Summarised risk and capital management report

Introduction

Effective risk and capital management is fundamental to the successful execution of our strategy, as we pursue our vision to build the leading financial services organisation in, for and across Africa.

The group's risk management, compliance and capital management functions are enabling functions that work with business to ensure the appropriate balance between risk, performance and growth, supported by specialist risk practitioners embedded within business lines and subsidiaries.

The section titled how we create value, on page 6, indicates the risk types that arise from each of the group's business activities, and each risk type is discussed in more detail in the sections that follow.

This report is a summary of the full risk and capital management report that complies with the requirements of Basel III and, where applicable, IFRS.

Board responsibility

The group's board has the ultimate responsibility for the oversight of risk.

For the period under review, the board is satisfied that the group's risk, compliance, treasury, capital management and group internal audit (GIA) processes generally operated effectively, that the group's business activities have been managed within the board-approved risk appetite, and that the group is adequately funded and capitalised to support the execution of the group's strategy. In the instances where the group incurred losses, breached risk appetite or was fined, the board is satisfied that management have taken appropriate remedial action.

RCM AFS SR For further details, refer to the risk and capital management report starting on **page 3**.

How we manage our risks and capital

The risk, compliance and capital management governance (RCCM) framework, approved by the group risk and capital management committee (GRCMC), sets out the group's approach to managing risk and capital. The framework has two components:

1

Governance committees

which are in place at both board and management level, with clearly defined mandates and delegated authorities

2

Governance documents

comprising standards, frameworks and policies which set out the requirements for effective oversight of risks, including the identification, assessment, measurement, monitoring, managing and reporting of risks, and requirements for the effective management of capital

Board subcommittees are tasked with providing oversight and guidance for effective RCCM and comprise the GRCMC, the GAC, the group IT committee and the group model approval committee.

The group manco has delegated responsibility for the oversight of material risk types to the group risk oversight committee (GROC), which is supported in its duties by a number of subcommittees. Given the group's focus on and substantial investments in IT as a strategic enabler, the group IT steering committee (a management committee) provides assurance that management has implemented an efficient IT governance framework that supports the effective management of resources, cost optimisation and risk mitigation in a secure and sustainable manner.

RCM AFS SR For further details of GROC subcommittees, refer to the overview section of the risk and capital management report starting on **page 3**.

For more information on board and management committees and their key terms of reference, refer to of the corporate governance report.

Governance standards and frameworks apply groupwide and are approved by the group board. Group, business line and legal entity policies are approved by relevant board or management committees and are aligned to these group standards and frameworks.

The group uses the three lines of defence governance model which promotes transparency, accountability and consistency through the clear identification and segregation of roles.

The first line of defence is the originators of risk in business lines and legal entities.

Second line of defence functions provide independent oversight of risks at a business line and legal entity level, with access to resources at the centre and embedded within the business lines and legal entities. Central resources provide groupwide oversight of risks, while resources embedded within the business lines and legal entities support management in ensuring that their specific risks are effectively managed as close to the source as possible.

GIA is the third line of defence and reports to and operates under a mandate from the GAC. In terms of its mandate, the GIA's role is to provide independent and objective assurance. The GIA has the authority to independently determine the scope and extent of work to be performed. All GIA employees report functionally to the group chief audit officer and operationally to the management of their legal entity.

How we think about our reputation

Upholding our reputation requires that we comply with regulations and rely on our people to act in accordance with our code of ethics. Failures in environmental and social risk management also present significant reputational risk.

Any damage to our reputation can impact our profitability and sustainability as it can lead to a breakdown in trust, confidence or business relationships with customers, investors and other stakeholders, and furthermore, negatively impact our ability to generate new business relationships and access sources of funding.

The group's crisis management processes are designed to minimise the reputational impact of risk events. Crisis management teams are in place both at executive and business unit level. Part of our crisis management processes is to ensure that the group's perspective is fairly represented in the media.

The group ethics officer and group chief executives are the formal custodians of the group's code of ethics.

The code of ethics is available on the group's website at **www.standardbank.com/ethics.aspx**

How we deal with regulatory change

Our broad range of products and services and the diverse jurisdictions in which our banking and insurance operations are located, and in which our clients operate, mean that the group is impacted by most of the regulatory changes facing the financial services industry globally. Given the increasing pace and complexity of regulatory changes and the different ways in which countries are implementing these changes, the regulatory and legislative oversight committee, a group risk oversight committee chaired by one of our joint chief executives, continuously assesses the risks and opportunities associated with regulatory change and provides guidance to the group.

Regulatory change has extensive bearing on our day-to-day operations, impacting areas as varied as IT systems, talent management, pricing decisions and product design, as well as decisions around our ethics and culture. This in turn places upward pressure on operating costs.

