's 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 the Group to post additional collateral.

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IFRS disclosures in terms of credit mitigation

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 that follows. The Group's policies for managing collateral have been discussed above. 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.

The Group offsets asset and liability amounts in the statement of financial position when it has the ability and intention to net settle – amounts in the maximum exposure column in the table on page 47 are stated net of these.

The percentage collateral reported in the table on page 47 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 credit impairments.

The Group 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

The Group in some cases holds guarantees and/or letters of credit from third parties which enable it 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.

The Group makes use of credit default swaps and credit insurance to manage its overall credit risk with major counterparties. These enable the Group to claim in the event of a deterioration in the credit quality of borrowers and counterparties.

The amounts shown on page 47 represent the notional value of the guarantees held by the Group, issued by corporate and financial institutional counterparties. In addition to these the Group takes guarantees from personal customers in respect of personal loans and smaller business loans. These are not quantified in the aforesaid table.

Physical collateral

The Group has 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 loans and securities borrowing transactions*** – typically the highly liquid securities which have been legally transferred to the Group subject to an agreement to return them for a fixed price; and
- ***finance lease receivables*** – typically the Group retains legal ownership of the leased asset and has the right to repossess the asset on the default of the borrower.

Cash collateral

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

Other

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

This category would also include any put options from holding companies or cession of loan accounts.

Audited

2011 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					
	2011					
	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	3 411	—	—	—	—	100
Other	47 282	—	—	—	7	93
Reverse repurchase agreements	6 739	—	—	—	57	43
Loans and advances to banks (refer to note 4)	57 432					
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
Initial margin	1 489	—	—	—	—	100
Settlement accounts	6 466	—	—	—	—	100
Other assets (refer to note 6)	13 504					
Retail Banking	318 733					
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	237 976	—	88	—	—	12
Other advances	11	—	—	—	—	100
Personal loans	14 383	—	—	—	—	100
Absa Business Bank	122 250					
Cheque accounts	27 174	1	55	31	—	13
Commercial asset finance	17 975	—	69	—	—	31
Commercial property finance	41 463	—	100	—	—	—
Term loans	35 638	—	30	6	—	64
Absa Capital	62 079	7	9	2	—	82
Other and inter-group eliminations	441	—	31	—	—	69
Loans and advances to customers (refer to note 9)	503 503					
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					

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2011 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					
	2010					
	Maximum exposure Rm	Guarantees, credit insurance and credit derivatives %	Physical collateral %	Cash collateral %	Other %	Unsecured %
Balances with other central banks	859	—	—	—	—	100
Balances with the SARB	12 912	—	—	—	—	100
Money market assets	5 031	—	—	—	—	100
Cash, cash balances and balances with central banks (refer to note 2)	18 802					
Land Bank bills	50	—	—	—	—	100
RSA government bonds	34 602	—	—	—	—	100
Reverse repurchase agreements	2 685	—	—	—	—	100
Treasury bills	10 878	—	—	—	—	100
Statutory liquid asset portfolio (refer to note 3)	48 215					
Collateralised loans	2 618	—	—	—	—	100
Other	19 305	—	—	—	11	89
Reverse repurchase agreements	5 572	—	—	—	100	—
Loans and advances to banks (refer to note 4)	27 495					
Debt instruments	11 694	—	—	—	—	100
Derivative assets	43 404	1	—	3	87	9
Money market assets	1 902	—	—	—	—	100
Trading portfolio assets (refer to note 5)	57 000					
Derivatives designated as cash flow hedging instruments	3 813	—	—	—	—	100
Derivatives designated as fair value hedging instruments	849	—	—	—	—	100
Hedging portfolio assets (refer to note 5)	4 662					
Accounts receivable	4 708	—	—	—	—	100
Initial margin	895	—	—	—	—	100
Settlement accounts	4 627	—	—	—	—	100
Other assets (refer to note 6)	10 230					
Retail Banking	323 427					
Cheque accounts	2 659	—	—	—	—	100
Credit cards	18 319	—	—	—	—	100
Instalment credit agreements	36 738	—	71	—	—	29
Loans to associates and joint ventures	4 827	—	—	—	—	100
Microloans	1 662	—	—	—	—	100
Mortgages	245 963	—	87	—	—	13
Other advances	31	—	—	—	—	100
Personal loans	13 228	—	—	—	—	100
Absa Business Bank[1]	127 792					
Absa Capital	58 378	4	12	1	—	83
Other and inter-group eliminations	(817)	—	—	—	—	100
Loans and advances to customers (refer to note 9)	508 780					
Insurance contracts	386	—	—	—	—	100
Investment contracts	474	—	—	—	—	100
Reinsurance assets (refer to note 11)	860					
Debt instruments	8 045	—	—	—	22	78
Derivative instruments	215	—	—	—	—	100
Money market assets	620	—	—	—	—	100
Investment securities (refer to note 12)	8 880					
Total	684 924					

Note

[1]During the year, the Group enhanced its collateral reporting system within Absa Business Bank. Although collateral data is available for the comparative period, the enhancements to the system resulted in the 2010 data not being comparable to current information. It is impractical to provide an estimate of the 2010 position and it is therefore not presented.

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2011 disclosures *(continued)*

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

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

Enforcement of collateral

Carrying value of assets held by Group at the reporting date as a result of the enforcement of collateral is as follows:

	Group	
	2011 Rm	2010 Rm
Residential properties		
Opening balance	449	344
Acquisitions	617	240
Disposals	(335)	(135)
Closing balance	731	449

Credit risk mitigation in terms of Regulatory disclosure requirements

Credit risk mitigation (CRM)

	Group						
			2011			2011	2010
IRB approach	Original credit and counter-party exposure Rm	Effects of netting agree-ments Rm	Ex-posure after netting and credit Rm	Eligible financial colla-teral Rm	Other eligible IRB colla-teral Rm	Miti-gation affecting LGD esti-mates Rm	Miti-gation affecting LGD esti-mates Rm
Banks	118 364	36 790	81 574	3 441	—	3 441	886
Corporate	275 757	3 860	271 897	2 409	92 465	94 874	103 222
Corporate	228 337	3 859	224 478	2 409	67 364	69 773	81 187
SME Corporate	35 832	—	35 832	—	20 882	20 882	18 096
Specialised lending – income producing real estate	4 519	—	4 519	—	4 219	4 219	3 939
Specialised lending – project finance	7 069	1	7 068	—	—	—	—
Local governments and municipalities	18 875	—	18 875	945	126	1 071	4
Public sector entities	13 486	777	12 709	465	247	712	1 003
Retail	440 266	—	440 266	62 456	559 758	622 214	627 530
Mortgages	297 442	—	297 442	—	542 896	542 896	555 650
Other	69 000	—	69 000	62 456	—	62 456	49 168
Retail – SME	22 583	—	22 583	—	16 862	16 862	22 712
Revolving credit	51 241	—	51 241	—	—	—	—
Securities firms	13 264	272	12 992	501	—	501	—
Sovereign	2 847	40	2 807	437	7	444	492
	882 859	41 739	841 120	70 654	652 603	723 257	733 137

The CRM is not taken into consideration for the Standardised approach.

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 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. The Group mainly relies on cash, government bonds and negotiable certificates of deposits (NCDs) as collateral for derivative contracts.

The Group intends to apply for permission to use the Internal Model Method (IMM) in the calculation of its RC requirements for these portfolios once the AIRB method for wholesale credit exposures has been embedded. However, during the year, all calculations were based on the CEM. The Group's policies for establishing impairment allowances for traded products' counterparties are based on applicable accounting requirements.

2011 disclosures *(continued)*

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

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

Credit derivatives

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

Exposure by instrument bought or sold

	Group			
	2011			
	Intermediation portfolio			
	As protection buyer		As protection seller	
	Banking Rm	Trading Rm	Banking Rm	Trading Rm
Credit derivative product type				
Credit-default swaps	—	6 987	—	10 494
Total return swaps	—	—	—	—
Other	8 813	—	690	—
Total notional exposure to credit derivative transactions	8 813	6 987	690	10 494

	2010			
	Intermediation portfolio			
	As protection buyer		As protection seller	
	Banking Rm	Trading Rm	Banking Rm	Trading Rm
Credit derivative product type				
Credit-default swaps	—	2 567	—	—
Total return swaps	—	—	—	7 253
Other	6 254	—	567	—
Total notional exposure to credit derivative transactions	6 254	2 567	567	7 253

Breakdown of OTC and credit derivative exposure

This book is volatile and increased interest rate and foreign exchange rate derivative exposure was driven by increased mark-to-market due to changes in the underlying instrument during the year.

	Group							
	2011							
	Gross positive fair value Rm	Current netting benefits Rm	Current exposure Rm	Expected positive exposure (CEM) Rm	Expected positive exposure netting (CEM) Rm	Exposure at default Rm	Collateral value 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

	2010							
	Gross positive fair value Rm	Current netting benefits Rm	Current exposure Rm	Expected positive exposure (CEM) Rm	Expected positive exposure netting (CEM) Rm	Exposure at default Rm	Collateral value Rm	Notional value Rm
Commodities	240	184	56	208	63	201	—	1 907
Credit derivatives	94	93	1	804	356	449	—	10 318
Equity derivatives	633	248	385	2 356	894	1 847	—	37 880
Foreign exchange derivatives	17 898	13 492	4 406	9 753	5 174	8 985	—	480 065
Interest rate derivatives	28 962	25 853	3 109	9 986	5 631	7 464	—	3 372 001
	47 827	39 870	7 957	23 107	12 118	18 946	—	3 902 171

2011 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

The Group enters into derivative contracts with rated and unrated counterparties. To mitigate counterparty credit risk, the Group stipulates credit protection terms, such as limitations on the amount of unsecured credit exposure it will accept, collateralisation in the event of a mark-to-market 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 the Group to provide similar credit protection terms, to which it 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 mark-to-market value on derivative contracts. Where the impact on the Group's 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 the Group's financial position.

As at the reporting date, no additional collateral would have been required for a one- or two-notch downgrade. An additional R7,3 million would have been required to be posted for a three-notch downgrade.

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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* (IFRS 7) 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. The Group regularly reconciles the data used for both financial (IFRS) and regulatory (Pillar 3) disclosures.

Impairment methods of assessment and use of allowance accounts

The Group establishes, 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 the attention of the Group, 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 which are individually significant or which 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 purposes 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

2011 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 which 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 RWAs.

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 the Group's position relative to other claimants. The 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 *Financial instruments: Recognition and Measurement* (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 by the end of the year. 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 the Group's 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.

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. Identified impairments are raised on an individual basis and is the difference between the outstanding capital and the present value of future cash flows.

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 within 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 impairments.

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.

The timing and extent of write-offs is driven by a write-off policy based on an age-driven concept. A write-off can also be triggered by a specific event, such as the conclusion of insolvency proceedings or other formal recovery actions which makes it possible to quantify the extent of the advance which is beyond a realistic prospect of recovery. Nonetheless, impaired loans are reviewed at least quarterly, ensuring irrecoverable 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 loan impairment charge in the statement of comprehensive income.

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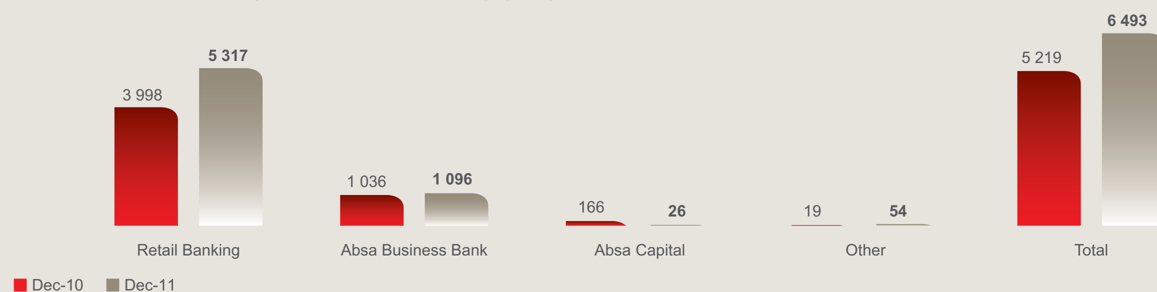
2011 disclosures *(continued)*

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

Write-offs (continued)



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 impairments (identified and unidentified)

Group

2011

Impairment of loans and advances to customers	Opening balance Rm	Net present value unwind on non-performing book Rm	Exchange differences Rm	Amounts written off Rm	Impairment raised identified Rm	Impairment raised unidentified Rm	Closing balance Rm
Retail Banking	10 789	(1 048)	—	(5 317)	4 648	(11)	9 061
Absa Business Bank	2 642	(125)	—	(1 096)	1 065	(55)	2 431
Absa Capital	471	(5)	1	(26)	128	(55)	514
Other	—	5	—	(54)	174	—	125
	13 902	(1 173)	1	(6 493)	6 015	(121)	12 131

2010[1]

Impairment of loans and advances to customers	Opening balance Rm	Net present value unwind on non-performing book Rm	Exchange differences Rm	Amounts written off Rm	Impairment raised identified Rm	Impairment raised unidentified Rm	Closing balance Rm
Retail Banking	10 130	(671)	—	(3 998)	5 471	(143)	10 789
Absa Business Bank	2 470	(87)	—	(1 036)	1 324	(29)	2 642
Absa Capital	547	(8)	(2)	(166)	121	(21)	471
Other	11	2	—	(19)	3	3	—
	13 158	(764)	(2)	(5 219)	6 919	(190)	13 902

Note

[1]Comparatives have been reclassified, refer to note 1.26.

2011 disclosures *(continued)*

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.

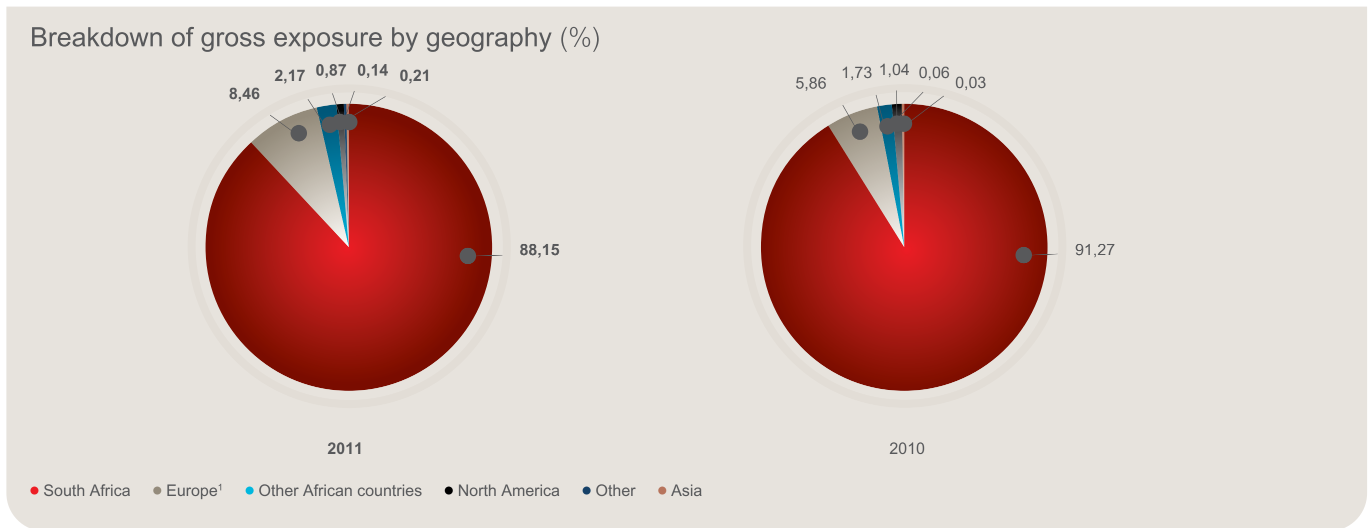
Diversification is achieved through setting maximum exposure guidelines to individual counterparties. Excesses are reported to the Group Risk Oversight Committee and the Board Risk Committee. Mandate and scale limits are used to limit the stock of current exposures in a loan portfolio and the flow of 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 the Group's business portfolios, a certain degree of risk concentration in the collateral portfolios is evident. The Group manages 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 the South African financial markets, a certain level of concentration with derivative counterparties is also to be expected. The Group manages 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 the Group's mark-to-market (MTM) exposure.

