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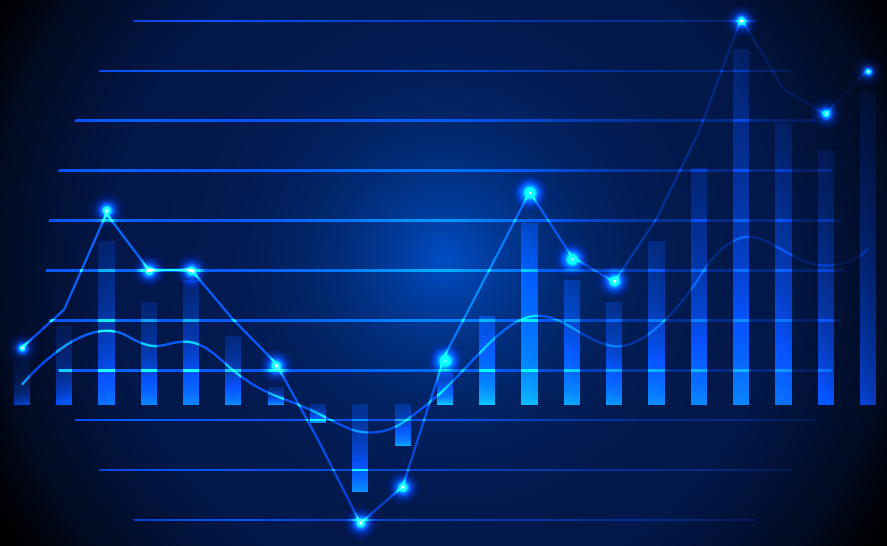


A reporting comparison for the informed investor in South Africa

Evolving 2011 - 2015

Contents

Foreword – The informed investor

Consistency and comparability

The Investor of today has significant challenges in terms of choice of financial information and complexity of regulation and consequently the difficulty to make an informed decision.

Information has also evolved with technology and is more readily accessible and fundamentally key for today's Investor to make an informed decision.

The risk framework within financial services during the last decade has demonstrated fundamental risks inherent in the market and consequently in investor choices. Now, as a result, financial institutions are constantly required to provide the much needed clarity, consistency and comparability through a robust approach to external reporting.

In this report, we analyse and compare certain aspects of financial reporting information for five banks listed on the JSE in South Africa.

Our focus of the report has been on consistency and comparability of risk reporting among financial institutions in South Africa operating in a regulated and ever complex post-financial crisis era.

The Informed Investor is able to make investment decisions based on a sound understanding of financial disclosures and core fundamentals of the underlying industry and investment opportunity identified.

Overview

The need for market discipline

The Basel Committee on Banking Supervision ("BCBS") has recognised the importance of market discipline and the need for reform within regulatory reporting in the financial services sector.

Pillar 3 of the Basel Framework aims to promote market discipline through regulatory disclosure requirements. These requirements enable market participants to access information relating to a bank's regulatory capital and risk exposures.

In order to bring about this meaningful change, the BCBS has identified guiding principles for financial organisations when approaching Pillar 3 reporting. These include:

1. Clarity within disclosures – disclosures should be presented in a form that is understandable to key stakeholders and communicated through an accessible medium. Complex issues should be explained in simple language with important terms defined.
2. Comprehensive disclosures – disclosures should describe a bank's main activities and all significant risks, supported by underlying data and information. The information provided should be sufficient in terms of both quantitative and qualitative characteristics.
3. Disclosures which are meaningful to users – disclosures should highlight a bank's most significant and emerging risks and how those risks are managed, including information that is likely to receive market attention. Furthermore, information which is no longer meaningful should be removed.
4. Consistency within disclosures – disclosures should be consistent over time in order to enable key stakeholders to identify trends in a bank's risk profile across all significant aspects of its business. Additions, deletions and changes over the period need to be highlighted and explained.
5. Comparability of disclosures with other financial organisations – level of detail and presentation of disclosures should enable key stakeholders to perform meaningful comparisons of business activities, prudential metrics, risks and risk management between banks.

Awareness makes a meaningful impact

With the BCBS 239 reporting target set by the South African Reserve Bank (January 2017) for all South African banks fast approaching, banks are in the process of establishing roadmaps of current reporting compliance and where additional disclosure and compliance will be required.