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For more information on other material regulatory developments, refer to annexure A of the risk and capital management report starting on **page 105**.

RISK HIGHLIGHTS

Basel III

We remain compliant with the minimum requirements adopted in South Africa in 2013 and are well positioned to comply with the requirements being phased in through to the deadline in 2019.

Credit risk

The group credit loss ratio improved to 1.00% (2013: 1.12%). Our PBB rest of Africa operation performed particularly well.

Funding and liquidity risk

We maintained our liquidity positions within the approved risk appetite and continued to advance our asset liability management capabilities and refine our approach to liquidity and interest rate risk management.

Operational risk

We continued to make progress in implementing the integrated operational risk framework to support the introduction of the advanced measurement approach throughout the group.

Capital management

We remain well capitalised above minimum regulatory capital adequacy requirements. The group issued its first Basel III compliant tier II instruments in 2014, totalling R2,25 billion.

Compliance risk

We assigned oversight responsibility for TCF legislation to the board audit committee and developed internal capacity.

Market risk

Trading book market risk and banking book interest rate risk remained well within approved limits.

Stress testing

The group participated in a stress testing exercise conducted by the International Monetary Fund as part of their South African financial stability assessment programme.

Country risk

The relative concentration of cross-border exposure for the sub-Saharan Africa region continued to increase, consistent with our strategic focus.

Insurance risk

We built capacity for the South African Financial Services Board's upcoming risk-based regulatory requirement for insurance and reinsurance organisations.

Summarised risk and capital management report | continued

Basel III update

The group has been compliant with the minimum requirements since their adoption in South Africa on 1 January 2013 and is well positioned to comply with the requirements that are being phased in through to 2019.

In January 2014, the SARB adopted the leverage framework issued by the BCBS. Final calibrations to this framework are expected by 2017. We continue to monitor our leverage ratio while proposals regarding its calibration are being finalised by the BCBS. This non-risk based measure is designed to complement the Basel III risk-based capital framework.

Capital management

What is capital management and what are its objectives?

Capital management is aimed at ensuring that regulatory capital requirements are met at all times and that the group and its principal subsidiaries are capitalised in line with our appetite and target ratios, both of which are approved by the board. Ultimately, capital management is aimed at protecting the group's depositors and providers of debt funding and capital from events that could put their funds at risk. Our capital management framework sets out how we achieve this.

The group manages its capital levels to support business growth, maintain depositor and creditor confidence, create value for shareholders and ensure regulatory compliance.

How do we manage capital?

The primary GROC committees that oversee the risks associated with capital management are the group asset and liability committee (ALCO) and its subcommittee, the group capital management committee.

Capital management covers both regulatory and economic measures of capital adequacy.

The capital management division is responsible for the following functions:

Strategic capital management

includes the raising of capital to realise growth opportunities and provide an optimal capital structure; advising on the dividend policy; facilitating capital allocation and risk-adjusted performance measurement; managing the internal capital adequacy assessment process (ICAAP) and capital planning process, including stress testing of capital supply and demand.

Portfolio analysis and reporting

includes the measurement and analysis of regulatory and economic capital, internal and external reporting and the implementation of new regulatory requirements.

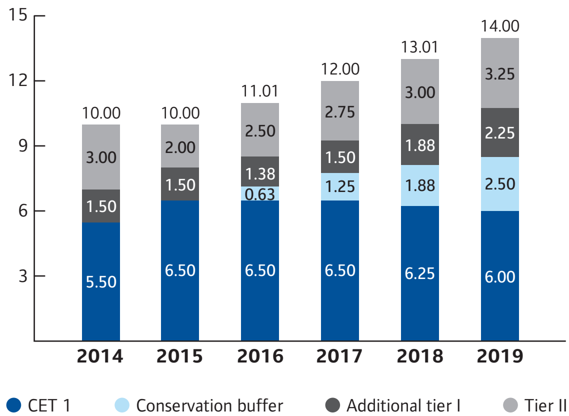
CIB and PBB capital management functions

are responsible for providing support on deal pricing, balance sheet utilisation and management of capital consumption against budgets.

Regional capital management functions

support the group's operations in the rest of Africa and outside Africa.

SARB minimum ratios (capital as a percentage of risk-weighted assets) effective 1 January each year (%)



How is regulatory capital measured?

The main regulatory requirements to be complied with are those specified in the Banks Act and related regulations which are aligned with Basel III.

Regulatory capital adequacy is measured through three risk-based ratios being common equity tier (CET) I, tier I and total capital adequacy. These ratios are a measure of the capital supply relative to the capital demand as measured by the total risk-weighted assets, and are measured against internal targets and regulatory minimum requirements.

