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Basel III & IFRS 9 Investor presentation

November 2015

Raisibe Morathi, Chief Financial Officer

Trevor Adams, Chief Risk Officer

Mike Davis, Group Executive: Balance Sheet Management

A Member of the OLDMUTUAL Group

Agenda

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IFRS 9

- Overview of IFRS 9
- Classification & measurement model
- Hedge Accounting

Raisibe Morathi

- Moving from incurred to expected credit loss
- Impact on income statement & balance sheet

Trevor Adams

Basel III

- Overview of Basel III
- SA market context
- Impact on balance sheet
- Optimisation strategies
- Impact on SA banks

Mike Davis

IFRS 9 – Key components

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Classification & Measurement Model

Financial assets

- Business model for managing financial assets (Business level)
- Contractual cash flow characteristics (Instrument level)

Financial Liabilities

- Financial liabilities same as IAS 39 except treatment of FV changes in own credit risk

Hedge Accounting

- Hedge accounting more aligned with risk management
- Macro hedge accounting still under discussion by IASB & provides options for IAS 39 to continue to be applied or to adopt IFRS 9 model

Expected Credit Loss (ECL) Model

- ECL rather than incurred credit losses
- Account for either 12 month ECL or life time credit losses depending on credit deterioration from origination
- Inclusion of off-balance sheet exposure
- Inclusion of forward looking macroeconomic overlay

IFRS 9 implemented 2018

IFRS 9 – Classification & measurement model at business level

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Models for managing financial assets

Amortised cost

Held-to-collect business model

- Objective to collect contractual cash flows over life of loan
- Infrequent or insignificant sales incidental to objective of business model
- Sales consistent with objective in response to credit deterioration (sale of NPL assets)

- Retail & Business Banking (e.g. Homeloans & Overdrafts,
- Corporate loans
- Corporate property finance

Fair value through OCI

Held-to-collect & sell business model

- Both collecting contractual cash flows & sales are integral to business model
- More frequent &/or significant level of sales (not trading)

- Originate to distribute (e.g. securitisations)
- Sell-down loan books
- Liquid asset portfolio - portion sales are made

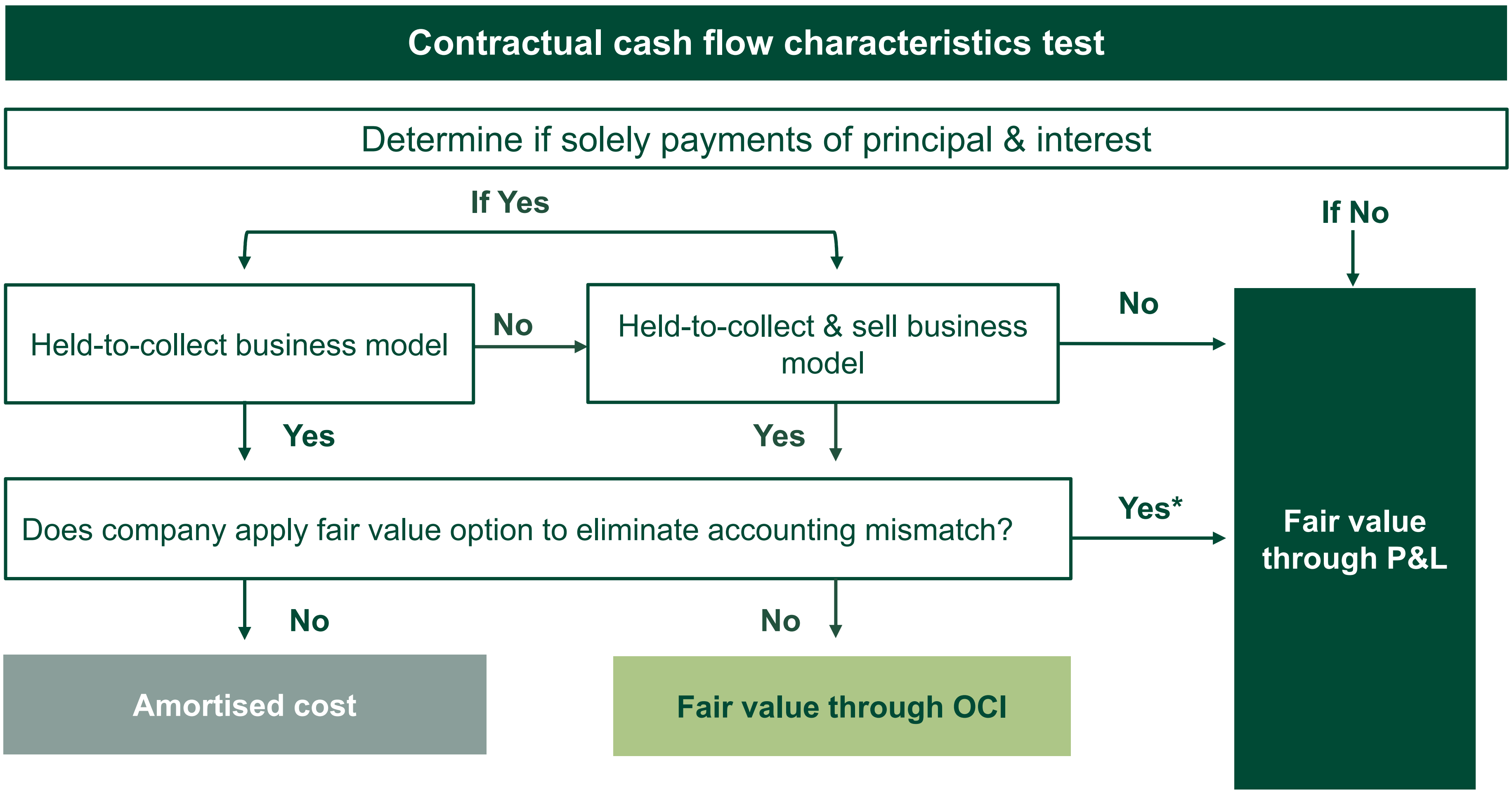
Fair value through P&L (FVTPL)

Residual

- Business model is neither Held-to-collect business model nor Held-to-collect & sell business model
- Collection of contractual cash flows are incidental to the objective of the model
- Trading, managed on a fair value basis, or maximising cash flows through sale

- Trading books (e.g. Global Markets)
- Derivatives
- Long-term & short-term insurance businesses

IFRS 9 – Classification & measurement model at financial instrument level



* Fixed rate loan book. As at 30 June 2015, Nedbank had designated R62,1bn of R648,8bn loan & advances book at Fair value through P&L. The designated book is predominantly comprised of fixed rate loans which are economically hedged via interest rate swaps. As a result Nedbank reported R38m unrealised loss in NIR (of R20,3bn total NIR) due to fair value movements. This option remains available under IFRS 9.

IFRS 9 – Classification & measurement model at financial instrument level

Rationale for Nedbank applying fair value option to eliminate accounting mismatch

In order to eliminate the accounting mismatch* **designation of fixed rate debt instruments at FVTPL is made on initial recognition.**

Fixed Rate Debt Instrument

IFRS 9 classification:

- Amortised cost
- Fair Value through OCI
- **Fair value through profit or loss - FVTPL**

Interest Rate Swap (IRS)

IFRS 9 classification:

- **Derivative - FVTPL**

Synthetic Instrument
(floating rate)
@ FVTPL

Instruments designated at FVTPL have to be fair valued

* If the fixed rate debt instrument is accounted for in the categories <u>other than FVTPL</u>, an accounting mismatch will arise.

IFRS 9 – Financial liabilities

Financial liabilities same as IAS 39 except treatment of FV changes in own credit risk

Financial Liabilities

- Trading book & derivatives remain FV
- Default category for other financial liabilities remains amortised cost, with exception of financial liabilities which is designated at FV (i.e. Fixed rate book)

Own Credit Risk

- For financial liabilities designated at FV:
  - Marked-to-market to continue & adjustments in FV of ‘own credit risk’ will be recognised in OCI
  - Changes in FV due to other factors (e.g. benchmark interest rate) recognised in P/L
  - Nedbank designates fixed rate liabilities which are economically hedged via interest rate swaps at FVTPL. As at 30 June 2015, R49,4bn of R690,5bn of liabilities designated at FVTPL
  - FV movement recognised in NIR for 2014 financial year – R38m unrealised loss
  - Portion attributable to changes in ‘own credit risk’ – R6m unrealised gain

IFRS 9 – Hedge accounting

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Hedge accounting not expected to have material effect for Nedbank

- Current immaterial hedge book at Nedbank (Approximately R400m hedged)
- Nedbank's hedge account in compliance with IAS 39 & IFRS 9
    - Note: Main difference is IFRS 9 eliminates the arbitrary 80% - 125% effectiveness test & aligns hedge designation with risk management practices

IFRS 9 excluded Macro Hedging & allows deferral of hedge accounting

- Macro Hedging allows the hedging of net positions / portfolio positions with derivatives as opposed to current requirements of one-to-one hedging (ie: designated asset/liability and derivative exposure).
- Macro Hedging would be more aligned with risk practices, and could reduce the requirement for designation at fair value of fixed rate book.
- Macro Hedging exposure draft has not been issued and longer road to finalisation
- IFRS 9 allows the deferral of Hedge Accounting (ie continue with IAS 39 principles) until Macro hedging is available so as not to comply with interim measures before Macro Hedging rules are finalised. Most financial institutions, like Nedbank, are considering adopting the deferral option.

IFRS 9 – Disclosure

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Quantitative

- Reconciliation of opening to closing amounts of loss allowance showing key drivers of change
- Write off, recoveries, & modifications of loan agreements (ie forbearance or restructures)
- Reconciliation of opening to closing amounts of gross carrying amounts showing key drivers of change
- Gross carrying amounts per individual credit risk grade

Qualitative

- Inputs, assumptions & estimation techniques for estimating ECL
- Write off policies, modification policies & collateral
- Inputs, assumptions & estimation techniques to determine significant increases in credit risk & default
- Inputs, assumptions & techniques to determine credit impaired

- Significant data required to meet new disclosure requirements
- Need to balance between data / compliance reporting vs being useful & meaningful to users of financial statements
- Need to consider impacts of OCI movements on key ratios (NAV) & location of fair value reporting in NIR (P/L) & Reserves (OCI).

IFRS 9 – Alignment to regulatory guidelines

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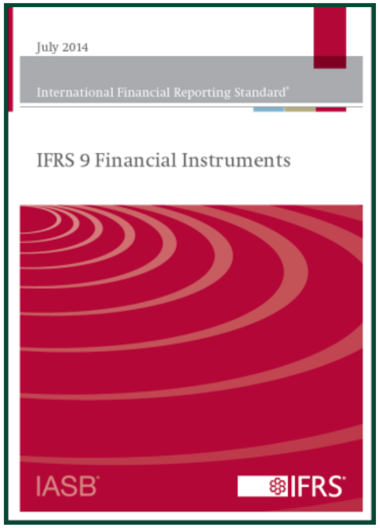
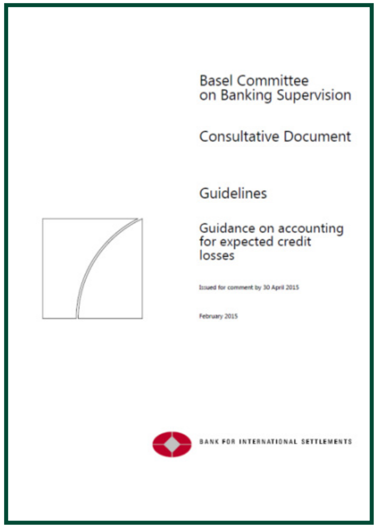
IFRS 9 Financial Instruments



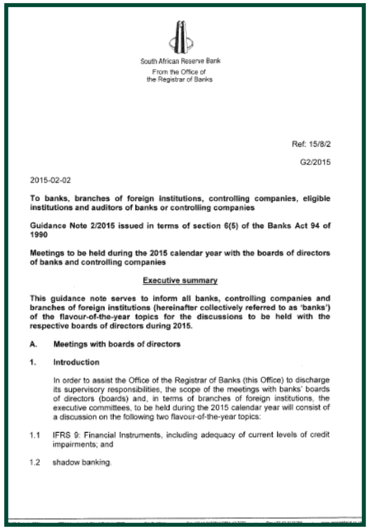
Finalised July 2014

BCBS guidance on accounting for Expected Credit Losses



Issued February 2015

SARB Guidance note 2/2015



South African Reserve Bank
From the Office of the Registrar of Banks

Ref: 15/8/2

G2/2015

2015-02-02

To banks, branches of foreign institutions, controlling companies, eligible institutions and auditors of banks or controlling companies

Guidance Note 2/2015 issued in terms of section 6(5) of the Banks Act 94 of 1990

Meetings to be held during the 2015 calendar year with the boards of directors of banks and controlling companies

Executive summary

This guidance note serves to inform all banks, controlling companies and branches of foreign institutions (hereinafter collectively referred to as 'banks') of the flavour-of-the-year topics for the discussions to be held with the respective boards of directors during 2015.