The longer-term solution for South African banks in order to achieve compliance will include: Identifying skills shortages in order to improve data aggregation and management.

Investment to replace legacy IT systems which are not adequately set-up for the future state of risk reporting.

Review and implement BCBS 239 regulations in conjunction with Pillar 3 reporting.

Optimise data usage and reporting roadmaps. Reduce duplicating the extraction of data and data calculations required by significant regulatory and reporting requirements

The short-term solution

Some financial institutions are likely to approach BCBS 239 and Pillar 3 reporting with the following:

- Identify the core requirements in order to achieve minimum adherence
- Adapt current systems in order to achieve compliance
- Modify a balanced approach in order to obtain an efficient trade-off between cost and resource allocation

A reporting comparison – The integrated report

The integrated report

An Integrated Report is prescribed to include the following 8 content elements in terms of the IIRC:

1. Organisational overview and external environment – describing what the organisation does, the circumstances under which it operates as well as the factors affecting the external environment in which the institution operates.
2. Governance – information on how the organisation's governance structure supports its ability to create value over the short, medium and long term.
3. Business model – providing an understanding of the institution's business model, from the inputs into the organisation, its processes and how the outputs aim to fulfil the organisation's strategic goals.
4. Risks and opportunities – establishing context for external users about the specific risks and opportunities facing the organisation's ability to create value over the short, medium and long term.
5. Strategy and resource allocation – information on what the organisation's strategic goals are, how it wants to get there and what it is doing in order to achieve the targets set.
6. Performance – describing how the organisation has, to an extent, already achieved its strategic objectives for the period under review as well as its effects on the key capitals within the business.
7. Outlook – providing information on the challenges and uncertainties affecting the business, and how these may affect the organisation's strategic goals and future performance.
8. Basis of preparation and presentation, and in doing so, takes account of general reporting guidance – how the entity determines what matters to include in the IR and how such matters are quantified or evaluated.

Our comparison

In performing our comparison of South African listed banks' integrated reports, our aim was to determine how consistent and comparable these extensive reports are for a provider of capital from a risk perspective.

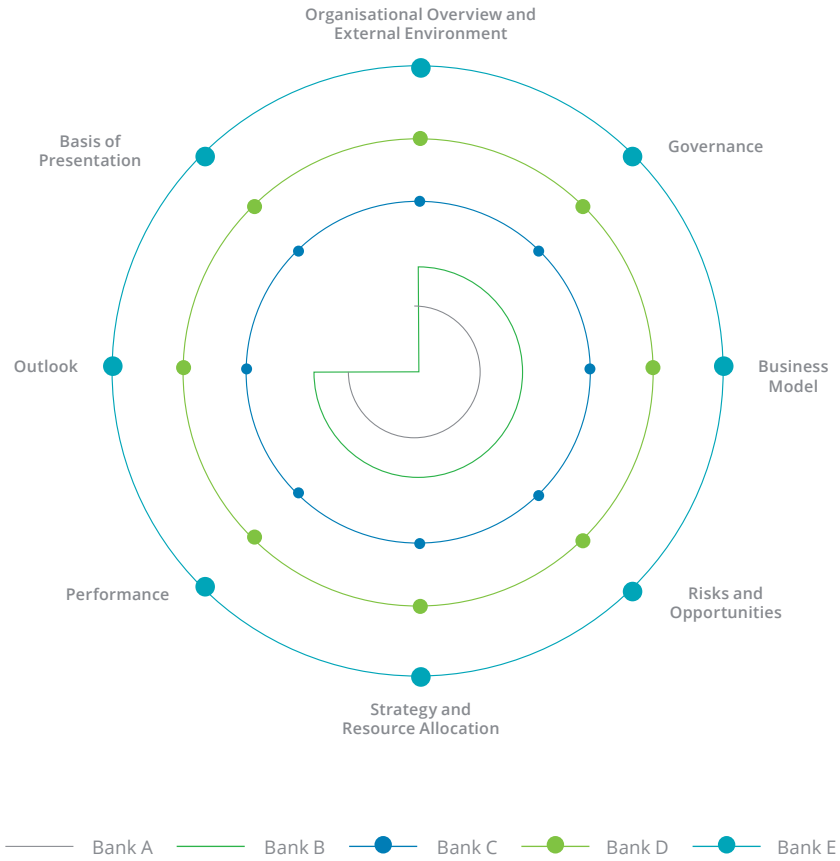
Both the International Integrated Reporting Council (IIRC) and the Basel Committee on Banking Supervision (BCBS) aim to drive consistency and comparability among financial reporting information.

