

Nonetheless, given global uncertainty, relatively poor growth in the domestic economy and the expectation that the inflation rate would return to the target range, the Monetary Policy Committee of the SARB kept the repo rate unchanged in 2011.

### The results

Overall, we delivered a strong set of results in 2011. We lifted headline earnings to R13,6 billion, up 21% on the prior year and increased the annual dividend to shareholders by 10%. ROE moved upward to 14,3%, compared to 12,5% in the prior year.

Strategically, we made good progress in growing universal banking operations in our chosen African markets. We continued to invest to ensure these operations are of sufficient scale for the opportunities available to them.

### How the group generates its revenue and key risks that it faces in doing so

The group generates its revenue from four broad sources:

- net interest income;
- fee and commission revenue;
- trading revenue; and
- income from insurance activities.

**Net interest income** contributed around half of total income and represents the difference between interest received by the group on funds lent to customers and otherwise invested, and the interest paid by the group to depositors and other providers of finance. Funds lent to individual customers include mortgage loans, instalment sale and finance leases on vehicles and other assets, as well as credit card facilities. Corporate loans include corporate lending facilities, structured finance, project finance and trade finance.

Interest rates charged are determined by considering the factors that influence the risk that the customer will not repay the funds advanced. Deterioration in this risk, otherwise known as **credit risk**, is reflected in credit impairment charges in the group's income statement.

The group requires funding for its lending and investment activities. Funding is obtained in the form of deposits placed by customers on which interest is payable. The interest rates on deposits are dependent on the term and size of the deposits and macroeconomic variables. Interest rates on assets and liabilities do not necessarily reprice at the same time and assets and liabilities consist of both fixed rate and floating rate instruments, resulting in **interest rate risk** to the group.

In addition to supporting tier I capital adequacy, the group uses its shareholders' funds to finance both

equity-related investments and a small portion of the loan book. Shareholders require a return in the form of dividends and growth in share price. No interest is paid on shareholders' funds. The benefit of this 'free funding' is a significant contributor to the **endowment effect** (refer to page 24 for a detailed explanation) and reduces during times of declining or persistently low interest rates.

Demand deposits placed can be withdrawn at any stage and banks therefore manage the **liquidity risk** that could materialise if a significant portion of total deposits is withdrawn without cash being available to settle these withdrawals, or if deposits being redeemed cannot be replaced with new deposits.

The group is required to hold minimum reserve balances with central banks, minimum amounts of liquid assets, as well as further voluntary liquidity buffers in its many licensed banking subsidiaries. Banks in most jurisdictions are typically able to access liquidity from central banks. This is normally priced at a central bank repurchase rate which is an important central bank-determined pricing trigger for managing monetary policy, and is a small component of a bank's funding base.

**Non-interest revenue** consists of fee and commission revenue and trading revenue, as well as a combination of diverse other non-interest revenue sources.

**Fee and commission** revenue is generated through transactional banking activities of corporates, small and medium businesses and individual customers. These fees and commissions are earned on banking transactions through various channels, which include branches, ATMs, telephone banking, point-of-sale devices and internet-based transactions such as online business banking, internet banking and trading products. The group also earns knowledge-based fees from corporate advisory and loan structuring activities as well as financial planning and insurance marketing and broking services.

**Trading revenue** is generated from trading activities on products such as foreign exchange, commodity, credit, interest rate and equity products. These trading activities are predominantly related to client flows and are managed within the group's risk tolerance levels. Through these activities the group is exposed to **market risk** as market prices on these asset classes may increase or decrease due to external factors. This risk can be reduced through offsetting trades with counterparties and other clients. The group generates revenue through the margins earned on accepting trading positions with clients and managing the net market risk trading exposure within its trading operations. To earn trading



revenue, the group takes on and manages **market risk**, **counterparty credit risk** included in credit risk and **operational risk** arising from large and complex trading operations.

**Other revenue** sources include underwriting profit and investment revenue from the group's short-term insurance operations, profit-sharing arrangements relating to the group's long-term insurance operations, as well as gains on property, private equity and strategic investment activities.

**Liberty** is 53,6% owned by Standard Bank Group and contributed 11% to the group's 2011 headline earnings. Liberty operates primarily in South Africa and has a presence in 14 other African countries. Liberty generates underwriting profits from its long-term insurance operations. Underwriting profit is earned over the life of an insurance product based on the difference between premiums received and investment returns earned and claims paid on the life or disability risks insured. These operations expose the group to changes in mortality, longevity, morbidity and withdrawal risks that are included under **insurance risk**. Liberty also provides long-term investment products and advisory services to clients and receives fees and shares in the investment return of assets managed on behalf of third parties. It also generates revenue through property investment and health insurance activities.

### Returns to shareholders

The group's shareholders are the primary providers of capital. They carry the ultimate business risk should the group's operations not be sufficiently profitable or through the erosion of value as a result of a decline in the group's share price. Shareholders are rewarded for accepting this risk through biannual distributions from the earnings of the group and the possibility of growth in share price. Share price growth is dependent on the group's ability to grow shareholders' equity on an annual basis at a rate that exceeds the rate that shareholders would expect for an investment with the risk profile of the group and expected future growth in returns. Further detail on economic returns is provided on page 35.



### Impact of the economic environment on key financial ratios

The table below sets out the key financial ratios that drive the earnings and ultimately the value of the group. The table also sets out the external economic factors influencing these value drivers assuming no management action, an indication of how these economic factors influenced the performance of the group in 2011, and the expected impact of these economic factors in 2012. Economic statistics provided relate to South Africa, which is the origin of 92% of the headline earnings of the group.

### Impact of economic factors on key financial ratios

Key financial ratio	Economic factor impacting key financial ratio	Impact on 2011	Expected impact on 2012
Growth in loans and advances	Debt-to-disposable income level	▲	▲
	GDP growth	▲	▲
	Interest rates	▲	▲
Net interest margin	Interest rates	►	▲
Credit loss ratio	Number of insolvencies and liquidations	▲	▲
	Collateral values	▲	▼
	Debt-to-disposable income level	▲	▲
Growth in non-interest revenue	GDP growth and inflation	▲	▲
	Market trading volumes	▲	▲
	Market price volatility	▼	▲
Growth in operating expenses	GDP growth	▼	▼
	Inflation rate	▼	►
Effective tax rate	Corporate tax rates	►	▲
Impact of translating income from operations outside South Africa into rand	Average rand exchange rate	►	▲
Growth in long-term insurance revenue	Equity market performance	►	▲
	Persistency of policy revenue	▲	▲
	Debt-to-disposable income level	▲	▲
Growth in ordinary shareholders' equity in operations outside South Africa	Closing rand exchange rate	►	▲

▲ *Improvement resulting in a positive impact on key financial ratio.*

▼ *Deterioration resulting in a negative impact on key financial ratio.*

► *Neutral.*