A. Meetings with boards of directors

1. Introduction

In order to assist the Office of the Registrar of Banks (this Office) to discharge its supervisory responsibilities, the scope of the meetings with banks' boards of directors (boards) and, in terms of branches of foreign institutions, the executive committees, to be held during the 2015 calendar year will consist of a discussion on the following two flavour-of-the-year topics:

1.1 IFRS 9: Financial Instruments, including adequacy of current levels of credit impairments; and

1.2 shadow banking.

Issued February 2015

Key extracts

"… expects banks to disclose similarities and differences in the methodology, data and assumptions used in measuring ECL for accounting purposes and expected losses for regulatory capital adequacy purposes."

"…, the Committee expects banks to develop systems and processes to use all reasonable and supportable information needed to achieve a high-quality, robust and consistent implementation of the approach."

"… view significant reliance on past due information (such as using the rebuttable presumption…) as a very low-quality implementation of an ECL model."

"…consideration of forward-looking information and macro-economic factors is essential to the proper implementation of an ECL accounting model."

Topics for discussion during SARB/ Board meeting

"Design of systems and processes to incorporate the changes (including the associated cost impact thereof)."

"Enhancements required to existing AIRB models…."

"Degree of integration among various divisions such as finance, risk and economists etc., as a result of IFRS 9."

"An initial impact assessment by the bank on its financial position, based on initial investigations ."

IFRS 9 – Alignment to regulatory guidelines

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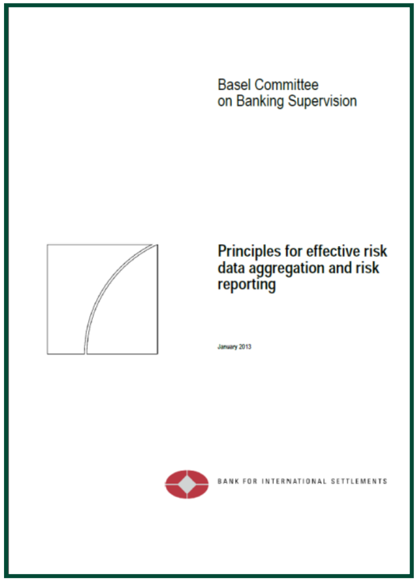
BCBS PRINCIPLES ON ACCOUNTING FOR EXPECTED CREDIT LOSSES

1	A bank's **board of directors** and senior management are responsible for appropriate **credit risk practices**, including internal controls to consistently determine allowances
2	A bank should have **methodologies** for assessing and measuring the level of credit risk on all exposures, with timely **measurement** of allowances building upon them
3	A bank should have **a process** in place to appropriately **group lending exposures** on the basis of shared credit risk characteristics
4	A bank's aggregate amount of allowances, should be **adequate** as defined by the Basel Core Principles, which is consistent with the objectives of IRFS9
5	A bank should have policies and procedures in place to **appropriately validate its internal credit risk assessment models**
6	A bank's use of **experienced credit judgment**, especially in the consideration of **forward-looking** information and **macro-economic factors**, is essential to ECL measurement
7	A bank should have, via its credit risk process, a strong basis for **common systems, tools and data** to assess and price credit risk, and account for ECL
8	A bank's public **reporting** should promote transparency and comparability by providing timely, relevant and decision-useful information

BCBS 239: "Principles for Effective Risk Data Aggregation and Risk Reporting" (RDARR)


Basel Committee
on Banking Supervision

Principles for effective risk data aggregation and risk reporting

January 2013

BANK FOR INTERNATIONAL SETTLEMENTS

Issued January 2013

Nedbank's Enterprise Data Programme (EDP), which incorporates BCBS 239: RDARR compliance, will significantly contribute to a high quality IFRS 9 implementation

Source: Basel Committee on Banking Supervision, Consultative Document , *Guidance on accounting for expected credit losses*, paragraphs:
1. 78, 2. A49, 3. A59, 4. 60

IFRS 9 – Group wide programme across all entities

>96% of Nedbank's impairments raised against portfolios on AIRB approach

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- **Nedbank Ltd solo** — > 95%
- **London branch** — 1,4%
- **Non-regulated entities** — 1,0%
- **Rest of Africa subsidiaries** — 2,3%
- **Nedbank Wealth International** — < 1%

Subject to AIRB Approach (Nedbank Ltd solo, London branch, Non-regulated entities)

Subject to Standardised Approach (Rest of Africa subsidiaries, Nedbank Wealth International)

High Basel III AIRB coverage provides sound foundation for development of IFRS 9 models & covers majority of group's portfolio (96%)

Alternative approaches will be developed for the remaining portfolios (non-SA), currently subject to Standardised Approach (approximately 4%)

Percentage of group balance sheet impairments

IFRS 9 – Changes & enhancements to existing AIRB models & approach for the Standardised portfolios

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- **Similar to other banks (refer Deloitte's international IFRS 9 survey), Nedbank is using its existing AIRB Basel models as the base for developing IFRS 9 models (for Nedbank Limited)**
  - A **'dual calibration'** approach has been followed using same model per portfolio / asset class
  - Ensures greater consistency between Basel & IFRS 9
    - Provides easily reconcilable inputs for capital (Regulatory Capital & Economic Capital) & impairment requirements
    - Maintain one set of models
  - Consistent independent validation rules can be applied across Regulatory Capital & impairments
- **Approximately 4% of group balance sheet impairments is subject to The Standardised Approach**
  - A simplified approach is under investigation for these portfolios
  - All portfolios where a suitable AIRB model currently exists can follow a similar approach to AIRB portfolios
  - For Retail portfolios in Rest of Africa: Subsidiaries & Wealth International, a delinquency based approach (to derive IFRS 9 stage classifications) is under consideration
  - All these approaches are currently under discussion with our external auditors

IFRS 9 – Practical / system implementation

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Changes and enhancements to existing AIRB models, & Data considerations

- Many of the data requirements are similar to that of the Basel models

PD models
- PD term structure to derive lifetime ECL measure
- Calibration periods (prior to macro-economic adjustments) may be shortened to reflect structural changes

High impact

LGD models
- LGD term structure to derive lifetime ECL measure (reflecting future changes in collateral values and EAD)
- Remove downturn adjustments
- Remove costs
- Different discount rates based on effective interest rates
- Balance weighted averages

Impact varies by asset class/product (e.g. high for secured lending)

EAD models
- EAD term structure to derive lifetime ECL measure (reflecting repayments and early settlements)
- Balance weighted averages
- EAD does not need to be floored at current exposure (e.g. instalment products)

Low impact expected

Macro-economic forward looking forecast overlays
(new feature - not allowed for Basel purposes due to TTC/ Downturn regcap requirements)

- Most of the Data requirements are similar
- However, there are some key additional Data requirements for IFRS 9
  - All risk parameters need to be regressed against macro-economic factors to ascertain forward looking macro-economic relationships
  - IFRS 9's lifetime loss feature requires estimates beyond a 12-month time horizon
    - Additional information regarding multi-year default rates or long term depreciation rates (e.g. collateral values for vehicle finance)
  - Other risk information used for (non-Basel) risk management purposes (e.g. clients' prepayment behaviour)

IFRS 9 – Key differences in IFRS 9 requirements

- IFRS 9 distinguishes between three different “stages”:
  - **Stage 1:** Performing loans *without* significant increase in credit risk since inception
  - **Stage 2:** Performing loans *with* significant increase in credit risk since inception
  - **Stage 3:** Defaulted loans → no material impact expected from IAS 39, except focus on probability weighted outcomes (e.g. cure vs. liquidation) may require some refinements of the existing approaches
- Migrating from Stage 1 to Stage 2 will have a material impact on impairments as lifetime expected losses (beyond a 12-month time horizon) have to be covered:

“Impairments” is history…. “Expected Credit Losses” is the new language

12-month expected credit losses

Stage 1

Transfer
if the credit risk on the financial asset has increased significantly since initial recognition

Move back
if transfer condition above is no longer met

Lifetime expected credit losses

Stage 2

Source: KPMG

IFRS 9 – Key differences in IFRS 9 requirements

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Key parameters	Basel III	IAS 39	IFRS 9
PDs			
Intention of estimate	▪ Average estimate of default within next 12 months	▪ Best estimate of likelihood and timing of credit losses over the loss identification period	▪ **12-month or lifetime ECL** depending on credit quality of the asset (including fully performing loans)
Period of measurement	▪ Long-run historical average over whole economic cycle – TTC	▪ Should reflect current economic conditions – point-in-time (PIT)	▪ Reflects current and **future economic cycles** to the extent relevant to the remaining life of the loan on a PIT basis
LGDs			
Intention of estimate	▪ Average estimate of the discounted value of post-default recoveries	▪ Current estimate of the discounted value of post-default recoveries	▪ Estimate of the discounted value of post-default recoveries. The measurement period is dependent on the relevant performance of the asset
Treatment of collection costs	▪ Recoveries net of direct and indirect collection costs	▪ Recoveries net of direct cash collection costs only	▪ Recoveries net of direct cash collection costs only
Discount rate	▪ Recoveries discounted using the bank's COE	▪ Cashflows discounted using instrument's original effective interest rate	▪ Cashflows are discounted at a discount rate which approximates the original effective interest rate. This discount rate is not changed because of impairment
Period of measurement	▪ Reflects period of high credit losses ▪ dLGDs required	▪ Should reflect current economic conditions – PIT	▪ Reflects current and **future economic cycles** to the extent relevant to the remaining life of the loan ▪ Should reflect current economic conditions (PIT) as well as the expected impact of future macro-economic conditions
EL			
Basis of exposure	▪ **Based on EAD**, which includes unutilised and contingent facilities	▪ Based on actual exposure (on-balance-sheet)	▪ **Based on EAD**, which includes unutilised and contingent facilities

The key difference is moving from a backward-looking “incurred loss” approach to a forward-looking “expected loss” approach

IFRS 9 – Accounting for the three stage model

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Change in credit quality since initial recognition

Stage 1	Stage 2	Stage 3
12 month expected credit losses (Expected credit losses that result from default events that are possible within 12 months)	**Lifetime expected credit losses** (Lifetime expected credit losses that result from possible default events over the life of the financial instrument)	**Lifetime expected credit losses (100% PD)** (Defaulted loans that result from possible default events over the life of the financial instrument)
Performing (Initial recognition*)	***Underperforming*** (Assets with significant increase in credit risk since initial recognition & not low credit risk*)	***Non-performing*** (Credit impaired assets No significant changes since IAS39)
Portfolio impairments	*Portfolio impairments*	*Specific impairments*

Recognition of expected credit losses (applies to the rows above)

Interest revenue

Effective interest on gross carrying amount	**Effective interest on gross carrying amount**	**Effective interest on amortised cost carrying amount** (i.e. net of credit allowance)

**Except for purchased or originated credit impaired assets*

IFRS 9 – Stage 1 to 2 to 3 migration factors

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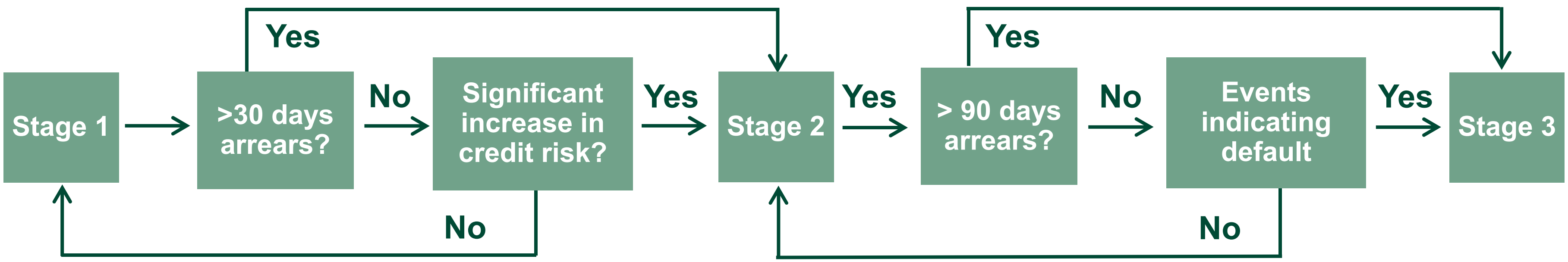