Breakdown of gross exposures by geographical area



Note

[1]The majority of the exposures reflecting under Europe relate to exposures to Bank Plc.

2011 disclosures *(continued)*

Concentrations of credit risk *(continued)*

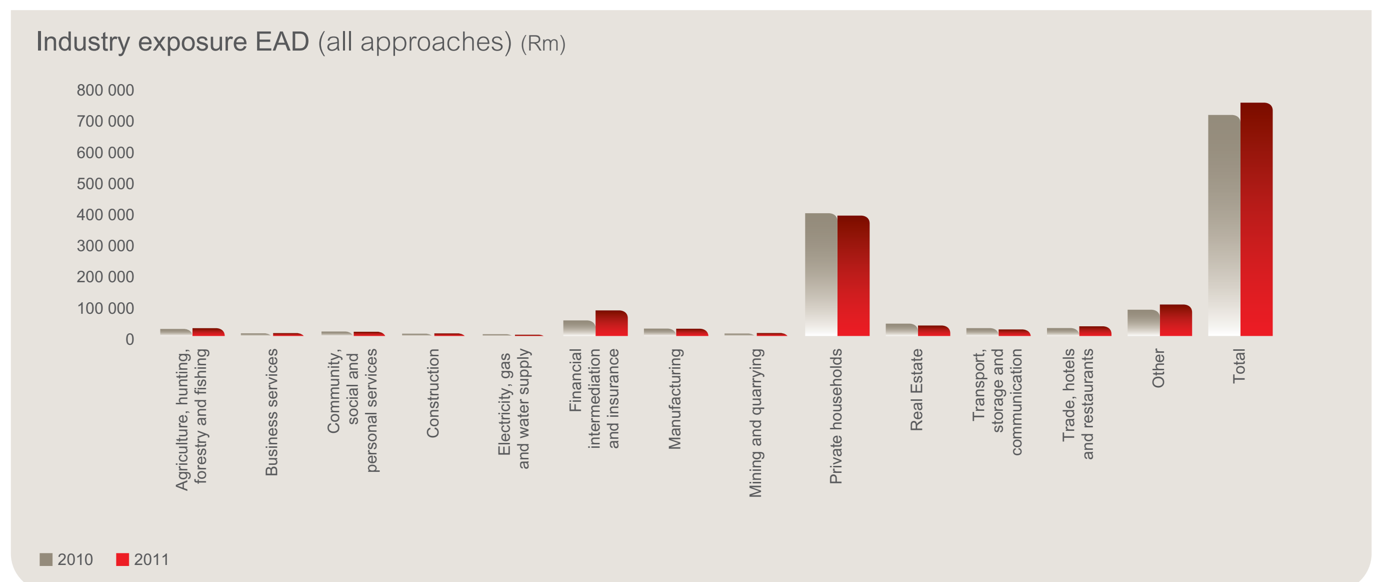
Breakdown of gross exposure by geographical area *(continued)*

Group

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

2010	South Africa Rm	Europe Rm	Other African countries Rm	North America Rm	Other Rm	Asia Rm	South America Rm	Total Rm
Standardised	48 215	—	9 272	—	—	—	—	57 487
Internal Ratings Based	788 700	53 741	6 623	9 516	568	313	—	859 461
FIRB	455 806	—	—	—	—	—	—	455 806
AIRB	332 894	53 741	6 623	9 516	568	313	—	403 655
	836 915	53 741	15 895	9 516	568	313	—	916 948

Breakdown of exposure per industry



Note

[1]The majority of the exposures reflecting under Europe relate to exposures to Barclays Bank Plc.

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2011 disclosures *(continued)*

Concentrations of credit risk *(continued)*

IFRS disclosures in terms of credit concentration

Geographical concentration of risk

	Group				
	2011				
	South Africa Rm	Rest of Africa Rm	Europe[1] Rm	Asia, Americas and Australia Rm	Total Rm
On-statement of financial position exposure					
Cash, cash balance and balance with central banks	16 840	2 264	—	—	19 104
Statutory liquid asset portfolio	57 451	22	—	—	57 473
Loans and advances to banks	5 839	1 709	48 255	1 629	57 432
Trading and hedging portfolio assets	56 067	389	24 132	3 170	83 758
Other assets	12 634	255	614	1	13 504
Loans and advances to customers	492 556	8 464	1 808	675	503 503
Reinsurance assets	509	51	306	143	1 009
Investment securities	5 236	722	—	—	5 958
Subject to credit risk	647 132	13 876	75 115	5 618	741 741
Off-statement of financial position exposures					
Financial guarantee contracts	79	231	46	—	356
Guarantees	11 920	1 306	—	—	13 226
Irrevocable debt facilities	42 670	950	2 024	545	46 189
Letters of credit	4 560	630	—	—	5 190
Subject to credit risk	59 229	3 117	2 070	545	64 961

	2010[2]				
	South Africa Rm	Rest of Africa Rm	Europe Rm	Asia, Americas and Australia Rm	Total Rm
On-statement of financial position exposures					
Cash, cash balance and balances with central banks	16 929	1 873	—	—	18 802
Statutory liquid asset portfolio	48 215	—	—	—	48 215
Loans and advances to banks	5 867	1 308	19 361	959	27 495
Trading and hedging portfolio assets	40 562	87	19 787	1 226	61 662
Other assets	9 298	221	583	128	10 230
Loans and advances to customers	498 723	7 388	1 146	1 523	508 780
Reinsurance assets	703	—	137	20	860
Investment securities	8 393	487	—	—	8 880
Subject to credit risk	628 690	11 364	41 014	3 856	684 924
Off-statement of financial position exposures					
Financial guarantee contracts	552	—	47	—	599
Guarantees	11 051	—	—	—	11 051
Irrevocable debt facilities	45 432	672	391	—	46 495
Letters of credit	4 976	3	—	—	4 979
Subject to credit risk	62 011	675	438	—	63 124

Notes

[1]The majority of the exposures reflecting under Europe relate to exposures to Barclays Bank Plc.

[2]Comparatives have been reclassified, refer to note 1.26.

2011 disclosures *(continued)*

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. The Group distinguishes between two types of wrong-way risk, namely:

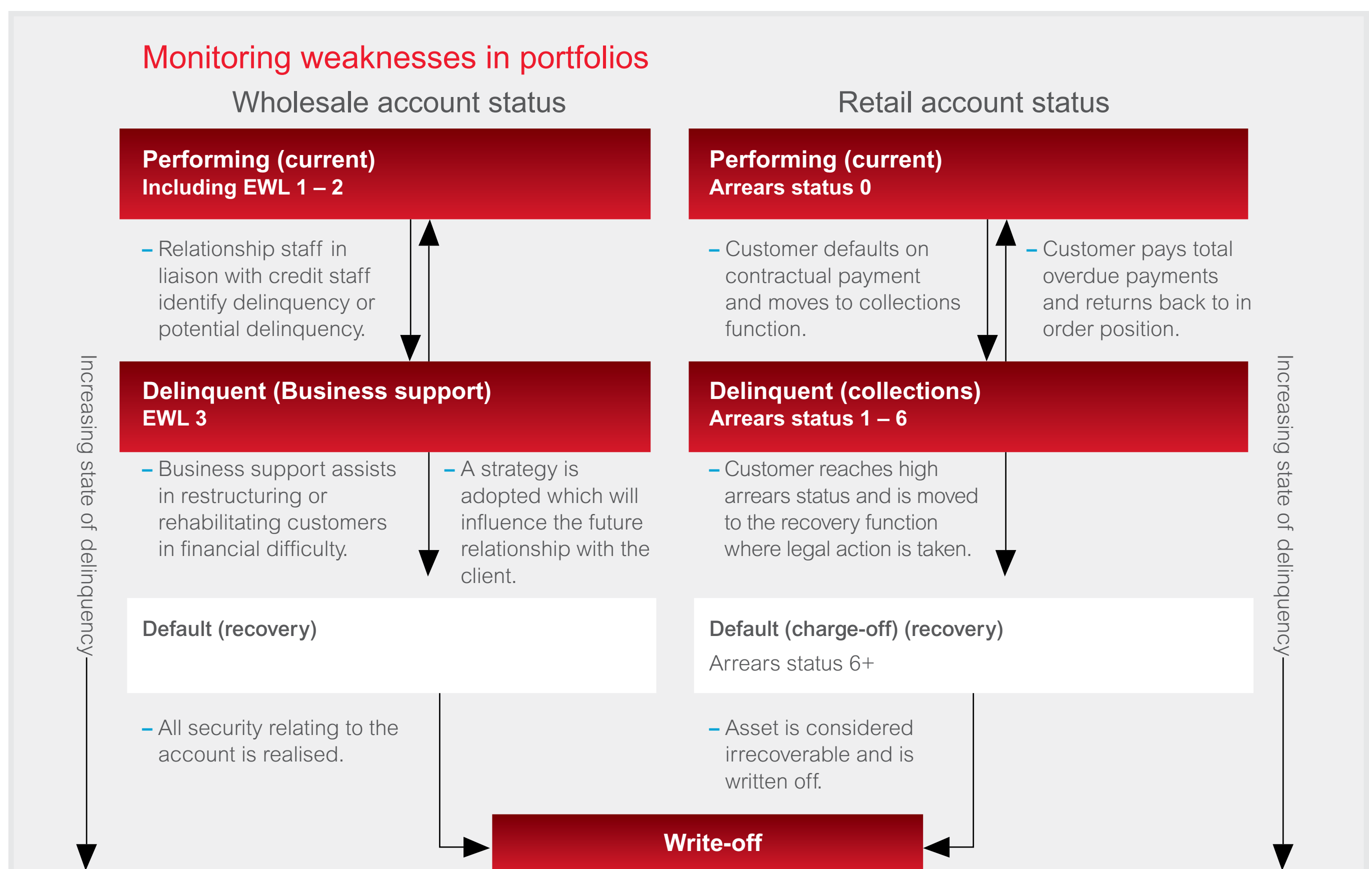
- specific wrong-way risk, which may arise in transactions with certain structural features, such as the collateralisation of a loan with the borrower's, or a related party's shares; and
- general or conjectural wrong-way risk, which may arise where the credit quality of the counterparty is related to 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.

The Group aims to limit both these risk types. However, it recognises the need to engage in certain transactions which could expose it to specific wrong-way risk, such as funding broad-based black economic empowerment (BBBEE) transactions.

Monitoring weaknesses in portfolios

Corporate accounts which are 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 Banking portfolios, which tend to comprise homogeneous assets, statistical techniques allow impairment to be monitored on a portfolio basis. It is consistent with Group 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.



2011 disclosures *(continued)*

Securitisation

Securitisation transactions, used as part of the Group's 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 ALCO. 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 as at the reporting date have involved the sale of the underlying assets to the securitisation vehicle. The Group has not originated any synthetic securitisation transactions. Nonetheless, the Group calculates appropriate capital charges in respect of the risk assumed, through the provision of liquidity facilities and retained exposures, as per the Basel II securitisation framework.

As at the reporting date, the Group has securitised its own assets relating to the home loan portfolio. The vehicle finance securitisation has matured. The origination of transactions based on other asset classes, such as CPF are considered on an ongoing basis.

Securitisation activities of the Group

Securitisation transactions have been used as a means of raising long-term funding. The Group applies the IRB approach in the assessment of its securitisation exposures for RC purposes and uses 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. Investments in securitisation exposures may be made directly or indirectly, through the Group's conduit, Abacas. It should be noted that the Group's conduit (Abacas) has been wound up in December 2011.

The following table provides a breakdown of the Group's role in each transaction during 2011:

Roles played by the Group in securitisation schemes	Originator	Sponsor	Investor (Absa)	Liquidity provider	Services provider	Credit enhance-ment/ subordi-nated loan
On the Cards Investment II			√			
Home Obligors Mortgage Enhanced Securities Proprietary Limited	√	√	√		√	√
Vukile Investment Property Securitisation Proprietary Limited			√	√		
Prime Realty Obligors Packaged Securities Proprietary Limited				√		
Nqaba Finance Proprietary Limited				√		
Grayston Conduit Proprietary Limited				√		
Ikhaya RMBS 2 Limited				√		
Nitro 2				√		
Nitro 3				√		
Nitro 4				√		
Blue Granite 1 Proprietary Limited			√			
Blue Granite 3 Proprietary Limited			√			
Blue Granite 4 Proprietary Limited			√			
Thekweni Fund 7 Proprietary Limited			√			

The following securitisation schemes have been redeemed in the year:

- Private Commercial Mortgages 2 Proprietary Limited;
- Ikhaya 1;
- Abacas; and
- Blue Granite 2 Proprietary Limited

Blue Granite 4 Proprietary has been purchased from Abacas and moved on-statement of financial position during the year.

2011 disclosures *(continued)*

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. Where the Group acts 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

	2011		2010	
	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 year.

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

The Group originated securitisation transactions performed according to expectations and no triggers were breached.

Outstanding securitisation balances

			2011		
IRB exposures	**Corporate receivables Rm**	**Retail: mortgages Rm**	**Retail: instal-ment sales and leasing Rm**	**Retail: other[1] Rm**	**Total Rm**
On-statement of financial position	—	4 958	—	—	4 958
On-statement of financial position	—	—	—	—	—
	—	4 958	—	—	4 958
Of which notes issued					
Investment grade	—	4 019	—	—	4 019
Sub-investment grade[2]	—	1 038	—	—	1 038

			2010		
	Corporate receivables Rm	Retail: mortgages Rm	Retail: instal-ment sales and leasing Rm	Retail: other[1] Rm	Total Rm
On-statement of financial position	—	4 533	—	2 554	7 087
On-statement of financial position	—	—	—	—	—
	—	4 533	—	2 554	7 087
Of which notes issued					
Investment grade	—	4 019	—	2 554	6 573
Sub-investment grade[2]	—	1 038	—	—	1 038

Notes

[1]Retail: Other represents Abacas (the Group is sponsor) being a conduit (asset backed commercial paper programme). This book has been wound up in December 2011.

[2]Sub-investment grade – BBB and below.