Our report focuses on five banks listed on the JSE in South Africa.

- Capitec Bank
- First Rand
- Barclays
- Nedbank
- Standard Bank

The IIRC guiding principles

The IIRC* outlines certain basic guiding principles for organisations when compiling an integrated report.



We notice from our findings that not all South African banks meet the basis for preparation standard principle. The IIRC requires organisations to clearly state how they determine what matters they include within their Integrated Reports and how the matters are quantified or evaluated based on materiality – as the basis of presentation of the Integrated Report.

Bank A state that their Integrated Report aims to provide stakeholders with enough relevant information and the approach is designed to present substance over form.

Bank B speaks of a materiality determination process which it has in place, which is described on a high-level basis.

Key risks facing South African banks

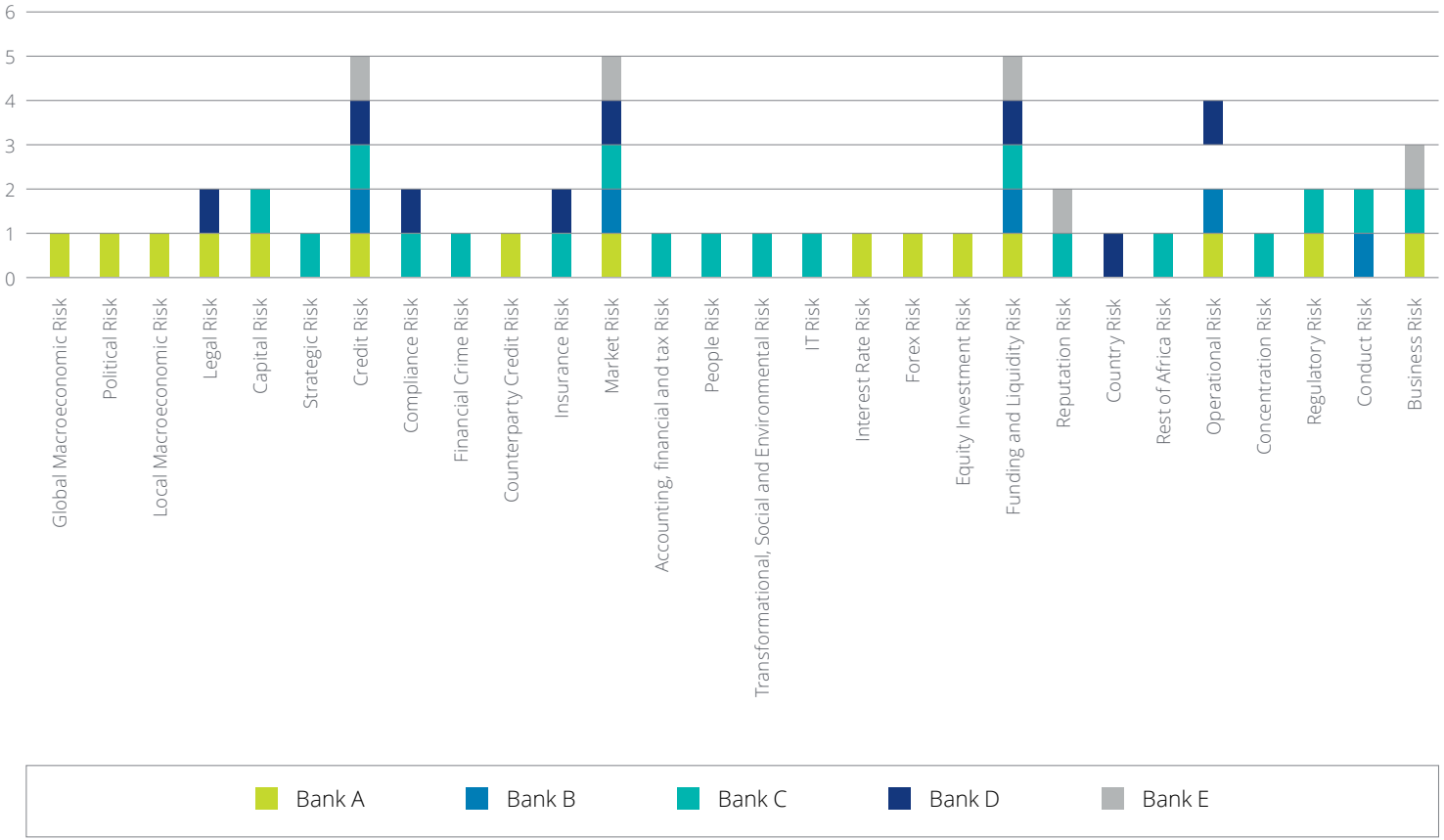
The key risks identified by institutions are those risks which they deem a priority in challenging the institution's ability to achieve its strategic objectives.