Stage 2: Indicators of a significant increase in credit risk

- An increase larger than a specified threshold in the average lifetime PD over the remaining life of the financial instrument
- The lifetime PD shall be adjusted for the macro-economic outlook over the short to medium term (1 to 5 years)
- Credit measures such as warning signals and watch lists in Wholesale result in a reassessment of the credit rating
- A tiered threshold approach based on NGR ratings
- For Retail, delinquency on obligations with Nedbank or on bureau profiles will trigger stage transition

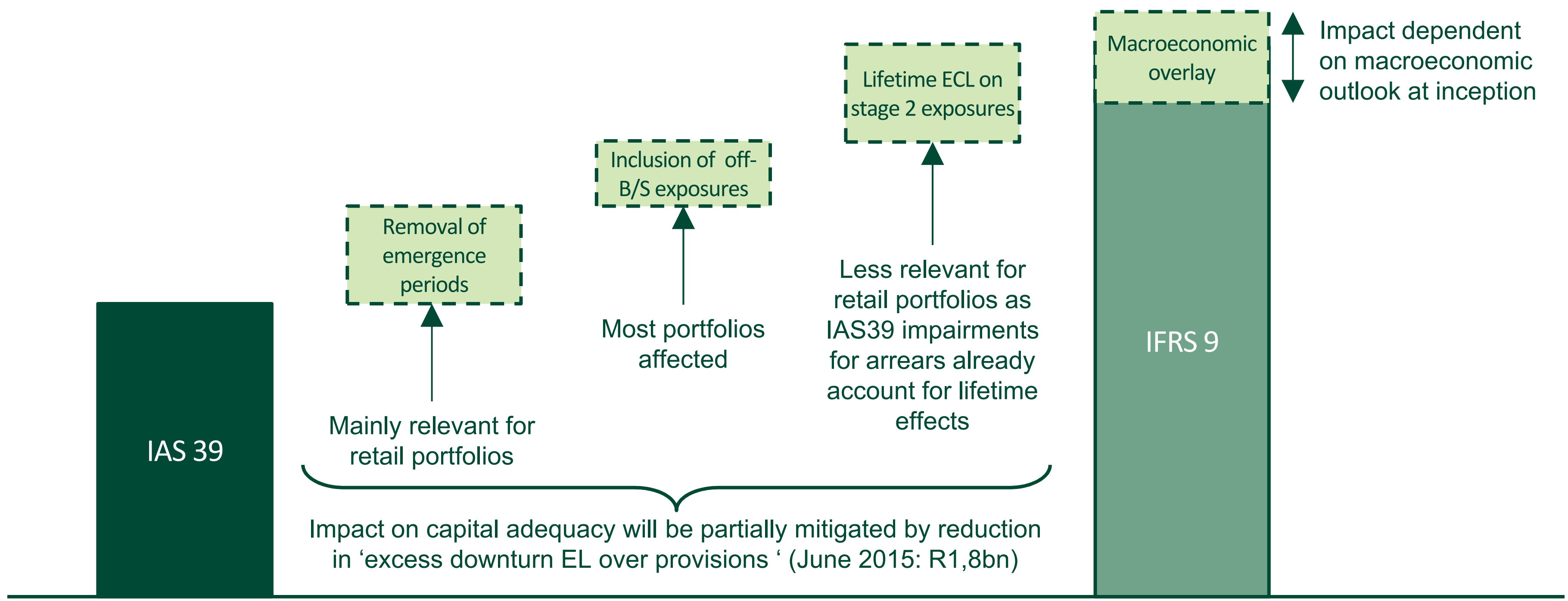
… with 30 days past due rebuttable presumption

Stage 3: Events indicating default

- Bankruptcy or financial reorganisation
- Breach of contract (past due / default)
- Borrower in significant financial difficulty
- Lender concession to borrower
- Disappearance of active market for financial asset
- Purchase of financial asset at deep discount reflecting incurred credit losses

… with 90 days past due rebuttable presumption

IFRS 9 – Drivers of impact on balance sheet impairments at inception (portfolio impairments)

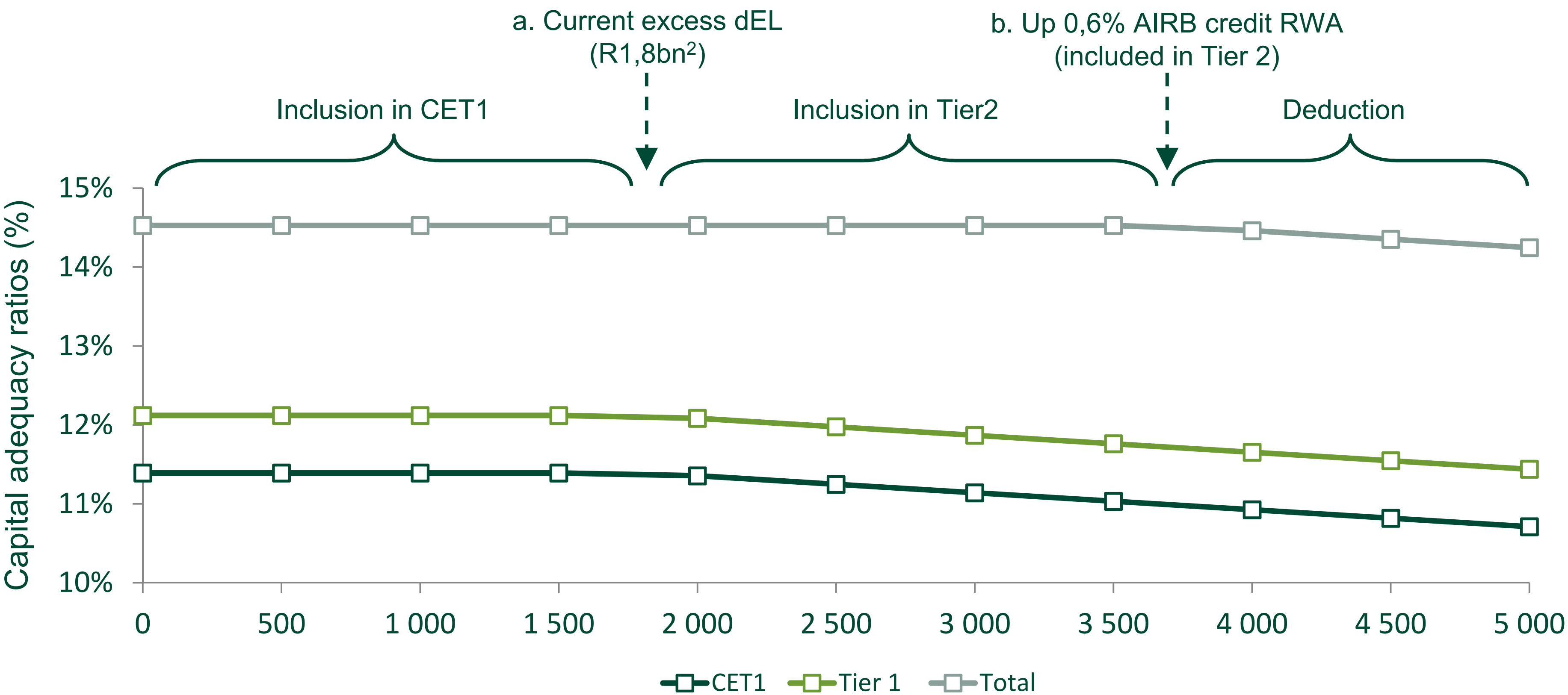


- IFRS 9 will lead to a general increase in B/S portfolio impairments & hence portfolio coverage
- Once-off impact at inception will be taken from reserves such that there is no impact on income statement
- Bank's capital adequacy ratio will only be affected by an increase in balance sheet portfolio impairments in excess of the current capital deduction due to 'excess downturn EL over provisions' (June 2015: R1,8bn)
- Actual long run average credit losses will not be affected by IFRS 9 as client defaults & subsequent recoveries are not driven by accounting standards.

Note: Illustrative impact

IFRS 9 – Impact on capital ratios on adoption

Additional balance sheet impairments required (Rm)

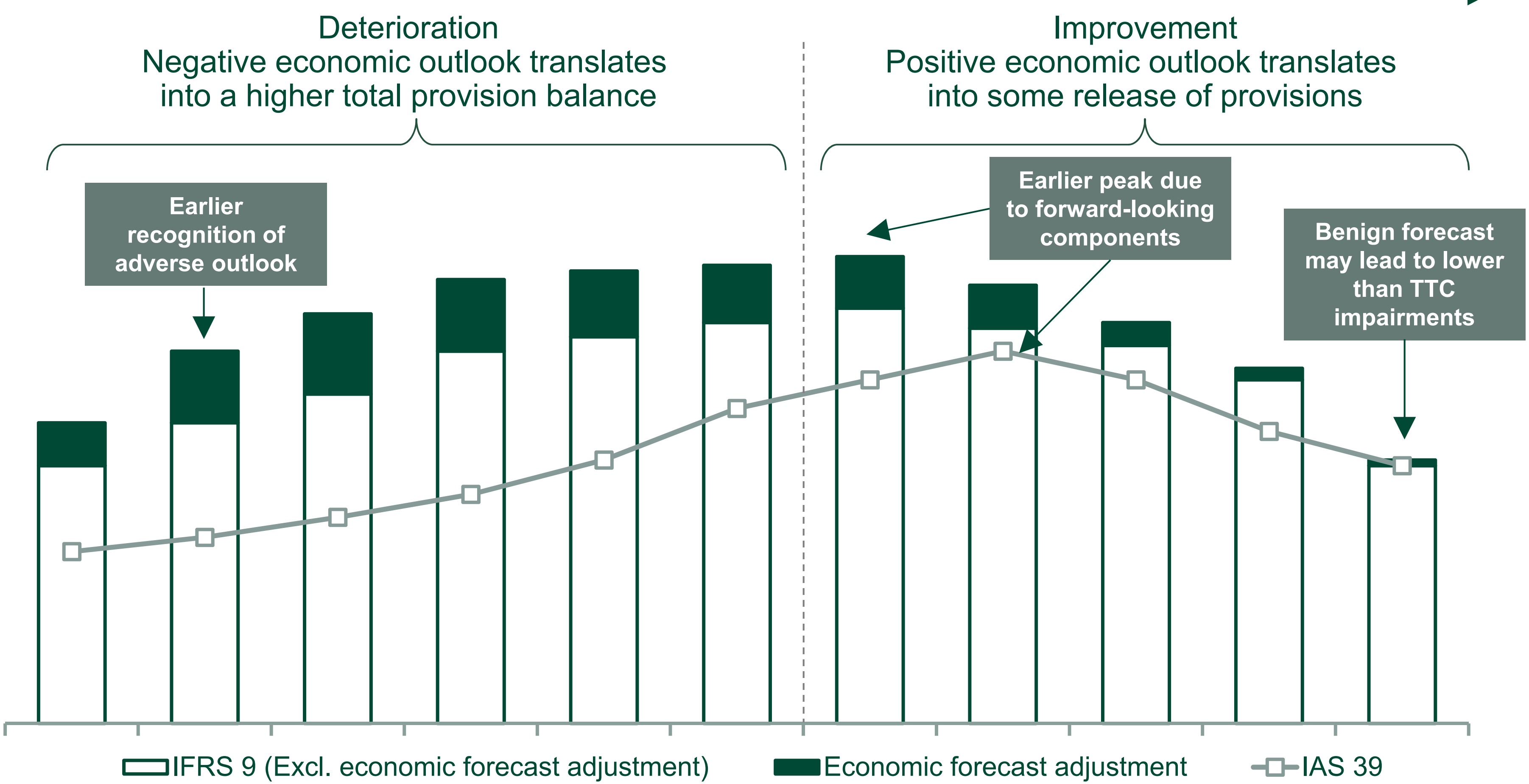


- Impact on capital ratios largely mitigated by current excess downturn expected loss (dEL) over IAS 39 provisions
  a. Current excess of dEL vs. IAS 39 provisions is required to be deducted from CET1 capital
  b. Any increase of IFRS 9 impairments up to the current dEL will not impact the CET1 ratio. Any surplus amounts can be included in Tier 2 capital up to a maximum of 0,6% of the groups AIRB credit RWA
- Awaiting impact of revised Basel treatment of accounting provisions which may impact qualifying capital

Note: Illustrative impact based on 30 June 2015 data | 2. refer p25c results booklet