2011 disclosures *(continued)*

Securitisation *(continued)*

Securitisation exposures (continued)

Retained or purchased securitisation exposures per asset class

	Group					
	2011			2010		
	Retained Rm	**Purchased Rm**	**Total Rm**	Retained Rm	Purchased Rm	Total Rm
Corporate/Sovereign/Banks	—	—	—	240	—	240
Residential mortgages	**946**	**1 100**	**2 046**	946	993	1 939
Retail – other	—	**368**	**368**	—	936	936
Small- and medium-sized entity	—	**150**	**150**	—	351	351
	946	**1 618**	**2 564**	1 186	2 280	3 466

Retained or purchased securitisation exposure by risk weight band

	Group			
	2011		2010	
Risk-weight band (%)	**Retained Rm**	**Purchased Rm**	Retained Rm	Purchased Rm
7 – 10	—	—	—	—
11 – 19	—	**437**	240	1 149
20 – 49	—	**1 126**	—	1 076
50 – 75	—	—	—	—
76 – 99	—	—	—	—
100	—	**55**	—	55
250	**23**	—	23	—
350	—	—	—	—
425	—	—	—	—
650	—	—	—	—
1 250 or deducted	**923**	—	923	—
	946	**1 618**	1 186	2 280

Rated securitised exposures in terms of IRB approach

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

	Group						
	2011						
	Corporate receivables Rm	**SME[1] receiva-bles Rm**	**Retail: mortgages Rm**	**Retail: revolving products Rm**	**Retail: instalment sales and leasing Rm**	**Retail: other Rm**	**Total Rm**
Total senior exposure rated BBB or better	—	—	**35,0**	—	**2,8**	**7,6**	**45,4**
Total base risk weight exposures rated BBB or better	—	**1,9**	**108,0**	—	—	**6,5**	**116,4**
Total exposure rated BBB or below	—	**5,4**	—	—	—	—	**5,4**
	—	**7,3**	**143,0**	—	**2,8**	**14,1**	**167,2**

	2010						
	Corporate receivables Rm	SME[1] receiva-bles Rm	Retail: mortgages Rm	Retail: revolving products Rm	Retail: instalment sales and leasing Rm	Retail: other Rm	Total Rm
Total senior exposure rated BBB or better	—	3,1	33,2	—	—	7,6	43,9
Total base risk weight exposures rated BBB or better	—	4,8	103,3	—	11,1	86,5	205,7
Total exposure rated BBB or below	—	5,4	19,2	—	—	—	24,6
	—	13,3	155,7	—	11,1	94,1	274,2

Note

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

2011 disclosures *(continued)*

Securitisation *(continued)*

Securitisation exposures (continued)

RWAs and capital deductions (IRB)

	Group			
	2011			
	RWAs Rm	Required capital[1] Rm	Primary capital and reserve funds Rm	Secondary capital and reserve funds Rm
Corporate receivables	—	—	—	—
Retail: instalment sales and leasing	29	3	—	—
Retail: mortgages	1 467	139	—	—
Retail: other	145	14	—	—
Retail: revolving products	—	—	—	—
SME[2] receivables	75	7	—	—
	1 716	163	—	—
	2010			
	RWAs Rm	Required capital[1] Rm	Primary capital and reserve funds Rm	Secondary capital and reserve funds Rm
Corporate receivables	—	—	—	—
Retail: instalment sales and leasing	113	11	—	—
Retail: mortgages	1 597	152	—	—
Retail: other	966	92	—	—
Retail: revolving products	—	—	—	—
SME[2] receivables	137	13	—	—
	2 813	268	—	—

Notes

[1]Required capital is calculated at 9,5%. This excludes the Group specific (Pillar 2b) add-on.

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

Strategic focus for 2012

Wholesale credit risk

Absa expects to see a continued improvement in wholesale impairment levels, and reduced exposure on the EWL. Focus areas for the year ahead include reducing concentrations to perceived higher risk sectors, enhancing the risk and control framework and further embedding the AIRB principles in the business.

Retail credit risk

The Group will continue to focus on value and balance sheet optimisation. The aim is to increase portfolio growth through defining low risk pockets/products and improve decision-making processes by continuously assessing market conditions and understanding the impact of economic shifts on the various portfolios. The Group will therefore remain focused on the quality and profitability of new business it writes and will continue to be selective in the type of business written within the mortgage portfolios.

As the economic recovery gains momentum, affordability should return and the Group will continue to focus on rehabilitating customer arrears as appropriate.

A key component in the 2012 strategic focus for retail credit risk is to reduce the non-performing loans, especially in the secured portfolios, by optimising the potential value when disposing of assets.

Securitisation

The strategic focus for securitisation transactions is to reduce the level of on-statement of financial position securitisation exposures.

Market risk

31 December

Highlights

- *Traded market risk and revenue down on volatile markets. Increased market volatility impacted liquidity and ability to monetise traded margins. Focus on risk management and efficient capital usage ensured a favourable risk-adjusted return.*
- *Interest rate risk in the banking book managed to low levels.*
- *Reserves more sensitive to market interest rate movements due to additional statutory liquid assets purchased and hedges executed during the year.*
- *Selected assets in the equity investment portfolio were exited.*

Key performance indicators

	Group	
	2011	2010
Average traded market risk DVaR (Rm)	**23,73**	27,85
Traded market risk RC (at 8% of RWAs) (Rm)	**669**	721
Banking book AEaR for a 2% interest rate shock (% of Group NII)	**<5%**	<5%
Equity investments in the banking book RWAs (Rm)	**22 168**	25 911

Audited

Introduction

Market risk is the risk that the Group's earnings or capital, or its 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. Market risk mainly arises from trading activities and equity investments. The Group is, however, also exposed to market risk through non-traded interest rate risk in its banking book.

Strategy

The Group's market risk management objectives are:

- understanding and controlling market risk through robust measurement, controls and oversight;
- facilitating business growth within a controlled and transparent risk management framework;
- ensuring traded market risk resides mainly in Absa Capital; and
- ensuring a higher degree of interest rate mismatch margin stability and lower interest rate risk over an interest rate cycle in the banking book.

Governance

Market risk is managed in terms of the Group's market risk control framework. This framework is set by the PRO for market risk, and is approved by the GRCMC. The board approves market risk appetite, on the recommendation of the GRCMC. The PRO sets a market risk limit framework within the context of the approved market risk appetite.

All market risks are reported to the GRCMC on a quarterly basis. The Market Risk Committee (MRC) 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.

Oversight for specific market risks are provided by the Trading Risk Committee (TRC), Group ALCO and ALCO subcommittees. The GIC considers, approves and monitors all equity investments and divestments by the Group.

The head of each BU, assisted by an independent business risk management team, is accountable for all its market risks. Each BU is responsible for identifying, measuring, managing, controlling and reporting market risk, as detailed in the market risk control framework. Group oversight is provided by the Group market risk team.

2011 in review

The trading environment during the year continued to be characterised by the sentiments of 2010 with initial expectations of economic recovery. This mood gave way to higher volatility as a result of spill-over impacts from the sovereign debt crisis and deteriorating traded market liquidity. These factors contributed to a lower trading risk profile as well as marginally lower trading revenue. The trading revenue-to-risk ratios remained favourable.

The traded market risk engine was upgraded further during the year to ensure enhanced performance and scalability to support trading expansion plans and regulatory change. Regulatory approval was maintained for use of the IMA, and improvements to the internal model resulted in reductions in required RC. There was also continued management by the Group of its traded RWAs towards a more efficient use of capital.

The Group's preparations for Basel II.5 were completed, impacts were actively managed throughout the year and internal reporting on an equivalent basis was undertaken to ensure the smooth transition and business embedment of new measures.

Absa continued to manage its structural and non-structural banking book interest rate risk to low risk appetite levels during the year. Cash flow hedge reserves were further bolstered during the year, as a result of favourable mark-to-market movements in the structural products and equity hedge programme. These mark-to-market movements will be released to the income statement on an accrual basis over the average life of the programme should market rates remain at current levels. Absa remains exposed to prime-JIBAR basis risk arising from the timing 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.

Selected assets in the equity investment portfolio were successfully exited during the year.

Regulatory change in 2011

The amended regulations relating to banks became effective on 1 January 2012. These amendments incorporate changes introduced globally as part of the enhancements to the Basel II framework (known as Basel II.5). The Group has extended its risk management approach to report on the newly-required measures. The most significant of these is stressed value at risk (sVaR) which has been reported internally on a daily basis for 2011. The regulator has provided the Group with the internal model multiplier to be used for sVaR in 2012. For indicative purposes, regulatory sVaR ended the year at R46,9 million and the stressed period used is March 2007 to April 2008. The Group expects sVaR to add between 75% and 100% onto the regulatory market risk capital requirement. The full Basel II.5 requirement will be calculated using a combination of VaR and sVaR on internal models and specific risk via the regulatory standardised approach.

Audited

Traded market risk

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. The Group's policy is to concentrate its traded market risk exposure within Absa Capital.

Market risk in Absa Capital is prevalent within both the trading book and the banking book, as defined for regulatory purposes. Interest rate risk in Absa Capital's banking book is subjected to the same rigorous measurement and control standards as its trading book, but the associated sensitivities are reported as part of the interest rate risk in the banking book section on pages 67 to 71.

Risk measurement

A suite of comprehensive techniques is used to measure and control traded market risk on a daily basis, which include DVaR, tail risk and stress testing.

Daily value at risk (DVaR)

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.

Absa Capital uses 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 of 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; and
- 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 two-year period.

This internal model is also used for measuring value at risk (VaR) over both a one-day and 10-day holding period at a 99% confidence level for regulatory back-testing and RC calculation purposes respectively. Absa Capital's VaR internal model has been approved by the SARB to calculate RC for certain 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, new products, which are awaiting regulatory approval, are capitalised by using the regulatory standardised approach.

Audited

Traded market risk *(continued)*

Approach *(continued)*

Risk measurement (continued)

Daily Value at Risk (DVaR) *(continued)*

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 back-testing, which counts the number of days when daily trading losses exceed the corresponding VaR estimate. The regulatory standard for back-testing is to measure daily losses against VaR assuming a one-day holding period and a 99% level of confidence. The regulatory green zone of four or less exceptions over a 12-month period is consistent with a good working VaR model. Back-testing reports are monitored daily. For Absa Capital's trading book, green model status was maintained during the year.

VaR estimates do have a number of limitations. These are:

- historical simulation assumes that the past is a good representation of the future. This 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 as at the close of business and 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 obtaining rate/price information.

To complement VaR, tail risk metrics, stress testing and other sensitivity measures are used.

Tail risk 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.

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. Absa Capital performs two main types of stress/scenario testing. First, 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. Second, 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 results are monitored daily in accordance with a stress limits and triggers framework.

Risk control

Risk limits are set and reviewed at least annually to control Absa Capital's 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. Trading risk limits are set at aggregate, risk category and lower levels and are expressed in terms of DVaR. This is further supported by a comprehensive set of sensitivity limits, including foreign exchange position limits, interest rate delta limits, option-based limits, tail risk and stress triggers and limits. Performance triggers are also used as part of the risk management process.

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

Risk reporting

Absa Capital's Market Risk team produces a number of detailed and summary market risk reports on a daily and monthly basis. These reports summarise the positions, risks and top stresses covering interest rate, foreign exchange, equity, commodity and credit spread. Absa Capital market risk reports are sent to Group Market Risk for review and inclusion in the monthly MRC and other governance committee reports, as required.

Traded market risk *(continued)*

2011 disclosures

Analysis of risk exposure

The following table reflects the 95% DVaR statistics for Absa Capital's trading book activities as measured by the Group's IMA for general trading position risk. Absa Capital's traded market risk exposure, as measured by average total DVaR, decreased by 14,8% to R23,73 million (2010: R27,85 million). This reduction was mainly due to a R4,4 million decrease in average equity DVaR emanating from reduced equity option volatility exposure. Expected shortfall showed a similar decrease, averaging R34,86 million during the year (2010: R39,04 million).

Absa Capital trading book DVaR summary

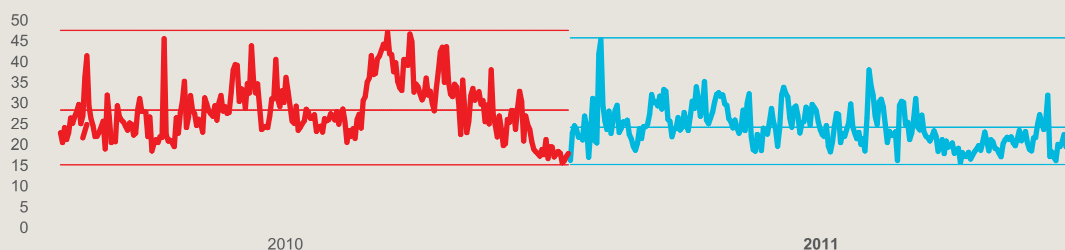
Audited

	2011				2010			
	Average Rm	High[1] Rm	Low[1] Rm	As at 31 Dec Rm	Average Rm	High[1] Rm	Low[1] Rm	As at 31 Dec Rm
Interest rate risk[2]	**19,09**	**36,69**	**10,67**	**14,12**	22,15	36,64	10,16	17,36
Foreign exchange risk	**8,13**	**25,68**	**1,89**	**5,07**	7,47	38,09	1,57	3,56
Equity risk	**4,76**	**10,83**	**2,38**	**5,18**	9,17	26,95	2,54	5,02
Commodity risk	**1,87**	**6,55**	**0,32**	**1,30**	1,41	4,78	0,30	0,71
Diversification effect	**(10,12)**	**n/a**	**n/a**	**(7,35)**	(12,35)	n/a	n/a	(9,24)
Total DVaR[3]	**23,73**	**44,77**	**15,22**	**18,32**	27,85	46,55	15,13	17,41

Disclosure enhancements will be introduced in the next reporting period to improve the visibility of the components within interest rate risk. Specifically, the Group will be reporting interest rate, credit and inflation asset classes separately. For an indicative view, DVaR values at the reporting date (on an undiversified basis) are R21,01 million, R11,66 million and R4,33 million, respectively.

The following graph shows the daily history of Absa Capital's total trading book DVaR for 2010 and 2011, along with the period averages and highs and lows. In comparison with 2010 and continuing the trend, the DVaR for the year has demonstrated reduced variability, lower average risk levels and a reduction in large DVaR days. Absa Capital does, on some occasions in the conduct of customer transactions, take on significantly larger than usual market risk. However, this is always undertaken within the Group's market risk governance framework.

Absa Capital trading book DVaR (daily values, period average, high and low) (Rm)



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 from the above table.

[2]Credit spread risk and inflation risk is reported together with interest rate risk.

[3]The total value at risk over a 10-day holding period at a 99% confidence level as at the reporting date was R92,64 million (2010: R97,67 million).

