“It would be a mistake to conclude that the only way to succeed in banking is through ever-greater size & diversity. Indeed, better Risk Management may be the only truly necessary element of success in banking”

Alan Greenspan
Contents

BASEL II
- Overview & status
  - Pillar 1
  - Pillar 2
  - Pillar 3 (disclosure)
- Credit quality evaluation

ECONOMIC CAPITAL
- Overview & status
- Compared to Basel II and IFRS (impairments)

CAPITAL IMPACT OF BASEL II & ECONOMIC CAPITAL

RISK, CAPITAL AND SHAREHOLDER VALUE MANAGEMENT
- End of a 5 year journey……
- New capital allocation basis (from 2008)
- Risk appetite
- Performance measurement (from 2008)
Paradigm shift in risk & capital management driven by Basel II

Philosophical
- Attitude to risk
- Evaluation of business opportunities
- Definition of risk appetite

Functional
- Approach to risk measurement
- Focus of risk monitoring
- Risk management

Strategic
- Involvement in business planning & strategy

<table>
<thead>
<tr>
<th>OLD THINKING</th>
<th>NEW THINKING &amp; EXECUTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk is bad</td>
<td>Risk is a bank’s core business</td>
</tr>
<tr>
<td>Minimise risk</td>
<td>Price for risk; client value management</td>
</tr>
<tr>
<td>Qualitative</td>
<td>Quantitative and qualitative</td>
</tr>
<tr>
<td>Conservative</td>
<td>Objective &amp; transparent (risk = capital)</td>
</tr>
<tr>
<td>Big names</td>
<td>Portfolio trends &amp; concentrations</td>
</tr>
<tr>
<td>Minimise risk taking</td>
<td>Optimise risk taking &amp; link risk with return (use risk as an enabler)</td>
</tr>
<tr>
<td>Limited (focus on downside risk)</td>
<td>Fully integrated, linked to performance measurement &amp; economic value creation (shareholder value based management)</td>
</tr>
</tbody>
</table>
Risk & capital management – evolved to become core strategic business partners

- Explicit link to strategy development and creation of shareholder value
- Primarily focused on optimisation of risk/return trade off
- Economic value-aligned performance measurement and management framework

Nedbank strong focus 2008 and beyond

- Primarily focused on protection of downside risk
- Includes internal control information, reporting process, early warning systems and limit setting

Risk vs. return optimisation

Risk management

Risk measurement

Loss minimisation

Compliance/monitoring

Loan officer

Risk control

Balance sheet protection

Risk / Return optimisation

Value creation

RISK & CAPITAL MANAGEMENT PHILOSOPHY

TIME
Nedbank’s Basel II implementation blueprint

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>RISK &amp; CAPITAL MEASUREMENT</strong></td>
<td><strong>RISK &amp; CAPITAL MANAGEMENT</strong></td>
<td><strong>VALUE BASED MANAGEMENT</strong></td>
</tr>
<tr>
<td>● Credit Models &amp; Scorecards (AIRB approach for Basel II)</td>
<td>● Credit Process Redesign (AIRB approach for Basel II)</td>
<td>● Credit Process Implementation (AIRB approach)</td>
</tr>
<tr>
<td>● Credit Portfolio Model</td>
<td>● Credit Portfolio Management (CPM)</td>
<td>● Credit Portfolio Optimisation</td>
</tr>
<tr>
<td>● Operational Risk Model (TSA → AMA)</td>
<td>● Asset / Liability Management (ALM)</td>
<td>● Risk-based Pricing</td>
</tr>
<tr>
<td>● Business Risk Model</td>
<td>● Operational Risk Management</td>
<td>● Client Value Management</td>
</tr>
<tr>
<td>● Earnings Volatility Model</td>
<td>● Market Risk Management</td>
<td>● Risk-based Capital Allocation</td>
</tr>
<tr>
<td>● Other Risk Models</td>
<td>● Capital Management</td>
<td>● Risk &amp; Capital Optimisation</td>
</tr>
<tr>
<td>● Capital Projection Model</td>
<td>● Reporting</td>
<td>● Risk Appetite</td>
</tr>
<tr>
<td>● Basel II Capital</td>
<td>● Chief Risk Officer ERM roles (Group Risk &amp; Clusters)</td>
<td>● Risk-based Strategic Planning</td>
</tr>
<tr>
<td>● Economic Capital</td>
<td>● Enterprise-wide Risk Management Framework (ERMF) (risk governance &amp; accountability)</td>
<td>● RAPM (linked to STI incentives)</td>
</tr>
<tr>
<td>● Risk Appetite</td>
<td></td>
<td></td>
</tr>
<tr>
<td>● RAPM</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**DATA MANAGEMENT** | **IT SYSTEMS, SOFTWARE & EDW** | **CHANGE MANAGEMENT**
# Three pillars of Basel II