IFRS 9 – Impact on portfolio provisions

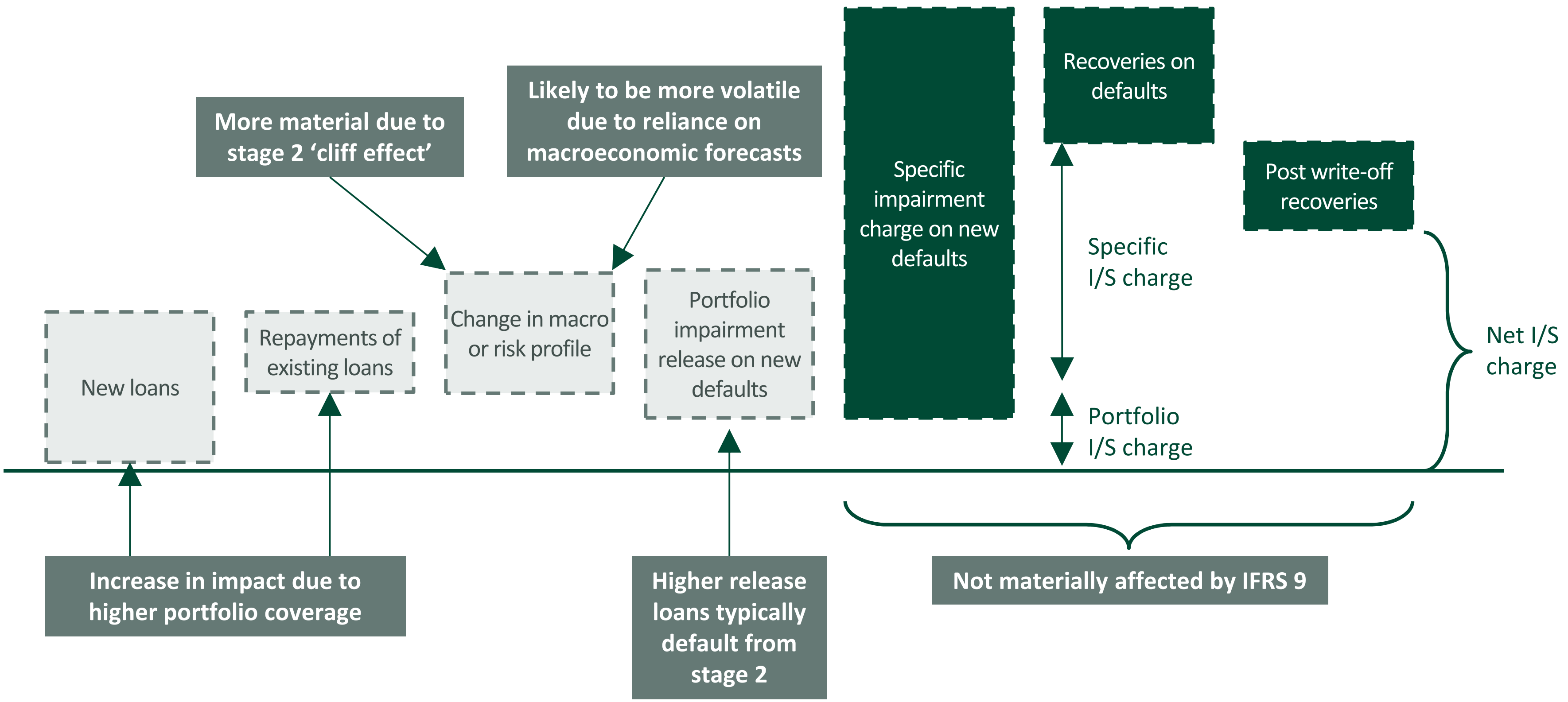
Economic cycle – Economic forecast embedded in provisioning process



Note: Illustrative impact
Source: Adapted from National Australia Bank

IFRS 9 – Impact on income statement impairments

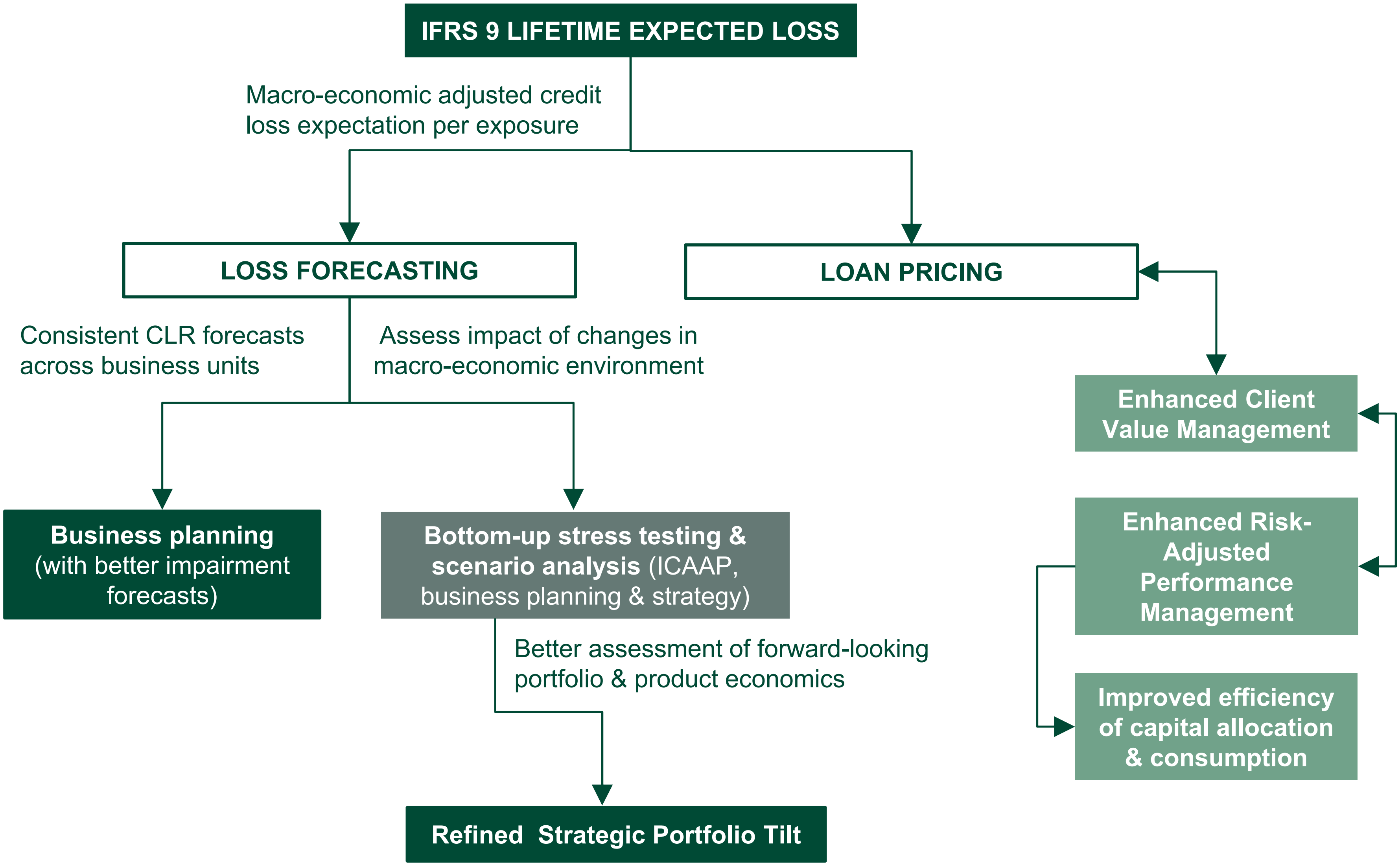
IAS 39: Build up of annual income statement charge



- Overall income statement impact over life of deal will not change however losses will be recognised earlier with potential increase in earnings volatility
- Some components likely to become slightly more volatile, in particular under changing macroeconomic environments (in both directions).

Note: Illustrative impact

IFRS 9 – Fundamentally enhance credit risk management & measurement frameworks



IFRS 9 – Where to from here?

Objective to complete IFRS 9 work by end 2016 + parallel run in 2017 = implement in 2018

2015		2016	2017	2018+
Initial assessment & planning	Foundational workstreams 1 – 6 & 12 – 16		Value-add work streams 7 - 11	
	Pilot models	All other models	▪ Parallel run (IAS 39 vs. IFRS 9) ▪ Model refinements ▪ Pre-audit of models (incl KPMG)	IFRS 9 replaces IAS 39 impairments Model maintenance

Driven by 16 work streams ranging from foundational IFRS 9 compliance to significant value-add functions & supported by comprehensive training & education programme on IFRS for 2016

1	IFRS 9 technical definitions & standards (policy)
2	Core IFRS 9 models
3	Loss forecasting & provisioning engine
4	IFRS 9 internal & external reporting (disclosure) & integration of Risk with Finance
5	Credit risk governance review and enhancements
6	Credit risk data & systems (including link with EDP & ME)
7	Forecasting, scenario analysis & stress testing upgrades
8	Strategic Portfolio Tilt, business planning & RAPM
9	Credit MI & internal reporting
10	Pricing, CVM & product design re-boot
11	Credit process & life cycle review - Retail & Wholesale
12	Strategic response to impact of IFRS 9 on BU & Group
13	Change Management
14	Quality Assurance & Audit
15	Macro-economic Forecasts
16	Programme Finance, Budgets & Benefits

Agenda

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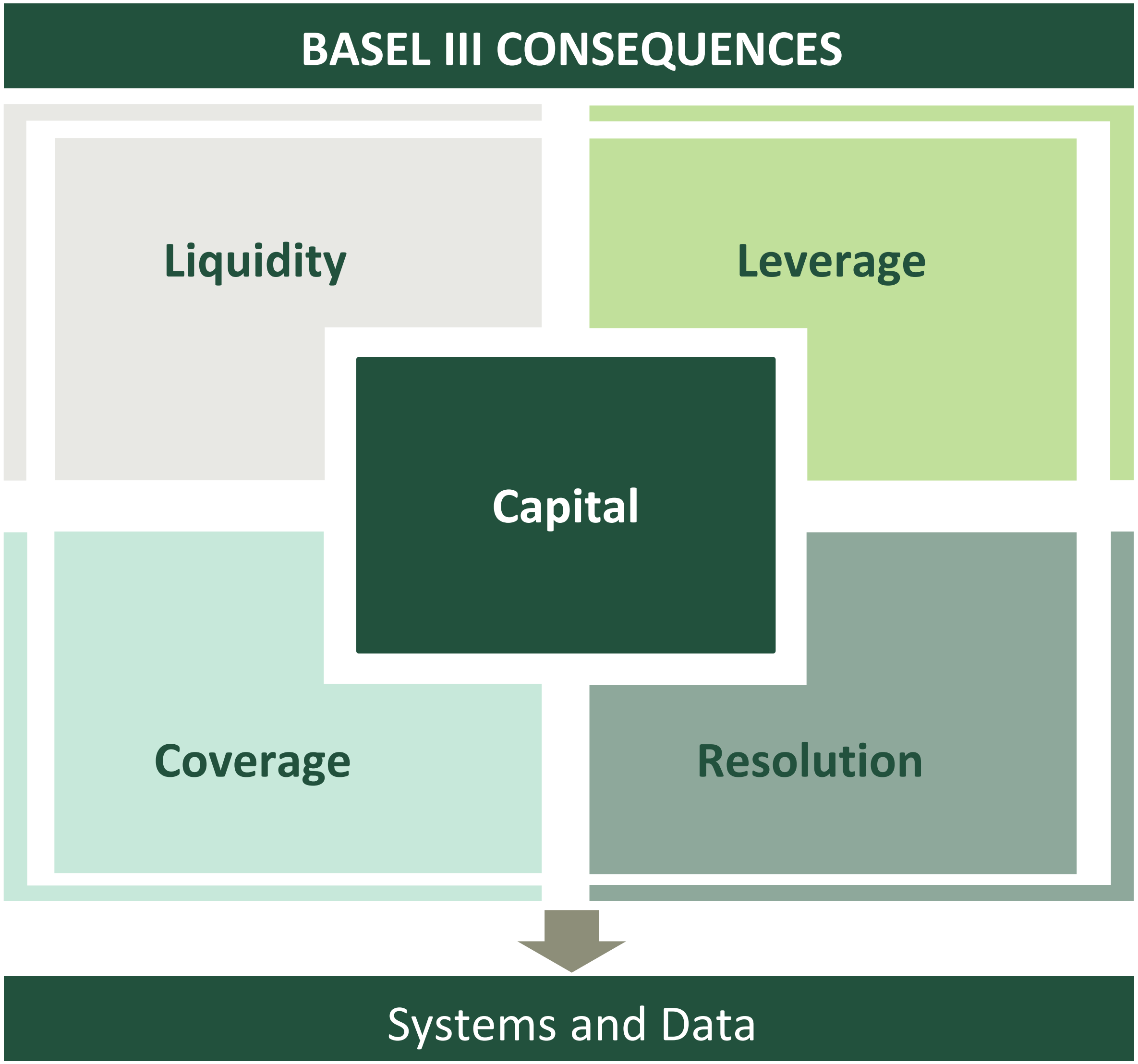
IFRS 9	▪ Overview of IFRS 9 ▪ Classification & measurement model ▪ Hedge Accounting	Raisibe Morathi
	▪ Moving from incurred to expected credit loss ▪ Impact on income statement & balance sheet	Trevor Adams
Basel III	▪ Overview of Basel III ▪ SA market context ▪ Impact on balance sheet ▪ Optimisation strategies ▪ Impact on SA banks	Mike Davis