These risks can be classified as internal, external or more commonly, a mix of the two. It is relevant in today's market that an institution is able to identify the key risks facing it, and be able to assess the likely impact and probability that such risks come to fruition.

The South African market in particular, brings about country specific risk, as well as political and socio-economic risk. The common risks which are identified by South African banks can be described below:

- Credit risk – the risk of a counterparty to a transaction failing to meet its contractual obligation
- Market risk – the risk of a loss or diminishment in the value of an investment due to adverse changes within market factors
- Funding and liquidity risk – the risk that a bank will not be able to settle its obligations as they become due and payable
- Operational risk – the risk of financial loss as a result of a failed system, policies or procedures which have been implemented

Key risks facing South African banks



Surprisingly, compliance or regulatory risk were only identified by 3 banks. Ever since the global financial crisis of 2008/2009, financial institutions have been placed under the spotlight and regulators are increasingly scrutinising their conduct and accountability.

Despite the increase in global cyber security attacks and IT breaches against financial institutions, Financial crime risk or IT risk was only identified by one bank as a key risk.

Only two banks identified country or rest of Africa risk, despite the vast African footprint a majority of the banks in this report have, coupled with the high levels of corruption and stringent operating environment reported on the continent.

All the banks highlighted Credit, Market, Funding and Liquidity and Operational Risk as key risks challenging the financial services sector.

The South African reporting structure

In order to provide a meaningful comparison of the Integrated Reports of South African banks, we first need to understand the approach followed by each bank in terms of what is included within each of their Integrated Reports.

Our report indicates a trend, whereby SA banks follow a concise reporting basis and adhere to the IIRC minimum content criteria. Additional lengthy disclosure, such as consolidated financial statements, sustainability reporting and risk and capital management reporting, find themselves in separate reports and can be found on the bank's websites.

The common themes appearing within Integrated Reports are the following:

- Organisational overview and performance review
- Consolidated financial statements
- Notes to the financial statements
- Governance and remuneration
- Risk and capital management review
- Glossary and shareholder information

