

Operational review: Personal & Business Banking

Overview

The group's Personal & Business Banking franchise continues to develop, a process facilitated by the economic tailwind in the South African market. Over the past three years the division has rebuilt its domestic market shares across most deposit and loan categories in line with its branch representation, and its systems and processes continue to be upgraded.

Steady improvements in its customer segmentation capabilities and customer service focus has enabled the division to steadily eliminate potential disconnects between customer needs and the appropriate products and distribution channels, while continuing to simplify and streamline value propositions and cost structures.

These achievements allowed the division to capitalise on the excellent conditions for retail banking in South Africa in 2005, with healthy consumer fundamentals underpinning strong transactional and lending growth. The division was able to maintain high customer service levels despite significantly increased business volumes and compliance requirements.

Although the credit environment in South Africa remained benign, the division has continued to improve its credit systems and collections capabilities, in part through new technology. This has positioned it well to support the growth in targeted product categories, such as credit cards, as well as to deal with a more challenging credit environment expected to materialise in due course.

Given the increasing mismatch between retail asset growth and retail deposits, necessitating the utilisation of more expensive wholesale funding, the division has concentrated on improving its deposit gathering capabilities to ease margin contraction. Market share of deposits has increased to 27% from 24% in 2002.

A key focus area for the year was restructuring the branch network and head office to eliminate functional overlaps and raise employee productivity. Executive responsibilities were redefined to clarify lines of accountability and authority, and ensure the necessary strategic focus to continue driving growth in an increasingly competitive South African market.

In the rest of Africa, sustained disinflation and positive GDP growth trends were experienced although decreasing country treasury bill rates resulted in margin contraction, which was exacerbated by the low loan to deposit ratio characteristic of banking in most African countries.

Management invested considerable time and focus integrating country operations into the group structure. Management structures were streamlined and in-country finance and banking skills strengthened, and good progress was made upgrading systems and standardising processes.

The combination of better macro economic conditions and operational improvements underpinned good growth in fee and commission revenue.

Strategy

Growth opportunities through partnerships

Partnerships and alliances have become an important way to advance market penetration and customer acquisition as well as deal with disintermediation.

SA Home Loans, a residential mortgage-backed securitisation company that is 43% owned by Standard Bank, was the first non-bank mortgage lender in South Africa. Since inception in 1999, it has securitised five tranches of its debtors' book with a total value of around R10 billion. It has recently introduced a fixed rate 20-year mortgage product, and continues to improve its turnaround times and efficiencies.

In 2005, we partnered with Edcon, one of South Africa's leading retailers, to provide a pre-approved credit card to qualifying customers. Edcon currently has in excess of 3,8 million store-card customers, of which 68% do not have a bank credit card. This venture has provided a means to lower barriers of entry in this category and leverage popular brands to attract new customers. The joint venture has performed well, achieving sales of 300 000 cards and debtor balances of R500 million in four months.

To increase its involvement in the consumer finance sector, the division acquired an interest in RCS Investment Holdings from Foschini, another leading local retailer. RCS has a personal loans business and offers credit cards to merchants outside the Foschini Group. RCS has a five-year track record and a customer base of around 160 000. The RCS business will combine the best practice in the Foschini Group gained through many years of consumer lending in the South African middle market with Standard Bank's banking expertise. This will enable this business to explore new consumer lending possibilities and gain a bigger share of this important market.

Extending financial services reach

Extending the reach of financial services in South Africa is a key challenge, compounded by increasingly complex and costly regulatory obligations. In this environment, ongoing development is required to design and deliver simple, cost-effective products and services wanted by the emerging customer which constitutes an important component of our customer base.

Specific focus was given to growing our presence in un-banked and under-banked market segments in 2005. Since the introduction of the Standard Bank Mzansi Blue Account in October 2004, the bank has acquired in excess of 300 000 Mzansi clients representing a market share of 15% which, considering the Postbank's large presence in this product, is satisfactory.