The group's capital supply consists of the following:

- **CET I:** ordinary share capital, share premium retained earnings and qualifying non-controlling interest less impairments, divided by total risk-weighted assets.
- **Tier I:** CET I and qualifying non-controlling interest plus perpetual, non-cumulative instruments with principal loss-absorption features issued under Basel III rules, divided by total risk-weighted assets. Perpetual non-cumulative preference shares issued under Basel I and II are included in tier I capital but are subject to regulatory phase-out requirements over a 10-year period, effective from 1 January 2013.
- **Total capital adequacy:** Tier I plus other items such as the general allowance for credit impairments and subordinated debt with principal loss-absorption features issued under Basel III, divided by total risk-weighted assets. Subordinated debt issued under Basel I and Basel II is subject to regulatory phase-out requirements over 10 years effective from 1 January 2013.

The capital demand is a function of the group's risk-weighted assets. Risk-weighted assets is calculated by applying risk weights as required in terms of the Banks Act regulations and internally derived risk parameters. The group's risk-weighted assets consist of both on- and off-balance sheet exposures and cover credit, market and risks.

The group complied with all externally imposed capital requirements during the current and prior year.

The group's CET I capital, including unappropriated profit, is R113,5 billion as at 31 December 2014 (2013: R105,8 billion). The group's tier I capital, including unappropriated profit, is R118 billion as at 31 December 2014 (2013: R110,8 billion) and total capital, including unappropriated profit, was R142 billion as at 31 December 2014 (2013: R136,1 billion).

What is economic capital measured?

Economic capital covers all material risk types to which the group is exposed, and not just those which attract regulatory capital. The economic capital models also recognise the benefits of diversification within and across risk types and across business lines and legal entities. Economic capital is monitored and allocated centrally, based on usage and performance, in a manner that enhances overall group economic profit and ROE. Economic capital adequacy is the internal basis for measuring and reporting all quantifiable risks on a consistent risk-adjusted basis. The group assesses its economic capital adequacy by measuring its risk profile under both normal and stress conditions.

Economic capital adequacy is incorporated into the group's ICAAP which covers both quantitative and qualitative capital management processes within the group and includes risk management, capital management and financial planning governance. The quantitative internal assessments of business models are used to assess capital requirements against all risks the group is or may become exposed to, to meet current and future needs and assess resilience under stressed conditions.

How did the group perform in terms of capital management during 2014?

The group remains well capitalised above minimum regulatory capital adequacy requirements and internal economic capital targets. The group issued its first Basel III compliant tier II instruments in 2014, totalling R2,25 billion.

Key indicators

		2014	2013
CET I capital adequacy ratio	%	**12.4**	12.6
Tier I capital adequacy ratio	%	**12.9**	13.2
Total capital adequacy ratio	%	**15.5**	16.2
Risk-weighted assets	Rm	**915 213**	841 272
Economic capital coverage ratio	times	**1.49**	1.63

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For further details, refer to the capital management section in the risk and capital management report starting on **page 17**.

Focus areas in 2015

- Provide an optimal capital mix for the group
- Ensure adequate positioning to respond to regulatory capital rules under the Basel III phase-in requirements
- Optimise financial resource allocation, including capital and liquidity between product lines, trading desks, industry sectors and legal entities to enhance overall economic profit and the group's ROE
- Participate in the BCBS quantitative impact studies to assess the impact of proposed regulatory amendments.

Risk appetite and stress testing

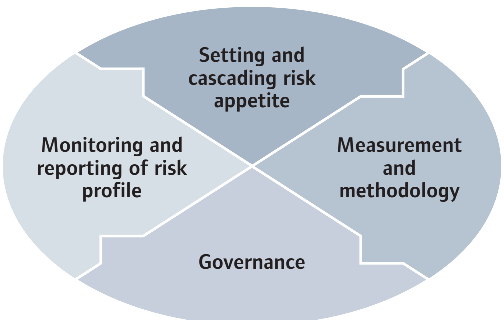
What is risk appetite and stress testing?

Risk appetite is an expression of the amount or type of risk we are willing to take to meet our financial and strategic objectives. It reflects our capacity to sustain losses while continuing to meet obligations as they fall due under both normal and a range of stressed conditions.

Stress testing is a management tool that is used to evaluate the sensitivity of the risk profile relative to risk appetite.

How do we manage risk appetite and stress testing?

The group manages risk appetite through a governance framework that provides guidance on the following:



Risk appetite is set and cascaded by group, business line and legal entity. The group risk appetite and stress testing committee, a subcommittee of GROC, is primarily responsible for overseeing risk appetite and stress testing. Liberty is represented on this committee to ensure consistent execution of these activities across the group.

Risk appetite has three dimensions: Level 1 risk appetite dimensions can be qualitative or quantitative and relate to available financial resources and earnings volatility. Level 2 risk appetite represents the allocation of level 1 risk appetite to risk types and is controlled through triggers and limits. Level 3 consists of a wide range of key metrics to monitor the portfolio at a risk-type level.