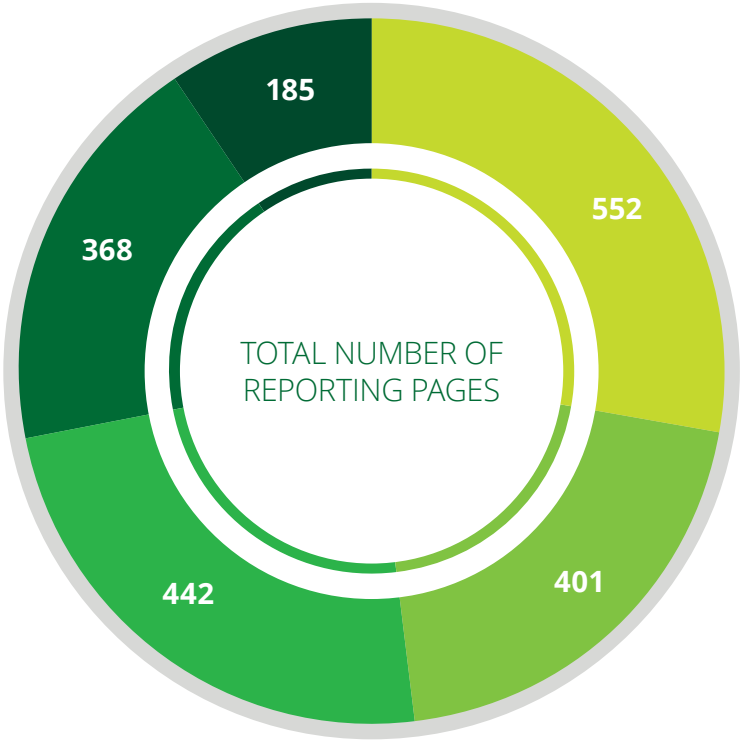
The South African reporting structure

The sheer volume, complexity, inconsistency and presentation of an integrated report is a task for the Investor.

The vast amount of information available both directly from the financial institution as well as from other sources with the intention of making an informed decision about whether or not to invest. The challenge facing organisations is establishing a picture for investors which captures the business environment in which it operates, its risks and compliance which are unique to the organisation.

We notice that all of this information is presented in various formats by financial institutions, spread across multiple reports.

Capitec reports within 185 pages, compared to the other 4 financial institutions. This is a result of a single segment approach from Capitec, compared to the multi-segments within which the other 4 financial institutions operate.



- First Rand - 30/06/2015
- Barclays - 31/12/2015
- Nedbank - 31/12/2015
- Standard Bank - 31/12/2015
- Capitec - 29/02/2016

The South African reporting structure

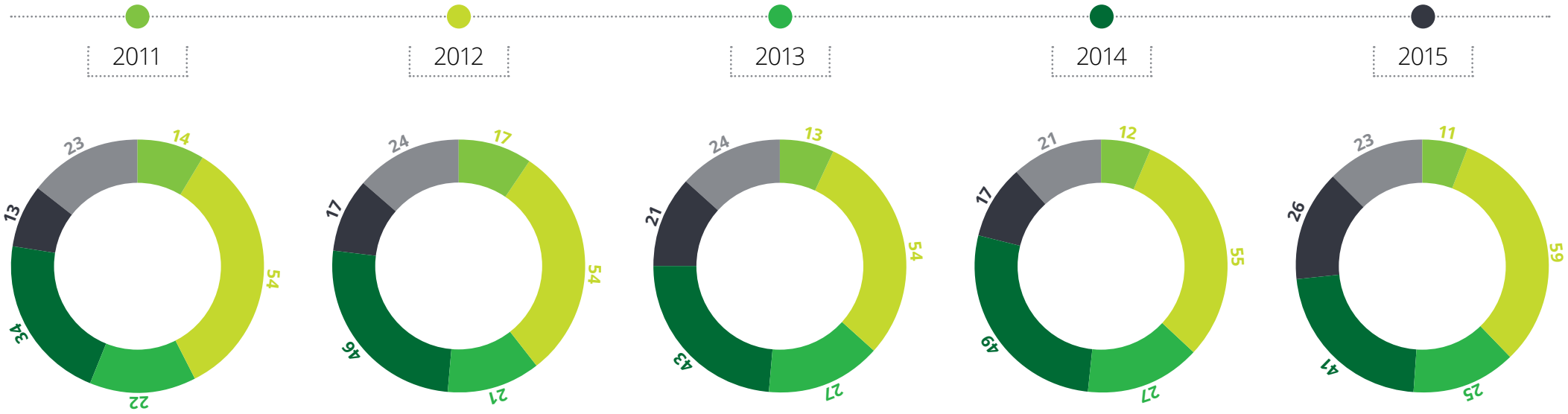
The reporting of the South African banks under comparison within this report is structured as follows:

Reporting Item	Capitec	Standard Bank	Barclays Africa	Nedbank	First Rand
Consolidated F/Ss	IR	Web	Web	Web	IR
Notes to the F/Ss	IR	Web	Web	Web	IR
Risk and Capital Management Report	IR	Web	Web	Web	IR