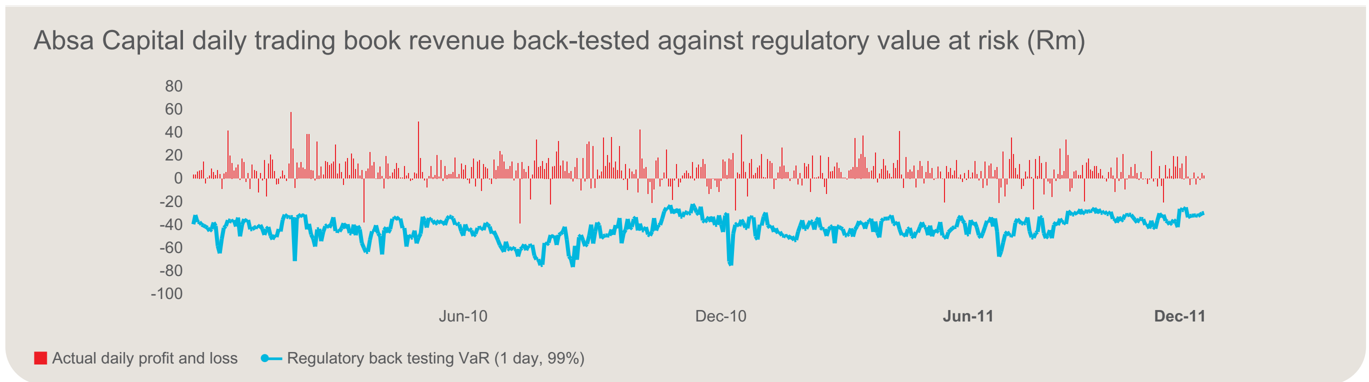
Traded market risk *(continued)*

2011 disclosures *(continued)*

Comparison of value at risk estimates with trading revenues

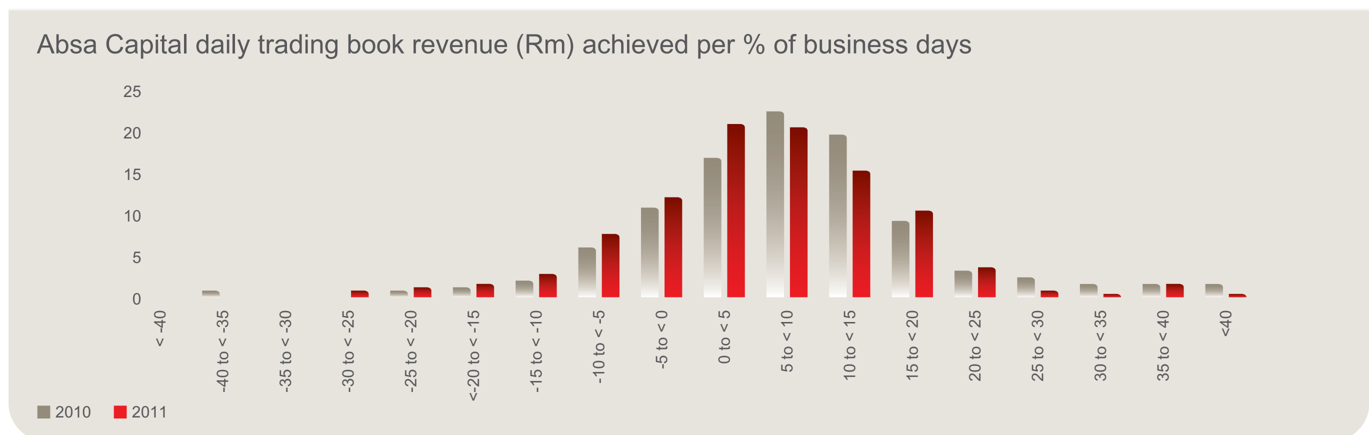
The following graph compares the total VaR estimates over a one-day holding period at a 99% confidence level with the daily revenues generated by the trading units from 2010 to 2011. Revenue as reported here relates to actual trading book revenue only, excluding fees, commissions, bid-ask spreads and net interest income, as required for regulatory back-testing purposes.

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



Analysis of trading revenue

The following histogram depicts the distribution of daily trading revenue for the Absa Capital trading book for the 12 months ended 31 December 2010 and 2011. 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 2011 decreased compared to that of 2010 due to fewer larger profit days. Note though that this change is partially offset by a higher frequency of smaller profit days. The percentage of positive revenue days declined slightly to 74% in 2011 from 78% in 2010, indicating more loss days compared to 2010.



Traded market risk *(continued)*

2011 disclosures *(continued)*

Minimum RC requirement

The Group's traded market risk minimum RC requirement comprises two elements:

- trading book positions where the market risk is measured under a SARB approved internal VaR model. 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 the Group's general position risk across interest rate, foreign exchange, commodity, equity and traded credit products. A description of the Group's internal model and controls may be found on page 63; and
- trading book positions which have not yet met SARB or the Group's internal conditions for inclusion within the approved internal model. The capital requirement is calculated using standardised regulatory rules. This approach currently applies to the Group's issuer specific risk exposures.

The total traded market risk minimum capital requirement decreased by 7% or R52 million year-on-year to the reporting date. This decrease was due to a smaller capital requirement from the IMA in line with reduced general position risk. This was offset by a rise in the standardised approach capital requirement, which increased in line with business growth.

Minimum RC requirement (at 8% of RWA) for traded market risk

	Group	
	2011 Rm	2010 Rm
IMA (DVaR model based)	**362**	501
Standardised approach	**307**	220
Interest rate risk	**226**	134
Equity risk	**81**	36
Foreign exchange risk, including gold	**—**	—
Commodity risk	**—**	—
Options	**—**	50
Total traded market risk capital requirement	**669**	721

Audited

Interest rate risk in the banking book

Approach

Interest rate risk is the risk that the Group's 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 within the statement of financial position, mainly due to repricing timing differences between assets, liabilities and equity. These risks impact both the earnings and the economic value of the Group.

The Group's objective for managing interest rate risk in the banking book is to ensure a higher degree of interest rate mismatch margin stability and lower interest rate risk 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 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 the Group's 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 the Group's 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). The Group's policy requires such direct option risk to be hedged explicitly.

Audited

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

Approach *(continued)*

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 the Group is 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 the Group commits 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.

Embedded customer optionality risk was not material during 2011.

Risk Measurement

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

Repricing profi2les

Instruments are allocated to time periods with reference to the earlier of the next contractual interest rate repricing date and the maturity date. Instruments which 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)

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 (DVaR)

The Group uses 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

EVE sensitivity measures the sensitivity of the present value of the banking book, at a specific PIT 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. The 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 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 MRC. 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 whilst the DVaR of the African subsidiaries' treasuries is reported monthly. The repricing profiles, AEaR, EVE sensitivity and stress results are reported monthly for both Group Treasury and the African subsidiaries.

2011 disclosures

Three separate interest rate sensitivity analyses for the Group's banking book are set out in the table that follows, 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 the Group's domestic, African subsidiaries and consolidated banking books shows 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 2010 to 2011.

The main reason for the increased sensitivity for the African subsidiaries' banking books is due to the further refinement and implementation of product structural assumptions with the aim to closely represent reality of the markets and facilitate better risk management.

Audited

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

2011 disclosures *(continued)*

Repricing profile *(continued)*

Expected repricing profile

Group

	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 Absa Bank Limited'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

	2010[4]			
	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	128 494	(33 570)	(26 521)	(33 699)
Derivatives[2]	(120 901)	32 111	24 474	64 316
Net interest rate sensitivity gap	7 593	(1 459)	(2 047)	30 617
Cumulative interest rate gap	7 593	6 134	4 087	34 704
Cumulative gap as a percentage of Absa Bank Limited's total assets (%)	1,1	0,9	0,6	5,0
Foreign subsidiaries' bank books[3]				
Interest rate sensitivity gap	435	(394)	(591)	410
Derivatives[2]	122	—	—	(121)
Net interest rate sensitivity gap	557	(394)	(591)	289
Cumulative interest rate gap	557	163	(428)	(139)
Cumulative gap as a percentage of foreign subsidiaries' total assets (%)	6,0	1,8	(4,6)	(1,5)
Total				
Cumulative interest rate gap	8 150	6 297	3 659	34 565
Cumulative gap as a percentage of the Group's total assets (%)	1,1	0,9	0,5	4,8

Notes

[1]Includes exposures held in the Absa Capital banking book.

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

[3]Includes NBC and BBM.

[4]Comparatives have been reclassified, refer to note 1.26.

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

2011 disclosures *(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 the Group's 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, as at the reporting date, result in a pre-tax reduction in projected 12-month net interest income of R475 million. A similar increase would result in an increase in projected 12-month net interest income of R464 million. AEaR therefore remains low, at well below 5% of the Group's net interest income, for a 200 bps rate shock.

A sensitivity analysis by major currency market interest rates indicates that earnings sensitivity to South African Rand (ZAR) market interest rates constitutes 86% of the total earnings at risk as reported for 31 December 2011 (31 December 2010: 96%), therefore indicating that the Group remains primarily exposed to South African market interest rates.

Audited

AEaR 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 31 December 2011				
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**
As at 31 December 2010[3]				
Domestic bank book[1] (Rm)	(376)	(176)	157	328
Foreign subsidiaries' bank books[2] (Rm)	(13)	(7)	7	13
Total (Rm)	(389)	(183)	164	341
Percentage of the Group's net interest income (%)	(1,7)	(0,8)	0,7	1,5
Percentage of the Group's equity (%)	(0,6)	(0,3)	0,3	0,5

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 2011 tax rate. 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 which are mark-to-market 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 decreased sensitivity of cash flow hedging reserves from 2010 to 2011 is due to an increase in the hedging activity of structural balances. The increased sensitivity of available-for-sale reserves from 2010 to 2011 is due to additional statutory liquid assets purchased during the year, classified as available-for-sale.

Notes

[1]Includes Absa Bank Limited's domestic banking book, which includes exposures held in the Absa Capital banking book.

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

[3]Comparatives have been reclassified, refer to note 1.26.

Audited

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

2011 disclosures *(continued)*

Sensitivity of reserves to market interest rate movements

	Group		
	2011		
	As at 31 December Impact on equity Rm	Maximum impact[1] Rm	Minimum impact[1] Rm
+ 100 bps parallel move in all yield curves			
Available-for-sale reserve	(1 005)	(1 012)	(793)
Cash flow hedging reserve	(1 664)	(1 758)	(1 652)
Total	(2 669)	(2 705)	(2 464)
As a percentage of Group equity (%)	(3,9)	(4,0)	(3,6)
– 100 bps parallel move in all yield curves			
Available-for-sale reserve	1 005	1 012	793
Cash flow hedging reserve	1 664	1 758	1 652
Total	2 669	2 705	2 464
As a percentage of Group equity (%)	3,9	4,0	3,6

	2010[2]		
	As at 31 December Impact on equity Rm	Maximum impact[1] Rm	Minimum impact[1] Rm
+ 100 bps parallel move in all yield curves			
Available-for-sale reserve	(841)	(875)	(675)
Cash flow hedging reserve	(1 731)	(1 794)	(1 506)
Total	(2 572)	(2 655)	(2 238)
As a percentage of Group equity (%)	(4,1)	(4,3)	(3,6)
– 100 bps parallel move in all yield curves			
Available-for-sale reserve	841	875	675
Cash flow hedging reserve	1 731	1 794	1 506
Total	2 572	2 655	2 238
As a percentage of Group equity (%)	4,1	4,3	3,6

Notes

[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 reported for the total.

[2]Comparatives have been reclassified, refer to note 1.26.

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

2011 disclosures *(continued)*

Interest rate sensitivity analysis – interest return on average balances

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

	Group					
	2011			2010[2]		
	Average balance Rm	Average rate[1] %	Interest income/ (expense) Rm	Average balance Rm	Average rate[1] %	Interest income/ (expense) Rm
Assets						
Cash, cash balances and balances with central banks	3 156	5,04	159	1 741	5,92	103
Statutory liquid asset portfolio	51 839	8,26	4 282	35 331	8,44	2 983
Loans and advances to banks and customers	529 446	8,47	44 843	540 874	9,16	49 550
Investment securities	10 468	3,73	390	14 157	3,50	495
Other interest[3]	—	—	1 547	—	—	1 110
Interest-bearing assets	594 909	8,61	51 221	592 103	9,16	54 241
Non-interest-bearing assets	142 652	—	—	137 917	—	—
Total assets	737 561	6,94	51 221	730 020	7,43	54 241
Liabilities						
Deposits from banks and due to customers	402 620	(3,99)	(16 046)	374 410	(4,67)	(17 477)
Debt securities in issue	146 216	(6,57)	(9 602)	166 417	(7,68)	(12 786)
Borrowed funds	13 714	(9,84)	(1 350)	13 198	(12,02)	(1 586)
Other interest[3]	—	—	206	—	—	948
Interest-bearing liabilities	562 550	(4,76)	(26 792)	554 025	(5,58)	(30 901)
Non-interest bearing liabilities	111 211	—	—	116 774	—	—
Total liabilities	673 761	(3,98)	(26 792)	670 799	(4,61)	(30 901)
Equity						
Capital and reserves						
Attributable to ordinary equity holders of the Group:						
Share capital	1 433	—	—	1 433	—	—
Share premium	4 565	—	—	4 728	—	—
Other reserves	1 896	—	—	1 890	—	—
Retained earnings	49 902	—	—	45 169	—	—
	57 796	—	—	53 220	—	—
Non-controlling interest – ordinary shares	1 360	—	—	1 357	—	—
Non-controlling interest – preference shares	4 644	—	—	4 644	—	—
Total equity	63 800	—	—	59 221	—	—
Total equity and liabilities	737 561	(3,63)	(26 792)	730 020	(4,23)	(30 901)
Net interest margin on average interest-bearing assets		4,11			3,94	

Daily averages have been used to calculate the average balances.

Notes

[1]The average prime rate for the year was 9,00% (2010: 9,87%).

[2]Comparatives have been reclassified, refer to note 1.26.

[3]Also includes fair value adjustments on hedging instruments and hedging items.

Audited

Foreign exchange risk

Approach

The Group is 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. The Group's policy is for transactional foreign exchange risk to be concentrated and managed within the Absa Capital trading book.

Some transactional foreign exchange risk also arises within 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 period under review amounted to R0,3 million (2010: R0,3 million) on an undiversified basis across these treasuries.

In accordance with the Group's policy, there were no significant net open currency positions outside the Absa Capital 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.

Translational 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 RWAs being denominated in foreign currencies. Changes in foreign exchange rates result in changes in the ZAR equivalent value of foreign currency denominated capital resources and RWAs.

The Group's 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, which are currently excluded from qualifying capital resources under SARB rules.

To minimise the volatility of capital ratios caused by foreign exchange rate movements, the Group aims 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 RWAs in line with the Group's capital ratios. 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.

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

- a higher or lower ZAR equivalent value of non-ZAR denominated RWAs, together with a higher or lower currency translation reserve within equity, representing the translation of non-ZAR subsidiaries, branches and associates net of 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; and
- a higher or lower value of available-for-sale investments denominated in foreign currencies, impacting the available-for-sale reserve.

Translational hedging considerations include exchange control regulations, the strategic nature of the investment, the 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 during 2011.

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 table to follow.

2011 disclosures

The Group's translational foreign exchange exposure arises primarily from its net investments in foreign subsidiaries and branches. 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 ZAR and the relevant functional foreign currencies.

The Group's total foreign currency net investment exposure remains low despite increasing by 29,6% from 2010, mainly due to the depreciation of the South African Rand, profits in the London branch, and the investment in Global Alliance Mozambique.