Stress testing is performed utilising one or a combination of stress testing techniques, including scenario analysis, sensitivity analysis and reverse stress testing, depending on the purpose of the test.

- **Routine groupwide macroeconomic stress testing** is conducted across all major risk types, on an integrated basis, for a range of economic scenarios of varying severity to measure the impact, after considering mitigating actions on results, against risk appetite. This forms a key input into the group's ICAAP.
- **Additional ad hoc stress testing** is done from time-to-time, usually to inform management of risks that may not yet form part of routine testing.
- **Supervisory stress tests** are called for by regulators and are usually run with prescribed assumptions and methodologies.
- **Business model stress testing** uses reverse stress testing techniques to explore vulnerabilities in a particular strategy or business model.
- **Stress testing for the recovery plan** is performed as part of the annual review of the recovery plan procedures and to provide guidance on early warning indicators and to assess the efficacy of the recovery options.
- **Risk type stress testing** is applied to individual risk types and can take the form of scenario or sensitivity analysis.

What were the key activities during 2014?

Stress testing and its importance as a risk management tool received significant attention globally during the year, as evidenced by the implementation of stress testing exercises by a number of international regulatory and oversight bodies. The group participated in a stress testing exercise conducted by the International Monetary Fund as part of their South African financial stability assessment programme, which included coverage of the group's rest of Africa operations, reflective of the group's position as a pan-African organisation.

The routine stress testing for ICAAP purposes was complemented by a number of internal stress testing scenarios conducted at various levels to provide insight and identify areas of vulnerability.

Risk appetite was formally reviewed to ensure alignment with the group strategy and incremental improvements were made to the risk appetite framework to facilitate embedding and cascading risk appetite throughout the organisation.

Focus areas in 2015

- Enhance the ability to quantify the impact of different macroeconomic environments on the future financial position
- Enhance the efficiency of stress testing processes
- Incrementally improve the risk appetite framework to integrate it with the stress testing framework and integrated financial resource planning process.

Credit risk

What is credit risk and how does it arise?

Credit risk is the risk of loss arising from the failure of counterparties to meet their financial or contractual obligations when due. Credit risk comprises counterparty risk (including primary, pre-settlement, issuer and settlement risk) and concentration risk (single counterparty, industry, product, geographic and maturity).

The group's credit risk arises mainly from wholesale and retail loans and advances, together with the counterparty credit risk arising from derivative and securities financing contracts entered into with our clients and market counterparties.

How do we manage credit risk?

The group manages credit risk in accordance with its credit risk and model risk governance standards, which provide for:

- maintaining a strong culture of responsible lending and a robust risk policy and control framework
- identifying, assessing and measuring credit risk clearly and accurately across the group, from the level of individual facilities up to the total portfolio
- defining, implementing and continually re-evaluating our risk appetite under actual and stress conditions
- monitoring the group's credit risk relative to limits
- ensuring that there is expert scrutiny and independent approval of credit models, credit risks and their mitigation.

The group's business lines are primarily responsible for credit risk management. An independent credit risk function is embedded within the business units, which is in turn supported by the overarching group risk function with credit review and monitoring responsibilities.

What were the key developments during 2014?

In a year characterised by falling commodity prices, interest rate hikes and a weakening rand, all group credit risk metrics remained within risk appetite.

Net loans and advances increased 11% in 2014 with growth in CIB of 18% and in PBB of 6%.

The group credit loss ratio improved to 1.00% (2013: 1.12%). CIB's credit loss ratio improved to 0.22% (2013: 0.41%) while PBB improved to 1.41% from 1.47%, with the credit loss ratio for its South African operation deteriorating to 1.53% from 1.45% in 2013, offset by improvements in PBB rest of Africa. The deterioration in the South African metric is attributable to a deteriorating performance in the card, instalment sale and finance lease portfolios, while mortgages improved marginally by 2 basis points (bps) to 0.80%.

Non-performing loans as a percentage of gross loans and advances improved slightly to 3.2% from 3.5% in 2013, with CIB and PBB both improving marginally. The South African PBB home loans book improved while vehicle and asset finance and card deteriorated. In the rest of Africa, the non-performing loan ratio improved.

Key indicators

		2014	2013
Credit loss ratio	%	**1.00**	1.12
Gross loans and advances	Rbn	**948**	860
Gross specific impairment coverage ratio	%	**44**	47
Non-performing loans ratio	%	**3.2**	3.5

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For further details, refer to the credit risk section in the risk and capital management report starting on **page 31**.