*Represent a fundamental shift in banking regulation*

<table>
<thead>
<tr>
<th>Pillar 1</th>
<th>Min Capital Requirements (rules based)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Sophisticated risk measurement for larger banks</td>
<td></td>
</tr>
<tr>
<td>- More than ever before, risk management will be a true competitive differentiator</td>
<td></td>
</tr>
<tr>
<td>- Pillar 1 covers: - Credit risk (stand alone) - Equity risk - Operational risk - Market trading risk - Securitisation risk</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pillar 2</th>
<th>Supervisory Review Process (subjective)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Significant increase in required regulatory role (esp. on-site visits)</td>
<td></td>
</tr>
<tr>
<td>- Supervisors review &amp; evaluate risk &amp; capital management in detail</td>
<td></td>
</tr>
<tr>
<td>- Regulators expected to differentiate capital ‘add ons’ based on quality of risk &amp; capital management</td>
<td></td>
</tr>
<tr>
<td>- Assessment of all other major risks (e.g. credit concentration risk, ALM), &amp; comprehensive “Internal Capital Adequacy Assessment Process” (ICAAP) from banks &amp; “Supervisory Review &amp; Evaluation Process” by regulator</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pillar 3</th>
<th>Market Discipline (disclosure)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Banks required to release much more information about risk profile</td>
<td></td>
</tr>
<tr>
<td>- Increased disclosure of risk measurement &amp; management practices, capital structure &amp; capital adequacy</td>
<td></td>
</tr>
<tr>
<td>- Debt &amp; share markets increasingly able to differentiate banks based on quality of risk &amp; capital management, risk vs. return optimisation, etc</td>
<td></td>
</tr>
</tbody>
</table>
Nedbank’s risk & capital approaches for Basel II

- Advanced Internal Ratings Based (AIRB) approach for **Credit Risk** ~ Pillar 1
  ('in-principle’ approval received from SARB on 29 June 2007)

- Market-based Simple Risk Weight Approach for **Investment Risk** (equity exposures) ~ Pillar 1

- Standardised Approach (TSA) for **Operational Risk** but worldclass operational risk management ~ Pillar 1
  ('in-principle’ approval received from SARB on 15 August 2007)

  Workstreams are far advanced for transition to the Advanced Measurement Approach (AMA) in 2009/2010 for Basel II but 2008 for Economic Capital

- Internal Model Approach (IMA) for **Market Trading risk** ~ Pillar 1

- Worldclass standards for **Credit Concentration & ALM (Interest Rate & Liquidity) risks** ~ Pillar 2

- Worldclass **Internal Capital Assessment Process** (ICAAP) & **Capital Management** ~ Pillar 2

✓ = best practice
Nedbank’s AIRB credit system

Quantum leap across Nedbank to world class practice in credit risk measurement & management

- Framework & Policy
- Loan Approval
- Monitoring
- Performance Measurement (RAPM)
- Reporting & Disclosure
- Risk-based Pricing & Client Value Management
- Expected Loss & Incurred Loss (impairments)
- Strategy & Business Plans
- Capital Management (Economic Capital, Risk Appetite & ICAAP)

Work commenced in 2003, AIRB credit system rollout in 2005, refined in 2006/7
Pillar 2 obligations under requirement for risk & capital assessment (ICAAP)

ICAAP 1
Every bank should have an ICAAP

ICAAP 2
Responsibility for bank’s ICAAP

ICAAP 3
Written record of ICAAP

ICAAP 4
Integral part of management & decision-making culture of a bank

ICAAP 5
Proportionality

ICAAP 6
Regular independent review

ICAAP 7
Forward-looking

ICAAP 8
Risk-based

ICAAP 8
Stress tests & scenario analysis

ICAAP 10
Diversification & concentration risk

ICAAP 11
Credit concentration risk

ICAAP 12
Capital models

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

Board and management oversight
- Understand nature and level of all material risks
- Set risk appetite and tolerance
- Assess and ensure capital adequacy
- Decide overall business strategy with regards to capital
- Set policies

Sound capital assessment
- Identification, measurement and reporting of all material risks
- Relate capital to risk
- Integrate capital with risk and business plans
- Capital management

Comprehensive risk assessment and management process
- Credit risk
- Market risk
- Operational risk
- Interest Rate risk
- Liquidity risk
- Reputational risk
- Strategic risk
- Concentration risk
- Procyclicality risk

Monitoring and reporting
- Evaluate level and trend of material risks
- Sensitivity analysis of key assumptions
- Corporate governance
- Produce reports for management and board

Internal control Review
- Internal and external audit reviews
- Monitor compliance
- Stress testing
- Identification and management of concentrations
- Documentation

SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

Economic Capital* (*although the term economic capital is not expressly used in the Basel II Accord, most leading banks have implemented it and this will comprise a fundamental component of their ICAAP, as is the case for Nedbank Group)
Nedbank’s ICAAP framework (Pillar 2)

**Quantitative Risk and Capital Measurement and Assessment**

<table>
<thead>
<tr>
<th>Pillar 1 risks</th>
<th>Pillar 2 risks</th>
<th>External factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit risk  (AIRB)</td>
<td>Concentration risk</td>
<td>Stress tests and scenario analysis</td>
</tr>
<tr>
<td>Market risk  (IMA)</td>
<td>Interest rate risk</td>
<td>Macro-economic risks</td>
</tr>
<tr>
<td>Operational risk  (TSA → AMA)</td>
<td>Liquidity risk</td>
<td>Group Strategic Planning Process (3 year business plans)</td>
</tr>
<tr>
<td></td>
<td>Business risk</td>
<td>Risk-based Capital Allocation and Risk Adjusted Performance Measurement (RAPM)</td>
</tr>
<tr>
<td></td>
<td>Strategic and Reputation risks</td>
<td>Incentives (STI)</td>
</tr>
<tr>
<td></td>
<td>Securitisation risk</td>
<td>Risk Appetite (tolerance)</td>
</tr>
<tr>
<td></td>
<td>Settlement risk</td>
<td>Capital planning (long run) and Capital Buffer Management</td>
</tr>
<tr>
<td></td>
<td>Residual risk</td>
<td>Capital management framework</td>
</tr>
</tbody>
</table>