Reporting Item	Capitec	Standard Bank	Barclays Africa	Nedbank	First Rand
Consolidated F/Ss	11	17	18	17	19
Notes to the F/Ss	59	83	170	120	209
Risk and Capital Management Report	25	136	114	185	138
Other items within the IR	90	132	99	150	186
- Overview/performance review	41	93	65	74	66
- Governance & remuneration	26	30	29	44	62
- Company F/Ss & Notes	-	-	-	-	22
- Glossary & other info	23	9	5	14	36
Total comparative pages	185	368	401	472	522

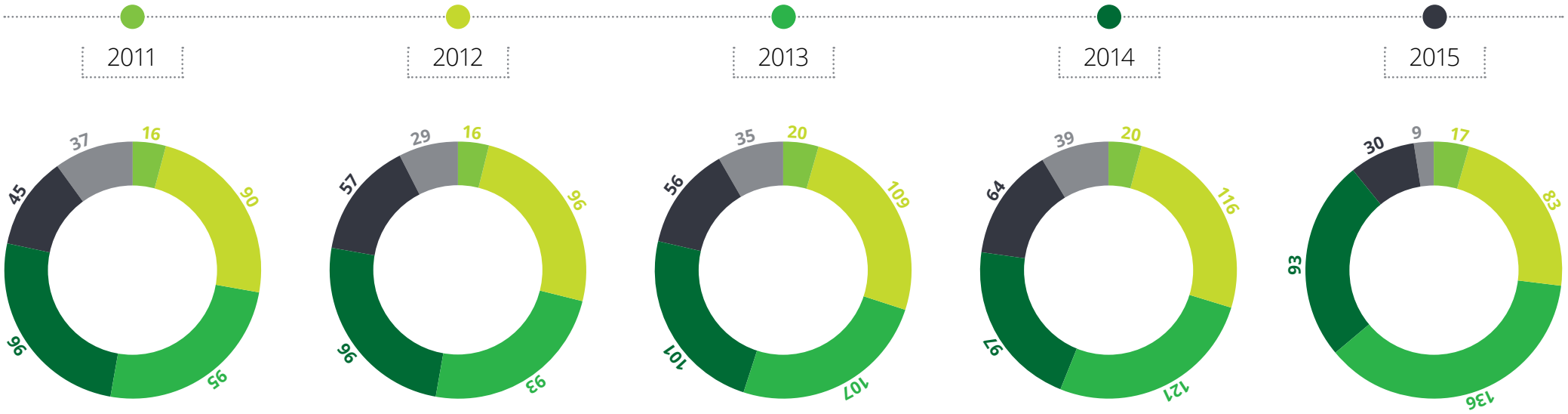
*IR – reporting item is included within the Integrated Report.
*Web – the reporting item is found on the institution's website in a separate report.

Look back over the past few years – Capitec Bank



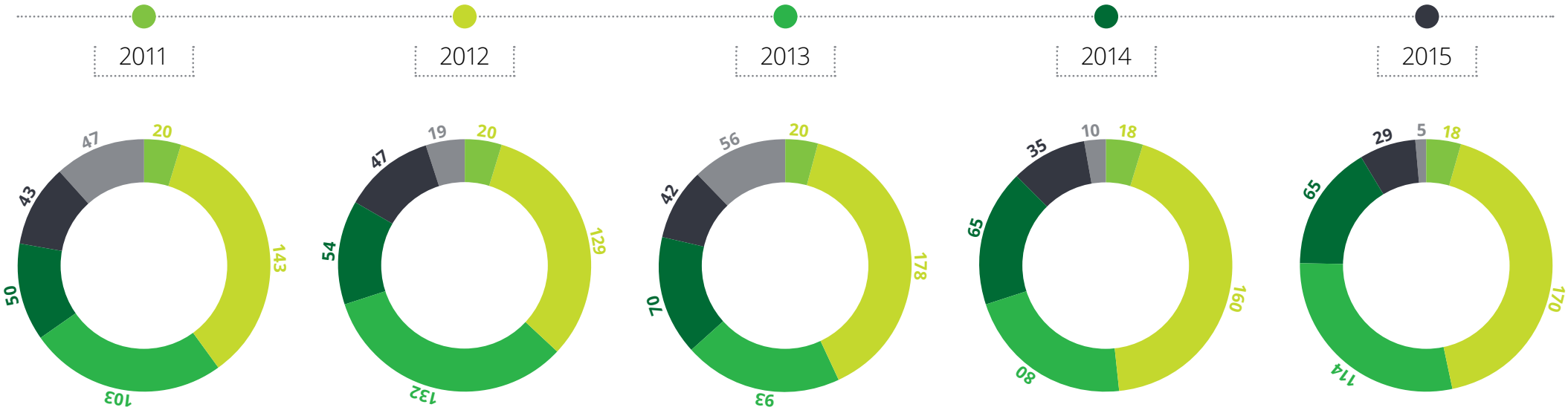
Capitec Bank has a consistent format and section split over the 5 year period of comparison for the production of their Integrated Report.