During 2005, the bank announced a 1,3% price increase in fees on the Mzansi account, as well as a 3,1% increase in our transactional E Plan savings and investments accounts, which are targeted at low-income customers. Value-for-money pricing continues to be a priority.

In our constant drive to provide affordable products and services to all our customers, opportunities to establish lower-cost distribution channels beyond the branch network are provided by new technologies. Standard Bank's joint venture with mobile telephone operator MTN to offer MTN Banking was a first of its kind mobile banking solution. Its SIM card embedded banking functionality provides a new level of convenience, enabling accounts to be opened and activated telephonically within minutes. It is among the most widely accessible banking products in South Africa. Although uptake has been slower than anticipated, with appropriate education and marketing this product should provide a viable option for previously un-banked customers. With MTN's vast reach into Africa, we expect this partnership to create further opportunities for Standard Bank to increase its market share across the continent.

Shift in international strategy

Providing an important basis for our growth strategy in Personal & Business Banking are the banking commonalities that exist in developing countries. These include emerging classes of borrowers, under-serviced regions and a desire for reasonably priced and reliable banking services. We believe that the successes achieved – and lessons learned – in South African retail banking can be replicated in other emerging markets. This can be achieved on a modular basis, increasing the flexibility we have to create and unlock value in other emerging markets.

As such, our strategic approaches to achieving retail growth across the group's emerging markets footprint can be described as follows:

- **“Optimise to grow”** – applicable in markets defined by mature infrastructure and operational stability, such as South Africa. In these markets, our strategic focus is on retaining existing customers, growing market share, building volume in profitable segments, extracting efficiencies and optimising operations.
- **“Invest to grow”** – applicable in markets with potential upside for economic growth, such as Angola. These markets tend to be characterised by low Standard Bank penetration, non-integrated systems, and customer service and satisfaction that could be markedly improved. Alternatively, they are markets where we would like to be represented but there are no acquisition opportunities available. Here, it is necessary to establish infrastructure and drive organic growth to build market share.
- **“Acquire to grow”** – applicable in markets where Standard Bank is under-represented relative to the country's economic potential

and where there are attractive acquisition opportunities, such as Nigeria and Argentina. These are strategic markets for long-term growth, where South African expertise can add value.

Executive focus and resources have been allocated to accelerate this international growth strategy. The group's existing geographic footprint provides the basis for this growth plan, and growth in Personal & Business Banking will be leveraged off our existing and expanding Corporate & Investment Banking presence.

Financial performance

Personal & Business Banking generated 44% of the group's headline earnings, and grew earnings by 22% in 2005. The division achieved an ROE of 30,9% and reduced its cost-to-income ratio from 62,8% to 60,0% in 2005.

Operational performance

South Africa

Home loans

The division continued to benefit from the domestic housing boom, with property prices up 21% in 2005 on 2004 and substantial growth in industry-wide mortgage lending. Standard Bank grew its mortgage book by 32%, with registrations increasing 25%. Market share has declined marginally from 28,2% to 27,5%. This decline includes a R4,5 billion securitisation of our home loan book, which if adjusted for would increase market share to 28,2%. We are satisfied we have managed to maintain market share considering the higher levels of competition in this market both in terms of pricing and credit granting.

The average size of a home loan written in 2005 was R395 000 (2004: R350 000), the average loan-to-value ratio of the home loan book is 70% (2004: 69%) and the average instalment to income ratio is approximately 22% (2004: 20%). Non-performing loans as a percentage of book improved from 1,51% in 2004 to 1,21% in 2005 and the number of properties in possession decreased by 49% in 2005 illustrating the low levels of defaults experienced and improved credit control in this business.

Vehicle and asset finance

The vehicle and asset finance motor book grew by 29% against a 26% growth in industry sales of new vehicles. The non-motor book growth was 1% with market share decreasing from 36% to 33%. This was mainly as a result of lost share in the other goods category which includes unsecured personal loans that we account for in other lending rather than in vehicle and asset finance.