**Integration of Risk and Capital Management into Strategy, Business Plans and Reward**

- Strategic Capital Planning
- Group Strategic Planning Process (3 year business plans)
- Risk-based Capital Allocation and Risk Adjusted Performance Measurement (RAPM)
- Incentives (STI)

**Governance, Qualitative Aspects and Supporting Infrastructure**

- Clearly defined roles and responsibilities for:
  - Business Clusters (incl. Cluster financial risk labs)
  - Group Finance and Group Capital Management
  - Group Strategy
  - Investor Relations
  - Group Risk
  - Group Internal Audit
  - Group Exco
  - Board of Directors

- Involving:
  - Identification of risk (risk governance, risk universe)
  - Control, management and monitoring of risk
  - Setting and managing risk appetite
  - Optimisation of risk and capital and return
  - Key involvement in business planning and strategy
  - Risk reporting, communications and disclosure
  - Risk management infrastructure
  - Championing enterprise-wide risk management

**Frameworks**

- AI RB Credit Framework
- Group Credit Portfolio Management
- Market Risk Framework
- ALM Framework
- Group Operational Risk Framework
- Economic Capital Framework
- EDW and Data Governance Framework
- Stress & Scenario Testing Framework (including macro-economic factor model)
- Risk Appetite Framework
- Capital Adequacy Projection Model
- Capital Buffer Management Framework
- Capital Management Framework
- Risk Adjusted Performance Measurement Framework (RAPM)
- Economic Capital Framework
- Strategic Capital Plan
- Group’s 3 year Business Plans
- Enterprise-wide Risk Management Framework (ERMF)
- Capital Management Framework

* = How Nedbank Group addresses the Basel II Pillar 2 ICAAP requirements
Regulation 43 of the new Basel II Regulations relating to Banks: -

“...bank shall disclose in its annual financial statements and other disclosure (e.g. quarterly / semi-annually) to the public, reliable, relevant and timely qualitative and quantitative information that enable users of that information, amongst other things, to make an accurate assessment of the bank's financial condition, including its capital-adequacy position, financial performance, business activities, risk profile and risk-management practices...”

Minister of Finance anticipated to sign new Basel II regulations into law by end October 2007 (for effect 1 January 2008)
New credit risk BA returns
- Basel II AIRB approach

Summary of selected credit risk related information

- Total advances
- Impaired advances
- Assets bought-in
- Total credit impairments
  - Specific credit impairments
  - Portfolio credit impairments
- Credit losses charge to income statement
- Total credit extended
- Exposure at default (EAD)
- Average probability of default (PD, EAD weighted)
- Average loss given default (LGD, EAD weighted)
- Total expected loss (EL)
- Best estimate of expected loss (BEEL)
- Net excess / (deficit) of total credit impairments compared to expected loss

IFRS (accounting-based)

Basel II (risk-based)

Credit risk exposure & capital requirement – analysed by Basel II asset class

- Corporate exposure
  - Corporate
  - Specialised lending - high volatility commercial real estate (prop development)
  - Specialised lending - income producing real estate
  - Specialised lending - object finance
  - Specialised lending - commodities finance
  - Specialised lending - project finance
  - SME corporate

- Purchased receivables - corporate

- Public sector entities

- Local government & municipalities

- Sovereign (including central government & central bank)

- Banks

- Securities firms

- Retail exposure
  - Retail mortgages
  - Retail revolving credit
  - Retail Other
  - SME retail
  - Purchased receivables - retail

- Securitisation exposure
New credit risk BA returns
- Basel II AIRB approach (continued)

- Analysis of credit exposure, that is EAD analysed by PD band (NGR) per master rating scale; EAD weighted average LGD (%); expected loss (EL)
  - Performing book in total & by PD band (NGR), & by asset class ✓
  - Non-performing book / book “in default” ✗
- EAD & credit conversion factors; Average effective maturity (EAD weighted); Analysis of expected loss & credit impairments
  - By asset class ✗
- Reconciliation of credit impairments
  - By balance sheet & income statement (opening to closing balance) ✓
- Analysis of past due exposures
  - By asset class & by days overdue (0-30 days, 31-61 days, 61-90 days & >90 days) ✓
  
  Note: Basel II definition of default = more than 90 days overdue
- Counterparty credit risk
  - Various analysis, including over-the-counter (OTC) & securities financing transactions (SFT) ✗
- Credit risk mitigation
  - By asset class and by type of credit risk mitigation ✗
- Restructured credit exposure (“distressed renegotiations” per IFRS 7) ✓
- Credit concentration risk ✓
Other AIRB credit disclosure

- Risk profile by NGR (PD) & NTR (EL) grades across credit portfolios / segments
- Migration across grades
- Portfolio migration (trends)
- Regulatory & economic capital by credit portfolio, asset class, business, etc
- Back testing of default rates (PDs), LGDs & EADs
- Stress test results (pillar 1 [risk] & pillar 2 [capital])
- Overall performance of AIRB system including results of validation, changes, etc
Nedbank’s master rating scales are the new common language of credit risk

Credit risk profile – as at 30 June 2007

Exposure per PD – NGR rating scale
(excludes CRM / collateral)

Exposure per EL – NTR rating scale
(includes CRM / collateral)

The NGR & NTR master rating scales are comprehensively used for:

- Credit approval (individual loan applications)
- Credit risk management
- Risk-based pricing & client value management
- Management and board reporting on credit risk
- Regulatory reporting & peer group comparison by SARB (from 2008)
- External reporting (Pillar 3) (started in 2005 - see annual report)
New basis for credit quality assessment arising from Basel II