Look back over the past few years – Standard Bank



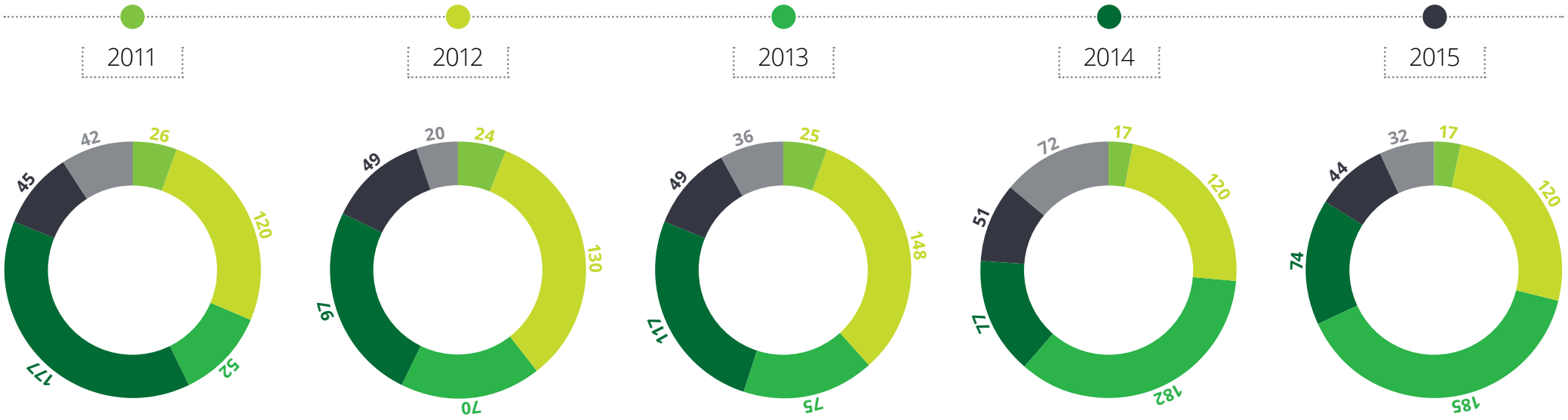
Standard Bank has separate reports for i) Risk and Capital Management and ii) Annual Financial Statements. The institution's risk and capital management report has increased over the 5 year period – in line with additional legislation which has come into effect.

Look back over the past few years – Barclays



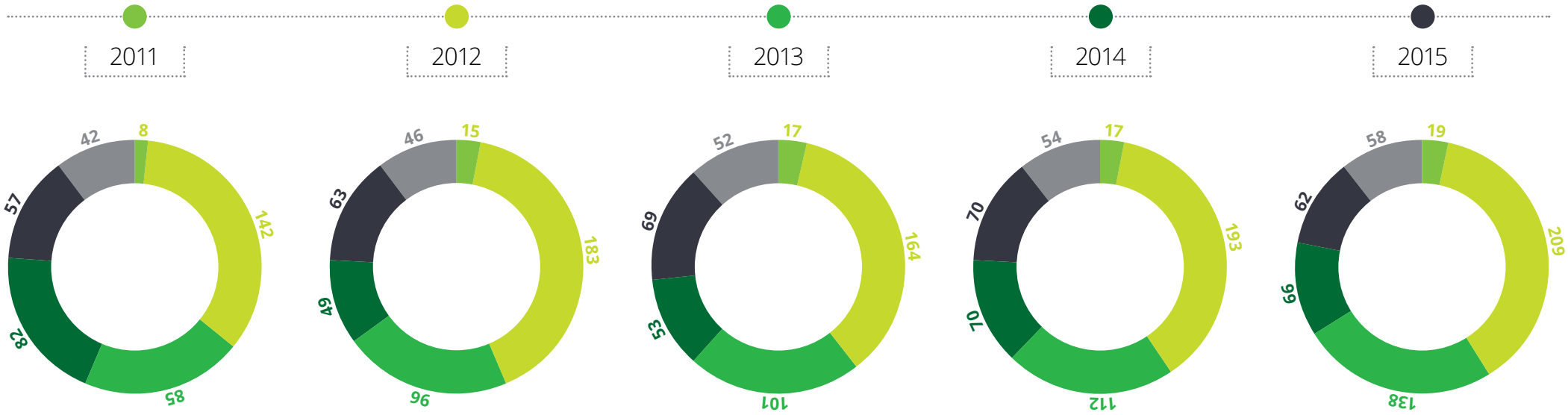
Barclays Africa has separate reports for i) Risk and Capital Management and ii) Annual Financial Statements. We see an increase in risk and capital management reporting over the last 3 financial periods, which is attributed to additional legislation coming into effect.