We believe we can improve our performance in this category and are investing in our sales force to drive this objective in the year

Operational review: Personal & Business Banking continued

Extending the reach of financial services in South Africa is a key challenge, compounded by increasingly complex and costly regulatory obligations, and pressing developmental issues.

ahead. Our sales team has been increased across all channels and in certain cases the division has re-entered the dealer market. These initiatives have begun to show good results. While turnaround times of finance applications have improved markedly, there is scope to reduce these further in 2006.

Card

The card business continued to perform well with significant improvements in earnings in this category. Cardholder spending increased by 30% and the lending book by 55%. For stores with StandardBank card terminals, credit card sales increased by 29%. This growth came primarily from first-time credit card holders rather than multiple cards being issued to existing holders. While bad debt ratios have increased, this was a planned feature of our accelerated growth strategy in this category. These ratios remain well within our internal targets and are better than international benchmarks.

Other lending

Balance growth of 21% in overdrafts, revolving credits and medium-term loans was due to a 16% increase in new customers,

a higher demand for credit, continued focus on cross-selling loans to our current account base and general process improvements.

Transaction and savings

The transactional business achieved strong year-on-year growth of 15% in the number of personal and business current accounts. Although the number of active E Plan accounts only grew by 5%, the balances on these accounts grew by 24%. This is important as it demonstrates a growing savings culture among low-income earners. The number of Maestro users increased by 33% with volumes increasing by 48%. Maestro is a simple card-based payment system that allows customers to make electronic payments directly from their accounts to retailers. The StandardBank cheque card achieved a 55% growth in the number of cards and the number of transactions increased by 69%.

Together with the growth in savings and investment deposit accounts, market share gains of approximately 2% were achieved in retail deposits.

ATMs experienced a 12% increase in the volume of transactions.

Loans and deposits by product

	Change %	2005 Rm	2004 Rm
Gross loans and advances	28	205 066	160 472
Instalment sale and finance leases	16	40 178	34 704
Mortgage lending	31	124 137	94 490
Card debtors	52	11 967	7 852
Transactional products	23	28 784	23 426
Credit impairments for performing and non-performing loans	17	(2 264)	(1 940)
Net loans and advances	28	202 802	158 532
Client deposit and current accounts	27	118 693	93 163
Current accounts	20	34 871	28 941
Cash management deposits	46	3 788	2 595
Call deposits	40	30 689	21 952
Savings accounts	22	14 085	11 544
Term deposits	(8)	22 699	24 583
Securitised funding		7 326	–
Other funding and loans	48	5 235	3 548
Interdivisional funding	28	70 287	55 093
Total	27	188 980	148 256

Rest of Africa

The 16 countries throughout the rest of Africa in which we operate have been ranked and prioritised according to the growth opportunities they offer and the most relevant strategic approach in each case has been determined. This has enabled the most appropriate management teams and capital structures to be put in place in each case.

The first phase of a comprehensive customer segmentation exercise has been completed, with further phases being continued in 2006. Significant system upgrades were carried out where necessary and systems across the continent are now more standardised. It is now possible to launch products simultaneously in all our African markets. The process of aligning our African operations to South African operating standards positively impacted service levels, with the independent Customer

Evaluation of Banks Survey showing a meaningful improvement from 8,42 (out of a total of 10) in 2004 to 8,97 in 2005.

Although it is reasonable to expect a three- to four-year timeframe before the full performance benefits of our strategic initiatives in Africa begin to flow through, the groundwork is done. It is pleasing that significant improvements in service levels have already been achieved and our various in-country product strategies have started to gain momentum.

Points of representation

	2005	2004
ATMs	4 151	3 603
Total points of representation	984	975

Focus areas for 2006

Going forward, Personal & Business Banking aims to balance between managing a mature business in a domestic market where growth in credit extension is expected to moderate, with potential growth opportunities outside South Africa.