- Definition of Default – for IRB banks
  - New fundamental basis for asset quality evaluation across banking industry (large banks)
  - Obligor overdue for more than 90 days & / or when bank is of opinion that obligor is unlikely to pay obligations in full without any recourse by bank to actions (minimum matters are specified in the new regulations – Reg 65)
  - Can apply for permanent condonation to use 3 monthly instalments (i.e. as = 90 days)

- Current DI 500 “Credit Risk Classification System” is retained for Standardised Approach banks only to supplement Basel II standardised approach risk weightings & requirements (for IRB banks this system is superseded by new IRB credit methodology)

- Concept of “minimum regulatory provisions” now obsolete. For IRB banks replaced by Expected Loss (EL) methodology & a requirement that EL be compared with accounting impairments under IFRS. The difference impacts qualifying capital

- Past Due Analysis up to 90 days for IRB Banks included as one supplement for credit quality analysis (0-30 days; 31-60 days; 60-90 days; >90 days – all based on EAD)
## Levels of capital

<table>
<thead>
<tr>
<th><strong>REGULATORY CAPITAL</strong></th>
<th><strong>ECONOMIC CAPITAL</strong></th>
<th><strong>AVAILABLE CAPITAL (BOOK EQUITY)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of capital required to protect bank against regulatory insolvency</td>
<td>Amount of capital required to protect group against economic insolvency, tailored to Nedbank Group</td>
<td>Net asset value, takes account of the two measures of required capital</td>
</tr>
<tr>
<td>Designed primarily to protect depositors &amp; creditors</td>
<td>Also used as a tool for many risk vs. return management applications such as risk-based pricing, client value management, RAPM, etc</td>
<td>Compared to regulatory capital &amp; economic capital to ensure solvency of both</td>
</tr>
</tbody>
</table>

- **MINIMUM CAPITAL YOU ARE TOLD TO HAVE**
- **CAPITAL YOU ACTUALLY NEED**
- **CAPITAL YOU HAVE**
Economic capital vs. Basel II

**Basel II Capital Accord**

**Pillar 1**
Minimum Capital Requirements (rules based)
- Sophisticated risk measurement for larger banks
- More than ever before, risk management will be a true competitive differentiator

**Pillar 2**
ICAAP and Supervisory Review Process (subjective)
- Significant increase in required regulatory role (esp. on-site)
- Supervisors review & evaluate risk and capital management
- Regulators expected to differentiate capital 'add ons' based on quality of risk & capital management

**Pillar 3**
Market Discipline (disclosure)
- Banks required to release much more information about their risk profile
- Improved disclosure of risk measurement & management practices, capital structure & capital adequacy
- Debt & share markets increasingly able to differentiate banks based on quality of risk & capital management, risk vs. return optimisation, etc

**NEDBANK’S ECONOMIC CAPITAL**

Nedbank’s Economic Capital (substantially) = Basel II pillar 1+ pillar 2
<table>
<thead>
<tr>
<th>BASEL II</th>
<th>ECONOMIC CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PILLAR 1</strong></td>
<td><strong>PILLAR 2</strong></td>
</tr>
<tr>
<td><strong>Credit Risk</strong> (stand alone)</td>
<td><strong>Credit Concentration Risk</strong></td>
</tr>
<tr>
<td>AIRB credit approach 1</td>
<td>Nedbank’s Credit Portfolio Model (using KMV software) 2</td>
</tr>
<tr>
<td><strong>Market Trading Risk</strong></td>
<td>N/A</td>
</tr>
<tr>
<td>Internal Model Approach (and CEM* for counterparty credit risk) 3</td>
<td>N/A</td>
</tr>
<tr>
<td>N/A</td>
<td><strong>ALM Risks</strong> ?</td>
</tr>
<tr>
<td>- <strong>Interest risk rate in banking book</strong> (Nedbank models this using IPS Sendero and on an Economic Value of Equity (EVE) basis) 4</td>
<td>- <strong>Liquidity risk</strong> ?</td>
</tr>
<tr>
<td>N/A</td>
<td>- <strong>Currency Translation Risk</strong> (rand volatility measure) 5</td>
</tr>
</tbody>
</table>

* will implement advanced internal model methodology in 2008 / 9
<table>
<thead>
<tr>
<th>BASEL II</th>
<th>ECONOMIC CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>PILLAR 1</td>
<td>PILLAR 2</td>
</tr>
<tr>
<td>Equity Risks</td>
<td>N/A</td>
</tr>
<tr>
<td>(investment and property risks)</td>
<td></td>
</tr>
<tr>
<td>Simple risk weight approach (300 / 400% vs 100% Basel 1)</td>
<td>6*</td>
</tr>
<tr>
<td>Operational Risk</td>
<td>N/A</td>
</tr>
<tr>
<td>Standardised Approach 7**</td>
<td></td>
</tr>
<tr>
<td>N/A</td>
<td>Strategic, reputational and other risks</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Assets</td>
<td>N/A</td>
</tr>
<tr>
<td>(100% risk weight)</td>
<td>8</td>
</tr>
</tbody>
</table>