Basel III – Consequences of implementation



Banks response through adjustments to strategy, pricing, balance sheet shape

Basel III - Overview

Basel 1 1988 | Basel 2 2008 | Basel 2.5 2009 | Basel 3 2013 | Basel 3 WIP

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December 2009 – BCBS released for consultation a package of proposals to strengthen global capital & liquidity regulation

Key areas of focus:

- Raise quality of bank capital
- Strengthen risk coverage
- Introduce measures to promote build-up of capital buffers in good times which are available for use in periods of stress (countercyclical buffers)
- Introduce a leverage ratio as a supplement to the Basel II risk-based framework
- Introduce global minimum liquidity standards:
  - Liquidity Coverage Ratio (LCR)
  - Net Stable Funding Ratio (NSFR)
- Develop recovery & resolution regimes

- December 2010 - Basel III requirements published
- January 2013 - endorsed a package of changes to the formulation of the LCR, including phase-in
- January 2014 - proposed material updates to NSFR & released LCR disclosure standards applicable from January 2015
- October 2015 - final NSFR standards released

Basel III – Impacts all components of balance sheet

KEY CHANGES ON THE ASSET SIDE

Counterparty Credit Risk

- Introduction of **additional charges** for counterparty credit exposures arising from banks' derivatives, repo and securities financing activities

New market risk and securitisation framework

- Introduction of a **stressed value-at-risk (VaR)** capital requirement
- **Increase of capital requirements** for re-securitisations in both the banking and the trading book

Liquidity Coverage Ratio (LCR)

- Introduction of a global minimum short-term liquidity standard, requiring banks to hold sufficient levels of high quality liquid assets

Selective origination on new lending

Higher pricing for new credit extension

- Closer review of remuneration policies especially in the case of weakening capital buffers

Supervisory review of new remuneration policies

Improvement of IT infrastructure and data quality

KEY CHANGES ON THE LIABILITY/CAPITAL SIDE

Net Stable Funding Ratio (NSFR)

- Introduction of a long-term structural ratio to address liquidity mismatches

Capital adequacy requirements

- Increase of the minimum Common Equity Tier 1, Tier 1 and Total Capital Adequacy requirements

Conservation/countercyclical buffer

- Introduction of additional capital conservation (2.5%) and counter-cyclical (0-2.5%) buffers to withstand future stress periods

Leverage ratio

- Introduction of a non-risk based measure of capital structure (Minimum Tier 1 ratio of 3% / SARB 4%)

Capital quality

- Requirement to form core capital predominantly through common shares and retained earnings

Capital deductions

- International harmonization of capital deductions and prudential filters (e.g. limited recognition of investments in FIs)

- Higher requirements on consistency and aggregation level
- Higher infrastructure capacity and real-time capabilities

Basel III – Impact on balance sheet & strategy

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Assets:

Optimise HQLA portfolios (Level 1 vs. Level 2 assets)

Active management of customer loan portfolios

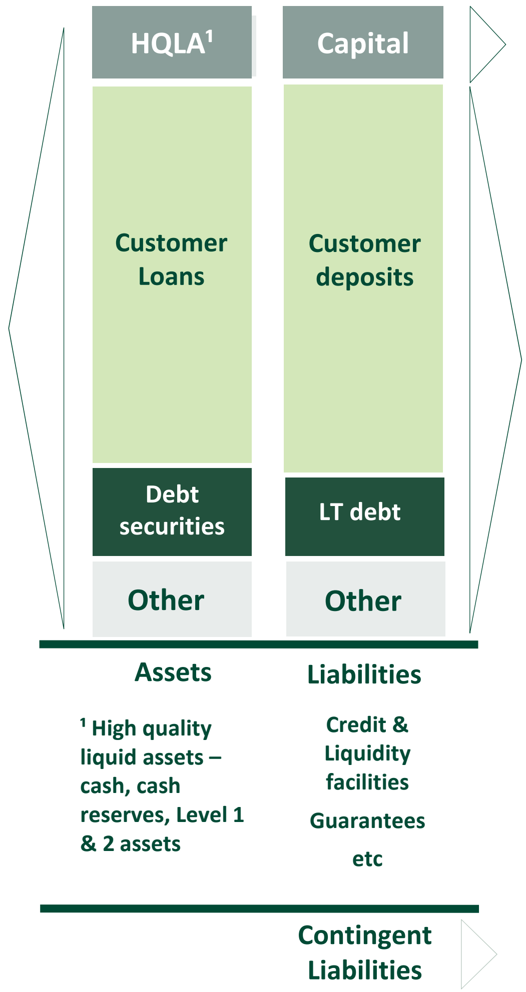
- Optimise growth in longer-term loans (selective origination)
- Price cost of liquidity buffers & increased duration into assets
- Structure commercial loans into qualifying Level 2 corporate bonds, rather than normal lending
- Strengthen risk transfer capabilities in terms of liquidity heavy assets (e.g. securitisation)

Reduce non-strategic liquidity consuming assets

- Assets ranging from fixed assets to non-strategic trading / investment assets

Asset & Liability Pricing:

Price for liquidity consumed & liquidity provided based on behavioural duration



Capital:

Higher capital levels

- Greater loss absorption, but ROE dilutive

Improved quality of capital – Focus on CET1

- New style AT1 & T2 capital fully loss absorbent as a going concern

Funding Liability:

Contractually lengthen funding profile

- DMTN/EMTN programmes, securitisation, bespoke or structured notes, covered bonds, etc
- Reduce short-term (0-30 day) financial deposits
- Innovate products with flexible duration & reduce 30 day cash outflow risk (32 day notice deposits)
- Reduce roll-down volatility in LCR / NSFR

Behaviourally lengthen funding profile

- Grow retail, SME & commercial deposits vs. non-operational, financial deposits

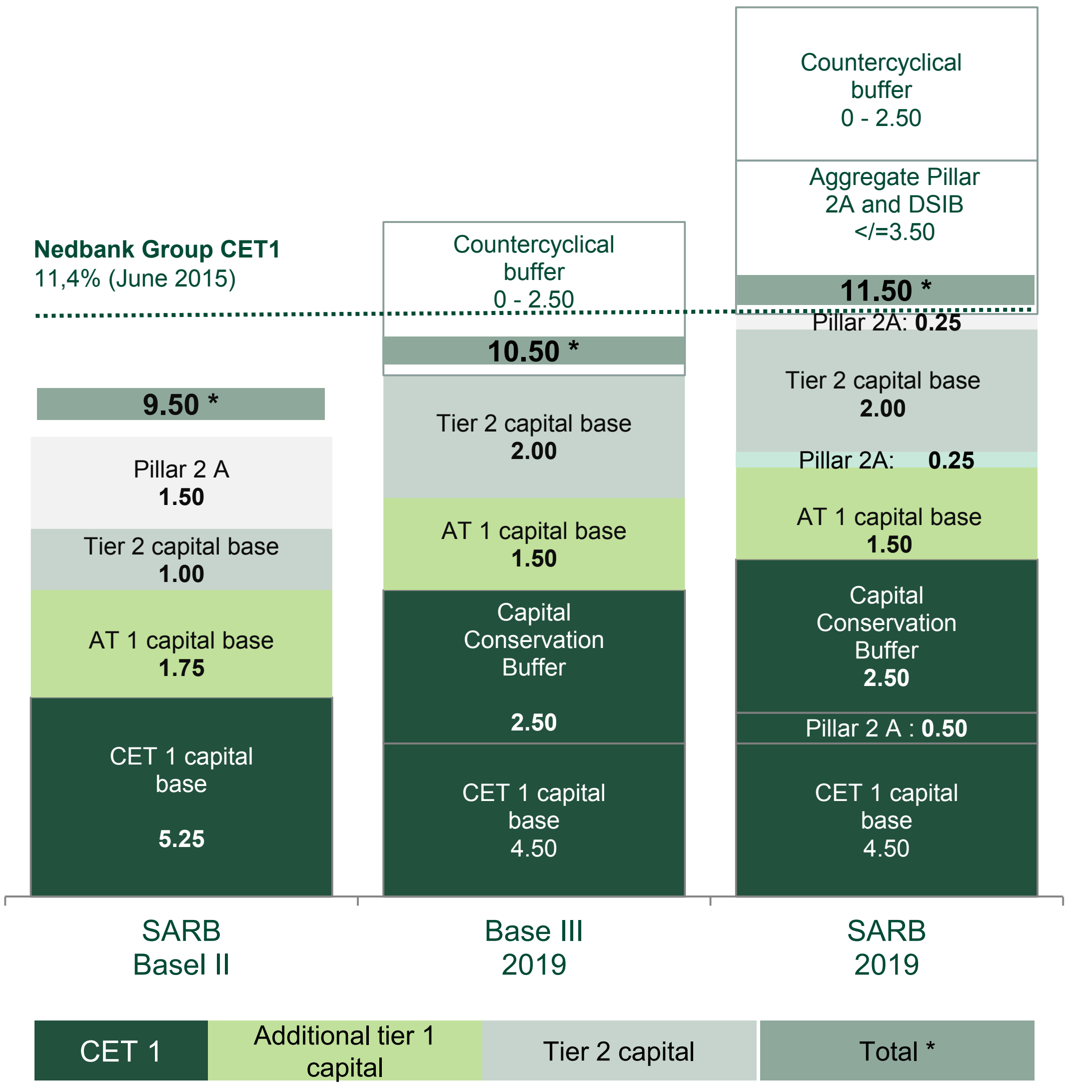
Diversify funding mix

- Diversifying by product, client, geographic region Minimise foreign currency mismatch risk

Active management of off-balance sheet risk

- Minimise liquidity facilities or at least fully price for Basel III
- Price for credit facilities in terms of Basel III

Basel III – Capital requirements & buffers



**Excluding Pillar 2B & DSIB & Countercyclical buffers for 2019*

Capital implications

- Stronger focus on common equity Tier 1 capital, being the most loss absorbent form of capital
- Capital instruments must be loss absorbent under both going & gone concern scenarios
- Additional capital buffers introduced
- Phase-out timelines on existing capital
- Phase-in timelines for new requirements
- Introduction of ‘Bail-in’ of debt

Increased **levels** & **quality** of capital

Increased **cost** of capital

Basel III – Qualifying capital changes & impact on strategy

<table>
<tr><td rowspan="3">Tier 2</td><td>Ranking</td><td colspan="2">▪ Senior to equity and AT1</td></tr>
<tr><td>Requirements</td><td>▪ May be callable after 5 years
▪ Step-up (approximately 100bps) on call date</td><td>▪ May be callable after 5 years
▪ No step-up and no incentive to redeem
▪ T&C’s must provide for conversion or write-off at Point of Non-viability
  ▪ Non-viability: the earlier of (i) a decision that a write-off, without which the bank or controlling company would become non-viable, is necessary, as determined by the Registrar or (ii) the decision to make a public sector injection of capital, or equivalent support, without which the bank or controlling company would have become non-viable, as determined by the Registrar
  ▪ The T&C’S of the instruments can state that once the statutory legislation for the South African recovery and resolution regime becomes enforceable, it then replaces the contractual T&C’s</td></tr>
<tr><td>Grandfathering</td><td colspan="2">▪ “Old style” Tier 2 capital instruments are to be phased-out at 10% p.a. w.e.f. 1 Jan 2013</td></tr>
</table>