Focus areas in 2015

- Refine the credit risk governance standard and supporting tools to support the group's credit risk appetite
- Apply appropriate and responsible lending criteria to ensure prudent lending practices in line with risk appetite
- Streamline and enhance credit risk management processes to enhance efficiencies
- Manage concentrations across counterparties, portfolios, industries and geographical regions
- Proactively mitigate economic stresses already evident, such as commodity stresses and the electricity load shedding impact on South African corporates
- Understand IFRS 9 requirements and prepare for adoption by 2018
- Improve risk data aggregation and risk reporting practices.

Summarised risk and capital management report | continued

Compliance risk

What is compliance risk and how does it arise?

Compliance risk is the risk of legal or regulatory sanction, financial loss or damage to reputation that may occur as a result of a failure to comply with laws, regulations, codes of conduct and standards of good practice applicable to our financial services activities. This includes addressing new laws and regulations, as well as amendments to existing laws.

How do we manage compliance risk?

The group manages compliance risk in accordance with its compliance governance standard. The compliance function operates independently of business as a second line of defence function.

Our approach to managing compliance risk is proactive as a core risk management activity.

TCF and market conduct are specific focus areas as the South African regulatory framework moves towards the Twin Peaks model of supervision, creating two regulators for the financial sector.

The following sub-risk types are managed as part of compliance risk and include:

- **Market conduct risk** is the risk of inappropriate execution of our business activities negatively impacting on our clients, markets or the group. It includes conduct of business, market integrity, financial inclusion and consumer education. Supervision of market conduct is expected to increase under the Twin Peaks model and we are actively responding to TCF by assigning oversight accountability to the board audit committee.
- To manage the risk of **money laundering and terrorist financing** we subscribe to the principles of the Financial Action Task Force, an intergovernmental body that develops and promotes policies to combat money laundering and terrorist financing. An integrated systems approach is being followed to support surveillance.
- We actively manage the legal, regulatory, reputational and operational risks associated with doing business in jurisdictions which, or with clients who, are subject to **embargoes or sanctions** imposed by competent authorities.
- To manage the risks associated with **regulatory change**, which arise due to the group operating in a highly regulated industry across multiple jurisdictions, we aim to embed regulatory best practice in our operations. Our regulatory advocacy unit assesses the impact of emerging policy and regulation on business.
- **Occupational health and safety** includes any risks to the health and safety of employees from hazards in the workplace or potential exposure to occupational illnesses, which are managed by the occupational health and safety team.

What were the key developments and activities during 2014?

The compliance function expanded its resourcing capability to improve sanctions alert and money laundering surveillance, strengthen its business advisory role and embed a culture of compliance across operations.

The development of capacity to support market conduct and TCF, as well as the review of capital solvency requirements under the solvency assessment and management programme, were specific focus areas. Compulsory compliance training was rolled out in the group during the year and all banking operations in Africa were visited by central compliance during the year.

The SARB imposed administrative sanctions and directives on various South African banks. SBSA was fined R60 million. The group's UK subsidiary, Standard Bank Plc, was fined GBP76 million (R134 million at the time of settlement) by the UK regulator for shortcomings in its application of anti-money laundering procedures and policies.

RCM AFS SR For further details, refer to the compliance risk section in the risk and capital management report starting on **page 63**.

Focus areas in 2015

- Continue to meet supervisory and legislative expectations, focusing on market conduct, data privacy practices and fostering a culture of compliance
- Enhancing automated surveillance capability to extend coverage and improve surveillance capabilities
- Assess the implications of digital compliance for market conduct and compliance risk management processes
- Revise our approach to compliance training and improve institutional capability.

Country risk

What is country risk and how does it arise?

Country risk, also referred to as cross-border transfer risk, is the uncertainty that a client or counterparty, including the relevant sovereign, will be able to fulfil its obligations to the group due to political or economic conditions in the host country.

How do we manage country risk?

Country risk is managed in accordance with the group's country risk and model governance standards.

All countries to which the group is exposed are reviewed at least annually. For each of these countries, internal rating models are employed to determine ratings for country, sovereign, transfer and convertibility risk. In determining the ratings, extensive use is made of the group's network of operations, country visits and external information sources. These ratings are also a key input into the group's credit rating models, with credit loan conditions and covenants linked to country risk events.

The model inputs are continuously updated to reflect economic and political changes in countries. The model outputs are internal risk grades that are calibrated to a country risk grade (CR) from CR01 to CR25, or a sovereign risk grade, transfer and convertibility (SB) rating scale from or SB01 to SB25. Countries rated CR08 and higher, referred to as medium- and high-risk countries, are subject to increased analysis and monitoring.

Country risk is mitigated through a number of methods, including:

- political and commercial risk insurance
- co-financing with multilateral institutions
- structures to mitigate transferability and convertibility risk such as collection, collateral and margining deposits outside the jurisdiction in question.