* will implement advanced internal model methodology in 2008 / 9
** will implement advanced measurement approach (AMA) in 2008 for ECap and 2009 / 2010 for Basel II
<table>
<thead>
<tr>
<th>FACTOR</th>
<th>BASEL II</th>
<th>ECONOMIC CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Measurement period</strong>&lt;br&gt;(time horizon)</td>
<td>1 year (forward looking)</td>
<td>1 year (forward looking)</td>
</tr>
<tr>
<td><strong>Confidence interval</strong>&lt;br&gt;(solvency standard)</td>
<td>99.9% (1 in 1 000 years) or A-</td>
<td>99.9% (1 in 1 000 years) or A-&lt;br&gt;<em>Nedbank’s current choice</em></td>
</tr>
<tr>
<td><strong>Diversification benefits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>● Intra-risk&lt;br&gt;(within a risk type, especially credit)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>● Inter-risk&lt;br&gt;(between risk types)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>● ‘Basel II capital formula calibrated to a large, well diversified international bank’</td>
<td></td>
<td></td>
</tr>
<tr>
<td>● ‘Basel II capital formula calibrated to a large, well diversified international bank’&lt;br&gt;(simple aggregation of all risks’ capital)&lt;br&gt;(part of ICAAP / SREP)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>AIRB credit methodology</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>● 6% scaling factor</td>
<td>✓</td>
<td>X&lt;br&gt;Through-the-cycle LGD</td>
</tr>
<tr>
<td>● Downturn LGD (dLGD)</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>
## Economic capital vs Basel II – available capital resources

<table>
<thead>
<tr>
<th>CAPITAL SOURCES</th>
<th>BASEL I</th>
<th>BASEL II</th>
<th>ECONOMIC CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tier 1</td>
<td>Tier 1</td>
<td>AFR</td>
</tr>
<tr>
<td>Core</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Share capital and reserves</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>- Minority interest</td>
<td>✓</td>
<td>✓ (to apply to SARB)</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Non-core</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Preference share capital</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>- Hybrid debt / capital instruments</td>
<td>-</td>
<td>✓ (limit 15% of tier 1)</td>
<td>✓ (no limit)</td>
</tr>
<tr>
<td><strong>Goodwill &amp; impairments</strong></td>
<td>(x)</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td><strong>Other regulatory vs. accounting (IFRS)</strong></td>
<td>(x)</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>differences &amp; unappropriated profits</td>
<td></td>
<td></td>
<td>✓ for unapp. profits</td>
</tr>
<tr>
<td>Impairments vs. EL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Basel II (dLGD)</td>
<td>-</td>
<td>(x)</td>
<td>-</td>
</tr>
<tr>
<td>- ECap (TTC lgd)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Next year’s pre-tax profit per business plan</td>
<td>-</td>
<td>-</td>
<td>✓ (50% taken)</td>
</tr>
</tbody>
</table>

(x) = deduction
Economic capital vs Basel II – available capital resources

<table>
<thead>
<tr>
<th>CAPITAL SOURCE</th>
<th>BASEL I</th>
<th>BASEL II</th>
<th>ECONOMIC CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess of tier 1 non-core capital</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>(limited to tier 2 total being 100% of tier 1)</td>
<td></td>
<td></td>
<td>No limit, all included in core capital (i.e. AFR)</td>
</tr>
<tr>
<td>Subordinated debt</td>
<td>✓ (limited to 50% of tier 1)</td>
<td>✓ (limited to 50% of tier 1)</td>
<td></td>
</tr>
<tr>
<td>General credit risk provision</td>
<td>✓</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Impairments vs. EL - Basel II (dLGD)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% if +ve (limit to 0.6% of credit RWAs)</td>
<td>-</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>50% if –ve (other 50% in Tier 1)</td>
<td>-</td>
<td>(x)</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

(x) = deduction
Basel II (expected loss) vs. IFRS (incurred loss)

**EXPECTED LOSS EXCEEDS INCURRED LOSS (IMPAIRMENTS)**

- Basel II
- IAS 39

- Unexpected loss
  - Total capital requirement
  - Capital deduction
    - 50% of Tier 1
    - 50% of Tier 2

- Incurred loss

- Overlaps
  - Book value - PV of expected future cash flows
  - PD x LGD x EAD

**INCURRED LOSS EXCEEDS EXPECTED LOSS (IMPAIRMENTS)**

- Basel II
- IAS 39

- Unexpected loss
  - Total capital requirement
  - Eligible Tier 2 Capital
    - Limited to 0.6% of credit RWA

- Incurred loss

**Eligible Tier 2 Capital**

- Limited to 0.6% of credit RWA
<table>
<thead>
<tr>
<th>BASEL II</th>
<th>IAS 39</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PDs</strong></td>
<td></td>
</tr>
<tr>
<td>Intention of estimate</td>
<td>• Conservative estimate of probability of default within next 12 months</td>
</tr>
<tr>
<td>Period of measurement</td>
<td>• Long run historical average over whole economic cycle – “through-the-cycle”</td>
</tr>
<tr>
<td><strong>LGDs</strong></td>
<td></td>
</tr>
<tr>
<td>Intention of estimate</td>
<td>• Conservative estimate is discounted value of post-default recoveries</td>
</tr>
<tr>
<td>Treatment of collection costs</td>
<td>• Recoveries net of direct &amp; indirect collection costs</td>
</tr>
<tr>
<td>Discount rate</td>
<td>• Recoveries discounted using entity’s cost of capital</td>
</tr>
<tr>
<td>Period of measurement</td>
<td>• Reflects period of high credit losses</td>
</tr>
<tr>
<td>EL</td>
<td></td>
</tr>
<tr>
<td>Basis of exposure</td>
<td>• Based on Exposure-at-Default (EAD), which includes unutilised facilities</td>
</tr>
</tbody>
</table>

For Nedbank’s credit economic capital, through-the-cycle LGDs are utilised as opposed to downturn LGDs for Basel II.
Nedbank’s economic capital model & position at 30 June 2007

**CREDIT RISK**

(including concentration risk)

Basel II AIRB credit methodology and sophisticated credit portfolio modelling, taking concentration risk and inter-risk diversification into account.

