Group chief executives' report

BEN KRUGER | SIM TSHABALALA

"Our vision is to be the leading financial services organisation in, for and across Africa, delivering exceptional client experiences and superior value. Africa is our home, we drive her growth, and our vision provides us with a set of primary goals and a standard of excellence that ensures we deliver on our purpose."

We continue to reposition the group in relation to the forces that are reshaping our industry. The extent to which we are changing the group, to ensure it remains relevant and responsive to its customers across Africa as an integrated financial services organisation, cannot be underestimated. This all-encompassing transformation, and the significant levels of investment we are allocating to it, is necessary to create an organisation that will be competitive and effective long into the future.

Macroeconomic conditions remained difficult in South Africa in 2014 as socio-political challenges and economic weakness persisted. In contrast, our markets in the rest of Africa maintained their strong performance, with some achieving growth rates in excess of 5% despite the slowing of the Chinese economy and the decline in the demand for commodities.

Our financial performance in 2014 reflects a strong performance from our continuing operations, which represent our core franchise, and a disappointing performance from the group's discontinued operation, the global markets outside Africa (GMOA) business, 60% of which has been sold to ICBC. Although total headline earnings grew by 1% to R17,3 billion, *pro forma* continuing operations, including 40% of the loss incurred in the discontinued operation (which is fully explained in the CIB review) improved from R17,4 billion to R19,6 billion. This was driven by robust revenue growth in our operations across the African continent. ROE declined to 12.9%, from 14.1% in 2013.

There has been no respite in the intensity of regulatory change since the global financial crisis in 2008, and we continue to adapt the group's systems and procedures accordingly. In particular, the group's capital structure has been aligned to the requirements of Basel III since the beginning of 2013. Significant regulatory changes are in the pipeline, which include the Basel III net stable funding requirement, the new Treating Customers Fairly (TCF) regime and more intensive market conduct supervision, such as the imminent Retail Distribution Review which seeks to align insurance distribution models with consumer protection legislation. Dealing with multiple jurisdictions across Africa and beyond adds considerable complexity to our regulatory compliance requirements. We manage this by instilling regulatory best practice across our operations and our group policies, which embrace international best practice, are adopted by all our subsidiaries in the rest of Africa.

The digital revolution is profoundly affecting the way financial services organisations operate. Most notable are the opportunities to improve customer engagement and develop customised products and services, and distribution channels that are more efficient and cost-effective and deliver better outcomes for customers. Whereas financial services businesses used to compete on the strength of their branch networks and products, now the competitive arena is defined by customer engagement underpinned by a single view of each customer, the use of data and analytics to gain deeper insight into customers' needs, and employing these systems to treat customers fairly. The complete overhaul of our IT infrastructure and core banking systems to replace our ageing legacy systems – which will continue through to 2017 – is the single most significant aspect of the group's transformation. Innovations and opportunities that are being enabled as we transform our core banking systems are already delivering significant value, most notably continuous improvement in the quality of service to our customers. Good progress was made during the year in rolling out innovative digital channels and making use of mobile technology.

Our investment in the development of an African franchise in recent years has yielded an extensive on-the-ground presence in 20 countries in sub-Saharan Africa and fit-for-purpose operations outside Africa to facilitate our strategy in, for and across Africa.

Group chief executives' report | continued

Headline earnings per share	+1%

1 070 cents

2013: 1 065 cents

ROE

12.9%

2013: 14.1%

On 1 February 2015, we completed the disposal of a 60% interest in Standard Bank Plc to ICBC. This is the final hurdle in repositioning our international operations and in redeploying our capital to support our Africa-focused growth strategy. Significantly, the transaction represents a major step forward in our strategic relationship with ICBC and launches a partnership in global markets between the largest banks (by assets) in China and Africa.

Strategy

The ultimate test of the group's strategy is whether it will enable us to deliver superior ROE and sustainable growth in earnings – either immediately or in the very near future, and whether superior performance will be sustained over the long term. We refreshed our strategy during the year to express this goal more explicitly, and to provide a strategic construct to guide the execution of the group strategy within our business units and enabling functions. Each of them are responsible for ensuring that their plans are aligned with the group strategy and values.

The rearticulated elements of our strategy encompass the group's purpose, the factors that underpin our legitimacy, our guiding principles and our vision. All of these elements express our belief that the long-term profitability of our group depends on the stability and wellbeing of our continent, and that our pursuit of profit in a competitive market will lead, in the main, to socially beneficial outcomes.

Our people and culture will determine our success in executing our strategy. As the foundation of our culture, our legitimacy is vitally important. It stems from our over 150-year heritage and is vested in the relationships we build with our customers, clients, employees, shareholders, regulators and other stakeholders. Our values underpin our legitimacy and are intended to reinforce the trust our stakeholders have in our organisation.

