South African Peer Bank Analysis - FY21

May 2022

EY

Building a better working world

Executive summary

SA Banks full year benchmark report 2021

2021 has resulted in a better than expected recovery coming off a low base in 2020. The largest SA Banks have all reported significant improvements in their reporting results due to increased transactional activity, less severe lockdown restrictions and return to what is considered "new normal". The Banks have reported higher yoy ROE due to decline in provisions, higher revenue growth and prudent cost control.

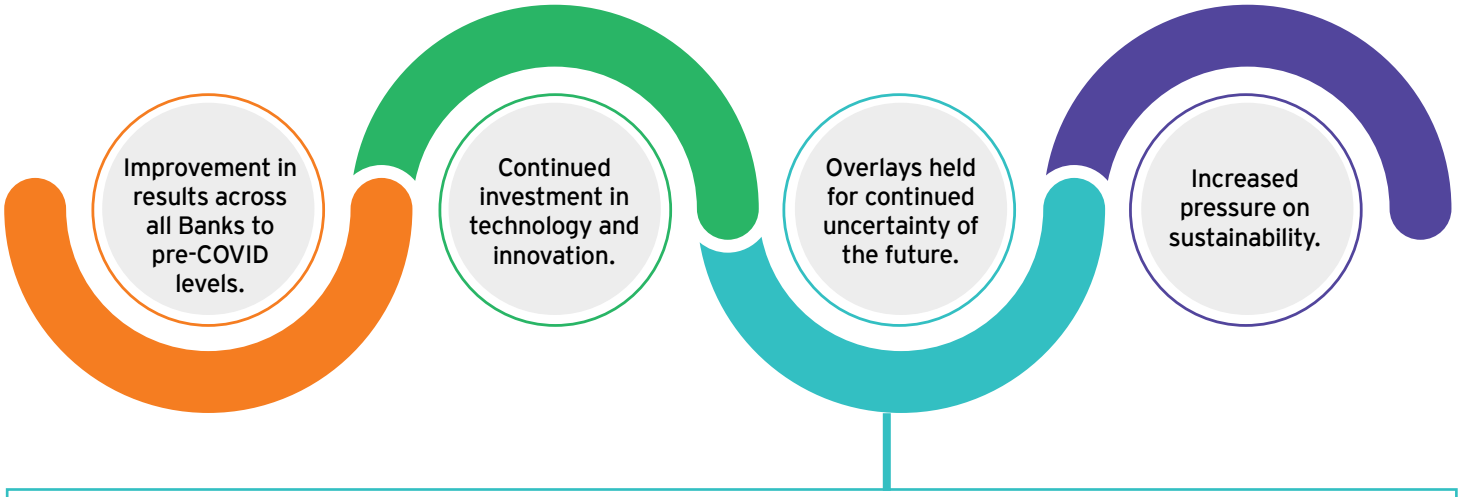
Notably, all Banks have reported a decrease in total ECL provision as well as lower ECL impairment charges. This trend driven by slight improvement in the macro-economic outlook, release of overlays and a general improvement in collection strategies and cures.

Management overlays and out of model adjustments have remained prevalent in 2021 Q4 due to continued uncertainty around the Covid-19 pandemic.

All Banks have continued to focus on evolving and executing on their strategy, with continued investments being made in technology and digital innovations. Whilst the main focus remained enhancing the customer platforms to improve service quality and engagement, the investments are also targeted to refine and enhance client on-boarding as well as the backend processes to streamline and optimize on operational processes. The Banks also continue to show strong diligence around cost containment initiatives.

Covid -19 has also been a turning point for financial intuitions to attach greater importance to ESG performance post pandemic. South African Banks have recognised climate change as a material risk in their latest disclosures. However, with the JSE and National Treasury publishing further guidance, the focus on sustainable finance continues to grow.

Key themes noted from the FY21 results:

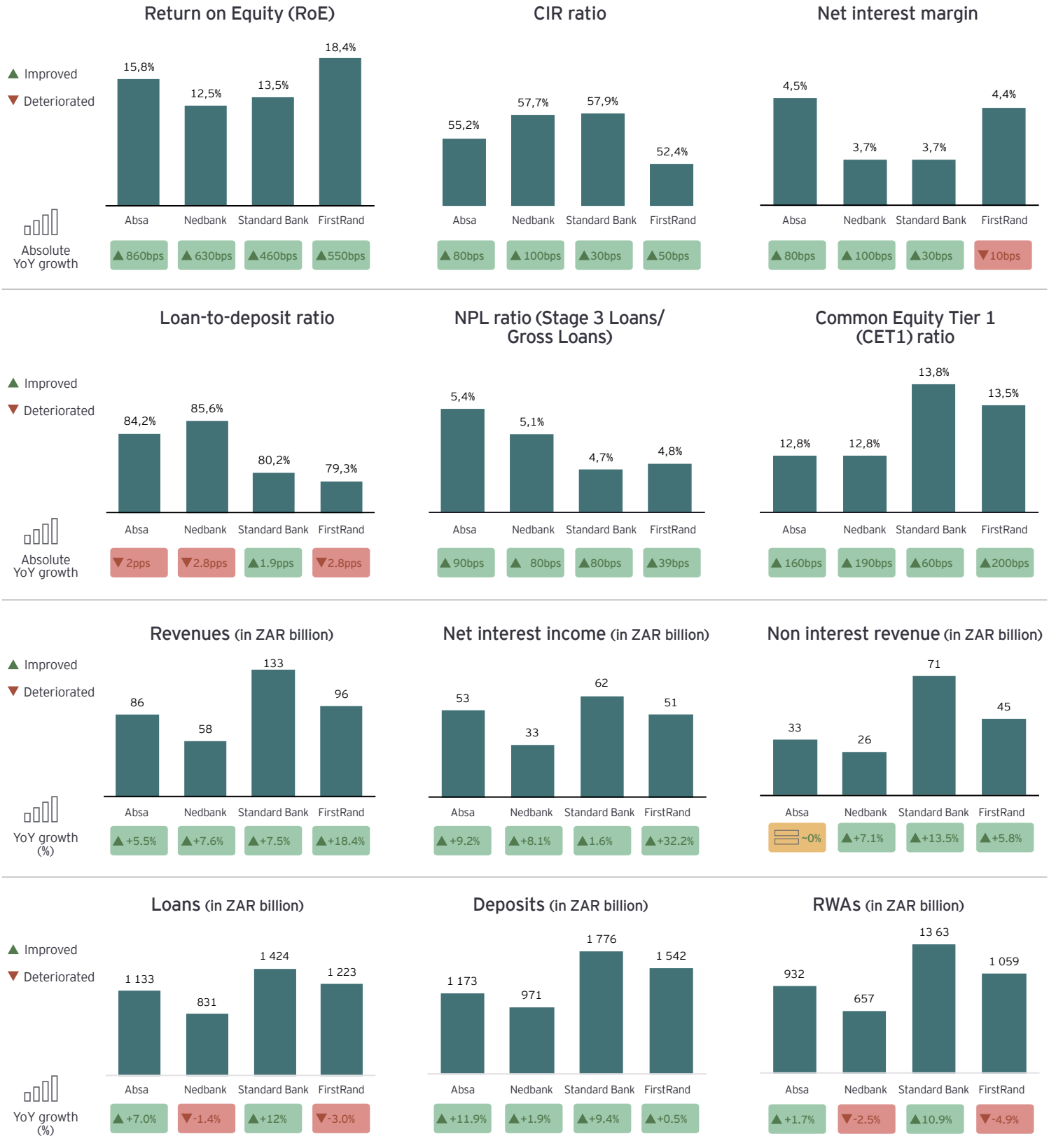


Emerging headwinds...