**MARKET RISK**

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Value (Rm)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading risk</td>
<td>15 070</td>
</tr>
<tr>
<td>ALM risk</td>
<td>3 782</td>
</tr>
<tr>
<td>Property risk</td>
<td>416</td>
</tr>
<tr>
<td>Investment risk</td>
<td>554</td>
</tr>
<tr>
<td>Forex risk</td>
<td>906</td>
</tr>
<tr>
<td>Business risk</td>
<td>1 873</td>
</tr>
</tbody>
</table>

**OPERATIONAL RISK**

Basel II standardised approach (moving to AMA in 2008)

**BUSINESS RISK**

Earnings-at-risk model

**MINIMUM ECONOMIC CAPITAL REQUIREMENT**

(after intra-risk diversification benefits)

**CAPITAL BUFFER**

(10% buffer for procyclicality, stressed scenarios, etc)

**TOTAL ECONOMIC CAPITAL REQUIREMENT**

Measurement period / time horizon: one year (same as Basel II)
Confidence interval (solvency standard): 99.9% (A-) (same as Basel II)

Minimum ECap 22 838

Minimum Economic Capital

R22 838m

Capital Buffer

R2 284m

Economic Capital Requirement

R25 122m

Available Financial Resources

R30 040m
# Basel II regulatory capital requirements

## Regulatory Minimum Capital Requirements

<table>
<thead>
<tr>
<th>Pillar 1</th>
<th>8.00%</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ Pillar 2a</td>
<td>1.50% (RSA systemic risk)</td>
</tr>
<tr>
<td>+ Pillar 2b</td>
<td>0.25% (may vary - idiosyncratic risk)</td>
</tr>
<tr>
<td><strong>Minimum required capital ratio</strong></td>
<td><strong>9.75%</strong></td>
</tr>
<tr>
<td>+ buffer</td>
<td>X% (board decision)</td>
</tr>
</tbody>
</table>

## Regulatory Minimum Capital Structure

<table>
<thead>
<tr>
<th>Capital Type</th>
<th>Minimum and Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary shares &amp; defined reserve funds</td>
<td>Minimum 75% of primary capital</td>
</tr>
<tr>
<td>Non-redeemable non-cumulative preference shares</td>
<td>Maximum 25% of primary capital</td>
</tr>
<tr>
<td>Hybrid debt instruments</td>
<td>Maximum 15% of primary capital</td>
</tr>
<tr>
<td>Other qualifying instruments / amounts (i.e. perpetual debt instruments, preference shares)</td>
<td>Maximum 100% of primary capital</td>
</tr>
<tr>
<td>Subordinated term debt</td>
<td><strong>Upper Tier 2</strong> (secondary capital) 9.5%</td>
</tr>
<tr>
<td>Tertiary capital</td>
<td><strong>Lower Tier 2</strong> (secondary capital) 2.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>9.5%</strong></td>
</tr>
</tbody>
</table>

Note: The buffer (X%) can be decided by the board of directors.

---

[Image of a diagram illustrating the capital structure with different colored sections representing primary, secondary, and tertiary capital, along with their respective minimum and maximum requirements.]

---

**Total**: 9.5%
Impact of Basel II & economic capital as at 30 June 2007

CAPITAL REQUIREMENT (in Rbn)

Basel I: @ 10% → 30.0
Basel II: 29.3

Economic Capital: 25.1

BASEL I

- Basel I capital requirement from 10% to 8% (pillar 1)
- Credit Parameters (PD, LGD)
- Limit Effect (EAD)
- Operational Risk
- Investment Risk
- 1.79% Pillar 2a + 2b

BASEL II

- Through the Cycle LGDs (vs. dLGD for Basel II)
- Remove Pillar 2 & Other Assets
- Transfer/ALM FX Risks
- Business Risk
- Investment Property Risk
- Inter-Risk Diversification Benefit
- Credit Concentration Risk
- 10% ECap Buffer

= Reduction

CAPITAL RESOURCES (in Rbn)

Basel I: 37.3
Basel II: 35.0

Economic Capital: 30.0

BASEL I

- General provision
- Impairments vs. EL
- Insurance entities & non-qualifying minorities
- Hybrid debt (tier 1)
- Share based payment & FCTR reserves

BASEL II

- Tier 2 debt
- 50% next year pre-tax profit
- Impairments vs. EL
- Unappropriated profits
- Other

ECONOMIC CAPITAL

CAPITAL RATIOS

<table>
<thead>
<tr>
<th></th>
<th>Basel I</th>
<th>Basel II</th>
<th>Economic Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>8.3%</td>
<td>7.9%</td>
<td>R4.9bn surplus</td>
</tr>
<tr>
<td>Total</td>
<td>12.4%</td>
<td>11.6%</td>
<td>(i.e. after 10% buffer)</td>
</tr>
</tbody>
</table>
Nedbank will be capitalised at greater of Basel II & Economic Capital:

- Target range for Basel II Total ratio: 11% - 12% (min 9.75%)
- Target range for Basel II Tier 1 ratio: 8% - 9% (min 7%)
- Target Economic Capital = A- debt rating + 10% buffer

Confirmed using macro-economic factor model to stress-test (ALCO & Board approved)