Look back over the past few years – Nedbank



Nedbank has separate reports for i) Risk and Capital Management and ii) Annual Financial Statements from the 2012 financial year onwards. The major change is an increase in risk and capital management reporting over the last 2 financial periods, which is attributed to additional legislation coming into effect.

Look back over the past few years – FirstRand



First Rand has an increasing trend with both notes to the financial statements as well as risk and capital management reporting. This can be attributed to additional legislation which has come into effect over the course of the periods under review.

A look at Pillar 3

General observations

Pillar 3 complements the minimum risk-based capital requirements and other quantitative requirements (Pillar 1) and the supervisory review process (Pillar 2) and aims to promote market discipline by providing meaningful regulatory information to investors and other interested parties on a consistent and comparable basis.

With more and more regulation in the pipeline, we have been tasked to assess the current disclosures of 5 South African banks against the requirements of Pillar 3 reporting as published by the BCBS.

The findings within this report compare the compliance of South African banks to the P3 reporting requirements. South African banking institutions face a SARB implementation deadline for BCBS 239 of 1 January 2017.

- Capitec Bank
- First Rand
- Barclays
- Nedbank
- Standard Bank

General observations

- While the proposed revisions of Pillar 3 disclosures will provide a more comparable reporting landscape, the regulators will need to consult closely with industry and stakeholders on the usefulness of Pillar 3 disclosures. The Enhanced Disclosure Task Force (EDTF) allows for the detailed review of disclosures (presently very prominent within the IFRS 9 disclosure process).

- Many of the proposed disclosures include very granular requirements and it is questionable whether it really provides value to stakeholders. The sheer quantity and technical detail alongside the density of banks' disclosures, could even be considered an impairment to not only the banks who need to complete them but also to the content user. The Pillar 3 reports should aim to be an effective tool for communication and not a volume heavy compliance exercise.

- The granularity and level of technicality entrenched in the proposed Pillar 3 disclosures will only be potentially of interest to, or understood by, a very small group of well-staffed institutional investors. It is arguable whether or not these revised disclosures will create the "level playing field" amongst large institutional investors, less sophisticated institutions and of course the individual investor.

- The implementation timeline for the revised Pillar 3 disclosers places a significant amount of pressure on banks who are currently finding the mandatory current regulation requirements challenging including, but not limited to, BCBS 239 and IFRS 9.

- The overall vision of harmonisation, consistency and comparability is shared across the industry and experts but there exists a real risk that this will not be achieved if local implementation varies or reflects different interpretations.

Basis of preparation

General observations

In preparing this reporting comparison, we have selected 5 major banks in South Africa.

- These companies include:
- Standard Bank of South Africa Limited
- First Rand Bank Limited
- Barclays Africa Group Limited
- Nedbank Limited
- Capitec Bank

Financial statements of the latest available financial year-ends for each of the companies have been used in order to obtain the information contained in this report. These were all 31 December 2015, except for First Rand Bank Limited which was 30 June 2015 and Capitec Bank Limited which was 29 February 2016.

All information is derived from Deloitte research of the audited and published annual financial statements and integrated reports and other publicly available information.

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