- The war in Ukraine could take a number of broad paths but there is no return to "business–before"
- Heightened geopolitical tensions impacting the global trade
- Prolonged and sustained high inflation subdued economic growth (stagflation)
- Further COVID-19 social restrictions and lockdowns
- Climate risk and strategy

FY2021 Financial performance snapshot

The Banks reported better ROE in FY21 primarily driven by the decrease in ECL provisions. All Banks posted higher revenue growth on the back of higher Net Interest Income and Non Interest Revenue due to improving economic activity.



Source: Absa, Nedbank, Standard Bank and FirstRand Annual & Interim Reports.
Note: The year-end for FirstRand is June 2021 while for other Banks it is December 2021. Therefore for a comparable benchmarking, FY21 for FirstRand is assumed to be 1H'22+2H'21.

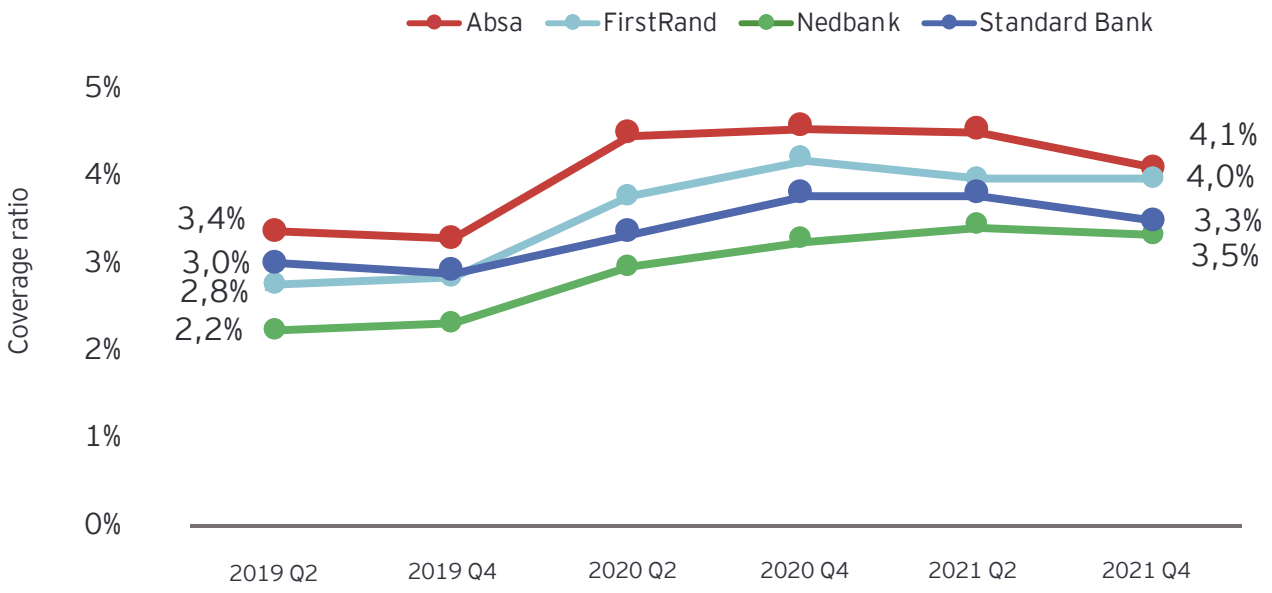
Bank's performance outlook

Financial Parameters	Nedbank	Absa	Standard Bank	FirstRand
NII growth	Upper single digits	Mid-single digit growth	+40-60bps, relative to FY20 NIM	-
Credit Loss Ratio (CLR)	80-100 bps	In the range of 75 to 100 bps	In the range of 70 to 100 bps	-
NIR growth	Upper single digits	-	-	Executing strategies to diversify NIR
Expense growth	Above mid single digit	Mid-single digit operating expense	-	Continued focus on cost management
CET 1 ratio	11.0-12.0%	> 12.0%	>11.0%	11.0-12.0%

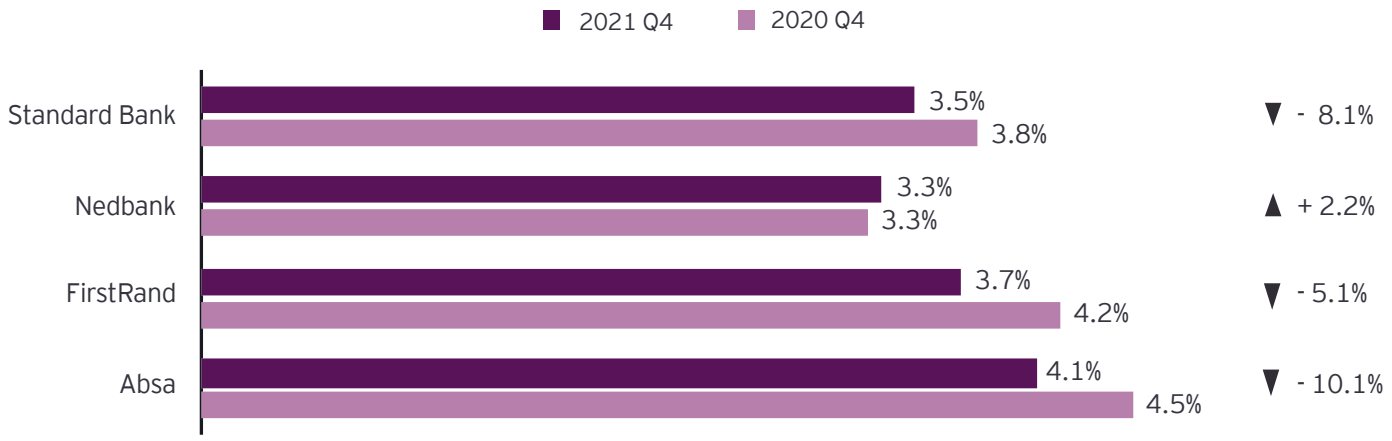
Long term outlook	Nedbank	Absa	Standard Bank	FirstRand
RoE	> 15% (>18% in long term)	>17% by FY24	17%-20%	Long term RoE-18%-22%
Cost to Income ratio	< 54% (<50% in long term)	Low 50s by FY24	Approaching 50%	-
Credit Loss Ratio (CLR)	60-100 bps	75 to 100bps	In the range of 70 to 100 bps	Through the cycle range of 100-110bps