What were the key developments in 2014?

The relative concentration of cross-border exposure for the sub-Saharan Africa region continued to increase, consistent with our strategic focus. Any exposure to conflict areas such as Eastern Europe and markets experiencing adverse economic conditions has been tightly managed.

Key indicators

		2014	2013
Medium- and high-risk country risk exposures	%	**62.2**	57.9
Sub-Saharan Africa	%	**36.4**	32.7
Other	%	**25.8**	25.2
Low-risk country exposures	%	**37.8**	42.1
Total		**100**	100

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For further details, refer to the country risk section in the risk and capital management report starting on **page 65**.

Focus areas in 2015

- Country risk appetite and the mitigation of country-specific risks will continue to be proactively managed in response to a challenging global economic and political risk environment
- We will continue to refine our country risk governance standard and portfolio management tools.

Summarised risk and capital management report | continued

Funding and liquidity risk

What is liquidity risk?

Liquidity risk is the risk that the group, although solvent, cannot maintain or generate sufficient cash resources to meet its payment obligations in full as they fall due, or can only do so at materially disadvantageous terms.

How do we manage funding and liquidity risk?

Liquidity risk is managed in accordance with the group's liquidity risk and model governance standards.

The nature of banking and trading gives rise to continuous exposure to liquidity risk. Illiquidity events may arise where counterparties who provide the group with short-term funding withdraw or do not roll over that funding, or normally liquid assets become illiquid as a result of a generalised disruption in markets.

The group manages liquidity in accordance with applicable regulations and within the group's risk appetite. The group's liquidity risk management governance framework supports the measurement and management of liquidity across both the corporate and retail sectors, to ensure that payment obligations can be met by the group's legal entities under both normal and stressed conditions. Liquidity risk management ensures that the group has the appropriate amount, diversification and tenor of funding and liquidity to support its asset base at all times.

What were the key activities and developments in 2014?

The group maintained its liquidity positions within its approved risk appetite. Appropriate liquidity buffers were held in line with regulatory, prudential and internal stress testing requirements, taking into account the global risk profile and market conditions.

The group continued to advance its asset-liability management capabilities and refine its approach to liquidity and interest rate risk management. The internal liquidity risk management framework has evolved to ensure that the group has sufficient liquidity resources to continue operating under a group-specific and industry systemic stress event. The liquidity risk technology framework was updated to support the implementation of relevant new regulations.

The South African markets were temporarily disrupted during 2014 on the back of the curatorship of African Bank Limited, which has resulted in the increase of funding costs for South African banks. The group's liquidity management systems, processes and frameworks proved resilient in the face of these disruptions.

The group manages liquidity risk as three integrated pillars:

1 Tactical (shorter-term) liquidity risk management	2 Structural (long-term) liquidity risk management	3 Contingency liquidity risk management
• manage intra-day liquidity positions • monitor interbank and repo shortage levels • monitor daily cash flow requirements • manage short-term cash flows • manage daily foreign currency liquidity • set deposit rates in accordance with structural and contingent liability requirements.	• ensure a structurally sound balance sheet • identify and manage structural liquidity mismatches • determine and apply behavioural profiling • manage long-term cash flows • preserve a diversified funding base • inform term funding requirements • assess foreign currency liquidity exposures • establish liquidity risk appetite • ensure appropriate transfer pricing of liquidity costs.	• monitor and manage early warning indicators for liquidity • establish and maintain contingency funding plans • undertake regular liquidity stress testing and scenario analysis • convene liquidity crisis management committees • set liquidity buffer levels in accordance with anticipated stress events • advise diversification of liquidity buffer portfolios.

Key indicators

	2014 Rbn	2013 Rbn
Eligible LCR HQLA comprising:	**174,2**	129,7
Notes and coins	**19,0**	15,9
Cash and deposits with central banks	**45,7**	33,4
Government bonds and bills	**97,7**	70,6
Other eligible assets	**11,8**	9,8
Management liquidity	**121,9**	108,8
Total liquidity	**296,1**	238,5
Total liquidity as a % of funding-related liabilities	**25.5%**	23.2%

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For further details, refer to the funding and liquidity risk section in the risk and capital management report starting on **page 68**.

Focus areas in 2015

- Enhance frameworks and systems to address new liquidity regulations
- Update and implement funds transfer pricing methodologies across the group to accurately price and measure the internal cost of funding, including, where applicable, the cost of Basel III liquidity regulations
- Evaluate the impact of a NSFR across the group and develop a transition plan for the liquidity risk structure and balance sheet management framework.

