Group chief executives' report

"We look back on 2016 with gratitude to all our clients and employees. We look forward to 2017 with confidence and optimism. The Standard Bank Group is firmly on track towards executing our strategy, achieving our vision and fulfilling our purpose".

Sim Tshabalala, Ben Kruger

R23 009 million
HEADLINE EARNINGS
2015: R22 187 million
Lib

15.3%
RETURN ON EQUITY (ROE)
2015: 15.6%
Lib

Over the 154 years of our history, the Standard Bank Group has become a byword for trustworthiness, stability and principled commitment to driving Africa's economic growth and socioeconomic development.

We are equally committed to providing consistently excellent service to our clients and to earning a consistently good profit for our shareholders.

During 2016, our group demonstrated resilience and character while making steady progress towards fulfilling our commitments to our clients, shareholders and other stakeholders. We are always mindful that clients and shareholders are not abstractions. Behind client segments, institutional investors and multinational corporations are always people – people who have entrusted us with their hard-earned money and with their hopes.

In our home economy, South Africa, the year began with a period of severe political uncertainty, leading to a dramatic fall in asset prices, in the external value of the currency, and in business and investor confidence. Working closely with business and labour, the government moved quickly and effectively to restore confidence in South Africa's fiscal discipline and to make a start on necessary structural reforms. Growth remained disappointingly slow during 2016 but, by the end of the year, the country had convincingly demonstrated the strength and quality of its most important institutions, had avoided both a sovereign downgrade and a recession, and looked set to enter a subdued recovery.

Mostly owing to weak commodity prices, sub-Saharan Africa as a whole grew at just 1.4%, its worst performance in 22 years. The region's largest economies fared particularly poorly and Nigeria slid into recession. The commodity price slump caused severe foreign currency shortages in Nigeria, Angola, Zambia and Mozambique giving rise to liquidity constraints and macroeconomic policy challenges for the authorities. African economies also had to contend with tighter global financing conditions, inflationary pressures arising from a strengthening dollar, and in many cases, high food prices due to the drought in the southern and eastern regions of Africa. However, several countries continued to grow fast and steadily, including Ethiopia and Ghana, and the members of the east African community.

Global markets were surprised by the United Kingdom's (UK) decision to leave the European Union in June and by the outcome of the United States (US) presidential election in November. The longer-term consequences of these developments remain to be seen but, we remain committed to our strategy and supporting sustainable real economic growth and inclusive development.

By the end of 2015, our group had completed the work necessary to ensure that our resources and energies were entirely focused on Africa and on connecting Africa to the wider world. We had also agreed that we would organise our strategy execution around our commitment to providing consistently excellent client service. If a structure or a process clearly helps us to serve our clients, it is earning its keep. If not, it needs to be rethought.

We do not expect our strategy to change any time soon. We understand, however, that a strategy focused on our dynamic continent and on exceeding clients' expectations in the digital age means that we can't afford complacency. We need to combine the agility and responsiveness of a digital start-up with the reliability and reach of a universal financial services group.

During the year, for example, PBB continued to make good progress in improving client experience through digitisation and – just as important – by modernising and streamlining our ways of working to remove unnecessary obstacles and delays that frustrate our clients.

CIB continued to ensure that its digital face to the world is up-to-date, and demonstrated its commitment to our corporate clients in the most practical way possible – by helping them to grow significantly faster than the surrounding economies while standing by those going through tough times. CIB also made good progress in developing a joint client franchise with the Industrial and Commercial Bank of China (ICBC) to meet the needs of the companies developing China-Africa trade and investment.

Liberty had a difficult year but the Wealth businesses within the group's banking activities did well in financial terms by radically improving service in our short-term insurance business in South Africa and by launching a new high net worth wealth management business in Ghana.

We are proud of the deep expertise and local knowledge contained in our business units, our 20 African banks, and our international and offshore businesses. But we also understand that our clients generally have very little interest in whether they are being served by PBB, CIB or Wealth, or whether the product they need comes from the Standard Bank of South Africa (SBSA) or from, say, Stanbic Bank Zambia. We are determined to deliver a universal banking and financial services experience to all our clients. During the year, we worked hard to lower internal barriers and to link up our businesses and we will put a lot more work into this over the years to come.

