Risk summary

Capital management	2011 in review	Looking forward

Definition

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

KPIs

	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	**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 the 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
- Advanced Internal Ratings Based (AIRB) approach for the wholesale credit portfolio.

Capital levels remain above board-approved target ranges for both Absa Group and Absa 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 our 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 credit portfolio.

We are actively engaging with the SARB to obtain more clarity on 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.

Credit risk	2011 in review	Looking forward

Definition

Loss to Absa 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) 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, reducing from R2,53 billion at 31 December 2010 to nil and notes held on the statement of financial position reduced from R2,2 billion to R1,6 billion 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.

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

We will 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. Furthermore, Absa intends to securitise a portion of the CPF portfolio in 2012.