Our guiding principles are designed to enable us to make well-considered decisions quickly and effectively. They pertain to keeping the promises we make to our clients and the speed, efficiency and thoughtfulness with which we fulfil those promises; the culture of accountability, effective decision-making and social relevance we wish to build; and the way in which we execute our strategy. We are currently rolling out our guiding principles to the organisation, which is involving broad-based consultation on the practical implications of these principles for the way we work.

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Becoming the leading financial services organisation in Africa

The strong economic growth profile of our African markets beyond South Africa is well-documented and continues to underpin our belief in Africa's potential. In particular, growth in sub-Saharan Africa over the last decade has increased the number of bankable businesses and households, as well as levels of household income. Furthermore, the financial markets in the rest of Africa are less developed than those in South Africa, with far higher growth potential.

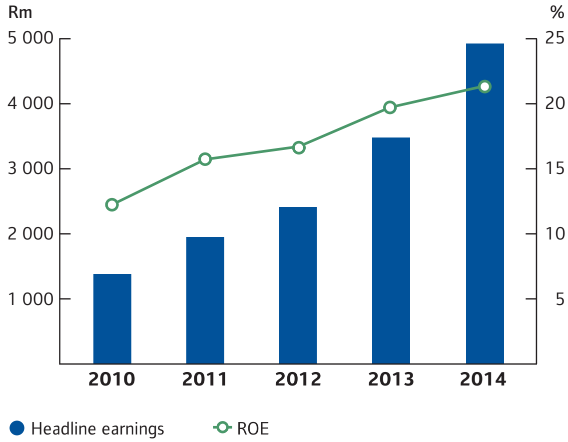
We have a powerful on-the-ground presence in the rest of Africa and our investment in the franchise's branch infrastructure is largely complete. The process of implementing the new core banking platform continues and is complete in six operations, the most recent being Ghana, with more than two million customers on the new platform. The number of personal and business banking customers we serve across the continent continues to grow, as does our track record of hallmark in-country and cross-border transactions for our corporate banking clients.

Rest of Africa regional headline earnings breakdown (%)

35	South and central Africa	(2013: 41)
30	East Africa	(2013: 26)
35	West Africa	(2013: 33)

The performance of our operations in the rest of Africa reflects these advances. In 2014, they contributed almost 30% of both the group's total income and headline earnings with an ROE of 21.5%. This compares to 17% and 12%, respectively, in 2010, with an ROE of 12.3%.

Rest of Africa legal entities



We face a number of challenges in the rest of Africa, including intense competition in the financial services industry across the continent, increasing pressure to comply with new regulatory requirements and the high cost of building distribution and systems infrastructure. We recognise that the opportunity of doing business in Africa carries inherent risks and we have measures in place to manage these risks.

Our deeply embedded presence in our markets and strong management teams with local expertise and high levels of accountability are critical elements of our risk management in Africa. Our teams in the rest of Africa are adequately supported by governance, compliance and risk management standards to ensure that we fulfil our principle of 'doing the right business right'. The improvement in our credit impairment performance reflects a strengthening risk management culture. Where we have received fines for non-compliance with regulatory requirements we have implemented remedial actions to prevent future transgressions.

Transforming our IT infrastructure

We continue to make significant progress in the comprehensive programme to develop a robust new IT architecture. The scale and reach of this programme is extensive and has elevated the role of IT from a support function to a critical enabler of our strategy. The major investments we have made in the transformation of our IT infrastructure have been considerably higher than our domestic competitors and have required patience and financial sacrifice from our shareholders. However, we remain resolute in our belief that these are critically important investments which will create a sustainable competitive advantage for the group.

The programme involves major projects to replace decades-old legacy systems with new IT architecture capable of meeting customer demands for more agility, higher levels of flexibility and increased availability. We are enhancing both our front-end customer engagement interfaces and our back-end systems to ensure that our IT infrastructure continues to provide stability, resilience and appropriate risk management as we adapt the organisation to remain competitive in a changing business environment. There are now 11,1 million customers on our new core banking systems in South Africa and the rest of Africa.

To ensure adequate executive focus on the management of our IT strategy, we have appointed a group chief information officer (CIO). The CIO is represented on the group management committee (manco) and business unit CIOs report IT matters to her, to ensure alignment between business strategies and the group IT strategy. A group IT committee was established as a subcommittee of the board and is responsible for ensuring the implementation of the IT governance framework across the group.