Our core banking replacement programme in South Africa and a number of the African countries is a key differentiator in our peer group comparisons. We made good progress during the year with new implementations going live in Nigeria, Zambia, Zimbabwe and Swaziland, with the remaining countries scheduled to go live during 2017. In South Africa, we achieved numerous new releases and are intending to close the programme successfully by the end of 2017. At present, spend on these programmes creates large intangible assets on our balance sheet and has a concomitant negative impact on ROE. Although we will continue to carry an annual amortisation charge once these programmes are completed, we will free up capital to be deployed in the business. We are acutely aware of the possibilities that our new platforms will provide to better serve our clients through faster digital deployment, better use of data analytics to improve sales and service, and improved risk and cost control.

Measurements and incentives matter a great deal. You will see that this year we have reported against five value drivers (client focus, employee engagement, risk and conduct, financial outcome and social, economic and environmental outcome in the communities in which we operate). We intend to create more direct links between each of these and the remuneration of our senior executives.

We need Standard Bank's people to care, to be energetic, to be frank and accurate, to work well together, and to be decisive. Our regulatory compliance, our trustworthiness and soundness, our clients' satisfaction and our profitability all directly depend on the extent to which Standard Bank's people embody these habits and values. We invest a lot of time and energy into signalling, modelling and reinforcing the idea that we need to be responsive, commercially minded, entirely reputable professional bankers who always do the right business the right way, and who want our clients to succeed.

We are pleased by the results of the 2016 SBSA employee experience survey. This found that 80% of employees agreed with the statement that "Standard Bank energises me to go the extra mile", up from 67% two years ago, that 91% felt proud to be associated with the bank (up from 85%), and that 86% would recommend SBSA as a good place to work, up from 80% two years ago. 82% of employees agreed that our commitment to employment equity has become more visible over the past two years.

We continue to make steady progress on transformation in South Africa, having reached our targets for black representation in middle and junior management, and being close to target for senior and top management. During 2016, we continued to take every opportunity to press for, and to achieve, more rapid transformation of senior and top management. This is reflected in the composition of the new group executive and management committees announced in November. We will continue to make internal transformation and diversity a top priority in 2017.

Arno Daehnke has established himself with great success as our group financial director, and is building and modernising with confidence, accuracy and flair on the excellent foundations established by his distinguished predecessor. We were delighted to be able to appoint Sola David-Borha as chief executive of our Africa business and Margaret Nienaber as chief executive of Wealth.

There is sometimes confusion about what bankers mean by "risk appetite" or "taking risks". We certainly don't mean behaving rashly or irresponsibly. But – as any entrepreneur or business owner will confirm – there's no growth without risk. A major part of our business is lending, which involves taking carefully judged risks on our clients' ability to succeed. When we get this right we make it possible for young people to study, for families to buy homes, and for businesses to grow and create jobs.

Despite a tough year in most of our markets, the group's credit portfolio remained steady. The group credit loss ratio improved slightly to 0.86%, and all group-level credit metrics were on steady or improving trends over the year. As was to be expected given persistently weak commodity prices, some shareholders wanted to better understand our concentration on natural resources and the potential impact on CIB's credit portfolio. CIB's client credit loss ratio was at the higher end of our target range during the middle months of the year, but we were able to manage our portfolios swiftly back to comfortable levels, well within our target range by year end, while also continuing to fulfil our purpose by supporting our private and public sector clients in difficult times.

Group and SBSA regulatory and economic capital positions remained within risk appetite throughout the year. With total capital adequacy at 16.6%[#] and common equity tier 1 capital adequacy of 13.9%[#], the group remains well-capitalised. Group and SBSA long- and short-term liquidity positions were conservatively managed, taking into account both likely and remotely possible demands for liquidity. However, there were persistent shortages of hard currency liquidity in several important African markets, most notably Nigeria and Angola.

People often ask us what "keeps us up at night". The answer is almost always cybercrime and fraud. Along with every other major financial institution, our group is subject to very frequent and increasingly sophisticated attempts at digitally assisted fraud. This year, for instance, we suffered a sophisticated multinational fraud that cost the group R300 million. This was painful and embarrassing for us but, crucially, our clients were unaffected. Vigilance against cybercrime remains an absolutely top priority. We will continue to do everything we can to ensure that our clients and our group are as well-protected as possible.