<table>
<tr><td rowspan="3">Additional Tier 1</td><td>Ranking</td><td colspan="2">▪ Senior only to equity</td></tr>
<tr><td>Requirements</td><td>▪ Perpetual, with call option after 5 years plus one day (or more)
▪ Step-up on call date</td><td>▪ Perpetual, with call option after 5 years plus one day (or more), subject to SARB consent
▪ No step-up and no incentive to redeem
▪ T&C’s must provide going concern loss absorption through conversion or write-off at the trigger level:
For equity accounted instruments:
Trigger level: As per Tier 2 Non-viability Event above
For liability accounted instruments:
Trigger Level: The earlier of Non-viability (see Tier 2 above) and 5.875% CET1</td></tr>
<tr><td>Grandfathering
(Base impact)</td><td colspan="2">▪ Existing Additional Tier 1 capital instruments are to be phased-out at 10% p.a. w.e.f. 1 Jan 2013
▪ Exception: Existing Hybrid Debt phased out by end 2014</td></tr>
</table>

Basel III – Leverage Ratio & impact

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Basel III leverage ratio of >3%	
$\dfrac{\text{Tier 1 capital}}{\text{Total assets + off-balance sheet (OBS) items}}$	≥ 3%
$\dfrac{\text{Total assets + off-balance sheet (OBS) items}}{\text{Tier 1 capital}}$	≤ 33.3x

SARB leverage ratio of >4%	
$\dfrac{\text{Tier 1 capital}}{\text{Non-risk sensitive exposure + off-balance sheet (OBS) items}}$	≥ 4%
$\dfrac{\text{Non-risk sensitive exposure + off-balance sheet (OBS) items}}{\text{Tier 1 capital}}$	≤ 25.0x

- Nedbank Group leverage ratio at 6,3% at June 2015 vs. internal risk appetite range of >5%
- Currently Tier 1-based (not Common Equity Tier 1)
- Calculated as average leverage ratio per quarter (monthly average)
- Reporting from 2013-2015, disclosure 2015, Pillar I requirement from 2018
  - SARB Regulation observation: 1 January 2013 - 31 December 2017, requirement from 1 January 2018

Impact

- Limited impact of Leverage on Nedbank as SA banks not over-geared
- Focus on offering & pricing off-balance sheet products & facilities

Basel III – Liquidity Coverage Ratio & Net Stable Funding Ratio

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Liquidity Coverage Ratio (LCR):

- The LCR identifies the amount of unencumbered, high quality liquid assets (HQLA) a bank must hold in order to fund the cumulative net cash outflows (NCOF) it would encounter under an acute short-term (30-day) stress scenario

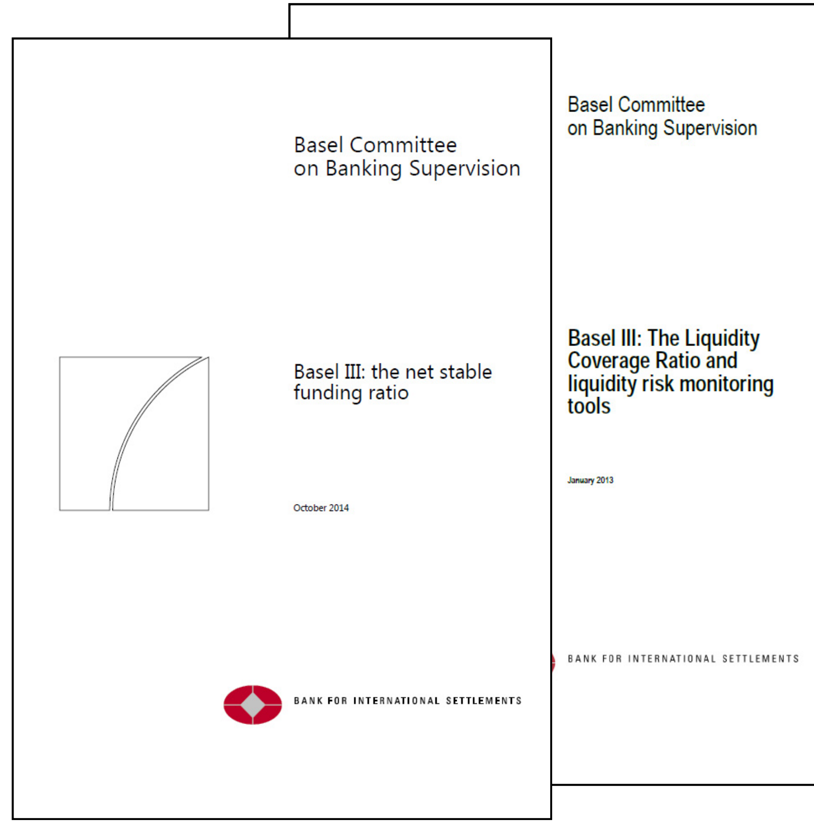
$$\text{LCR} = \frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflows over a 30-day time period}} \geq 100\%$$

Net Stable Funding Ratio (NSFR):

- The NSFR is defined as the amount of available stable funding (ASF) relative to the amount of required stable funding (RSF)

$$\text{NSFR} = \frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq 100\%$$

- The NSFR is a structural or long-term ratio designed to be applied by banks under normal or business-as-usual market conditions, where maturity transformation is limited to the extent that a bank funds itself using short-term and / or less stable funding


Basel Committee on Banking Supervision

Basel III: the net stable funding ratio

October 2014

BANK FOR INTERNATIONAL SETTLEMENTS

Basel Committee on Banking Supervision

Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools

January 2013

BANK FOR INTERNATIONAL SETTLEMENTS

Basel III - Transition Period:

- Basel has provided for a transition period to full compliance. Nedbank LCR at 76,3% at June 2015

Transition Period	2015	2016	2017	2018	2019
Liquidity Coverage Ratio (LCR) %	60	70 (76,3)*	80	90	100
Net Stable Funding Ratio (NSFR) %	Observation period			Introduce minimum standard	

Compliance requirements

* *Nedbank LCR at 30 June 2015*

Basel III – SA market context

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Favourable Factors

- **Closed Rand system** where large commercial banks are the clearing banks
  - Rand liquidity cannot leave the banking system (unlike the Eurozone)
  - The location of liquidity is transparent within the system at all times
  - Non-Rand lending is not material
  - Cross border/ foreign sector funding is low
- **SA banks proportionally higher common equity tier 1 capital** levels vs. many international banks
  - The conservative capital structure (more loss absorbing permanent capital) should be considered within overall liquidity risk management framework
- SA fully embraced the principles of Basel II & III by adopting a robust risk management approach
- **Legislation such as National Credit Act (NCA) reduces systemic risk** & need for oversized liquidity buffers

Less Favourable Factors

- **Low household savings** driven by a preference for consumption over savings
  - A bias towards contractual savings in pension & provident funds, with regulatory asymmetries which have contributed to higher wholesale funding in the banking system
- Relatively **small domestic capital markets** in the context of Basel III requirements
- **Expensive off-shore markets** constrained by overall appetite for emerging market paper
- **Depositor liquidity preferences biased towards short-term deposits** (including regulations which limit the structural duration of domestic money market funds)
- **Insufficient pool of liquid assets**

Basel III – Impact of LCR & NSFR on SA markets

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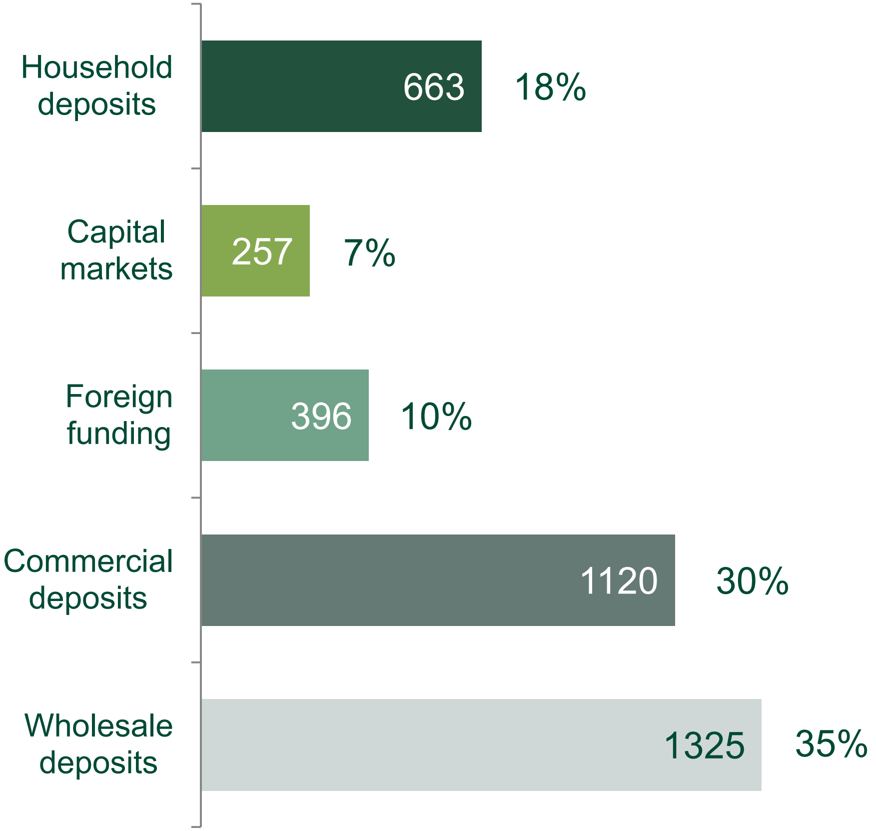
Structural funding composition of total R3,8tn market (June 2015)

Funding Mix (Rbn)
Total Funding Base (%)



Basel III implications

LCR Positive /
LCR Negative

LCR: run-off **10%** / NSFR: ASF factor **90%**

LCR: run-off **0%** / NSFR: ASF factor **100%**
For longer dated funding

LCR: run-off **25%** to **40%** / NSFR: ASF factor **50%**
Depending on operational nature of relationship

LCR: run-off **25%** to **40%** / NSFR: ASF factor **50%**
Depending on operational nature of relationship

LCR: run-off **25%** to **100%** / NSFR: ASF factor **0%**
Depending on operational nature of relationship

Basel III – LCR
High Quality Liquid Assets

$$\text{LCR} = \frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflows over a 30-day time period}} \geq 100\%$$

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- HQLA's are assets which can easily and immediately be converted into cash at little or no loss of value
- HQLA's must exhibit the following **fundamental characteristics**:

  a) **Low risk / high credit quality**
  - Low risk and high credit quality assets are typically easier to convert into cash

  b) **Ease and certainty of value**
  - Assets must be standardised, homogenous and simply structured debt instruments

  c) **Low correlation with risky assets**
  - HQLA should not be subject to wrong-way risk (i.e. loss of value and liquidity should not be correlated to financial market stress)

- **Listed on a recognised Exchange**
- HQLA's must exhibit the following **market characteristics**:

  a) **Active and sizeable market**
  - It should be evident based on historical data that there is both market depth and breadth in terms of the assets ability to trade

  b) **Low volatility**
  - Relative to other assets these assets should be less prone to market volatility

  c) **Flight to quality**
  - There should be a tendency to move into these assets in a systemic crisis

High Quality Liquid Asset Portfolio (HQLA)		
Asset-type	**Min / Max % of HQLA**	**Weighting Factor**
Level 1 asset Coins & notes Central bank reserves Treasury Bills Central bank debentures Government bonds	**Min 60%**	**100%**
Level 2 A assets Sovereign & Public Sector assets (Risk weight ≤ 20%)[1] Corporate securities AA- or higher Covered bonds AA- or higher	**Max 40%**	**85%**
Level 2 B assets RMBS Corporate securities A+ to BBB- Listed equities	**Max 15%**	**75%** **50%** **50%**
Committed liquidity facility	**Max 40%**	**100%**

The Committed Liquidity Facility (CLF)

Given structural shortage of level 2 assets in SA SARB has undertaken (Guidance Note 08/2014) to provide banks with a committed liquidity facility for up to 40% of HQLA

[1]The risk weights are as per the Basel II standardised approach to credit risk.