- Plans are advanced to issue hybrid debt capital in Q4 2007 (qualifying as Tier 1 on 01/01/2008)
- Management actions executed over past 3 years have removed excess risk on B/S & aligned risk profile with Board’s risk appetite
- Strategic capital planning & dynamic capital management in place since 2005, for example

### Subordinated debt maturity profile

Creating a Nedbank yield curve & diversifying internationally
Journey to worldclass risk & capital management

**BASEL II**  
**CAPITAL MANAGEMENT**  
**ECONOMIC CAPITAL**  
**RISK APPETITE**  
**RAPM**  
**INCENTIVES**

### 2003 / 2004
- **BUILD RISK AND CAPITAL CAPABILITIES & INTRODUCE THE NEW CONCEPTS**

### 2005
- **EDUCATE, USE, SHADOW REPORTING, REFINED & INTEGRATE INTO 3-YEAR STRATEGIC PLANNING (FIRST TIME)**

### 2006
- **FINE TUNE, FULL REPORTING & REWARD (FIRST TIME)**

### 2007
- **FINALISE (100%) READY FOR 2008 FULL APPLICATION**

### 2008
- **FULL PERFORMANCE MEASUREMENT & CAPITAL ALLOCATION ON RISK ADJUSTED (RAPM) BASIS**

---

**SHAREHOLDER VALUE**

**Groupwide capital steering & optimisation**

**Stage 1:**
- Economic Capital quantification  
  (consistent, bottom up measurement of all material risks)  
- Risk Governance (ERMF)  
- Risk Identification

**Stage 2:**
- Strategic Capital Management  
- RAPM (linking risk to return)  
- Risk Appetite quantification  
- Capital Management Framework

**Stage 3:**
- Governance, risk measurement & quantification  
  (Nedbank Group's Basel II Programme as the catalyst)

---

**RISK & CAPITAL MANAGEMENT SOPHISTICATION**

**Completion Dates:**
- Completed in 2004
- Introduced in 2005
- On track to be fully “business as usual” from 2008

**Aligned with the end of Nedbank’s 3 year strategic recovery and the implementation of Basel II in South Africa**
Capital management framework – rolled out in 2005

We believe we now have worldclass enterprise-wide risk and capital management in place.
A vital aspect of our focus on value based management is the clear line of sight between creating value for shareholders, portfolio risk management at the centre & day to day decisions in our businesses.

Shareholder value based management

**External view**
- Shareholder return requirements (share price + dividends)
  - Long term
  - Short term

**Internal view**
- Primary objective = ECONOMIC VALUE CREATION
- ERM analytical capabilities, processes, management, control, etc
- Portfolio risk management
- Active capital management
- Day to day decision making

**Line of sight**
- Delivering shareholder value based management
  - Establish performance expectations of shareholders
  - Define consistent internal view of economic value measurement, creation & reward across Nedbank based on concept of economic profit (EP)
  - Risk based capital allocation & RAPM (using ECap)
  - Risk appetite setting
  - Effective reporting & communication of risk using Economic Capital (ECap)
  - Align Nedbank’s ERM management processes & metrics (EP & ECap) with Group’s primary strategic objectives and business planning process
  - Create culture of considering economic value creation / destruction when taking decisions at all levels (e.g. proper risk-based pricing & client value management)
  - Economic-based performance measurement (using RAPM) & reward accordingly
Economic (& Basel II) capital a sophisticated quantitative enterprise-wide measurement of risk

By major risk type

- Total Risk
  - Is the inherent volatility or potential fluctuation in a Nedbank Group’s net asset value
  - Portfolio measurement and Inter-risk & Intra-risk diversification
    - Credit Risk 67%
    - Market Risks 16%
    - Operating Risks 17%

By business Unit

- Total Capital Requirement
  - Total Risk
    - Issuer Risk
    - Counter-Party Risk
    - Transfer Risk (Sovereign)
    - ALM Risk
    - Trading Risk
    - Investment Risk
    - Property Risk
    - Operational Risk
    - Business Risk

- Operating Risks
  - Market Risks
  - Credit Risk
  - ALM Risk
  - Trading Risk
  - Transfer Risk
  - Counter-Party Risk

Economic Capital provides a scientific apples-to-apples quantification / measurement & comparison of risk across all businesses & major risk types in Nedbank Group. This also enables ‘capital’ to be allocated to the various business units & their return measured on a proper ‘risk vs. return’ basis (i.e. RAPM), & a focus on both downside risk & upside potential.
New 2008 risk based capital allocation methodology

TO END 2007

Capital allocated using 10% of Basel I RWAs

- Non-core tier 1 (prefs) not allocated
- Tier 2 (debt) not allocated

<table>
<thead>
<tr>
<th>Basel I Capital</th>
<th>Economic Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rbn*</td>
<td>Rbn*</td>
</tr>
<tr>
<td>Nedbank Capital</td>
<td></td>
</tr>
<tr>
<td>4 013</td>
<td>4 080</td>
</tr>
<tr>
<td>Nedbank Corporate</td>
<td></td>
</tr>
<tr>
<td>14 184</td>
<td>9 783</td>
</tr>
<tr>
<td>Nedbank Retail</td>
<td></td>
</tr>
<tr>
<td>7 658</td>
<td>8 471</td>
</tr>
<tr>
<td>Imperial (50,1%)</td>
<td></td>
</tr>
<tr>
<td>888</td>
<td>1 223</td>
</tr>
<tr>
<td><strong>Operating Units</strong></td>
<td><strong>Economic Capital</strong></td>
</tr>
<tr>
<td><strong>26 743</strong></td>
<td><strong>23 557</strong></td>
</tr>
</tbody>
</table>