Throughout the year – as every year – we continued to set the tone from the top by placing an extremely strong emphasis on our values, on compliance with all applicable regulation, and on doing the right business the right way.

We spent a substantial amount of time on making contributions to public policy and regulatory development in South Africa and internationally. We regard this as a duty that flows directly from the group's purpose and values; as a responsibility that Africa's largest financial services group, in terms of assets, must accept; and – most importantly – as a commercial imperative in support of our clients' and shareholders' interests. The group's cost structure, revenue possibilities, client service, profitability and sustainability are all greatly influenced by the quality of the institutions responsible for economic policy, governance and financial sector regulation.

Group headline earnings were R23 billion in 2016 with group ROE at 15.3%[#]. Although our ROE is within our target range of 15% to 18%[#], we had aimed to be higher up in our target range. While our banking activities ROE of 16.8% was pleasing, we had aimed for our group ROE of 15.3% to be higher up in our target range of 15% – 18%. The dilution of the group's ROE was as a result of the inclusion of the group's share of Liberty's earnings (which was 61% down from the previous year) and the combination of the minority interests in our other banking interests, being ICBC Standard Bank Plc (ICBCS) and ICBC Argentina (which together recorded a loss of R8 million for the year).

We are pleased to report that, despite difficult market conditions, banking activities' headline earnings grew by 9% to R22.1 billion, generating an ROE of 16.8%. The strong growth in revenue reflects the positive momentum in our franchises while our costs include further investments in our people, technology, infrastructure, digital transformation and starting a new business in Côte d'Ivoire.

PBB produced headline earnings of R12.6 billion, up 12%, at an ROE of 18.7% – continuing the strong trend of recent years. PBB's results reflect our decision to shift the centre of gravity of

12%

R12.6 billion

PBB HEADLINE EARNINGS

at an ROE of

18.7%

16%

R10.6 billion

CIB HEADLINE EARNINGS

at an ROE of

20.0%

Lib

the business towards serving medium-sized corporations, entrepreneurs and Africa's rapidly growing middle class. PBB's results also reflect good cost discipline and effective credit control.

CIB grew headline earnings by 16% to R10.6 billion at an ROE of 20%. This year marks the completion of a five-year journey following the decision to dispose of our international operations in order to restore profitability and returns for shareholders. CIB's performance reflects its balanced sectoral and country portfolios; its ability to partner with clients that are able to outperform the surrounding economies; its unique strengths as a banking partner for multinationals doing business in Africa and along the China-Africa trade and investment route; its capacity to assist African sovereigns and corporations to raise funds efficiently and at good prices on global capital markets; and its sectoral expertise in power and infrastructure, mining and metals, oil and gas, telecoms, diversified industrials and retail.

The group's other banking interests (being our 40% share in ICBCS and the 20% holding in ICBC Argentina) produced a small loss for the group of R8 million. While a loss can never be good news, we are pleased that losses attributable to the group from ICBCS have halved compared to 2015. We remain convinced that the group's strategic partnership with ICBC helps to position us in a unique way as evidenced, for example, by the progress we are making in developing and delivering renminbi-denominated capabilities for our clients. We expect that our investment in ICBCS will achieve a breakeven financial result in the near term.

Considering the weak performance of the South African economy over the year, the high levels of uncertainty and volatility over the period, intense and ever-increasing competition, and our high market shares, we believe that SBSA did well to achieve a 9% increase in headline earnings to R14.6 billion at an ROE of 15.8%, exceeding the prior year's return of 15.5%.

The group's businesses in Africa beyond South Africa generated headline earnings of R5.7 billion, 3% up on 2015, adjusted for once-off gains on principal investment management in west Africa in the prior year. In a year when sub-Saharan Africa's GDP grew slowly, we believe that the ROE of 20.6%, of the respective businesses, represents a strong set of results.