Basel III – LCR
Net Cash Outflows

$$\text{LCR} = \frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflows over a 30-day time period}} \geq 100\%$$

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- NCOF's are defined as the cumulative net cash outflows that a bank could encounter under an acute short-term (30 day) stress scenario
- NCOF's reflect the net difference between:
  - cash outflows linked to deposits, unsecured & secured funding together with other liabilities, and
  - cash inflows linked to secured lending, loans & advances and other assets,

  over a cumulative 30 day period
- Retail & SME customers are assumed to have the lowest propensity to withdraw deposits under a stress scenario (LCR run-off 10%)
- Non-Financial Commercial depositors and Financial Wholesale depositors with Operational Relationships are deemed to have a lower propensity to withdrawal deposits (LCR run-off 25%) than those same customers without Operational Relationships (LCR run-off between 40% and 100%)
- Financial Wholesale depositors without Operational Relationships are assumed to have the highest propensity to withdraw deposits (LCR run-off 100%)

NCOF 0 to 30 Days		
Client-type / Tenor	**LCR Positive / LCR Negative**	**Run-off Factor**
Cash Outflows		**< 30 days**
Deposit outflows		
Retail & SME deposits		10%
Operational deposits	(Defined on page 13)	25%
Non-operational deposits: Non-financial commercial deposits		40%
Non-operational deposits : Financial wholesale deposits		100%
Unsecured funding outflows		
Capital market instruments		100%
Secured funding outflows		
Level 1 assets repo (sell / buy) Level 2 assets repo (sell / buy)		0% 15%
Other outflows		
Derivatives & other outflows		100%
Committed/Uncommitted credit & liquidity facilities		5% to 10%
Cash Inflows		**< 30 days**
Secured lending inflows		
Level 1 assets reverse repo (buy/ sell) Level 2 assets reverse repo (buy/sell)		0% 15%
Other inflows		
Retail & commercial entity loans & advances Financial entity loans & advances		50% 100%
Derivative & other inflows		100%

Basel III – LCR composition

High Quality Liquid Assets (HQLA)		Weighting Factor
Level 1 asset	**LCR Positive / LCR Negative**	**100%**
Level 2 A assets		**85%**
Level 2 B assets		**25% to 50%**
Committed liquidity facility		**100%**
Net Cash Outflows (NCOF) 0 to 30 Days		**Run-off Factor**
Cash outflows		
Deposit outflows	**LCR Positive / LCR Negative**	
Retail & SME deposits		**10%**
Operational deposits		**25%**
Non-operational deposits: Non-financial commercial deposits		**40%**
Non-operational deposits : Financial wholesale deposits		**100%**
Unsecured funding outflows		
Capital market instruments		**100%**
Secured funding outflows		
Secured funding - Level 1 & 2 asset repo (sell / buy)		**0% to 15%**
Other outflows		
Derivatives & other outflows		**100%**
Committed & Uncommitted credit and liquidity facilities		**5% to 10%**
Cash Inflows		
Secured lending inflows		
Secured lending - Level 1 & 2 asset reverse repo (buy/sell)		**0% to 15%**
Other inflows		
Retail, commercial & Financial entity assets		**50%** to **100%**
Derivative & other inflows		**100%**

Basel III – NSFR
Available Stable Funding

$$\text{NSFR} = \frac{\text{Available amount of stable funding (ASF)}}{\text{Required amount of stable funding (RSF)}} \geq 100\%$$

- ASF is the portion of capital & funding liabilities (including deposits / long-term capital market debt) expected to be stable out to one year
- Basel has calibrated the stability of liabilities across two dimensions:

  a) **Funding Tenor:**
  - Long-term liabilities are assumed to be more stable than short-term liabilities

  b) **Funding & Client Type**
  - Qualifying Basel III capital instruments are deemed to be the most stable source of funding
  - Retail & SME deposits are assumed to be more stable in the < 1 year bucket than deposits from non-financial commercial customers
  - Operational deposits from financial customers are as stable as non-financial commercial customers
  - Non-operational deposits from financial customers do not qualify as stable funding (ASF< 6mths 0%)

ASF Factors

Client-type / Tenor	≤ 6 mths	> 6 mths ≤ 1 year	> 1 year
Qualifying Capital	100%	100%	100%
Retail[1] & SME[2] Deposits	90%	90%	100%
Non-financial Commercial Deposits[3]	50%	50%	100%
Financial Operational Deposits[4]	50%	50%	100%
Financial Non-Operational Deposits[5]	0%	50%	100%
Repo Transactions[6]	0%	50%	100%
Other Liabilities[7]	0%	50%	100%

Funding Tenor →

Funding & Client-type ↑

NSFR Positive / NSFR Negative

BA900 Classifications:

1. Household Deposits
2. Non-financial corporates, unincorporated businesses, Non-profit organisations with deposits < R7.5m
3. Non-financial corporates, unincorporated businesses, Non-profit organisations with deposits > R7.5m and Central government, Provincial governments, Social security funds, Local government, Public non-financial corporate sector (such as Transnet, Eskom and Telkom),
4. Deposits in current & cash management transactional accounts
5. SA banks, Other monetary institutions, Public financial corporate sector (such as IDC, DBSA), Public investment Corporation (PIC), Insurers, Pension funds, Financial corporate sector (Money market funds, unit trusts, fund managers)
6. Repo's with financial entities and central banks
7. Minority interests, deferred tax, trade payables, derivative liabilities, etc.

Basel III – NSFR
Required Stable Funding

$$\text{NSFR} = \frac{\text{Available amount of stable funding (ASF)}}{\text{Required amount of stable funding (RSF)}} \geq 100\%$$

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- RSF: amount of stable funding required to support liquidity profile of a bank's assets & off-balance sheet exposures (OBEs)
- Basel has calibrated the required stable funding needed to support an asset across two dimensions:

  a) **Asset Tenor:**
  - Long-term assets require more stable funding than short-term assets

  b) **Asset Quality, Liquidity Value & Roll-over Obligations Required to Protect the Lending Franchise**
  - Assets with low credit risk weightings are easier to securitise or use as collateral for stress funding
  - Banks have greater obligations to roll-over loans to non-financial Retail, SME & corporate clients than they do to financial institutions in terms of protecting their lending franchise

The NSFR assumes that **50%** of Retail & SME loans will **roll-over** on maturity vs. **15%** for loans to Financial institutions

RSF Factors

Note this table reflects the sub-set of assets most relevant to the business clusters

Asset-type / Tenor	**≤ 6 mths**	**> 6 mths ≤ 1 year**	**> 1 year**
	Asset Tenor		
Loans to Financial institutions secured by Level 1 assets (Reverse Repos)	**10%**	**50%**	**100%**
Loans to Financial institutions	**15%**	**50%**	**100%**
Loans to Retail & SME customers (maturity < 1 year)	**50%**	**50%**	**-**
Residential Mortgages (Risk weight < 35%) [1]	**50%**	**50%**	**65%**
Loan to Non-Financial entities (Risk weight < 35%) [1]	**50%**	**50%**	**65%**
Loan to Non-financial customers (Risk weight > 35%) [1]	**50%**	**50%**	**85%**
Exchange traded equities, commodities, Initial margin against derivatives	**-**	**-**	**85%**
Non performing loans / Derivative assets	**100%**	**100%**	**100%**
All other on-balance sheet assets	**100%**	**100%**	**100%**
Off-Balance sheet obligations	**5%**	**-**	**-**

Asset quality & Liquidity value

[1]The risk weights are as per the Basel II standardised approach to credit risk. A residential mortgage with a LTV < 80% is assigned a < 35% credit risk weight and 65% RSF. A residential mortgage with a LTV > 80% is ssigned a > 35% credit risk weight and 85% RSF

NSFR Positive / **NSFR Negative**

Basel III – NSFR composition

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Client-type / Tenor	ASF		
	< 6 mths	> 6 mths < 1 Year	> 1 Year
Qualifying Capital	100%	100%	100%
Retail & SME Deposits	90%	90%	100%
Non-financial Commercial Deposits	50%	50%	100%
Financial Operational Deposits	50%	50%	100%
Financial Non-Operational Deposits	0%	50%	100%
Repo Transactions	0%	50%	100%
Other Liabilities	0%	50%	100%

Asset-type / Tenor		RSF		
		< 6 mths	> 6 mths < 1 Year	> 1 Year
Coins & notes, excess central bank reserves		0%	0%	0%
Loans to Financial institutions secured by Level 1 assets (Reverse Repos)		10%	50%	100%
Loans to Financial institutions		15%	50%	100%
Loans to Retail & SME customers (maturity < 1 year)		50%	50%	-
Residential Mortgages (Risk weight < 35%)	(LTV≤80%)	50%	50%	65%
Loan to Non-Financial entities (Risk weight < 35%)	(AAA to AA-)	50%	50%	65%
Loan to Non-financial customers (Risk weight > 35%)	(LTV>80%, A+ or less)	50%	50%	85%
Exchange traded equities, commodities, Initial margin against derivatives		-	-	85%
Non performing loans / Derivative assets		100%	100%	100%
All other on-balance sheet assets		100%	100%	100%
Off-Balance sheet obligations		5%	-	-

Basel III – LCR optimisation strategies

High Quality Liquid Assets (HQLA)	LCR Positive / LCR Negative	Weighting Factor
Level 1 asset	Increasing proportion of L1 vs. L2 assets will increase LCR, but at a higher negative carry cost to bank Trade-off needs to be managed on an instrument-by-instrument basis, however negative carry cost saving on L2 assets vs. L1 assets, will generally support increasing L2 assets up to 40% cap	100%
Level 2 A assets		85%
Level 2 B assets		25% to 50%
Committed liquidity facility		100%

Net Cash Outflows (NCOF) 0 to 30 Days		Run-off Factor
Cash outflows		
Deposit outflows	LCR Positive / LCR Negative	
Retail & SME deposits	Increase the behavioural stickiness or behavioural duration of deposits: • Replace Financial wholesale deposits with Retail, SME & Non-financial commercial deposits • Increase Operational deposits	10%
Operational deposits		25%
Non-operational deposits: Non-financial commercial deposits		40%
Non-operational deposits : Financial wholesale deposits		100%
Unsecured funding outflows		
Capital market instruments	Minimise cliff-effect of capital market roll-down	100%
Secured funding outflows		
Secured funding - Level 1 & 2 asset repo (sell / buy)		0% to 15%
Other outflows		
Derivatives & other outflows		100%
Committed & Uncommitted credit and liquidity facilities		5% to 10%
Cash Inflows		
Secured lending inflows		
Secured lending - Level 1 & 2 asset reverse repo (buy/sell)		0% to 15%
Other inflows		
Retail, commercial & Financial entity assets	Increase cash-inflows from short dated assets	50% to 100%
Derivative & other inflows		100%

Basel III – LCR optimisation strategies

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1. **Lengthen contractual deposit / funding tenor**
   - 32 day notice deposits
   - Term deposits
   - Capital market issuance

2. **Lengthen behavioural funding tenor**
   - Increase retail, SME and commercial deposits
   - Increase operational / transactional deposits

$\Big\}$ **LCR Optimisation**

LCR Deposit / Funding NCOF

LCR Positive
LCR Neutral
LCR Negative

Increase Deposit Stickiness (Behavioural Duration)

Lengthen Deposit / Funding Tenor

	< 30 days			> 30 days		
		LCR Resultant Asset Portfolio			LCR Resultant Asset Portfolio	
Deposit outflows	LCR Run-off Factor	HQLA	Loans & Advances Lending Capacity	LCR Run-off Factor	HQLA	Loans & Advances Lending Capacity
Retail & SME deposits	10%	10%	90%	0%	0%	100%
Operational deposits	25%	25%	75%	0%	0%	100%
Non-operational deposits:						
Non-financial entity deposits	40%	40%	60%	0%	0%	100%
Financial entity deposits	100%	100%	0%	0%	0%	100%
Unsecured funding outflows						
Capital market instruments	100%	100%	0%	0%	0%	100%

Basel III – NSFR optimisation strategies

1. Lengthen contractual deposit / funding tenor
2. Lengthen behavioural funding tenor (increase retail, SME. Commercial deposits, increase operational /transactional deposits)
3. Shorten asset tenor (Originate more assets with a tenor < 1 year)
4. Increase credit quality (increase proportion of assets with risk weight ≤ 35%
5. Increase liquidity quality of assets (increase the proportion of tradable assets)