ECL coverage ratio movements

Change in ECL Coverage Ratio - 2019 Q2 - 2021 Q2*



Change in ECL Coverage Ratios - Post Covid -19



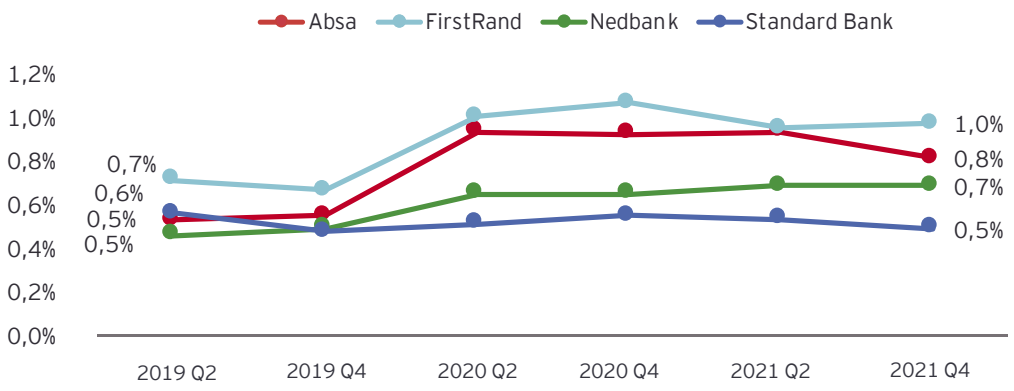
Increased stability in coverage ratios post 2020 Q4

- Coverage ratios have decreased for all Banks except Nedbank when comparing 2020 Q4 and 2021 Q4. The coverage ratios for Absa, First Rand and Standard Bank decreased by 10.1%, 5.1% and 8.1% respectively from 2020 Q4. Nedbank's ECL coverage ratio has FirstRand increased by 2.2%.

Source: Absa, Nedbank, Standard Bank and FirstRand Annual & Interim Reports.

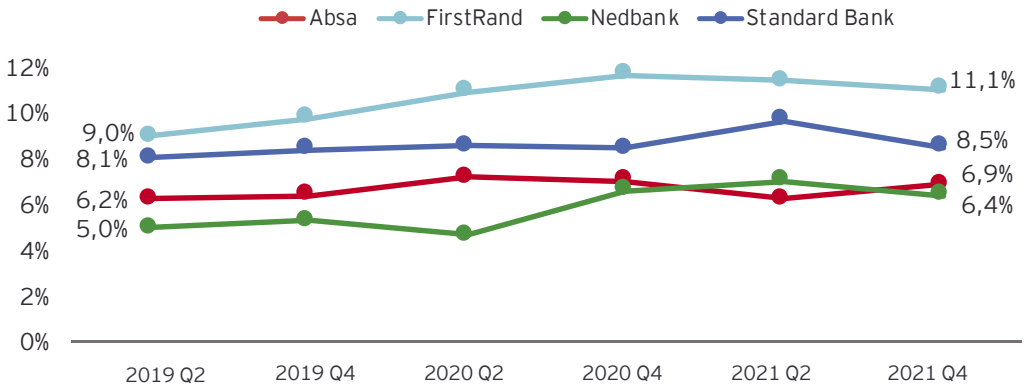
ECL coverage ratio movements (by Stage)

Stage 1 ECL Coverage Ratio – 2019 Q2 – 2021 Q4



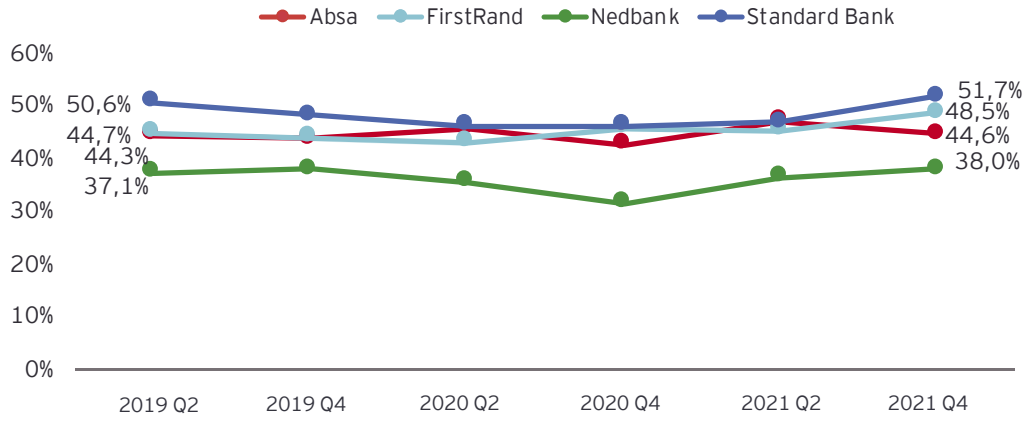
- Stage 1 coverage ratios have shown small decreases from 2020 Q4 to 2021 Q4 across all peer Banks, except Nedbank which saw a slight increase.

Stage 2 ECL Coverage Ratio – 2019 Q2 – 2021 Q4



- Increases were observed in the Stage 2 coverage ratios for Standard Bank and Nedbank in 2021 Q2 followed by subsequent decreases in 2021 Q4. The Absa coverage ratio, however, saw a decrease and a subsequent increase over the same period. A decreasing trend in stage 2 coverage ratio was observed for FirstRand from 2020 Q4.

Stage 3 ECL Coverage Ratio – 2019Q2 – 2021Q4

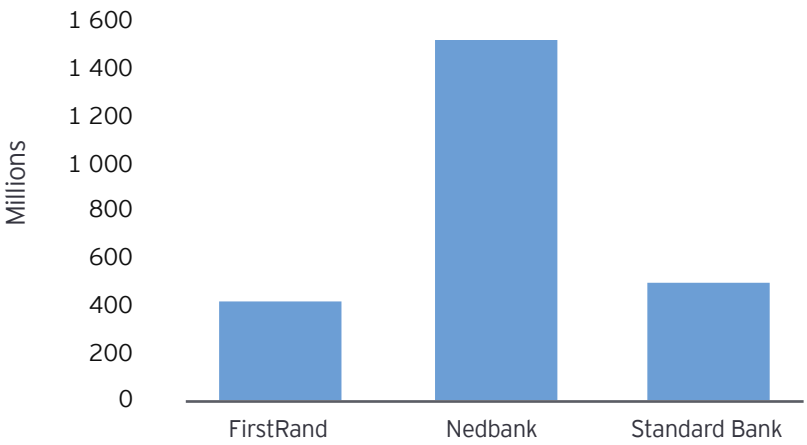


Source: Absa, Nedbank, Standard Bank, FirstRand and Investec Annual & Interim Reports.