Optimising our business and operating models

In PBB SA, we continued to focus on improving the customer experience as well as building a strong and evolving digital infrastructure with the capacity to innovate and the agility to respond to the changing needs of our customers. PBB's operations in the rest of Africa achieved profitability during the year, which has been largely attributable to strategic adjustments such as refining its customer acquisition strategy to target profitable customers in high-value personal and business banking segments. PBB has also strengthened its credit risk management practices across the African continent particularly in the application of lessons learnt in unsecured lending in prior years.

CIB has undergone an organisational restructuring in recent years to support the group's Africa strategy. This has included the disposal of the group's operation in Russia, and its controlling interests in its operations in Turkey and Argentina. It is working hard to complete the sale of Brazil, and has scaled back other operations that did not offer a clear strategic link to Africa. Disposal of the controlling share of the GMOA business to ICBC represents the final stage of this process to create a streamlined CIB comprising only its strategically aligned operations. During the past year CIB has focused on the complex and costly processes and regulatory requirements involved in separating the disposed operation from the group and formalising the legal status of those that have been retained. CIB is now in a position to focus exclusively on driving its Africa strategy.

To ensure that we leverage the collective strength of our integrated financial services business, we continue to dismantle silo mentalities and find opportunities for collaboration across the business units. There are a number of examples to demonstrate this, including CIB's dependence on PBB's branch network and presence, and PBB's reliance on CIB's foreign exchange capacity; the symbiosis between CIB and private clients; or the aggregation of savings by our wealth businesses and PBB's distribution of wealth products. We intend to deepen these synergies to present a seamless service to customers.

Group chief executives' report | continued

In this regard, the group has established Standard Bank Wealth (SBW) to focus on non-banking financial services across its existing operating segments. SBW will be responsible for aligning the strategies of these businesses to best leverage the group's existing competitive advantages in the wealth markets of South Africa and the rest of Africa. SBW will enhance the group's service offerings to the PBB client base and drive additional penetration, and will attempt to realise the potential that exists between CIB and the wealth businesses. SBW will also be responsible for high net worth wealth management, which is a business serving a customer segment across all of Standard Bank's geographies. A small central team of highly skilled executives has been established to strengthen the group's focus on developing the wealth franchise in partnership with PBB, CIB and Liberty.

Our greatest competitive advantage

Our people represent our definitive competitive advantage and we continue to strengthen our people management practices. Our more open and consultative approach to leadership has increased the level of our engagement with staff, and we believe our people have a clear understanding of how they contribute to our refreshed strategy and to driving Africa's growth. They also have a deeper understanding of the culture of accountability, effective decision-making and social relevance we wish to build. The business units have increased their levels of staff engagement to embed their strategies, inspire commitment and constantly remind their people that the expectations of customers and clients are at the centre of everything we do. We remain committed to best practice people management and offering a workplace where high performance is expected and rewarded.

We continue to provide significant opportunity for personal advancement. Our group expenditure in 2014 on training amounted to R746 million (2013: R638 million), of which R27,8 million (2013: R19,6 million) was invested in our graduate programme.

Creating wealth through Tutuwa

Standard Bank Group concluded its BEE ownership transaction, Tutuwa, in October 2004. This resulted in 10% direct ownership of our South African operations by the Tutuwa BEE consortium. The Tutuwa scheme encompassed Tutuwa Managers' Trusts for current and former black managers of SBSA, the Tutuwa Community Trust focused on black SMEs and community development, and empowerment partners Safika and Shanduka. At December 2014, we had approximately 6 100 black beneficiaries of the managers' trusts, and 261 black SMEs participating in the initiative.

The Tutuwa initiative's 10-year lock-in period ended on 31 December 2014. We introduced beneficiary engagement programmes during 2014 to inform beneficiaries of their options in terms of selling their shares and provide them with the necessary financial education to make sound financial decisions. Tutuwa Plus was implemented to ensure the sustainability of the black SME beneficiaries in our Tutuwa initiative beyond the vesting of their shares. The programme assists these businesses in making sound investment choices and will provide for ongoing business advisory support following the SMEs' exit from the initiative. Standard Bank believes that the Tutuwa scheme has successfully fulfilled a substantial part of Standard Bank's commitments under the Financial Sector Charter, by proactively supporting economic transformation in our country, and making a real difference to the lives of historically disadvantaged people. Tutuwa has created R10,7 billion in value for 6 100 current and former Standard Bank employees, 261 black-owned small businesses, and two empowerment partners, while also establishing a foundation to support education and youth initiatives. Each of the small business beneficiaries will receive a direct benefit of between R2 million and R3 million, allowing them to grow their businesses, employ more people and contribute to the overall prosperity of South Africa.