In South Africa, specific focus areas will include:

- Reviewing, managing and reducing costs, closing revenue leakages and product gaps, and driving the profitability of direct channels through volume increases.
- Improving people management, with leadership support and branch management training targeted at further improving service levels.
- Driving our customer acquisition strategies through new and existing partnerships and existing channels within the bank.
- Continuing to drive deposit gathering to limit further margin erosion.

In the rest of Africa, focus areas will include:

- Continuing to apply the South African model of getting the basics of service and sales right.
- Streamlining the business banking segment by transferring the larger corporate clients to Corporate & Investment Banking and the small and medium corporate segment to Personal & Business Banking to improve service levels to these customers.
- Launching lending products (credit cards, home loans and vehicle and asset finance) into seven African countries.

Operational review: Corporate & Investment Banking

Overview

The group's Corporate & Investment Banking franchise is underpinned by two main centres in Johannesburg and London, which work together to support its operations across a broad international footprint.

The division posted a good performance in 2005, off a high base, despite fewer trading opportunities domestically and internationally. The performance of our international operation was disappointing with lower revenue being generated across most trading areas. Low levels of credit impairment charges were experienced during the year with recoveries of prior period credit impairments and the reversal of surplus provisions resulting in an overall recovery for the year.

After a period of strong organic growth in the South African market, our focus has been on aligning our businesses in the rest of Africa and internationally along the lines of the successfully implemented customer-centric model established in South Africa over the past five years.

Operational focus over the last year was on structuring executive reporting lines, teams and systems to ensure competitive services and structured products across all operations. We continued to invest significantly in retaining and incentivising teams of talent.

Strategy

Besides the ongoing process of integration and alignment, the year was one of reflection given the changes in global wholesale banking markets. Emerging markets continued to gain in popularity, with developing countries improving their credit ratings and a growing appetite for emerging markets risk among investors. In this environment, traditional emerging market participants like ourselves are encountering increased competition from the large established global banks in our chosen markets.

In the face of these new challenges, we have had to reconsider the best way to reposition the business for sustainable growth. We identified that although we are in the appropriate markets, to remain competitive we need to enhance our regional and in-country capabilities with urgency. This has been set as a key strategic imperative in the years ahead, and will require significant further investment in people and infrastructure. The cost of this investment will inevitably have an impact on returns in the short term.

Corporate & Investment Banking has formulated a three-part growth strategy.

Growing off a high base in South Africa

This will involve:

- positioning the bank to maximise exposure to Black Economic Empowerment (BEE) activity, in terms of both empowerment financing and advisory services;
- capitalising on the financing needs arising from the infrastructure development activity planned in South Africa in the short to medium term, and the rest of Africa's development in the longer term; and
- increasing the proportion of net interest income to total income due to the increased potential for corporate loan growth.

Growing our business in the rest of Africa

This will involve:

- ensuring that we capture the banking business associated with trade flows intra-Africa and between Africa and other emerging markets;
- maintaining focus on providing customer-centric solutions to corporate customers, whilst leveraging off the group's skills and products; and
- focusing on banking the Government and International Organisation (GIO) sector and donor flows on the continent.

Growing the regions outside of Africa

This will involve:

- building depth and scale in regional businesses in emerging markets in Asia, the Americas, Europe and the Middle East;
- driving penetration of core competencies such as resource banking and global markets capabilities into the regions;
- identifying specific regional product opportunities; and
- linking existing investment banking businesses in key markets with the acquisition of commercial banks such as the pending transaction in Argentina.

Financial performance

Corporate & Investment Banking comprises 45% of the group's earnings (2004: 50%). Headline earnings grew by 7% in 2005, off a high base in the prior year. This headline earnings growth was made up of an 8% decline in global markets, an 8% increase in banking and trade finance and a 27% increase in the investment banking category.

An ROE of 27,0% (2004: 27,2%) was achieved. The cost-to-income ratio of 54,0%, compared to 51,5% in the prior year, worsened due to reduced revenue in the international business. Costs were well contained to a 7% increase.

Operational performance

Global markets

Global markets house the division's financial markets and treasury activities including the resource banking and money market funding units.