Liberty's earnings attributable to the group were R955 million for 2016, down 61% on the prior year. The immediate causes of Liberty's poor performance are the weak South African economy and its effects on persistency and on the performance of Liberty's shareholder investment and policyholder portfolios; abnormally high risk claims; operational losses and poor investment performance in Stanlib; and the negative accounting effects arising from the consolidation of the recently listed Liberty Two Degrees REIT, as more fully discussed in the group finance review on page 90.

Our measures of success include our relevance and value to our diverse stakeholder groups, including our clients, employees and regulators. In South Africa, for example, we have been closely involved in the CEO Initiative, through which the business sector has partnered with government and organised labour to develop shared responses to slow growth, inequality and unemployment. We partnered with solar energy providers to enable the generation of 190 megawatts of solar photovoltaic energy – enough to power 92 500 homes. And by restructuring the loans of a number of our agricultural clients, who were hard hit by prolonged drought, we kept more than 50 000 hectares of land in production, secured a number of permanent and seasonal jobs, and enabled affected clients to sustain turnover.

You will have seen media coverage of the Competition Commission's referral to the Competition Tribunal of its complaint that a group of banks colluded in the trading of foreign currency pairs during 2007 to 2013. While we would like to reassure you that we will engage fully with the relevant authorities in relation to this serious matter, the group has not yet been given access to the information relied on by the Competition Commission in making its referral and cannot comment further at this time.

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Looking forward

We expect a slight acceleration in global growth, particularly in emerging markets, in 2017. For most African countries, growth prospects look set to improve in 2017 as commodity prices gradually rise. We expect that the South African economy will perform better than it did in 2016, but that growth will still be too slow to reduce unemployment significantly or to increase real income per capita. The surprising outcomes of the UK referendum on EU membership and the US presidential election add some uncertainty to the outlook, as does the likelihood of continued turbulence in South Africa's political economy as the ruling party prepares to elect a new leader.

We remain committed to improving our ROE up through our target range.

In line with our strategic value drivers (see pages 12 to 15 for more detail), we will execute our strategy by placing our clients at the centre of everything we do; working to earn and keep our clients' and stakeholders' trust by doing the right business the right way; and implementing a simple, routine and easily executed universal financial services' operating model that supports the delivery of a consistently excellent client experience and generates shared value for the communities in which we live and work.

We will do this with the support of dynamic and engaged teams, who live the group's values (page 10); who are deeply connected with our purpose and our clients; and who hold themselves personally accountable and responsible for our business.

During 2017, we will be focusing particularly on the following:

- **Efficient allocation of capital and human resources to selected African countries, sectors, and clients:** during 2016, we sharpened the tools we use to allocate resources and we expect our returns on capital, expertise and effort to rise as a result.
- **Agility:** we are pleased with the increasing leanness and responsiveness of the group, and will intervene quickly again during the year as necessary in response to changing market conditions.
- **Cost efficiency:** our longer-term focus remains on ensuring that IT and other infrastructure costs are within industry benchmarks and, even more importantly, that they make a growing positive contribution as measured by client satisfaction, shareholder return and support of Africa's growth.
- **Completing the modernisation of our core banking systems:** we will continue to create a fully digital bank. We are, however, also increasingly turning our attention to ensuring that our people use the new systems with efficiency, agility and creativity to keep up with – and exceed – our clients' expectations for expert, accurate and thoughtful service.
- **Increasing the simplicity and efficiency of our reporting lines and structures** and helping our employees to do excellent work, to enjoy what they do, and to feel stimulated and rewarded by their part in implementing our strategy and fulfilling our purpose.
- **Working closely with our colleagues in our Wealth business which includes Liberty:** we will assist Liberty to recover as quickly as possible and we will support its management as they execute a longer-term strategy to restore Liberty's competitiveness.
- **Delivering shared value** by carefully measuring and steadily growing our contribution to the social, economic and environmental wellbeing of the communities we serve, and by participating in debates on matters of relevance to the group, our clients and our stakeholders.

It is a great privilege to lead our group and to help drive Africa's growth and development.

We look back on 2016 with gratitude to all our clients and employees. We look forward to 2017 with confidence and optimism. The Standard Bank Group is firmly on track towards executing our strategy, achieving our vision and fulfilling our purpose.