Audited

Foreign exchange risk *(continued)*

2011 disclosures *(continued)*

Foreign currency translation sensitivity analysis

	Group				
Functional foreign currency	**Sterling Rm**	**Tanzanian shilling Rm**	**Mozambican metical Rm**	**Botswana Pula Rm**	**Total Rm**
As at 31 December 2011					
Foreign currency net investments	**1 902**	**432**	**556**	**5**	**2 895**
Impact on equity from a 5% currency translation shock	**95**	**22**	**28**	**—**	**145**
As at 31 December 2010					
Foreign currency net investments	1 481	276	477	—	2 234
Impact on equity from a 5% currency translation shock	74	14	24	—	112

Other market risks

Asset management structural market 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 within Absa Financial Services. Asset management structural market risk was not material during the year.

The Group maintains 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, the Group could be required or might choose to make additional contributions to the defined benefit plan. Financial details of the pension plans are provided in note 45 of the Group's annual financial statements.

Audited

Equity risk in the banking book

Approach

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.

The Group's 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 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 the Group's equity investments are held in Absa Capital and Absa Business Bank. Equity and other investments held by insurance entities of the Group are addressed in the insurance risk management section of this report.

Audited

Equity risk in the banking book *(continued)*

Approach *(continued)*

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 annual 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 analysis, 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 the venture capital and similar activities of the Group 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 *Interests in Joint Ventures* (IAS 31). The relevant accounting policies for equity investments are discussed in note 1.7 of the Group's annual 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.

The Group has adopted the market-based simple risk weight approach to calculate RWAs and RC for equity risk in the banking book. According to this approach, RWAs are calculated using weightings of 300% and 400% 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 risk in the banking book is based on investment type and portfolio risk modelling and varies from 35,2% to 100%.

2011 disclosures

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 Banks, excludes third-party equity investments under management for which the Group does not bear the risk, 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 management section of this report).

The size, composition, RWA component and EC requirement of the Group's equity investments in the banking book are reflected in the following table after recognition of guarantees. As at the reporting date, the statement of financial position value of such investments amounted to R5 747 million (2010: R6 757 million). Of the R5 747 million investment exposure as at the reporting date, R5 384 million is held for capital gains purposes and the remainder for strategic and other purposes.

The decrease in the equity exposure from the prior year is mainly due to the realisation of selected equity investments.

Equity risk in the banking book *(continued)*

2011 disclosures *(continued)*

Equity investments in the banking book

	Group	
	2011 Rm	2010 Rm
Statement of financial position	**5 747**	6 757
Exchange-traded investments, associates and joint ventures[1]	**694**	1 025
Privately held traded investments, associates and joint ventures[2]	**5 053**	5 732
Fair value of exchange-traded investments, associates and joint ventures[3]	**694**	1 039
RWAs	**22 168**	25 911
Exchange-traded investments, associates and joint ventures[1]	**2 083**	3 074
Privately held traded investments, associates and joint ventures[2]	**20 085**	22 837
Economic capital	**3 007**	4 036
Exchange-traded investments, associates and joint ventures[1]	**544**	399
Privately held traded investments, associates and joint ventures[2]	**2 463**	3 637

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

Realised and unrealised gains/(losses) on equity investments

	Group	
	2011 Rm	2010 Rm
Cumulative realised gains/(losses) arising from sales and liquidations	**64**	117
Total unrealised gains/(losses) recognised directly in the statement of financial position	**34**	(19)

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

- the Group does not have any latent revaluation gains/(losses), i.e. unrealised gains/(losses) which are not recognised in the statement of financial position or statement of comprehensive income; and
- the Group does not have unrealised gains/(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 adopted by the Group, i.e. all unrealised gains/(losses) that are not recognised in the statement of comprehensive income cannot be recognised in primary or secondary capital and reserve funds.

Notes

[1]Includes significant minority financial investments deducted from net qualifying RC, amounting to Rnil (2010: Rnil).

[2]Includes significant minority financial investments deducted from net qualifying RC, amounting to R26 million (2010: R23 million).

[3]To address specific SARB Pillar 3 requirements 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 (2010: R14 mlllion). The differences relate to conservative impairments applied on the listed associates, which followed a prudent and considered assessment by the board, therefore resulting in the fair value of the said investments being higher than the statement of financial position values. Additionally, there are no differences between the fair value and market value of exchange traded investments, associates and joint ventures.

Equity risk in the banking book *(continued)*

2011 disclosures *(continued)*

Equity sensitivity analysis of Group's investments, including insurance activities' investments

Note 12 of the Group consolidated 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. Compared to the preceding analysis, 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 financial year; and
- this analysis should be read in conjunction with the Insurance Risk Management section, which addresses life insurance mismatch risk and life and short term insurance investment risk, including also investment exposures other than equity investments.

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

Audited

	Group									
	2011					2010				
	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, 3, 4]	(79)	—	758	79	—	(51)	—	1 262	51	—
Listed equity investments	(76)	—	705	76	—	(38)	—	817	38	—
Unlisted equity investments	(3)	—	53	3	—	(13)	—	445	13	—
Group listed and unlisted equity investments, excluding insurance activities' investments[1, 4, 5]	(275)	(12)	5 712	275	12	(323)	(10)	6 672	323	10
Listed equity investments	(34)	(4)	744	34	4	(47)	(3)	985	47	3
Unlisted equity investments	(241)	(8)	4 968	241	8	(276)	(7)	5 687	276	7
Total Group equity investments[1]	(354)	(12)	6 470	354	12	(374)	(10)	7 934	374	10

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]Equity hedge structures were in place for the shareholders' equity investment portfolio in 2010. This assisted to hedge downside risk on equities if market values decrease with more than 6% and resulted in counterparties sharing in positive returns if market values increased with between 2% and 4%. No equity hedge structures were in place as at 31 December 2011.

[4]The reclassification of the 2010 figures relates to equity investment balances previously reflected against Group excluding insurance activities, now reflected under insurance activities. The total Group equity investments figure was not impacted. As a result of the reclassification, the sensitivities have been adjusted accordingly to reflect these changes.

[5]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'.

Strategic focus for 2012

The sovereign debt crisis and spill-over effect into the South African economy is expected to cast a shadow over 2012 and remains closely monitored.

From 2012, the Basel II.5 bank regulations will result in an increased market risk RC requirement primarily due to stressed VaR. Traded market risk is expected to return to more normal levels as Basel II.5 implementations become embedded, removing one of the key drivers of uncertainty. Countercyclical enhancements to our traded market risk economic capital model will also result in an increase in internal capital.

The Group will therefore remain focused on risk-adjusted returns and efficient use of risk capital across trading desks and products. Key focus areas remain our low capital consuming customer flow, cash equities and prime brokerage businesses. We will also continue to focus on customer risk solutions for sub-Saharan Africa markets.

Disclosure enhancements will be introduced in respect of Basel II.5 changes and to improve visibility of the Inflation and Credit Spread asset classes.

With interest rates expected to remain at low levels for 2012, interest rate risk in the banking book will continue to be managed to low levels.

The focus in 2012 for equity investments is to continue to balance the portfolio composition in line with the Group's risk appetite, with further selective exits, as appropriate.

Highlights

- *Liquidity risk management process remains robust and comprehensive.*
- *Continued strong increase in surplus liquid assets held.*
- *Continued improvement in wholesale funding term.*
- *Increased proportion of funding base from retail and commercial sources.*
- *Successful liquidity simulation exercise completed.*

Key performance indicators

	Group	
	2011 %	2010 %
Long-term funding ratio	**26,8**	25,6
Loans-to-deposits ratio	**88,1**	92,1

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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 which 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

The Group's liquidity risk management objectives are:

- growing and diversifying the funding base to support asset growth and other strategic initiatives;
- lengthening the Group's funding profile in order to improve key liquidity metrics, thereby reducing the Group's liquidity risk exposure;
- continuing to build surplus liquid asset holdings in view of the Basel III liquidity requirements; and
- focusing on lowering the weighted average cost of funding, within agreed parameters for liquidity risk.

Governance

Liquidity risk is managed in terms of the Group's liquidity risk control framework. This framework is set by the PRO for liquidity risk, and is approved by the GRCMC. The board approves liquidity risk appetite and the funding plan, as recommended by the GRCMC. The PRO also sets a liquidity risk limit framework within the context of the approved liquidity risk appetite.

All liquidity risks are reported to the GRCMC on a quarterly basis. Group Treasury is responsible for managing liquidity risk on behalf of the Group and meets regularly to review and approve the control framework and policy for liquidity risk management. Group Treasury reports monthly to the MRC, thereby ensuring a constant review of the Group's liquidity position. The Group ALCO meets quarterly to review liquidity risk requirements, objectives and management actions.

Liquidity risk is managed centrally by Group Treasury with certain risk management responsibilities delegated to BUs.

2011 in review

Absa's liquidity position remained strong during the year as the Group continued to focus on increasing its surplus liquid asset reserves, extending its funding term and on growing its deposit base. Relatively slow growth in the South African economy meant that the supply of liquidity remained strong as banks did not have to lend out as much money as is the case during periods of strong economic growth. The Group successfully issued senior unsecured debt to further extend its funding term and diversify its funding base. The Group also succeeded in reducing its reliance on wholesale money market funding sources. The cost of liquidity remained high, although it is less than the peak levels seen towards the end of 2009 and 2010. The appetite for term funding in the money markets reduced towards the end of the year, driven largely by asset managers having to rebalance the duration profiles of their money market funds.

The Group took steps during the year to further enhance its liquidity risk framework, thereby ensuring the approach used to determine the amount of liquidity risk the Group is comfortable with continues to evolve in line with international best practice.

In line with market practice, the Group conducted a liquidity stress simulation exercise, involving senior management, to test the adequacy of the Group's liquidity contingency plans. These exercises are conducted from time to time, under the auspices of an external audit firm, to ensure appropriate senior management focus on liquidity risk management and to ensure the Group is well prepared for a liquidity stress event. The exercise proved that the Group is well prepared for a liquidity stress event.

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Approach to liquidity risk

A dedicated team in Group Treasury is responsible for implementing the liquidity risk framework and policy and for ensuring that liquidity risk is adequately managed across the Group. The dedicated team in Group Treasury also monitors and manages the Group's 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 (behavioural adjusted) liquidity positions, as well as the stress tested liquidity position into consideration.

Business-as-usual liquidity 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 the Group's 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 the Group's 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 the Group's 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 the Group's 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 the Group's operations.

Through scenario analysis and stress testing, the Group aims to manage and mitigate liquidity risk by:

- determining, evaluating and testing the impact of adverse liquidity scenarios;
- 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. The Group's overall objective is to ensure that during a liquidity stress event, the Group's 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 is used to evaluate the efficiency 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' (CFLP) 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. A successful simulation exercise was completed during the second half of the year.

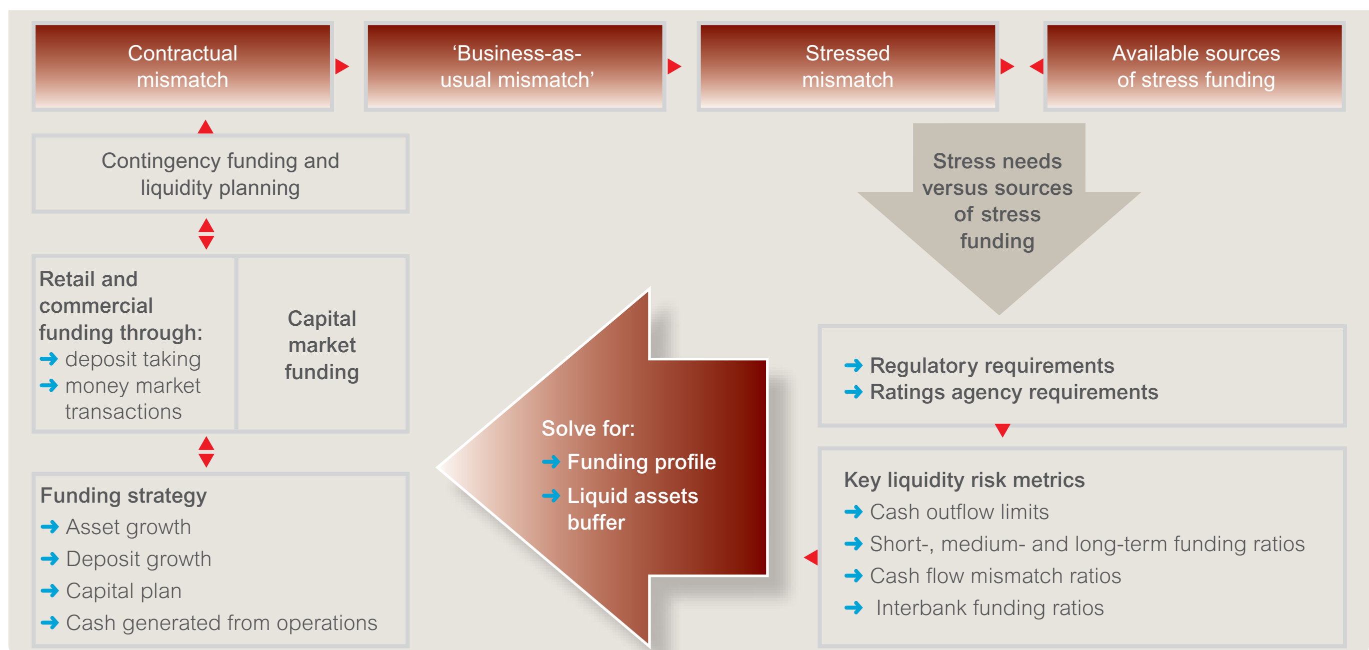
Approach to liquidity risk *(continued)*

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.

The liquidity risk management approach of Absa is summarised in the diagram below:



2011 disclosures

Regulatory changes in 2011

The focus on the potential implications of the proposed Basel III liquidity framework during 2010 continued during the year. The Group participated in further QIS studies, which were released by the BCBS to fine-tune the calibration of the proposed liquidity ratios. These are expected to continue in 2012. The proposed Basel liquidity rules afford a large amount of discretion to national supervisors such as the SARB. The South African National Treasury has acknowledged that South African banks face a challenge in relation to the Basel liquidity framework as a result of certain structural features of the South African economy as detailed in the document entitled "A safer financial sector to serve South Africa better". A task force was set up by National Treasury with the mandate to find ways in which the structural shortcomings of the South African economy could be improved to assist banks in complying with the Basel III liquidity rules. These rules require substantially more liquidity reserves, and that banks have a substantially longer funding term (both of which are in short supply in South Africa). Absa is actively participating in this initiative.

The expectation is that banks will begin reporting of information under the Basel liquidity framework during 2012. Compliance with the two key liquidity Basel ratios is only required from 2015 and 2018 respectively.