- An increase in Stage 3 coverage ratios was observed for all Banks except for Absa post 2021 Q2.

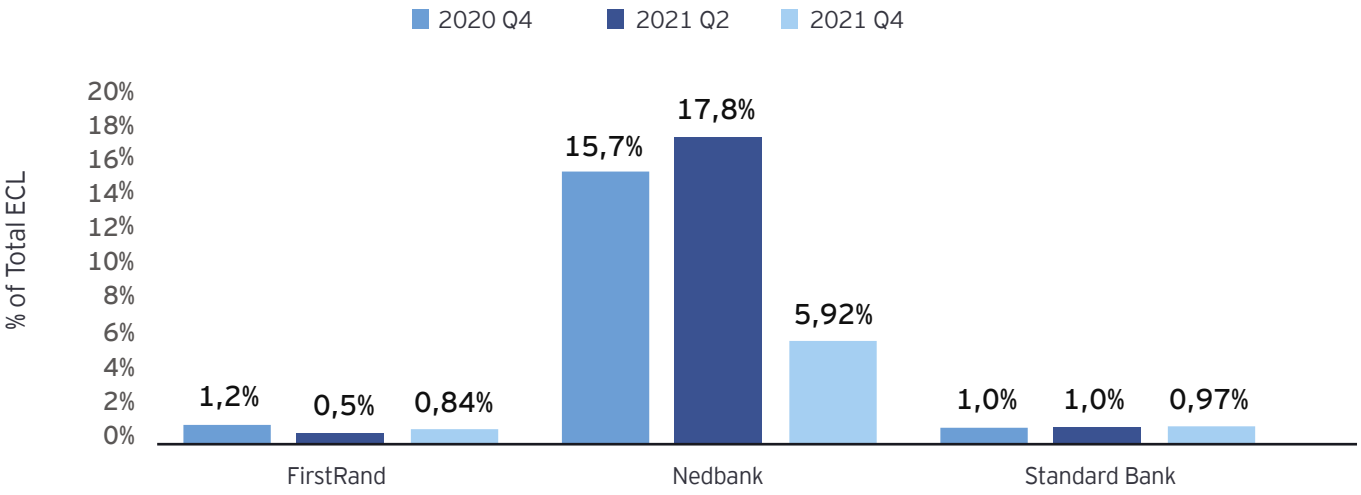
Management Overlays

IFRS 9 ECL Management Overlays - 2021 Q3/4*



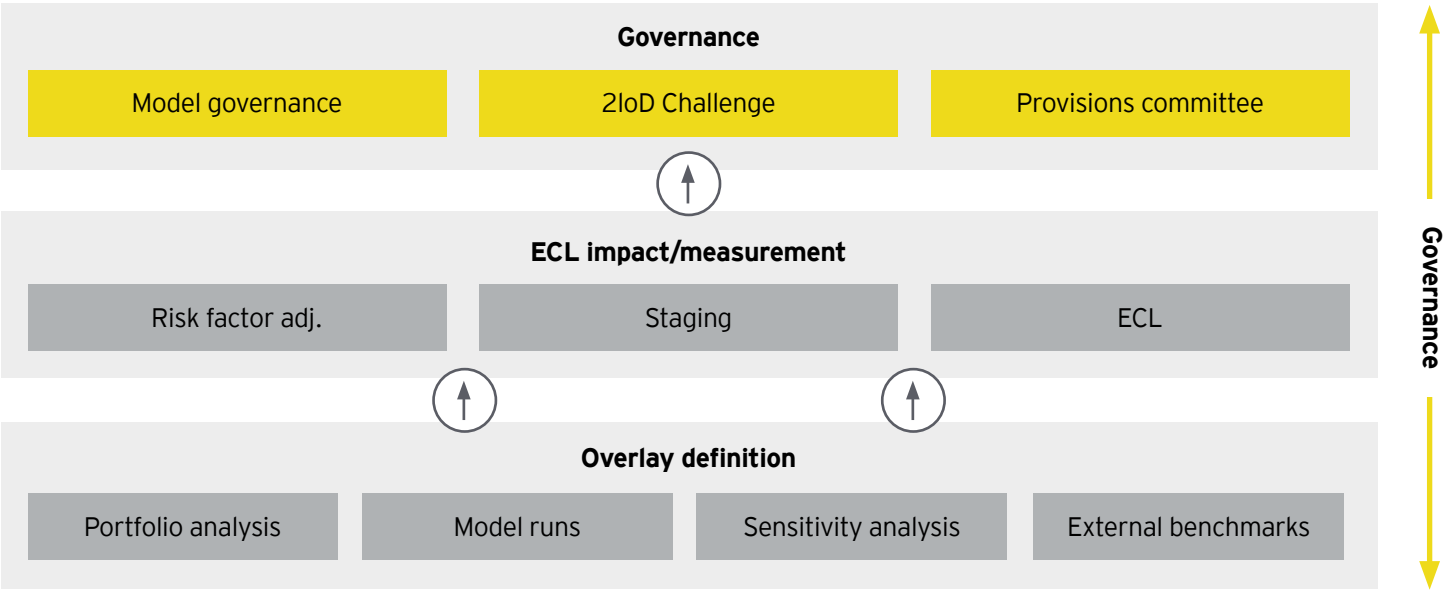
Source: Absa, Nedbank, Standard Bank and FirstRand Annual & Interim Reports.
* Absa did not explicitly disclose their overlays for 2021 Q4.