NSFR Positive / NSFR Neutral / NSFR Negative

Lengthen Deposit / Funding Tenor

Increase deposit stickiness

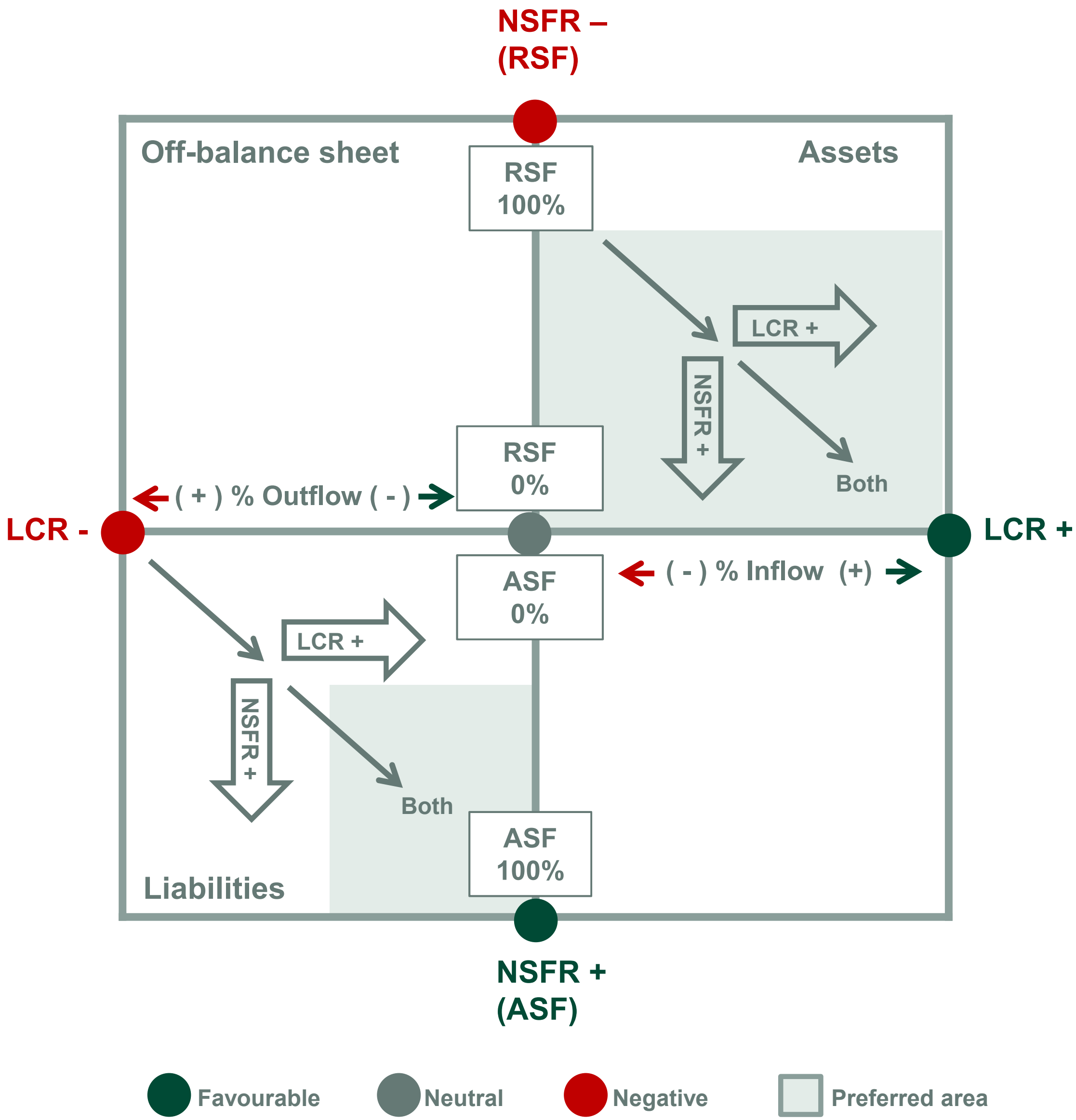
Client-type / Tenor	< 6 mths	> 6 mths / < 1 Year	> 1 Year
	ASF		
Qualifying Capital	100%	100%	100%
Retail & SME Deposits	90%	90%	100%
Non-financial Commercial Deposits	50%	50%	100%
Financial Operational Deposits	50%	50%	100%
Financial Non-Operational Deposits	0%	50%	100%
Repo Transactions	0%	50%	100%
Other Liabilities	0%	50%	100%

Shorten Asset Tenor

improve Credit &/or Liquidity Quality

Asset-type / Tenor	< 6 mths	> 6 mths / < 1 Year	> 1 Year
	RSF		
Loans to Financial institutions secured by Level 1 assets (Reverse Repos)	10%	50%	100%
Loans to Financial institutions	15%	50%	100%
Loans to Retail & SME customers (maturity < 1 year)	50%	50%	-
Residential Mortgages (Risk weight < 35%) (LTV≤80%)	50%	50%	65%
Loan to Non-Financial entities (Risk weight < 35%) (AAA to AA-)	50%	50%	65%
Loan to Non-financial customers (Risk weight > 35%) (LTV>80%, A+ or less)	50%	50%	85%
Exchange traded equities, commodities, Initial margin against derivatives	-	-	85%
Non performing loans / Derivative assets	100%	100%	100%
All other on-balance sheet assets	100%	100%	100%
Off-Balance sheet obligations	5%	-	-

Basel III – LCR & NSFR optimisation strategies



Managing LCR & NSFR together

- Objective to optimally tilt towards "ratio favourable products" while minimising loss of asset margin or increasing funding costs
- Changes to an asset or liability will impact either LCR or NSFR or both
- Potential asset strategies:
  - Funding fixed assets off-balance sheet
  - Tilt towards lower RWA assets that consume less capital & liquidity
  - Use liquidity premiums & charges to direct tilt
  - Hold higher levels of Level 2 assets
- Potential liability strategies
  - Refinance deposits from non-operational financial entities
  - Increase market share of commercial operational deposits
  - Create interbank covered bond market

Basel III – Impact of LCR & NSFR on SA banks

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Balance sheet shape changes

- Increased proportion of high quality liquid assets to total assets & will continue to increase as per LCR
- Selective long dated advances growth
- Increased bond origination vs. traditional lending
- Greater preference for household & commercial deposits vs. wholesale deposits
- Capital market funding has increased with future issuance dependant on the final NSFR compliance level for SA

Prices have started to increase in order to incorporate

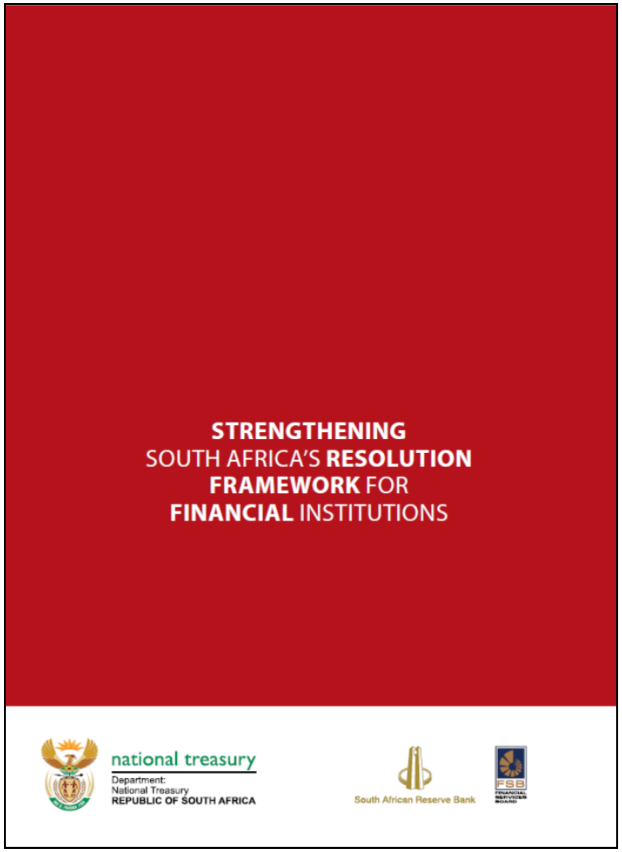
- Cost of higher liquid asset levels
- Loans & advances need to price in the higher funding costs of tenor & diversification
- Prices have increased for household & commercial deposits (Basel III friendly deposits)
- Client yields have increased on both sides of the balance sheet

Margins squeeze in the short to medium term, before being managed through

- Client yields / price increases
- Bank efficiencies
- Selective volumes

Basel III – Proposed resolution framework

- National Treasury, SARB & FSB released for comment a white paper Resolution Plan titled “Strengthening South Africa’s Resolution Framework for Financial Institutions” in August 2015.
- **Draft Special Resolution Bill expected to be finalized by mid-year 2016 & enacted by 2017**. This means South Africa will not comply with the international requirement to have an enacted Resolution Plan in place by end-2015.
- The white paper which sets out the resolution framework for financial institutions has introduced and / or confirmed the following:
  - Establishment of a **Resolution Authority** (SARB) for managing the resolution of a financial institution
  - Creation of a **Deposit Guarantee Scheme (DGS)** - paper released for comment in Oct-15
  - Introduction of the **Bail-in-Concept** - defined as any process outside liquidation that has the effect of allocating losses to liability holders & shareholders, for purposes of increasing the capital ratio of an institution, is envisaged to take place through either contractual or statutory bail-in, depending on circumstances
  - Establishment of the **No-Creditor-Worse-Off (NCWO) rule**
    - No creditor to be worse off in resolution than it would be in normal liquidation
    - Sequence of creditors bailed-in should respect & be in line with hierarchy of creditor claims in liquidation
  - Possible introduction of the **total loss-absorbing capacity (TLAC) principle**
    - The regulatory framework requires regulated institutions to hold loss-absorbing capital (LAC), such as regulatory capital, as well as gone-concern loss absorbing capacity (GLAC), which collectively make up total loss-absorbing capacity (TLAC)



Basel III – Summary

MAKE THINGS HAPPEN NEDBANK GROUP

- SA Banks well above minimum regulatory requirements & within new Basel III target ranges on day one as a result of proactive and early capital management actions
- LCR compliance during the transitional phase-in will be achieved through acquisition of surplus liquid asset buffers & the creation of level 2 assets
- NSFR standard now finalised
  - Even in revised form this ratio will remain challenging for SA banks
  - Will impact balance sheet shape in its final form
  - Will result in lower levels of bank transformation
  - Catalyst for the expansion of the capital markets
  - Banks already lengthening funding profiles
- No issue with leverage, but this non-risk based ratio has created a focus on off-balance sheet bank products
- All other aspects on track and work-in-progress at SARB and/or the Basel committee being closely monitored
- Additional international regulatory reforms may impact SA banks
- Basel III is not over and continues to evolve

THANK YOU

Implementation timelines

Key Components	Basel III 2013-2019	2013	2014	2015	2016	2017	2018	2019
Capital	▪ Improved quality and definition of capital		□	□	□	■		
	▪ Higher RWA requirements	■						
	▪ Higher minimum ratios	□	□	□	□	□	□	■
	▪ New capital buffers				□	□	□	■
	▪ Fully loss absorbent capital instruments	□	□	□	□	□	□	■
Leverage	▪ Leverage ratio			■				
Liquidity	▪ Liquidity coverage ratio (LCR)			□ 60%	□ 70%	□ 80%	□ 90%	■ 100%
	▪ Net stable funding ratio (NSFR)						■ 100%	
	▪ Liquidity risk management standards	■						
Other	▪ Counterparty credit risk (CCR) & CCPs	□	■					
	▪ Securitisation framework review (V2)		■					
	▪ Trading book review (v2)		■					
	▪ Recovery & Resolution Plan		□	■				
	▪ Pillar 3 – enhancements to disclosure	□	■					
	▪ Other items (WIP)	□	□	□	□	□	□	■
IFRS 9	▪ Expected Credit Loss (ECL) Model						■	
	▪ Classification & Measurement Model						■	
	▪ Hedge Accounting						■	

■ = implementation date
□ = phasing-in

IFRS 9 – Key definitions

Terms	Definitions
Credit Risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation
Credit Loss	The difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e. all cash shortfalls), discounted at the original effective interest rate
Probability of Default (PD)	The degree of likelihood that the borrower of a loan or debt will not be able to make the necessary scheduled repayments
Loss given Default (LGD)	LGD reflects the economic loss expected on a transaction in the event of default, expressed as a percentage of the exposure. LGD = 1 – Recovery Rate (RR) RR = Value of Collateral/Value of the Loan
Exposure at Default (EAD)	A total value that a bank is exposed to at the time of default. Each underlying exposure that a bank has is given an EAD value and is identified within the bank's internal system.
Expected Credit Loss (ECL)	The weighted average of credit losses with the respective risks of a default occurring as the weights? ECL = PD x LGD x EAD
12-month expected credit losses	Are a *portion* of the lifetime *expected credit losses* and represent the amount of *expected credit losses* that result from default events that are possible within 12 months after the reporting date.
Lifetime expected credit losses	The *expected credit losses* that result from all possible default events over the life of the financial instrument.
Amortised cost of a financial asset	The amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortisation using the effective interest method, adjusted for any loss allowance.
Gross carrying amount of a financial asset	The amortised cost of a financial asset, before adjusting for any loss allowance

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