Key metrics under Basel liquidity risk framework and timeframes for compliance

Risk metric	Purpose of metric	Compliance required by:
Liquidity coverage ratio (LCR)	To promote 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.	2015
Net stable funding ratio (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.	2018

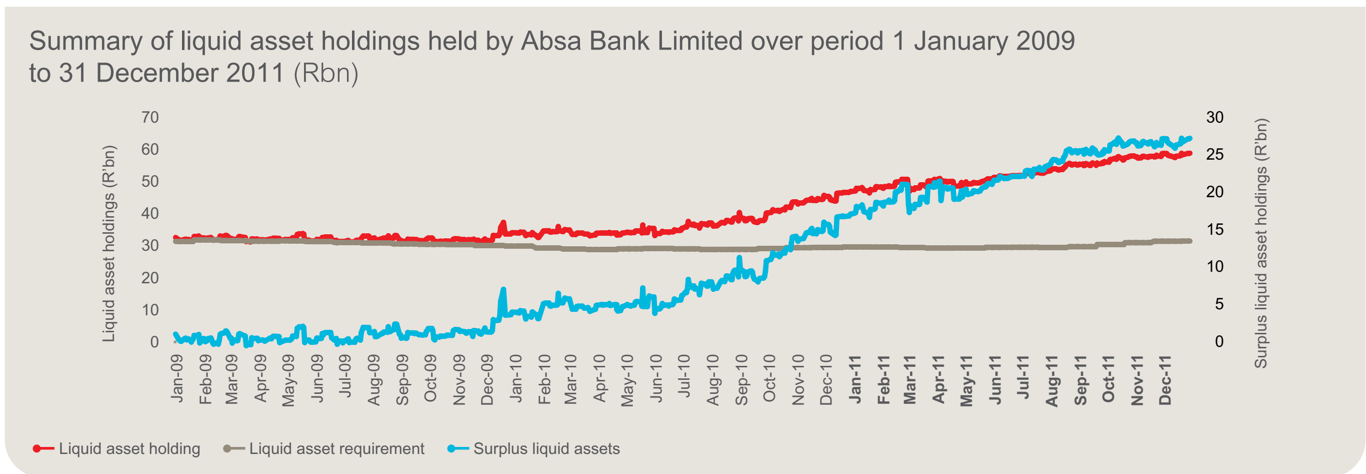
2011 disclosures *(continued)*

Regulatory changes in 2011 *(continued)*

The manner in which the Basel liquidity framework will be incorporated into local regulations is crucial, and was a major focus of the industry discussions during the year. Despite these uncertainties, the Group has already started taking steps to increase the amount of surplus liquid assets held and to extend the term of its wholesale funding book, ahead of the timeframes required by the Basel rules outlined in the previous table. A gradual approach is required as the required resources are in short supply, and because there is a possibility that the cost of securing these resources will increase over time as the Basel compliance deadlines draw near. Further information on progress made and on the plans for 2012 can be found in the sections that follow.

Surplus liquid assets held

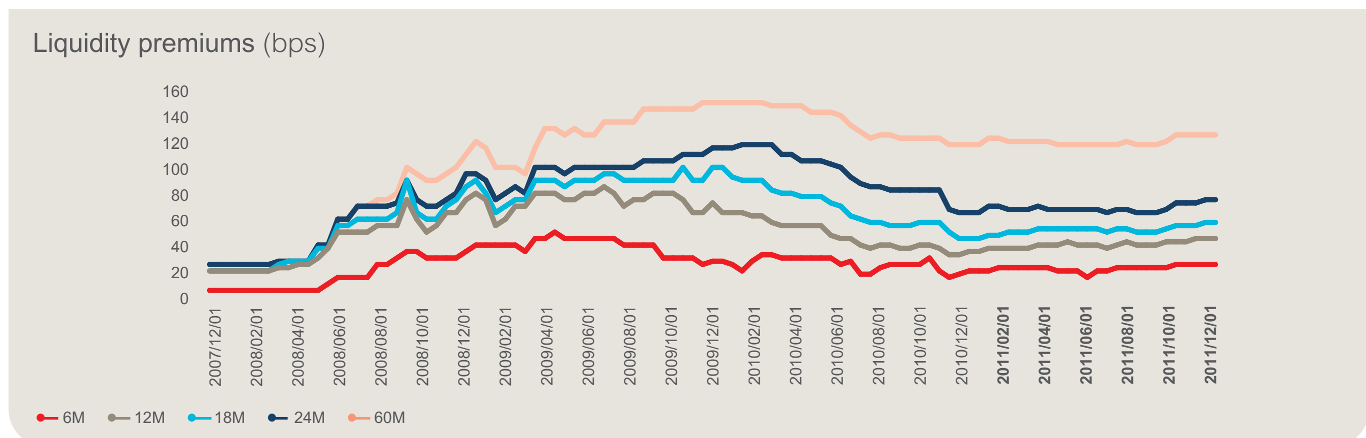
The level of surplus liquid assets held by Absa (defined as unencumbered liquid assets held in excess of the amount required to be held in accordance with the regulations) increased during the year. As at the reporting date, R27 billion of surplus liquid assets was held, an increase of R10 billion on the amount held at 31 December 2010.



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 periods of time longer 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 2010, meaning that South African banks had to secure funding for a large part of the year at liquidity premium levels far exceeding pre-crisis levels, which had a negative impact on profitability during the year. Liquidity premiums started reducing towards the end of 2010 and the cost of liquidity remained broadly stable during the year. However, funding commitments made during 2010, when liquidity premiums were at historically high levels, is still having an impact on profitability. The current cost of liquidity is still higher than pre-2008 levels, especially in relation to longer term funding.

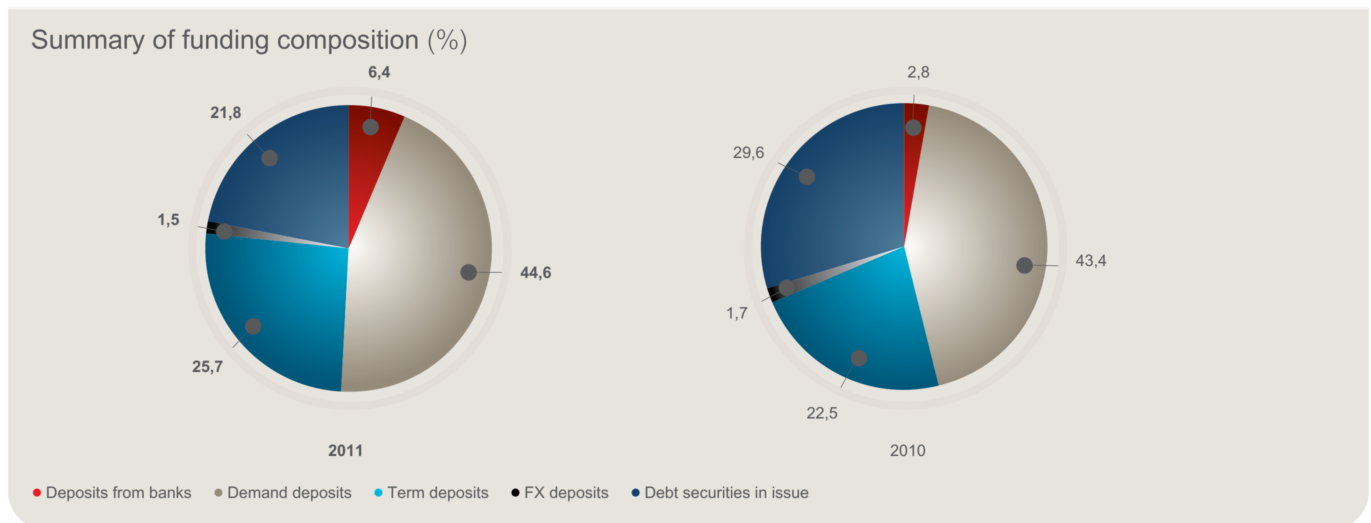


2011 disclosures *(continued)*

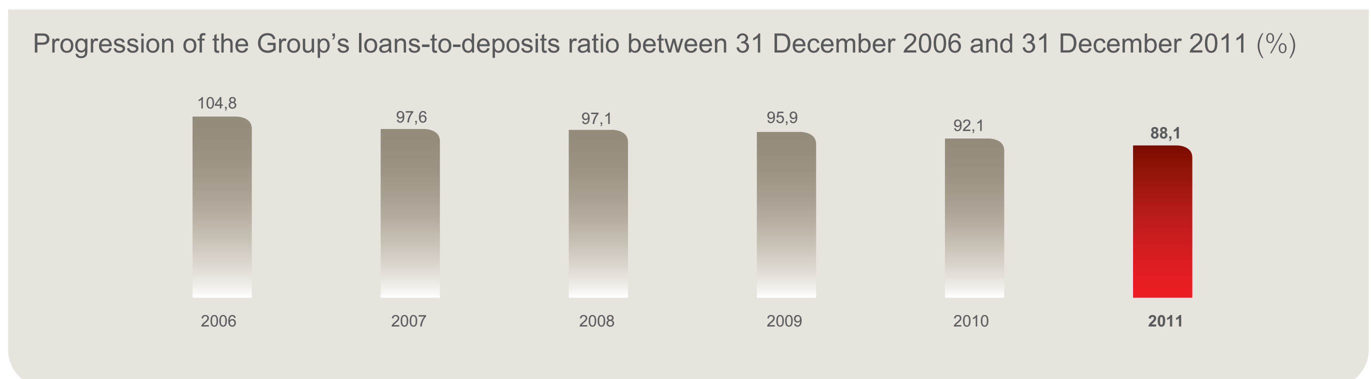
Funding structure

The funding position of the Group has improved during the year due to strong deposit growth combined with selective asset growth, leading to a reduced reliance on wholesale funding. Retail Banking remains partly funded by retail deposits, while the corporate business became self-funded during the year. The Group relies on wholesale funding markets for the balance of funding required. Absa Capital acts as the Group's '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. The Group has 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.



The progression of the loans-to-deposits ratio of the Group is summarised in the graph below. The ratio has improved during the year, as a result of continued focus on asset quality and prudent liquidity risk management practices.



2011 disclosures *(continued)*

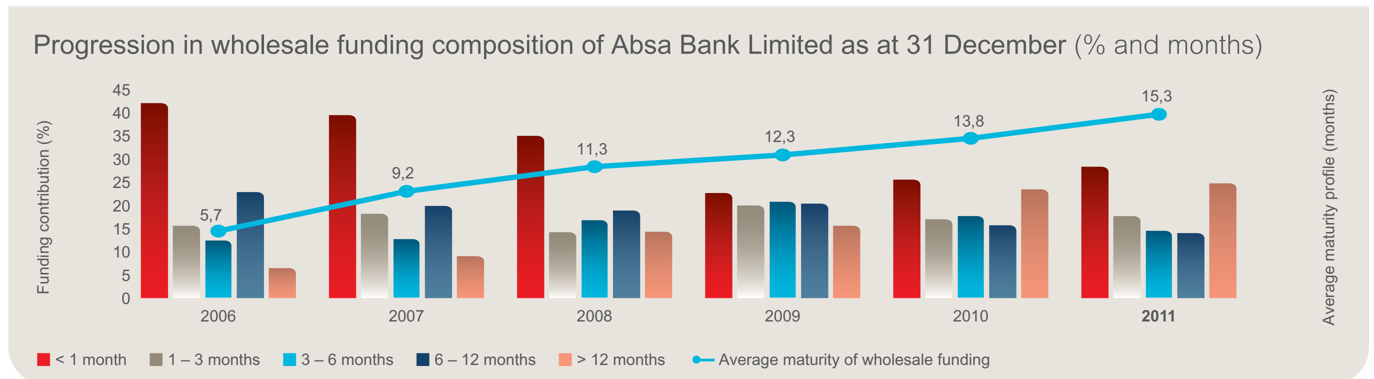
Funding structure *(continued)*

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

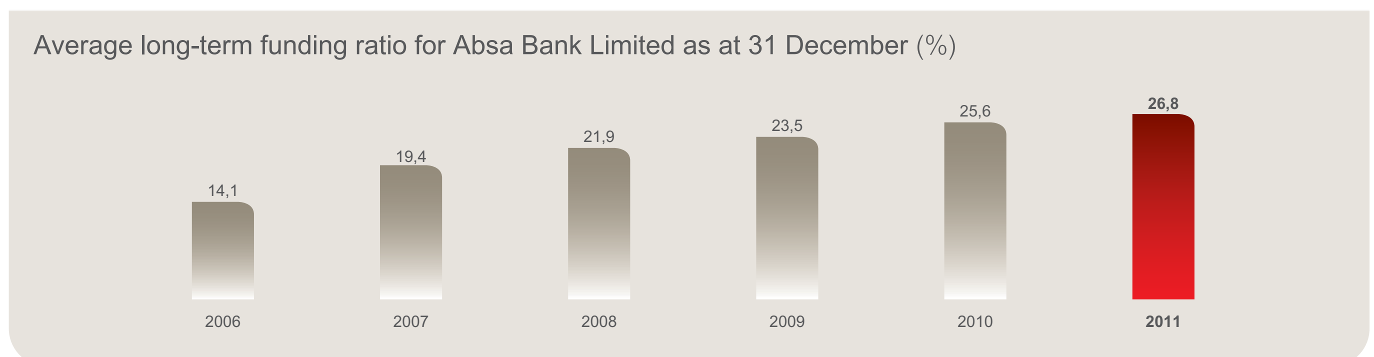
	Group	
	2011 Rm	2010 Rm
Advances		
Loans and advances to customers (note 9)	**503 503**	508 780
Deposits		
Deposits due to customers (note 22)	**440 960**	387 598
Debt securities in issue (note 23)	**130 262**	164 545
	571 222	552 143
Ratio	**88,1%**	92,1%

Lengthening the funding profile of the Group's funding base is a key strategic aim. Despite structural constraints in the South African economy which limit the extent to which South African banks are able to lengthen their funding profiles, the Group continued to take steps during the year to further lengthen the funding profile within these constraints.

The graph below summarises the extent to which Absa has been able to extend its wholesale funding profile since 31 December 2006. The weighted average remaining term of wholesale funding has increased from approximately six months at 31 December 2006 to approximately 15,3 months 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 the funding structure of Absa is the long-term funding ratio. This ratio reflects the proportion of total funding with an outstanding term in excess of six months. The positive progression in Absa's long-term funding ratio is depicted in the graph below.



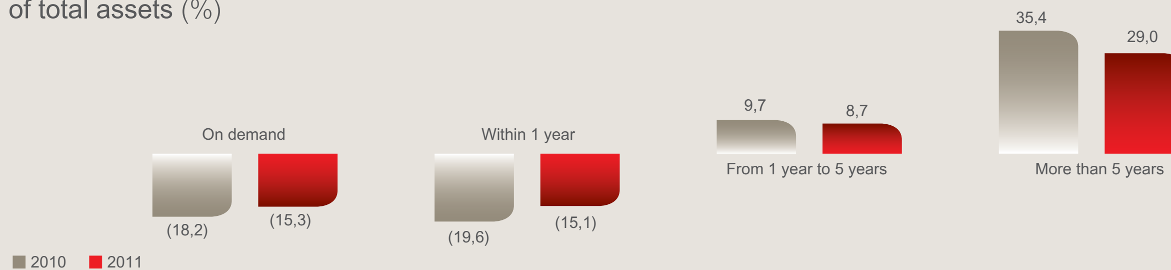
Capital markets funding is also used to extend the funding term of the Group. R6 billion of term funding was issued by the Group during the year.

2011 disclosures *(continued)*

Contractual and behavioural liquidity mismatch positions

The graph below summarises the Group's contractual mismatch position. The contractual mismatch position over five years improved during the year as a result of prudent liquidity management practices and a further extension in funding term which was achieved by increased capital markets issuance, improved product mix and a continued focus on securing longer-dated money markets funding.