Tough trading conditions were experienced particularly in international emerging markets where low volatility, a tightening of spreads from increased competition and high levels of global liquidity significantly reduced trading opportunities.

Trading income in our international business was also adversely impacted by a continued shift from a reliance on proprietary trading, with lower value at risk utilisation, to becoming more client focused. Our strategy to build and develop a structured product capability in the international business started to yield positive results towards the end of the year, with strong customer demand for tailored solutions in capital markets and access to local emerging markets.

The foreign exchange market continued its trend of low volatility and spread tightening particularly in our core rand product. The foreign exchange business achieved good results despite the environment presenting limited opportunities.

The equities trading business performed well with increased business confidence in South Africa boosting local equity markets and strong business flows.

Strong revenue flows were generated by the securitisation and debt origination businesses. The securitisation team also successfully concluded the group's first asset-backed securitisation transactions: R4,5 billion of mortgage loans and R3 billion of vehicle and asset finance receivables.

The debt securities business experienced strong flows during the year notwithstanding tough market conditions. The international principal trading business generated increased revenues relative to 2004, despite running a lower level of market risk.

In precious metals trading, strong physical related short-dated trading flows were experienced from a well-diversified global client base. However, a strict anti-hedging stance among precious metal producers continued in 2005, resulting in a lack of long-

dated transactions which dampened revenues. Base metals trading reported good revenues against a background of significant interest in the metals markets and 20-year price highs. The growth of the Chinese economy coupled with increased hedge fund activity, continued to drive the market. Although the volatility in oil prices during the year augured well for the commodity trading business, structural changes to the team outside of Africa resulted in lower than expected revenues.

The mining finance and structured commodity finance businesses continue to be regarded as leading arrangers and providers of structured financing facilities for metal producers and the development of mining projects. The buoyant metals markets seen in 2005 resulted in increased competition from financial institutions not previously as active in the mining and metals sector. Consequently, the market also experienced downward pressure on returns and loan terms.

The energy finance team had a strong year and benefited from an expanded client base. This resulted in a well-diversified spread of risk and transaction structures. Progress was made in expanding the team's transaction capability in the power and renewable energy sectors.

The treasury funding unit in South Africa experienced continued margin pressure as a result of the significant amounts of term funding required to support the strong asset growth across the South African business, together with increasing the average long-term structure of the funding book in line with internal prudential guidelines.

Major IT investment in 2005 and 2006 will see the implementation of the latest global systems in interest rates and equities trading, credit trading and energy trading. This will enable us to introduce a fuller product range, leading to an improved customer service offering across the range of our global markets activities.

We have a strong and mature global markets team in South Africa as evidenced by the following recently awarded accolades:

- In Risk Magazine's South African market survey, Standard Bank was rated first overall and ranked first in nine categories across the interest rate and equity derivative businesses.
- Standard Bank was voted "Best Bond House" for 2005 by the Bond Exchange of South Africa Spire Awards, and also won awards in four other categories.

The challenge going forward is to export this model to the rest of our operations by scaling up our regions, completing the IT infrastructure implementation and hiring and up-skilling staff.

Operational review: Corporate & Investment Banking continued

For Corporate & Investment Banking to remain competitive internationally, we need to enhance our regional and in-country capabilities with urgency.

Banking and trade finance

The banking and trade finance business encompasses corporate lending, transactional banking businesses, custodial services and trade finance business.

Competition in the vanilla corporate lending market generally remained fierce with margins coming under pressure. The transactional banking business grew volumes, introduced new products and won major new accounts.

The electronic banking business grew market share substantially by focusing on enhancing customer service and improving technology. The project to roll out corporate electronic banking technology in the rest of Africa is progressing well.

The custody business also had a great year, achieving record volumes and assets under management.

Specialised finance continued to broaden its business, with innovative transactions closed in Turkey, Asia, the Middle East, Russia and Mexico. Most notable was the joint underwriting of a major acquisition of South-East Europe's largest oil refinery. The group also established its credentials in the rapidly expanding Islamic finance market with two significant transactions underwritten and subsequently oversubscribed in general syndication.