Now that the lock-in period is over, and to the extent that beneficiaries exercise their right to sell some or all of their shares, black ownership of the bank is likely to reduce in the short to medium term. This is because selling at least some shares after 10 years of participation in the scheme would be a natural choice for some beneficiaries. Standard Bank believes that the right of beneficiaries to fully and freely access the value inherent in their shares in a manner of their choosing is very important as a pillar of empowerment.

While Standard Bank will continue its transformation journey both in terms of the other pillars of the financial sector scorecard and more generally, we are confident that we have complied in full in respect of ownership. Having reviewed the level of black ownership in Standard Bank and bearing in mind the pressing need for transformation to be as broad-based as possible, we have concluded that the positive effects of employing our capital to lend into the wider economy – and particularly in support of transformational infrastructure and enterprise development – will yield a far greater benefit to South Africa than a second empowerment deal structured along the lines of Tutuwa.

Prospects

Expected global economic growth has been revised down by the International Monetary Fund to 3.5% from 3.8% previously. Although economic output is expected to receive a boost from lower oil prices, this is expected to be more than offset by diminished medium-term growth expectations in many developed and emerging economies. The global growth profile is expected to continue to be unbalanced with the United States the only major economy with raised growth expectations.

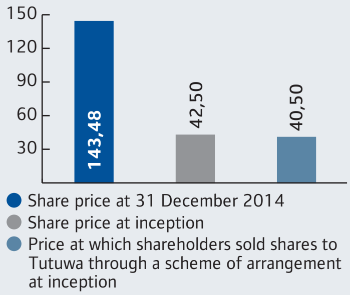
South Africa will continue to face structural and cyclical headwinds in 2015, exacerbated by an under-supplied electricity market. However, some relief is likely from the fall in the price of oil, which has resulted in downward revisions to inflation expectations and upward revisions to growth forecasts due to higher real disposable incomes for households. While sub-Saharan Africa's outlook is influenced by lower commodity prices, the overall growth profile remains robust. The group's brand and strategic position has never been stronger following a steady realignment of the group's resources to focus on our customers on the African continent. The group's medium-term ROE target of between 15% and 18% remains in place and reflects our confidence in the ability of our people to deliver the necessary consistent growth to achieve this target.

Tutuwa highlights

Standard Bank is proud of the outcome of Tutuwa both in terms of the overall reach and distribution of beneficiaries across the country and in terms of the real value it has created for its participants.

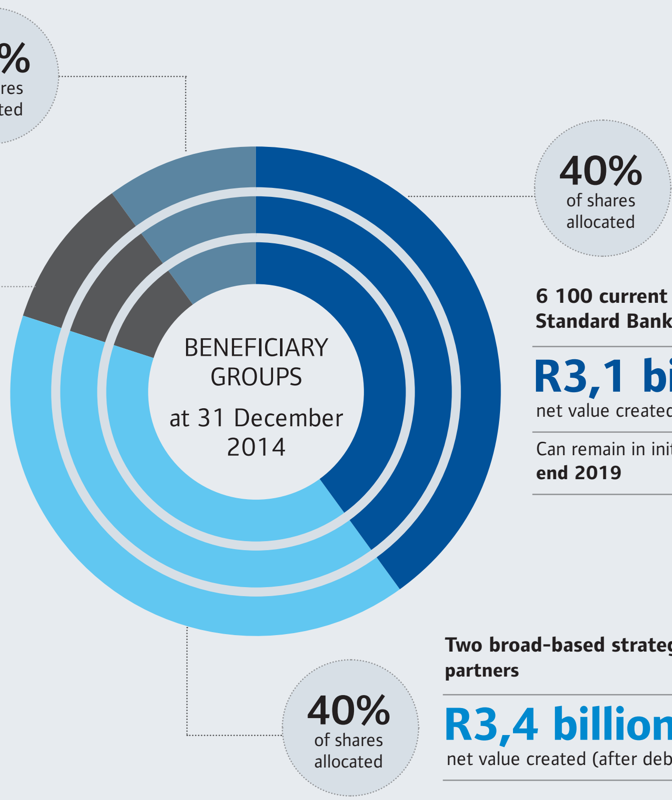
R10,7 billion
net value created for **all beneficiaries** including cash distributions of R2,5 billion

Headline numbers from inception to 31 December 2014 – whole scheme (Rm)



Taxation

More than
R1 billion
in PAYE
paid over in 2015 on behalf of Managers' Trusts beneficiaries



Community foundation

R880 million
net value created (after debt)

6 100 current and past Standard Bank employees

R3,1 billion
net value created (after debt)

Can remain in initiative to **end 2019**

261 small, medium and micro enterprises

R805 million
in net value (after debt)

R2,6 million
average value per business

Two broad-based strategic partners

R3,4 billion
net value created (after debt)