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



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

Liquidity risk measurement – discounted:

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Group – Discounted

	2011				
	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	42 012	11 207	401	3 812	57 432
Trading portfolio assets	84 380	—	—	—	84 380
Derivative assets	45 604	—	—	—	45 604
Non-derivative assets	38 776	—	—	—	38 776
Hedging portfolio assets	4 299	—	—	—	4 299
Other financial assets	4 253	2 439	1 325	5 487	13 504
Loans and advances to customers	80 933	61 271	132 939	228 360	503 503
Reinsurance assets	158	412	382	57	1 009
Investment securities	515	3 203	6 298	11 166	21 182
Financial assets	241 300	108 764	147 271	272 444	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
Derivative liabilities	48 703	—	—	—	48 703
Non-derivative liabilities	7 257	—	—	—	7 257
Hedging portfolio liabilities	2 456	—	—	—	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	361 895	227 645	78 664	44 348	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	(120 595)	(118 881)	68 607	228 096	57 227

Liquidity risk

31 December

Audited

2011 disclosures *(continued)*

Contractual and behavioural liquidity mismatch positions *(continued)*

Liquidity risk measurement – discounted (continued)

	Group				
	2010[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	19 123	1 795	2 823	—	23 741
Statutory liquid asset portfolio	3	17 479	10 142	20 591	48 215
Loans and advances to banks	17 337	7 150	1 084	1 924	27 495
Trading portfolio assets	61 393	—	—	—	61 393
Derivative assets	43 404	—	—	—	43 404
Non-derivative assets	17 989	—	—	—	17 989
Hedging portfolio assets	4 662	—	—	—	4 662
Other financial assets	1 758	1 817	6 601	54	10 230
Loans and advances to customers	78 979	62 847	114 642	252 312	508 780
Reinsurance assets	—	236	474	150	860
Investment securities	353	4 608	8 528	10 957	24 446
Financial assets	183 608	95 932	144 294	285 988	709 822
Non-financial assets					16 135
Total assets					725 957
Liabilities					
Deposits from banks	7 555	4 108	3 164	579	15 406
Trading portfolio liabilities	47 454	—	—	—	47 454
Derivative liabilities	43 527	—	—	—	43 527
Non-derivative liabilities	3 927	—	—	—	3 927
Hedging portfolio liabilities	1 881	—	—	—	1 881
Other financial liabilities	5 786	2 543	432	327	9 088
Deposits due to customers	252 754	111 413	8 237	15 194	387 598
Debt securities in issue	—	115 295	42 985	6 265	164 545
Liabilities under investment contracts	150	2 273	7 367	4 174	13 964
Policyholder liabilities under insurance contracts	—	2 029	1 103	(131)	3 001
Borrowed funds	123	722	10 304	2 500	13 649
Financial liabilities	315 703	238 383	73 592	28 908	656 586
Non-financial liabilities					7 222
Total liabilities					663 808
Equity					62 149
Total equity and liabilities					725 957
Net liquidity position of financial instruments	(132 095)	(142 451)	70 702	257 080	53 236

Note

[1]Comparatives have been reclassified, refer to note 1.26.

Audited

2011 disclosures *(continued)*

Contractual and behavioural liquidity mismatch positions *(continued)*

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

	Group					
	2011					
	On demand Rm	Within 1 year Rm	From 1 year to 5 years Rm	More than 5 years Rm	Discount effect Rm	Total Rm
Liabilities						
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
Derivative liabilities	48 703	—	—	—	—	48 703
Non-derivative liabilities	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
Total liabilities	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

	2010[2]					
	On demand Rm	Within 1 year Rm	From 1 year to 5 years Rm	More than 5 years Rm	Discount effect Rm	Total Rm
Liabilities						
On-statement of financial position						
Deposits from banks	8 517	3 198	4 082	3	(394)	15 406
Trading portfolio liabilities	47 454	—	—	—	—	47 454
Derivative liabilities	43 527	—	—	—	—	43 527
Non-derivative liabilities	3 927	—	—	—	—	3 927
Hedging portfolio liabilities	—	1 492	2 280	1 207	(3 098)	1 881
Other financial liabilities	5 786	2 543	432	327	—	9 088
Deposits due to customers	254 361	114 160	13 954	20 734	(15 611)	387 598
Debt securities in issue	881	117 814	52 630	11 354	(18 134)	164 545
Liabilities under investment contracts	150	2 347	9 834	6 295	(4 662)	13 964
Policyholder liabilities under insurance contracts	243	1 771	1 600	(131)	(482)	3 001
Borrowed funds	123	1 840	13 491	5 304	(7 109)	13 649
Total liabilities	317 515	245 165	98 303	45 093	(49 490)	656 586
Off-statement of financial position						
Financial guarantee contracts	599	—	—	—	—	599
Loan commitments[1]	46 074	—	1 171	—	—	47 245

The Group manages its behavioural (business-as-usual) mismatches within board-approved limits. The behavioural mismatch position over one year improved during the year, despite the challenging economic environment.

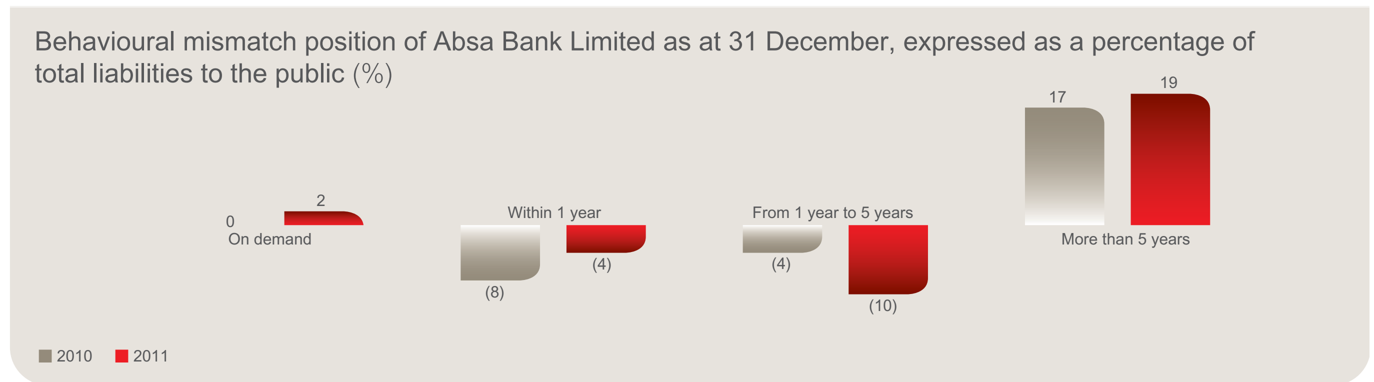
Notes

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

[2]Comparatives have been reclassified, refer to note 1.26.

2011 disclosures *(continued)*

Contractual and behavioural liquidity mismatch positions *(continued)*



Stress and scenario testing

Further steps were taken during the year to reduce reliance on unsecured funding sources and to increase surplus liquid assets. As part of stress and scenario testing, the Group's 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.

During the year, further progress was also made on assessing liquidity risk and formulating the Group's liquidity risk appetite (measured as the number of days that the Group is expected to survive a defined liquidity stress scenario). The Group has extended this horizon and now holds sufficient liquidity resources to meet the Group's liquidity risk appetite, which is to be able to survive a severe liquidity stress for a minimum period of 30 days. Management will continue to focus on liquidity risk management within the Group during 2012 and on the implementation of Basel III.

Strategic focus for 2012

Liquidity risk measurement and management has received significant attention during 2010 and 2011. As outlined previously, regulators have allowed a period of several years for full implementation of the Basel III liquidity rules. Compliance with the LCR, which is aimed at promoting the short-term resilience of a bank's liquidity risk profile, is required by January 2015, whereas compliance with the NSFR, which is aimed at promoting resilience over a longer time horizon (one year), is required by January 2018. The Group will continue to focus on liquidity risk to maintain and continuously improve its strong liquidity risk position ahead of Basel III and to ensure full compliance within the required timeframes.

Highlights

- *AMA approval maintained for the Group, subject to the relevant RC floors.*
- *Operational risk losses remained within appetite and risk and control assessments and key risk indicators did not indicate any adverse risk beyond operational risk appetite.*
- *Continued focus on control enhancements for financial and violent crime resulted in decreases in losses.*

Key performance indicators

	Group	
	2011	2010
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.

The Group recognises the significance of operational risk and is committed to enhancing the measurement and management thereof. Within the Group's operational risk framework, qualitative and quantitative methodologies and tools are applied Group-wide to identify and assess operational risks and to provide management with information for determining appropriate mitigating measures.

Strategy

The Group's operational risk management objectives are:

- further embedding on operational risk-aware culture throughout the Group;
- holding a risk-sensitive RC for operational risk under the AMA;
- enhancing controls using automated solutions as far as possible, specifically relating to fraud and e-fraud;
- meeting regulatory requirements;
- proactively managing and effectively mitigating key operational risks;
- setting and monitoring appropriate operational risk appetite and tolerance levels; and
- further improving and embedding post-event follow-up and recovery actions, including full controls reviews related to unexpected losses.

Governance

Operational risk is managed in terms of the Group's operational risk control framework. This framework is set by the PRO for operational risk, and is approved by the GRCMC. The board approves the operational risk appetite, on the recommendation of the GRCMC. The PRO also sets limits of risk authority framework within the context of the approved operational risk appetite.

All operational risks are reported to the GRCMC on a quarterly basis. The Operational Risk Committee (ORC) meets every quarter to review, approve and make recommendations relating to the operational risk profile. Ongoing assessments of the effectiveness of operational risk management are carried out through the internal audit process.

The head of each BU, assisted by an independent business risk management team, is accountable for all its operational risks. Each BU is responsible for identifying, measuring, managing, controlling and reporting operational risk as detailed in the operational risk control framework.

2011 in review

The Group's operational risks remained within appetite. Losses are within acceptable levels and indications from risk and control assessments (RCAs) and key indicators (KIs) do not indicate any adverse risk beyond appetite.

Expected losses accounted for the bulk of losses, while unexpected losses contributed to budget variances for losses in the Group.

The implementation of new controls improved the management of fraud risk and resulted in fewer losses for the year compared to 2010. The total value of losses for the year was also down, while recoveries improved.

Absa also implemented several control improvement projects during the year, which included new systems and technological processes to reduce operational risk and consequent losses.

While aggressive 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.

Audited

Approach to operational risk

The Group manages operational risk through the PRP, which consists of clearly defined individual frameworks. Each of the individual frameworks is owned by a particular individual as appointed by the Chief Risk Officer and the relevant roles and responsibilities to manage the risk are set out in each framework.

Operational risk is recorded and reported according to the operational risk management framework. Absa applies the AMA to calculate the economic and RC requirements for operational risk and is subject to the relevant RC floors, communicated by the SARB from time to time. However, certain areas are not included in the AMA approach, namely:

- joint ventures and non-controlling interests where the Group is unable to dictate the operational risk framework or capital methodology;
- 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; and
- certain subsidiaries where partial AMA is applied.

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

2011 disclosures

Basel II measurement elected

The Group continued with the AMA approach that was initially adopted during 2008. The AMA has been applied to the majority of the BUs in the Group. A few smaller entities with the Group, however, continue to use the Standardised Approach and the Basic Indicator Approach (BIA).

Capital modelling

The model used to determine the Group's operational risk capital was reviewed and approved for continued use. Management regularly considers the need for any changes or updates to the model to ensure it is in line with best practice narrowing industry practices and regulatory feedback.

The AMA approach follows a key risk scenario-based process that uses internal and external loss data.

Key risk scenarios (KRSs) are the main drivers of the model. KRSs also provide a forward-looking view of operational risk and the Group believes this is currently the most effective way to measure unexpected losses.

Operational risk capital is allocated on a risk-sensitive basis to clusters and BUs.

Coverage of the AMA approach

The AMA approach 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.

2011 disclosures *(continued)*

Coverage of the AMA approach *(continued)*

Insurance in mitigation of operational risk

Insurance is used as a mechanism to mitigate operational risk. The Group's Short-Term Insurance Committee (STIC) is responsible for designing and for managing the principal insurance programmes that mitigate key aspects of the Group's operational risk. The STIC ensures that these policies are current and remain applicable to the Group's operating environment. The STIC also oversees specific insurance cover purchased at Group or segment level to discharge statutory and regulatory duties, or to meet counterparty commitments and stakeholder expectations.

The primary insurance policies purchased by the Group are:

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

Strategic focus for 2012

Management will continue embedding fraud prevention processes and controls through further implementation of fraud systems. This is expected to limit further increases in losses, but nevertheless, fraud will remain the key operational risk within the Group.

The Group will ensure operational risks due to the implementation of new projects and programmes in response to pressures of the changing economic and regulatory environments are effectively mitigated. Plans to further establish the African presence will require continuous reassessment of capability changes required. Operational risks related to this will be a continued focus as part of the changes in the Group. While risks due to 'change' have not traditionally resulted in operational risk losses, additional focus will be placed on sound project and programme management in the future. Continued focus will also be applied to regulatory risks created due to the introduction of increased regulatory oversight, as well as changes to current regulation and the introduction of new regulations.

While significant investment in technology is being undertaken, risks related to technology failure will remain. Technology risk management capabilities will be further enhanced. Consumerism is not currently causing significant losses but, given regulatory changes and increasing focus on consumer protection, any trends will be monitored. Enhanced customer focus will continue in this regard.

In addition to the above, improvements achieved during the year on RCAs, as well as the robust process for managing losses have set the platform from which operational risk losses can be further reduced in 2012.

Highlights

- *Insurance exposure taken on in Africa through establishment of Absa Life Botswana, and acquisition of Global Alliance in Mozambique, in line with the Absa strategy to expand into Africa.*
- *All insurance risk types remained well within the set insurance appetite.*
- *A realignment of the Absa Life portfolios with revised asset allocations was completed.*
- *Absa's local insurance entities submitted results of the first QIS related to the SAM legislation.*
- *Short-term loss ratios were stable, reflecting the benefits of diversifying insurance risks between different sources of short-term insurance risk.*

Key performance indicators

	Group	
	2011 %	2010 %
Short-term loss ratio	**67,4**	68,5
Life new business margin	**7,4**	9,5
Return on shareholders' assets versus benchmark	**7,3 vs 6,9**	13,8 vs 10,7

Audited

Introduction

Insurance risk is the risk that future claims and expenses will exceed the allowance for expected claims and expenses in measuring policyholder liabilities and in product pricing. Within the Group, four categories of insurance risk are recognised, namely short-term insurance underwriting risk, life insurance underwriting risk, life insurance mismatch risk and life and short-term insurance investment risk. These four categories of insurance risk are managed within different entities within the Group.

Strategy

The Group's insurance risk management objectives are:

- ensuring risk management and governance provide the foundation for long-term sustainability of the insurance businesses;
- pursuing profitable growth opportunities while maintaining a healthy balance between growth and risk;
- seeking diverse business opportunities through business lines which complement the traditional bancassurance products;
- balancing exposure between life and short-term insurance to harness the benefit of the relative independence of the life and short-term business risks; and
- identifying opportunities to grow risk exposures outside South Africa where there is low or negative correlation to corresponding South African risks.

Audited

Governance

Insurance risk is managed in terms of the Group's insurance risk control framework. This framework is set by the PRO for insurance, and is approved by the GRCMC. The board approves insurance risk appetite, as recommended by the GRCMC. The PRO sets an insurance risk limit framework within the context of the approved insurance risk appetite.