Management Overlays %*



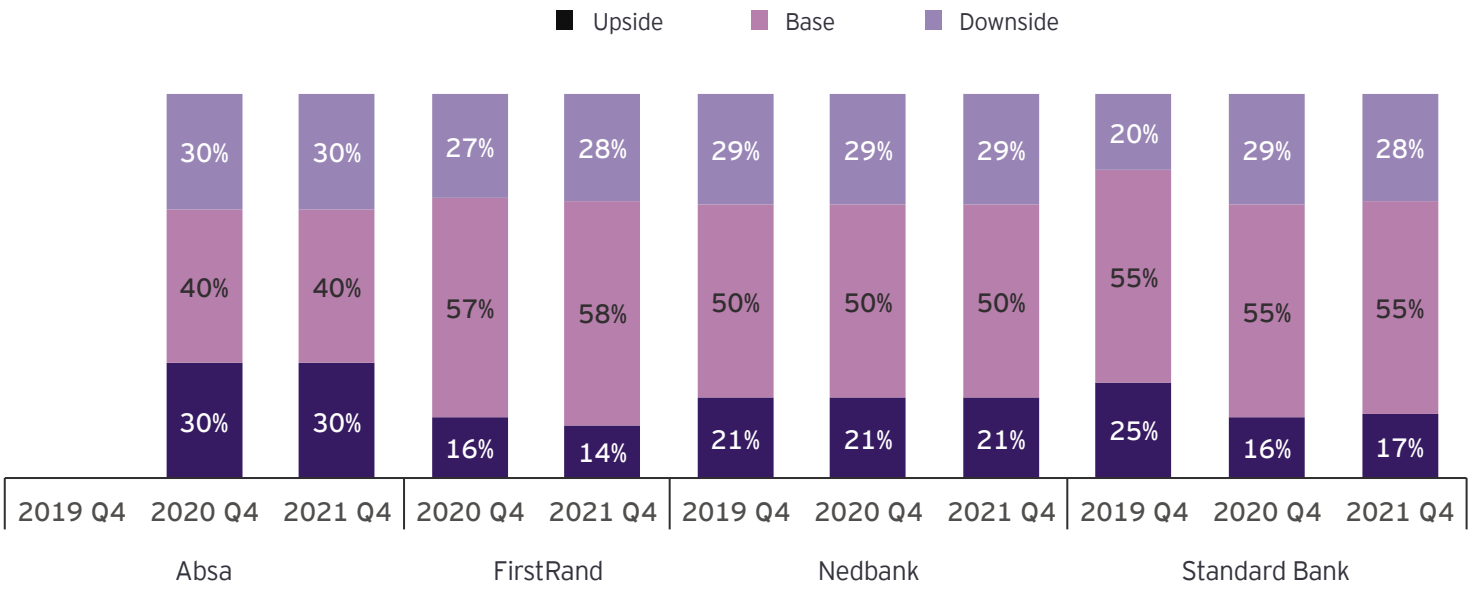
Source: Absa, Nedbank, Standard Bank and FirstRand Annual & Interim Reports.
* Absa did not explicitly disclose their overlays for 2021 Q4.

IFRS 9 overlay Framework



As the global economic starts to normalise to the 'new normal', there are still a level of uncertainty that exists with new risks emerging, which may not necessarily be adequately captured by the current IFRS 9 model that may require Banks to hold additional overlays. Its important that these overlays/management adjustments follow a robust governance process especially where expert judgement is applied. It should be clear what is the purpose of the overlay/management adjustments and how this will be released in the future when the risks are no longer relevant.

Macroeconomic Scenario Weightings - 2019 Q4 - 2021 Q4



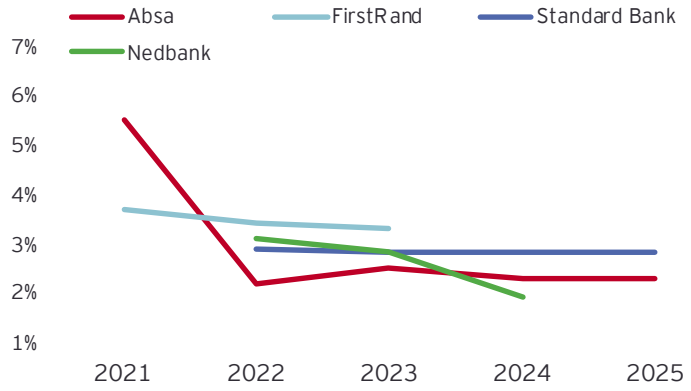
Macroeconomic outlook improvements observed from 2021 Q4

Banks have made revisions to their macroeconomic scenarios and forecasts from 2019 Q4 to capture the economic environment.
Absa and Nedbank have kept their scenario probability weightings unchanged pre- and post-Covid. Standard Bank has put more weight on the downturn scenario for 2021 Q4 from 2021 Q2.
FirstRand, on the other hand, have decreased the weighting on their downturn scenario by 1%, with a corresponding increase in the upturn scenario.
Absa's upside scenario GDP forecasts also appear more conservative than the those of the other banks.

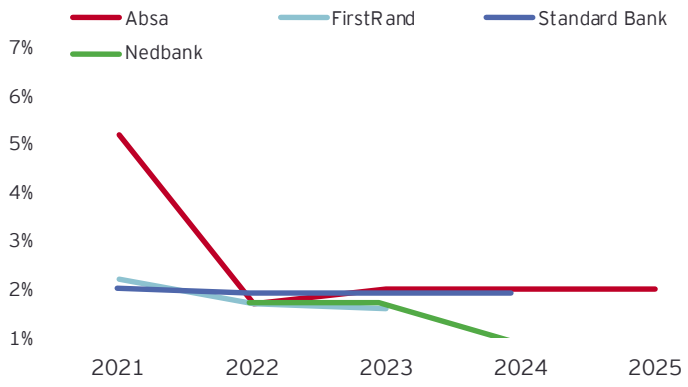
Source: Absa, Nedbank, Standard Bank and FirstRand Annual & Interim Reports.
* Absa did not explicitly disclose their overlays for 2021 Q4.