As from 1 January 2015, the group is required to comply with the LCR, a metric introduced by the BCBS to measure a bank's ability to manage a sustained outflow of customer funds in an acute stress event over a 30-day period. The ratio is calculated by taking the group's HQLA and dividing it by net cash outflows. The minimum regulatory LCR requirement effective 1 January 2015 is 60%, increasing by 10% annually to reach 100% by 1 January 2019. The group is on track to meet the minimum phased-in Basel III LCR standards and as at 31 December 2014, exceeded the 60% minimum requirement.

From 2018, the group will also be required to comply with the Basel III NSFR, a metric designed to ensure that the majority of term assets are funded by stable sources, such as capital, term borrowings or funds from stable sources. The final BCBS NSFR framework was issued in October 2014.

Basel III implementation timeline

Liquidity	2013	2014	2015	2016	2017	2018	2019
LCR	Bank disclosure starts		60% minimum standard	70% minimum standard	80% minimum standard	90% minimum standard	100%
NSFR						100%	100%

Summarised risk and capital management report | continued

Market risk

What is market risk and how does it arise?

Market risk is the risk of a change in the market value, actual or effective earnings, or future cash flows of a portfolio of financial instruments, including commodities, caused by adverse movements in market variables such as equity, bond and commodity prices, currency exchange and interest rates, credit spreads, recovery rates, correlations and implied volatilities in all of these variables.

The group's key market risks are:

- **trading book market risk** resulting from financial instruments, including commodities, held on the trading book, due to normal global markets trading activity
- **interest rate risk in the banking book** resulting from the different repricing characteristics of banking book assets and liabilities
- **equity risk in the banking book**, which is the risk of loss arising from a decline in the value of the group's investment in listed and unlisted equities caused by the deterioration of the underlying operating asset value, net asset value, enterprise value of the issuing entity or a decline in the market value of the instrument itself
- **foreign currency risk**, which is the translation effect on the group's net assets in foreign operations, intragroup foreign-denominated debt and foreign-denominated cash exposures and accruals
- **own equity-linked transactions**, which is the group's exposure to changes in its share price from equity-linked remuneration commitments.

How do we manage market risk?

Market risk is managed in accordance with the group's market risk, model risk and equity risk governance standards, with oversight from the group ALCO and group equity risk committee, both of which are subcommittees of GROC.

What were the key developments in 2014?

Trading book market risk and banking book interest rate risk remained well within approved limits. Trading book average value-at-risk (VaR) remained low as the group maintained a conservative approach to market risk. The daily profit and loss results for the year showed a profit for 247 out of 260 trading days, which is reflective of CIB's client flow business model (2013: 246 out of 259 days).

Focus areas in 2015

- Monitor and manage traded market risk, banking book interest rate risk and associated hedges in the context of current market volatility, including monetary policy decisions
- Review implications of proposed revised trading book and new interest rate regulations.

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For further details, refer to the market risk section in the risk and capital management report starting on **page 77**.

Key indicators

		2014	2013
Trading book			
VaR model status from back-testing		**Satis-factory**	Satis-factory
Average VaR exposure	Rm	**40,8**	45,8
Average stressed VaR exposure	Rm	**436,9**	396,7
Closing VaR exposure	Rm	**40,0**	37,8
Closing stressed VaR exposure	Rm	**409,3**	475,7
Interest rate risk in the banking book			
Effect of 15% and 2% downward parallel interest rate shock across all foreign currency and rand yield curves, respectively, on interest income/(loss)	Rm	**2 622**	2 702
Equity positions in the banking book			
Total fair value of exposure	Rm	**2 293**	2 678
Foreign currency risk			
Impact of 10% (2013: 10%) depreciation in foreign currency rates on other comprehensive income and profit or loss – banking	Rm	**1 231**	414

Insurance risk

What is insurance risk and how does it arise?

Insurance risk is the risk that actual future demographic and related expense experience will differ from that expected and hence that used in measuring policyholder liabilities and in pricing products.

Insurance risk arises due to uncertainty regarding the timing and amount of future cash flows from insurance contracts.

Insurance risk applies to long-term insurance operations housed in Liberty and the short-term insurance operations housed in Liberty Africa and Standard Insurance Limited.

How do we manage insurance risk?

Insurance risk is managed in accordance with the group's long-term and short-term insurance governance standards.

The management of insurance risk is essentially the management of deviations of actual experience from the assumed best estimate of future experience, on which product pricing is based. Insurance risks are managed through processes applied prior to and on acceptance of risks and those applied once the risks are contracted.

For long-term insurance risk, the statutory actuaries, the Liberty group business risk committee and the Liberty chief risk officer (CRO) provide independent oversight of compliance with risk management policies and procedures and the effectiveness of the company's insurance risk management processes.

All insurance business units are responsible for the day-to-day identification, management and monitoring of insurance risk. Management is also responsible for reporting any material insurance risks, risk events and issues identified to senior management through predefined escalation procedures.