NEDBANK GROUP BOOK EQUITY

<table>
<thead>
<tr>
<th></th>
<th>Excluding goodwill</th>
<th>Including goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excluding goodwill</td>
<td>23 274</td>
<td>23 274</td>
</tr>
<tr>
<td>Including goodwill</td>
<td>26 979</td>
<td>26 979</td>
</tr>
</tbody>
</table>

* Based on current estimates

2008 ONWARDS

Economic Capital allocated, aligned to Group’s ord shareholders’ equity (i.e. core Tier 1 capital)

- Excess cost of prefs, hybrids and sub-debt allocated to clusters
- Goodwill not allocated

2007 year end results will be reported on both the old & the new basis
Risk appetite is an articulation of risk capacity or quantum of risk Nedbank Group is willing to accept in pursuit of its strategy, duly set & monitored by the board, & integrated into strategy & business plans.

### NEDBANK’S GROUP-LEVEL RISK APPETITE METRICS

<table>
<thead>
<tr>
<th>Group metrics</th>
<th>Definition</th>
<th>Measurement methodology</th>
<th>Targets*</th>
<th>Within targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings at risk (EAR)</td>
<td>Pre-tax economic earnings potentially lost over a one year period</td>
<td>Measured as a 1-in-10 year event (i.e. 90% confidence level)</td>
<td>Less than 100%</td>
<td>✓</td>
</tr>
<tr>
<td>Chance of regulatory insolvency</td>
<td>Event in which losses would result in Nedbank being undercapitalised relative to minimum regulatory capital ratios (both Tier 1 &amp; Total capital ratios)</td>
<td>Utilises earnings at risk, &amp; compares to capital buffer above regulatory minimum - a 1-in-x years chance of regulatory insolvency</td>
<td>Better than 1 in 20 years</td>
<td>✓</td>
</tr>
<tr>
<td>Chance of experiencing a loss</td>
<td>Event in which Nedbank Group experiences an annual loss (on an economic basis)</td>
<td>Utilises Earning at Risk by comparing to expected profit over the next year</td>
<td>Basel II basis: 1 in 20-30 years by 2007, thereafter 1 in 30–50 years</td>
<td>✓</td>
</tr>
<tr>
<td>Economic capital adequacy</td>
<td>Nedbank adequately capitalised on an economic basis to its current target debt rating</td>
<td>Measured by comparing available capital to Economic Capital requirement</td>
<td>Equivalent rating of A- or better</td>
<td>✓</td>
</tr>
</tbody>
</table>

* Set in 2004, will be revised in Q4 2007 for 2008 – 2010 business plans
Communicated since 2005 that RAPM will be applied (i.e. for remuneration ~ STI) from 2008 onwards, following the end of Nedbank’s 3 year recovery & Basel II going live in RSA

- Primary focus of performance measurement at Group & Business Unit level will switch to an absolute shareholder value add (SVA) measure from the current relative measure (i.e. from % RoE to Rv Economic Profit (EP), & specifically delta EP (ΔEP)

- RoE is fine during a recovery period but:
  - RoEs (or RAROCs) can be achieved by clusters shrinking the business or lower growth (& ∴ lower capital usage) while destroying EP for the Group
  - Out-performance profitable growth at same or slightly lower RoE is not rewarded
Performance measurement from 2008 (continued)

- Strongest correlation of Total Shareholder Return (TSR) is with $\Delta$ EP growth

<table>
<thead>
<tr>
<th>Indicator for TSR:</th>
<th>Compare</th>
<th>$R^2$</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE vs. TSR</td>
<td></td>
<td>3%</td>
</tr>
<tr>
<td>$\Delta$ROE vs. TSR</td>
<td></td>
<td>29%</td>
</tr>
<tr>
<td>EP vs. TSR</td>
<td></td>
<td>33%</td>
</tr>
<tr>
<td>$\Delta$EP vs. TSR</td>
<td></td>
<td>73%</td>
</tr>
</tbody>
</table>

*Source: Oliver Wyman*

- At GROUP level, IFRS earnings & average book equity will be the basis for $\Delta$EP performance measurement

- At BUSINESS CLUSTER level this will be $\Delta$EP using:
  - IFRS earnings (not “risk-adjusted” earnings but will report / monitor both bases)
  - Allocated excess costs of non-core equity (i.e. prefs / hybrids / tier 2 debt)
  - Allocated group capital endowment benefit in clusters’ ECap % ratios
  - Unallocated goodwill funding costs (i.e. goodwill held at the centre)
  - Target average economic capital allocation (per business plans)
  - Group diversification benefits are allocated / incorporated in economic capital allocation
  - Target capital buffer % allocation (only as necessary to align total economic capital allocation with the Group’s book equity; otherwise buffer capital held at the centre)
Performance measurement from 2008 (continued)

- Business clusters target RoE %s used in setting hurdle rates
  (i.e. differentiated by cluster)

- Reforecasts / revisions to targets: -
  - Quarterly reforecasting process already in place
  - Capital Management Committee underpins Group Opcom and ALCO
  - Agreement with business clusters to ‘take back’ or ‘allocate more’ capital
    depends on whether their request is EP enhancing to the Group
  - Clusters’ must manage target economic capital as requested per business
    plan, no longer conveniently based on actual, fluctuating usage
  - Overs / unders to Group’s target capital not allocated (Group Capital
    Management’s responsibility to manage)
Thank you