Comparison of Real GDP Growth Forecasts – 2021 Q1/2

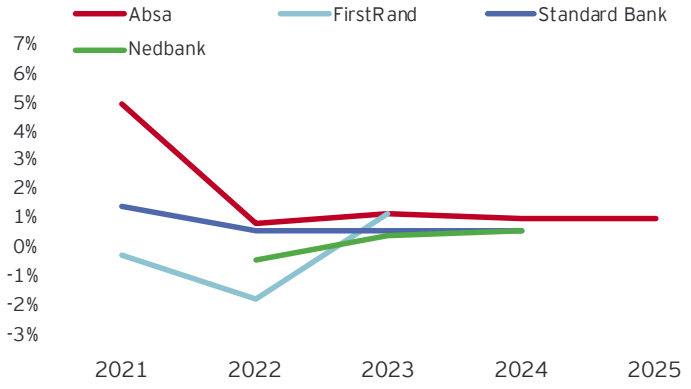
Upside Scenario



Base Scenario



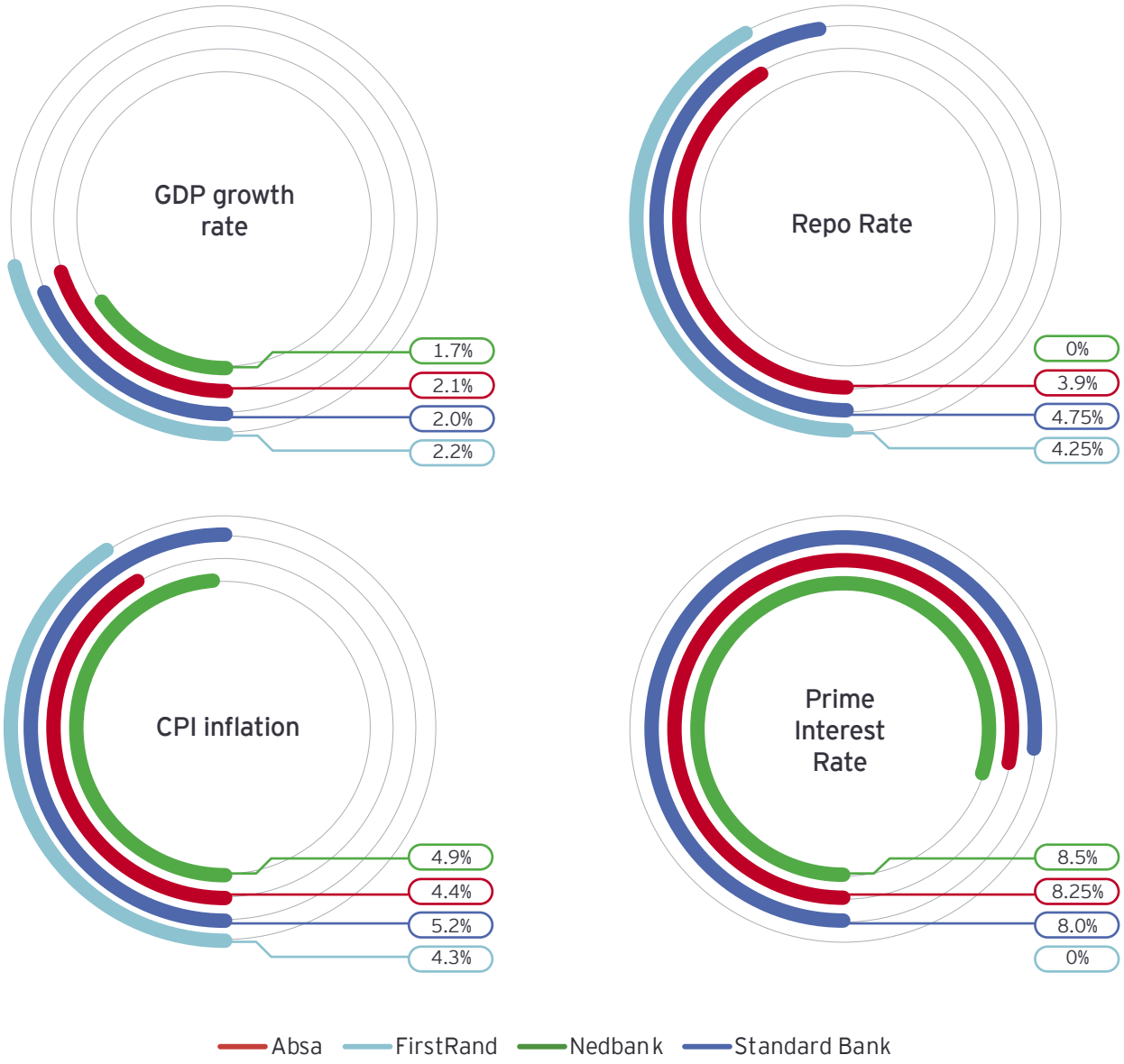
Downside Scenario



Source: Absa, Nedbank, Standard Bank, FirstRand and Investec Annual & Interim Reports.

Bank's macroeconomic outlook

Economic Parameters

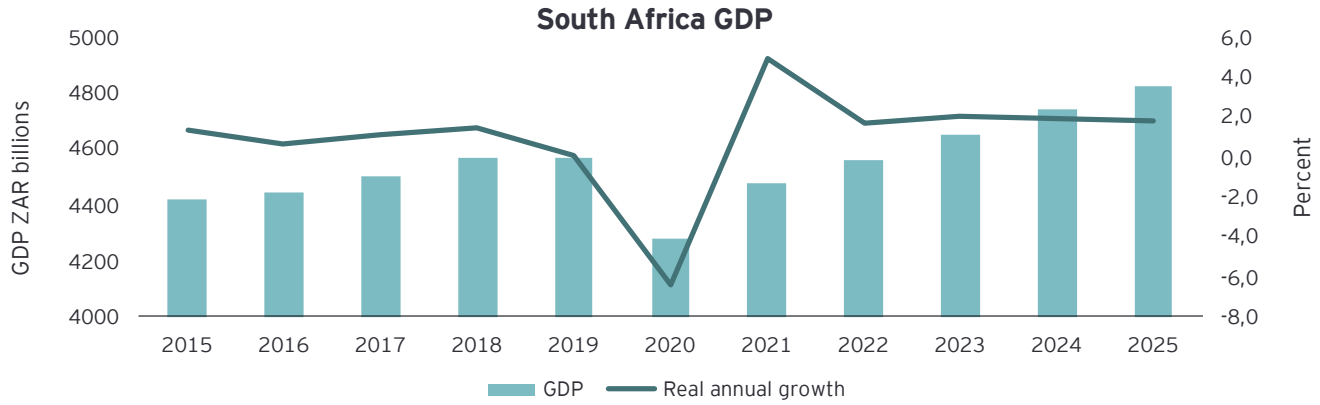


EY Outlook

The Covid-19 pandemic has continued to adversely affect the global economy, two years since it began. Access to Covid-19 vaccines has been growing, but remains unequal, and the emergence of the Omicron variant had seen global mobility restrictions reappear at the end of 2021. Significant economic risk has emerged in an already vulnerable recovery, with the war in Ukraine. The disruption in the supply of oil, energy and certain food and food-related items such as wheat and fertiliser from Russia and Ukraine will place upward pressure on inflation. While at the same time, global growth will come under pressure, with downward revisions in forecasts expected. Some are anticipating a period of stagflation - stubbornly high inflation coupled with weak economic growth and high unemployment.

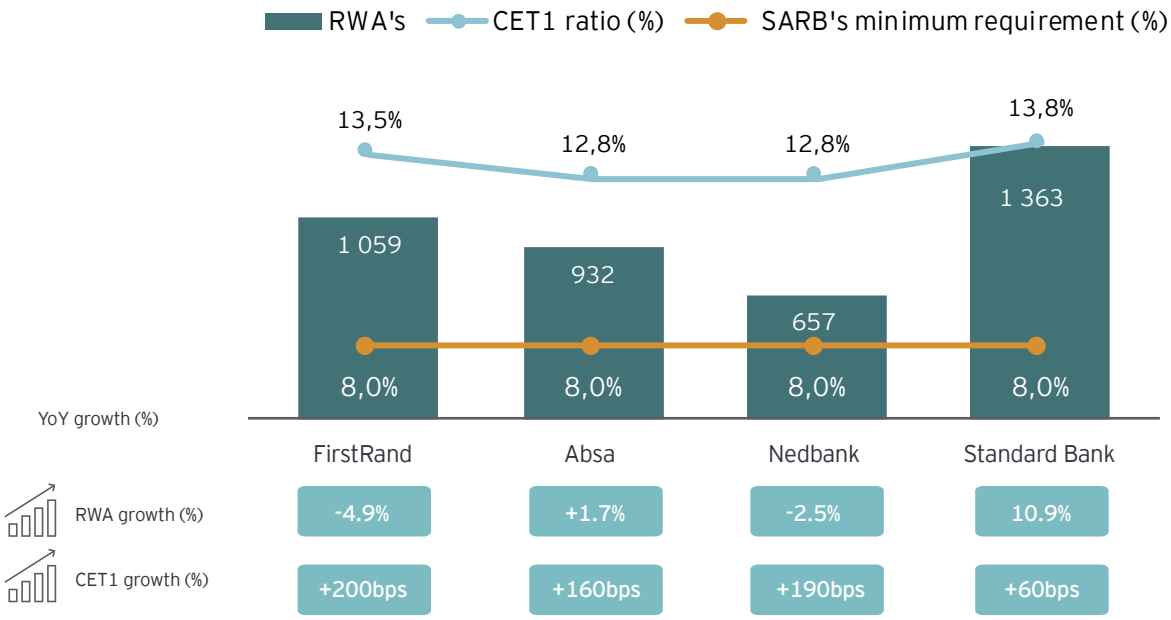
The South African economy grew by 4.9% in 2021, following a contraction of -6.4% in 2020. The recovery was driven by increased economic activity, but partially held back by pandemic related restrictions and civil unrest in July 2021. Commodity prices in 2021 were almost 40% higher than 2020 which provided the Treasury with a boost to revenue in the form of direct and indirect taxes. However, exports have been negatively hit by the unavailability of rail infrastructure and unstable electricity supply. Load shedding increased by 38.1%, from 859 hours in 2020 to 1136 hours in 2021, according to the Council for Scientific and Industrial Research. In 2021, CPI averaged 4.5%, the midpoint of the inflation target range. Citing increased inflation pressures, the Monetary Policy Committee of the South African Reserve Bank (SARB) introduced two successive 25-basis point hikes in November 2021 and January 2022. The developing international and local events underline the continued importance of considering economic risk under multiple scenarios.