Short-term insurance risk is managed primarily through pricing, product design, investment strategy, risk rating and reinsurance. The underwriting strategy seeks diversity to ensure a balanced portfolio and is based on a large portfolio of similar risks over a large geographical area.

What were the key activities in 2014?

The group continued to build capacity for the South African Financial Services Board's upcoming risk-based regulatory requirement for insurance and reinsurance organisations under the solvency assessment and management (SAM) programme, with the introduction of a number of methodologies and embedding of policies across the business.

A centralised Liberty group reinsurance function was formed and is responsible for the optimisation and monitoring of reinsurance across the Liberty group.

Focus areas in 2015

- We will continue to focus on insurance risks across the group and particularly on components of SAM to ensure readiness for implementation in 2016 and cascade risk appetite to business units.

RCM AFS SR

For further details, refer to the insurance risk section in the risk and capital management report starting on **page 91**.

Summarised risk and capital management report | continued

Operational risk

What is operational risk and how does it arise?

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

Operational risk includes a number of subtypes which are managed and overseen by specialist functions:

- model risk
- tax risk
- legal risk
- environmental and social risk
- IT and change risk
- information risk
- cyber risk
- compliance risk
- financial crime control
- physical commodities

How do we manage operational risk?

Operational risk is managed in accordance with the operational risk governance framework, which in turn is supplemented by governance standards for the subtypes referred to above.

Operational risk is a natural part of any business activity. Our aim is not to eliminate all exposure to operational risk, as this would not be commercially viable or possible. The group's approach to managing operational risk is to adopt fit-for-purpose operational risk practices that assist business line management to understand their inherent risks and reduce their risk profile, while maximising their operational performance and efficiency.

The integrated operational risk (IOR) management function is independent from business line management and is part of the second line of defence. It is responsible for:

- developing and maintaining the operational risk governance framework
- facilitating business's adoption of the framework, oversight and reporting
- challenging the risk profile.

The function proactively analyses root causes, trends and emerging threats, advises on the remediation of potential control weaknesses and recommends best practice solutions.

Individual teams are dedicated to each business line and report to the business unit CRO. IOR also provides dedicated teams to enabling functions such as finance, IT and human capital. These teams work alongside their business areas and facilitate the adoption of the operational risk governance framework. As part of the second line of defence, they also monitor and challenge the business units' and enabling functions' management of their operational risk profile.

A central function, based at a group level, provides groupwide oversight and reporting. It is also responsible for developing and maintaining the operational risk governance framework.

Business continuity management identifies potential operational disruptions and provides a basis for planning for the mitigation of disruptions. The group's framework encompasses emergency response preparedness and crisis management capabilities to manage the business through a crisis to full recovery.

The group buys insurance to mitigate operational risk. This cover is reviewed annually. The group insurance committee oversees a substantial insurance programme. The primary insurance policies in place are the group crime, professional indemnity and group directors' and officers' liability insurance policies. The group does not include insurance as a mitigant in the calculation of regulatory capital.

What were the key activities and developments in 2014?

The group continued to apply the integrated approach to risk management where financial crime control, information risk and operational risk management are combined into a single IOR management unit.

We continue to make progress in implementing the IOR framework to support the introduction of the advanced measurement approach throughout the group. We have also focused on ensuring consistency in the application and design of operational risk tools across the group and we continued to see benefit in fraud awareness initiatives that prove to be an effective deterrent mechanism.

Potential losses arising from external fraud in the base metal repo business in China, which is part of the group's discontinued operation and under legal privilege, has contributed to an operational risk appetite breach at both a CIB and group level. Risk mitigation is in place, including original legal documentation to support our title over metal in port (USD40 million), as well as a strong external legal opinion supporting an insurance claim of USD129 million.

There was a significant increase in litigation against some of our African businesses, all of which are being defended and none of which are expected to have a material adverse impact on the group. Legal resources were restructured and enhanced to improve the processes and controls to manage legal risks.

Ongoing changes in environmental legislation and regulation combined with increasing enforcement continues to place pressure on screening lending and operational activities.

Focus areas in 2015

- Enhance the risk profile methodology to further enable comparisons with risk appetite and tolerance
- Scan the operating environment for emerging threats and trends
- Promote continuous customer and employee awareness of financial crime
- Fight crime through supporting in-country initiatives and through the South African Banking Risk Information Centre
- Increase capability of the cyber security operations centre
- Enhance legal resourcing capabilities to better service transactions originated outside South Africa
- Improve legal network to ensure minimum standards of legal support and more efficient access to resources
- Raise environmental and social risk awareness within the group
- Improve internal processes to manage environmental and social risks arising from legislation
- Increase the understanding of risks and opportunities posed by climate change.

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For further details, refer to the operational risk section in the risk and capital management report starting on **page 97**.