All insurance risks are reported to the GRCMC on a quarterly basis. The Absa Financial Services Governance and Control Committee (AFS GCC) and the Capital and Investment Risk Committee, meet quarterly to review, approve and make recommendations relating to the management of insurance risk including identifying, assessing, managing and reporting on all risks related to insurance underwriting, mismatch and investments. The Actuarial Review Committees and Capital and Investment Committees, at insurance entity level, are responsible for monitoring risk management, control effectiveness and principal risk reporting across all insurance entities.

The executive of each insurance entity is accountable for all its insurance risks. Each insurance entity is responsible for identifying, measuring, managing, controlling and reporting insurance risk as detailed in the insurance risk control framework.

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

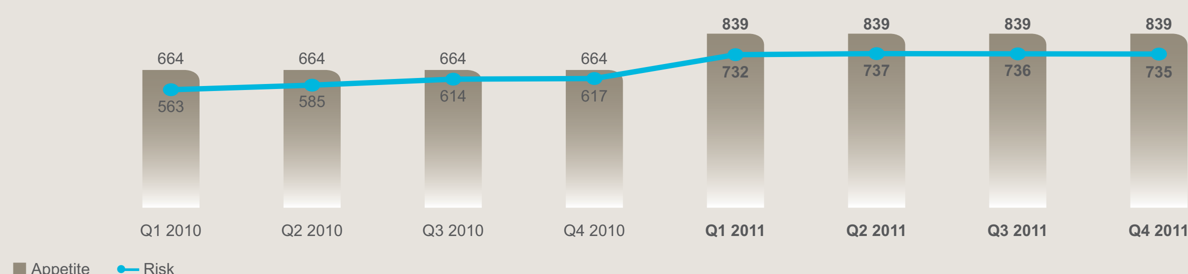
- **short-term insurance underwriting risk** is managed through underwriting authority mandates and through referral to an Underwriting Review Committee, as and when required. Risk governance is monitored by the Governance and Control Committees, the Actuarial Review Committee and Principal Risk reporting;
- **life insurance underwriting** is monitored on a monthly basis by an Underwriting Risk Forum, to ensure the risk taken on is in line with the risk priced and reserved for. Risk governance is monitored by the Governance and Control Committees, the Actuarial Review Committee and Principal Risk reporting;
- **life insurance mismatch risk** is monitored on a monthly basis by the Investment Risk Committee. A quarterly review is conducted by the Absa Financial Services Capital and Investment Risk Committee and an annual review by the Actuarial Review Committee; and
- **investment risk** is monitored by the Investment Risk Committee.

2011 in review

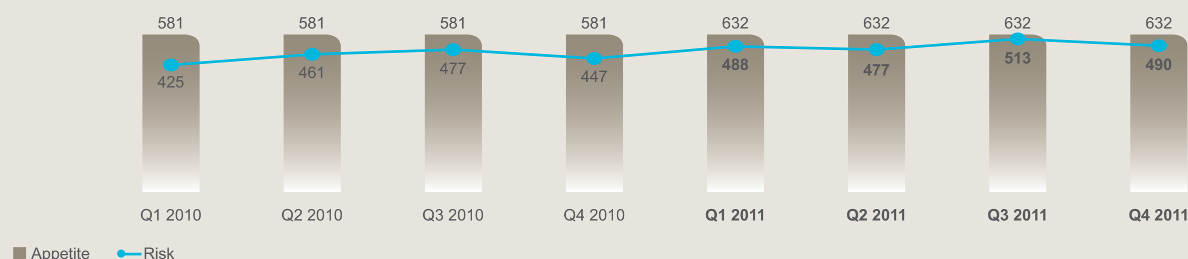
All insurance risk types remained well within the set appetite limits. A realignment of the Absa Life portfolios with revised asset allocations was completed during the year. The realignment resulted in improved matching between assets and policyholder liabilities, and a decrease in the risk profile of shareholder assets. There was increased focus on profitability management per product line and corrective measures were implemented to ensure products met the required levels of return. A review of risk management processes was carried out and indicated the entities are well prepared for the impending SAM legislation.

Management monitored short-term and life insurance underwriting risk utilisation on a monthly and quarterly basis against the appetite levels set for the year. The utilisation varied in accordance with expectations and in line with underlying business growth. Utilisation for both categories of risk remained within appetite throughout the year.

Short-term insurance underwriting risk (Rm)

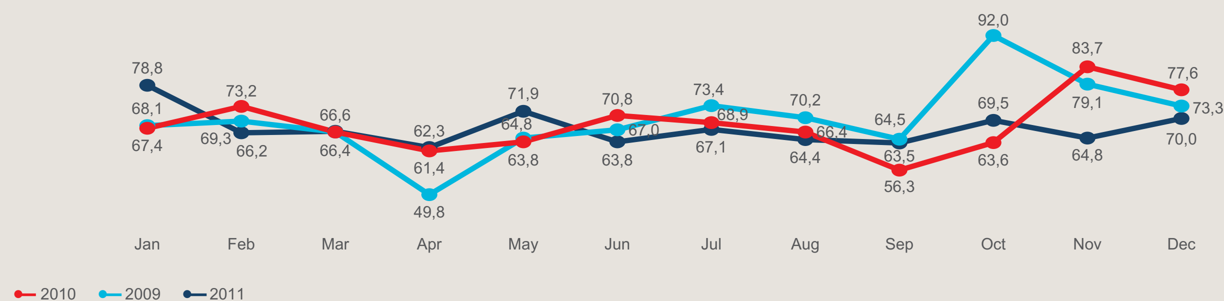


Life insurance underwriting risk (Rm)



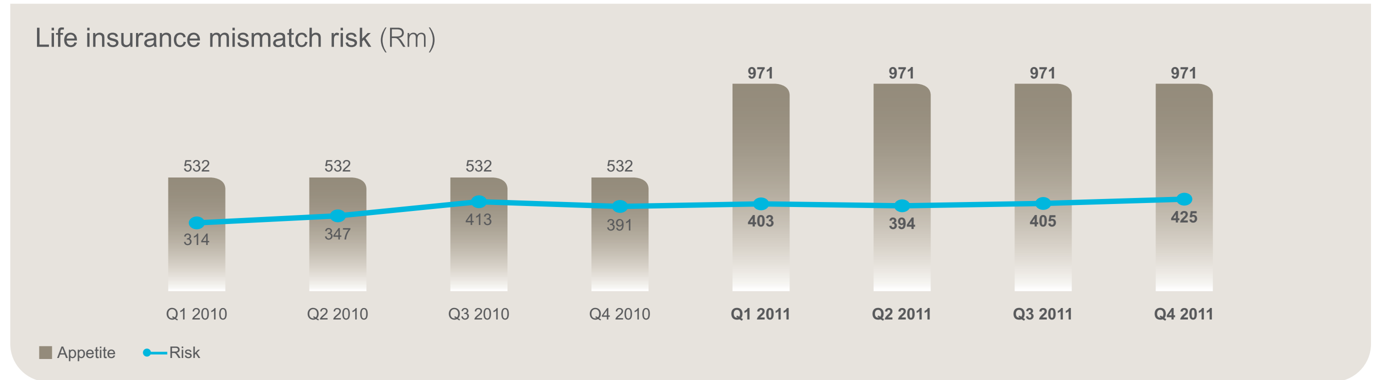
Short-term insurance loss ratios were flat over the year despite an increase in weather-related claims in the agricultural sector.

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



Life insurance mismatch risk remained well within appetite throughout the year, specifically because the appetite set was based on potential experience over a market cycle, and actual investment conditions were relatively benign.

2011 in review *(continued)*



Investment risk decreased significantly during the year due to disinvestment by Absa Life from equities versus an appetite that allowed for unchanged equity investment. The final equity hedge protecting equity holdings expired during September 2011.

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

Approach to insurance risk

The four categories of insurance risk recognised within 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 Absa Life's policyholder liabilities is inappropriate to match the profile of these liabilities.
- **Life and short-term insurance 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, Absa Insurance Risk Management Services, Absa *idirect* and Absa Manx Insurance Company (Absa Manx). Life insurance underwriting activities are undertaken by Absa Life, Absa Life Botswana and Woolworths Financial Services, through an Absa Life cell captive. Global Alliance Mozambique underwrites both life and short-term insurance business.

Short-term insurance underwriting risk, life insurance underwriting risk, life insurance mismatch risk and investment risk are core to the business of the insurance entities. The successful management of these risks ultimately determines the success of the entities.

Audited

Risk management

Short-term insurance underwriting risk

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 the 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 table below 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 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 the Group does 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 which 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.

2011 disclosures

Audited

Short-term insurance underwriting risk

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 R3,0 billion (2010: R2,8 billion).

Reinsurer credit risk

The credit risk in respect of reinsurance partners is managed by ensuring the entities only transact with reinsurers with 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 credit rating is as follows:

	% of premium income
AAA	**2,1 (2010: 1,3)**
AA	**42,0 (2010: 10,9)**
A	**55,9 (2010: 87,8)**

Concentration risk

The primary risk of concentration arises from exposure to personal and commercial business in Pretoria, Johannesburg and the East Rand. Approximately 13% (2010: 12%) of the total gross sums insured are located in Pretoria, 11% (2010: 15%) in Johannesburg and 12% (2010: 12%) in the East Rand. These exposures are reduced significantly through reinsurance protection. The maximum expected loss for a one in 250-year event is a loss of R3,0 billion (2010: R2,8 billion).

Outstanding claims reserves

Outstanding claims reserves are held for claims which 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 R463 million (2010: R566 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 R146 million (2010: R141 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 Absa Life's board 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

2011 disclosures *(continued)*

Life insurance underwriting risk *(continued)*

Reinsurer

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

	Standard and Poor's rating	Description	Parental guarantee
Treaty and facultative reinsurer, 28,3% (2010: 35,4%) of business ceded	AA–	Very strong	No
Treaty and facultative reinsurer, 25,3% (2010: 22,3%) of business ceded	AA+	Extremely strong	Yes
Treaty and facultative reinsurer, 9,4% (2010: 8,9%) of business ceded	AA–	Very strong	No
Treaty and facultative reinsurer, 35,6% (2010: 29,9%) 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 (2010: 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			
	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**

	2010			
	Gross of reinsurance		Net of reinsurance	
Benefit band per life assured	Total benefits assured Rm	%	Total benefits assured Rm	%
0 – 250	54 193	58	51 696	65
250 – 500	8 608	9	4 979	6
500+	30 919	33	22 671	29
	93 720	100	79 346	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

The business uses experienced underwriters to review risk cover applications in excess of specified limits and evaluate them against established standards. Human Immunodeficiency Virus (HIV) testing is carried out in all instances where the application exceeds the specified limits. 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.

Audited

2011 disclosures *(continued)*

Life insurance underwriting risk *(continued)*

HIV and Aids risk

Absa Life is exposed to 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 most recent investigation was performed during the fourth quarter of 2010. 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 Absa's 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 on a monthly basis 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 to model the liabilities is incorrect or incomplete. 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 ASSA's Professional Guidance Note 104 and further discretionary margins, where considered necessary by the statutory actuary. No changes in compulsory margins were made from 2010 to 2011.

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	
	2011 %	2010 %
Risk-free rate of return	**7,75**	8,00
Equity return	**11,25**	11,50
Cash return	**5,75**	6,00
Overall investment return	**7,31**	7,90
Risk discount rate	**11,00**	11,25
Expense inflation	**4,75**	4,50

Audited

2011 disclosures *(continued)*

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 ASSA's Professional Guidance Note 104 have been applied in the valuation of liabilities. These margins are summarised in the table below.

Compulsory margins

Assumption	Margin
Mortality	7,5% (increase for assurance) (2010: 7,5%)
Morbidity	10% (2010: 10%)
Lapse	25% (e.g. if the best estimate is 10%, the margin is 2,5%) (2010: 25%)
Surrenders	10% (increase or decrease, depending on which alternative increases liabilities) (2010: 10%)
Expenses	10% (2010: 10%)
Expense inflation	10% (of estimated escalation rate) (2010:10%)
Charge against investment return	25 bps in the management fee or an equivalent asset-based or investment performance-based margin

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			
	2011		2010	
	Insurance liability Rm	**Change %**	Insurance liability Rm	Change %
Central value (as published)	**1 357**	**—**	1 391	—
Mortality and morbidity +10%	**1 460**	**7,6**	1 523	9,5
Lapse rate +10%	**1 315**	**(3,1)**	1 350	(3,0)
Renewal and termination expense +10%	**1 378**	**1,6**	1 415	1,8
Expense inflation +1%	**1 373**	**1,2**	1 409	1,3
Investment return -1%	**1 435**	**5,8**	1 466	5,4

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 at least every second year. 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. Monthly meetings are held with the asset manager to monitor these asset durations and targeted levels.

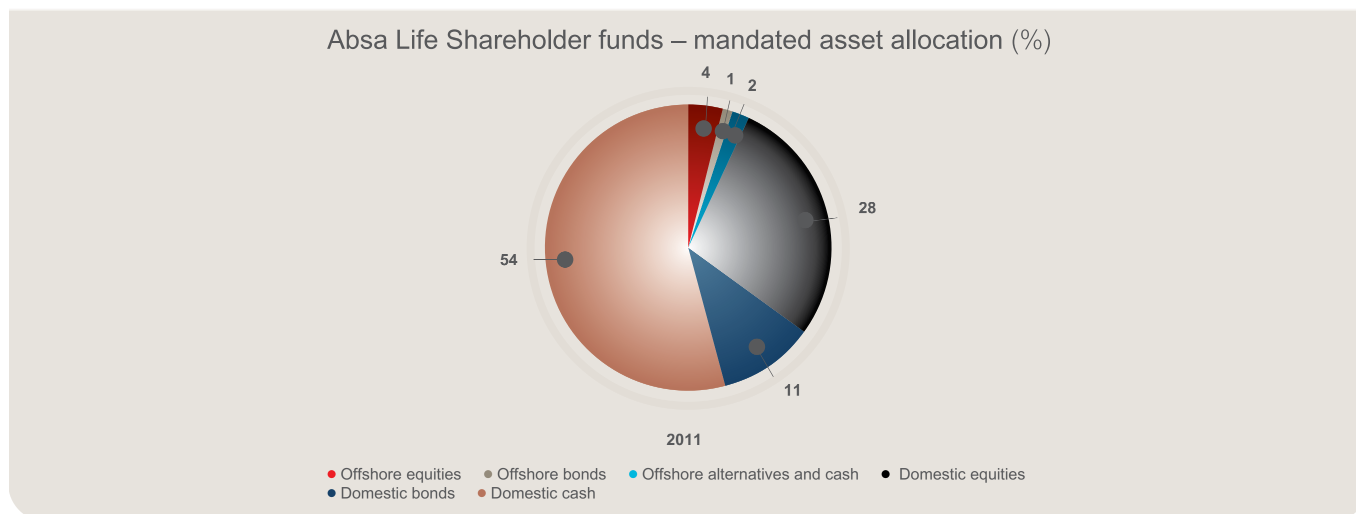
Audited

2011 disclosures *(continued)*

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



Revised asset allocations were implemented during the year following a review of the retained capital asset allocation conducted in 2010. 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.

Strategic focus for 2012

The business 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, enhancing risk reporting and measurement, with the aim of improving the monitoring of risk appetites and capital requirements across the insurance businesses and, in particular, in respect of non-South African insurance exposures.