The South African economy is expected to average 1.9% between 2022 and 2025 (Oxford Economics). Developments in Europe, in addition to the evolution of Covid-19 variants globally make these projections uncertain, with risks weighted to the downside. While South Africa's terms of trade and commodity exporters will benefit from higher commodity prices, the heightened food and fuel price inflation will hit South African consumers hard. The extension of the Covid-19 grant of R350 to March 2023 will support individuals affected by joblessness in the short term, and the government is exploring other temporary measures to soften the blow of inflation in 2022. However, there is a concern regarding pressure to make such measures permanent and the effect this would have on the government's fiscal consolidation path. There has been progress on key economic reforms of late, most recently the auctioning of radio spectrum by the telecommunications regulator, which will improve investor confidence. Government must urgently address hindrances to self-generation to address the electricity shortage, which acts as a ceiling on the country's growth potential.



Financial performance - Capital

RWAs (ZAR billion) and CET1 ratio – as of FY-21



CET1 internal target by banks, and buffer against minimum requirements

FY21	Internal target	Change from FY20	Surplus compared to requirement
FirstRand	11.0-12.0%	+200bps	+550bps
Absa	>12.0%	+160bps	+410bps
Nedbank	11.0-12.0%	+190bps	+410bps
Standard Bank	17.0-20.0%	+60bps	+580bps

Note: FY21 end for FirstRand is June 2021.

- Standard Bank maintained strong capital adequacy ratios, with a CET1 ratio of 13.8% (FY20:13.2%) and a total capital adequacy ratio of 16.9% (FY20: 16.1%).
- CET1 ratio of all Banks is well above the SARB minimum requirement of 8% with an average capital buffer of ~487bps.
- FirstRand's RWA declined 5% to R1059bn, largely due to lower credit and counterparty risk.
- Standard's RWA increased by 10.9% in FY21 largely due to 9% increase in credit risk RWAs.
- ABSA's RWA increased by 1.7% to R932bn, largely due to 1% increase in credit risk RWAs. The Group remains well capitalised, comfortably above minimum regulatory capital requirements.
- Nedbank's RWA decreased by 2.5% supported by credit RWA optimisation.

Sustainability / climate change disclosures emerging at pace

The intense interest in sustainability and climate change has continued apace in recent months, with significant developments in terms of the expectations related to sustainability disclosures and the continued growth in sustainable finance. For the Financial Services sector and specifically banks, this presents both risks and opportunities as companies must ensure that they have in place strong systems to manage Environmental/ Social/ Governance (ESG) risks and opportunities and improve their performance, whilst they capitalise on the opportunities tied to the growth of sustainable finance – any form of financial service that incentivizes the integration of long-term ESG criteria into business decisions, with the goal of providing more equitable, sustainable and inclusive benefits to companies, communities and society. The banking industry in South Africa just like the global one is working on these two intertwined objectives. While the challenges and risks are significant, banks have a once-in-a-generation opportunity to provide and benefit from products and services that will help to create a more climate-friendly and sustainable economy.

South Africa's Bank's have recognised that climate change is a material risk, impacting the ability of the institutions to generate value for all stakeholders over the long term. Investec Limited, FirstRand, Nedbank, Absa, and Standard Bank have issued reports aligned to the Task Force on Climate-related Financial Disclosures (TCFD) evidencing the banks' progress to better integrate, understand, and manage the risks arising from climate change including via financed emissions. The measurement of financed emissions has been noted as pivotal to managing risk as well as identifying opportunities relating to greenhouse gases, as noted by the Partnership for Carbon Accounting Financials (PCAF). The work done thus far by South African Banks in response to evolving stakeholder expectations has been analysed by Just Share against the TCFD recommendations highlighting some areas for improvement especially in relation to risk management and integration of scenarios . As expectations continue to increase and disclosure frameworks evolve, consistent data of the highest quality will be key, and Banks should continue to invest in ensuring that their understanding of sustainability risks and opportunities and the data they track in relation to these are strengthened in line with the market developments.

In December 2021, the JSE provided some insights into their expectations in relation to disclosures on sustainability through the launch of draft Sustainability and Climate Disclosure guidances, with the aim of promoting heightened transparency and best practice in ESG disclosures. Most recently the release of the International Sustainability Standard Board's (ISSB) draft Disclosure standards on Sustainability and Climate Change which are intended to deliver a baseline for sustainability disclosure standards and improve the quality of information utilised by capital market participants in their decision-making processes provides another indication of the direction of travel. In parallel, the Securities and Exchange Commission (SEC) released a proposal for new rules that would require companies to disclose their risks related to climate change and their greenhouse gas emissions. The emergence of these standards should ultimately support a convergence in terms of sustainability and climate change disclosures however it may take some time for full clarity. In the meantime, the importance of quality and robust ESG data and alignment of sustainability risk and opportunities management across all parts of the company's business will continue.

Sustainable finance continues to grow

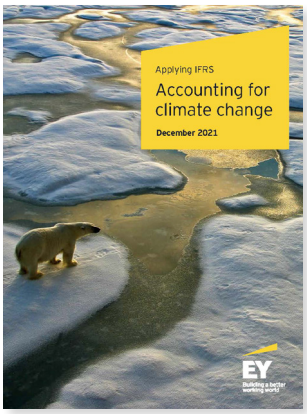
In October 2021, the National Treasury published a technical paper to guide financing of a sustainable economy, proposing a South African definition for sustainable finance as contributing to the delivery of the sustainable development goals, a just transition to a low carbon and climate resilient economy and financial stability and encompassing financial models, services, products, markets and ethical practices to deliver resilience and long-term value in each of the economic, environmental, social and governance aspects . As part of this initiative a range of actions can be expected including the launch of South Africa's "Green Taxonomy" aligning to that of the EU and which will support voluntary disclosures on "green" and "environmentally-friendly" investments for example to address climate change. The focus on sustainable finance is already clear for example through the demand for investor participation in green projects and commercial banks' investments into the REIPPPP (Renewable Energy Independent Power Producer Procurement Programme).

Consumer demand in conjunction with investor sentiment and dynamic regulations is fast-tracking climate change and sustainability-focus to the top of industry priorities and as such opportunities tied to sustainable finance will continue to arise, though banks will need to consider carefully how they track their products/ services to avoid claims of green washing and to drive real world impact. The increasing complexity of the business environment is showcasing the benefit for organisations to evaluate their broader value impacts and outcomes surpassing those of ordinary financial disclosures.

Applying IFRS – Accounting for Climate Change

EY has recently hosted a webcast on **"Why sustainability could be the next frontier in reporting?"**. The panelist included Sue Lloyd, who is the Vice -Chair of the International Sustainability Standards Board (ISSB). For the link to the replay of the webcast.

Click here



EY has also released a publication relating to **Accounting for Climate Change.**

Click below to download a copy.

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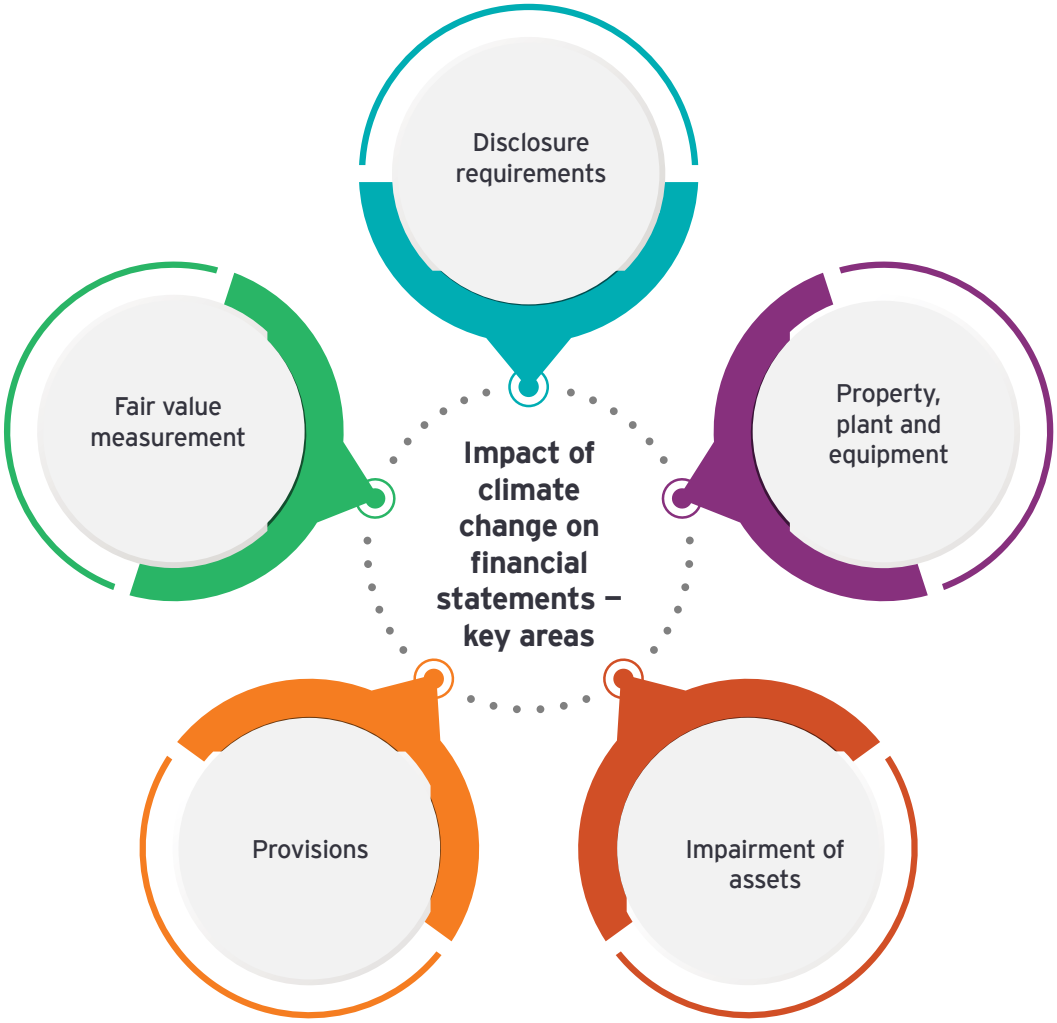

Abbreviations

- **FirstRand:** FirstRand limited
- **Absa:** Absa Group limited
- **Nedbank:** Nedbank Group limited
- **Standard Bank:** Standard Bank limited
- **NII:** Net interest income
- **non-II:** Non interest income
- **NIM:** Net interest margin
- **CIR:** Cost to income ratio
- **ROE:** Return on equity
- **COE:** Cost of equity
- **NPL:** Non-performing loans
- **ECL:** Expected credit losses
- **CLR:** Credit loss ratio
- **bps:** basis points
- **p.p.:** percentage points
- **RWAs:** Risk weighted assets
- **CET1:** Common equity tier 1

About the report

EY Global Banking and Capital Markets Benchmarks analyze the financial performance of South African banks.

Database and Report: The deck covers 4 South African Banks – Absa Group Limited (Absa), Nedbank Group Limited (Nedbank), Standard Bank Group Limited (Standard Bank) and FirstRand Limited (FirstRand).

The analysis presented helps identify trends about the financial performance of the banks and compare them against their peers.

Period comparison: All information is sourced from publicly available Annual & Interim Reports.

Methodology and notes:

- The financial year end for FirstRand is June 2021, while for other Banks it is December 2021. Therefore in order to ensure comparability, FirstRand is assumed to be Jan'21-Jun'21 (FY-2H'21) + Jul'21-Dec'21 (FY-1H'22) and similarly for FY20.
- IFRS reported numbers are used across banks to facilitate like for like comparison.
- **Stage 2 exposure:** Gross Stage 2 loans / Gross total loans
- **Stage 3 exposure:** Gross stage 3 loans / Gross total loans
- **Stage 3 ECL coverage:** Stage 3 impairments allowance / Stage 3 loans
- Wherever data is not reported by the banks for FY21, ratios such as credit loss ratio and Cost-to-Income ratio for FY21, are EY calculated. Hence, there could be a variation.
  - For eg. In FirstRand CIR was calculated after adjusting the financial calendar for a comparable analysis with the rest of the peers.

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