Loans and advances by product

	Change %	2005 Rm	2004 Rm
Gross loans and advances	30	133 620	102 662
Overnight lending	35	27 477	20 365
Term lending	17	47 639	40 610
Loans granted under resale agreements	48	26 291	17 750
Commercial property finance	34	16 196	12 095
Other loans and advances	35	16 017	11 842
Credit impairments for performing and non-performing loans	(4)	(1 439)	(1 494)
Net loans and advances	31	132 181	101 168

Telecommunications finance posted strong growth. The scale of transactions increased significantly, new risk distribution channels were developed and the client base doubled. Major successes included the largest project financing deal in the Ukraine and a first mandate in Pakistan.

Trade finance had a good year – despite further tightening of margins in key markets. Good volumes in the trade finance business also contributed significantly to the growth in profitability.

The distribution group had another successful year placing over USD10 billion of syndicated loans, trade finance and forfaiting paper, and successfully arranging 45 syndicated financings, primarily in Russia, the former Commonwealth of Independent States (CIS), Eastern Europe and the Middle East. The business retained its position as a market leader in the arranging and placing of emerging market syndicated debt and was ranked by Loanware as the top arranger and distributor of syndicated loans for financial institutions in Russia, Ukraine and Kazakhstan.

Investment banking

Investment banking includes the equity investment and advisory businesses, project finance, structured and property-related lending as well as the off-shore asset management and wealth management units.

The specialist corporate finance advisory team, the mining and metals advisory group and the equity investments businesses performed well during the year. In South Africa, BEE deals continued to drive business growth. Major transactions concluded during the year included introducing BEE partners into Medi-Clinic, SA Eagle, Assore and Tiger Brands.

Other notable deals included a fair and reasonable opinion for the Venfin board in respect of the Vodafone offer as well as a number of transactions and assignments in Papua New Guinea, Scandinavia, Central Europe and the Americas.

Standard Bank, as the global adviser for the Celtel International B.V. Group, was mandated to raise medium-term financing for Celtel Kenya Limited through a floating rate secured bond on the Nairobi Stock Exchange. The deal is the largest corporate bond on the Nairobi Stock Exchange and also in the East African Community region. Furthermore, this is the first time that Kenyan Shilling denominated debt has been placed outside of Kenya.

The low interest rate environment resulted in robust increases in property prices in South Africa. This boosted performance in the property finance and advisory services business with positive

mark-to-market profits being generated and sizeable realisations in the listed property investment portfolio. There was also significant growth in the property lending book, which contributed to increased profitability.

Structured finance encompasses longer-term structured lending to corporates, primarily in the form of asset- or project-backed financing. The structured finance division won a number of major mandates in 2005 that should generate good returns in the coming years. The project finance division is currently focused on infrastructure investment in Africa and in particular the Gautrain project which, in spite of a number of delays and some controversy, appears to be moving towards finalisation. The Gautrain is a 77km high-speed rail link that will connect Johannesburg and Pretoria.

Focus areas for 2006

Standard Bank's Corporate & Investment Banking business is focused on becoming a strong emerging markets contender and is pursuing new opportunities in market sectors that show strong growth potential.

Focus areas in the year ahead will include:

- A continued focus on building our customer base and offering better services.
- Retaining key staff and completing the programme of hiring and up-skilling staff in the international businesses to enhance our regional and in-country capabilities.
- Driving people and infrastructure development aggressively and achieving greater economies of scale in the international businesses.
- Acquisition opportunities in key markets focusing on product related businesses and commercial banking opportunities in conjunction with Personal & Business Banking.

Operational review: Investment Management & Life Insurance

The strong growth enjoyed in the South African investment markets during the latter half of 2004 continued throughout 2005. Liberty Life and Stanlib were beneficiaries of this growth.

Overview

For the life insurance industry, 2005 could well be regarded as a significant turning point. The unfavourable rulings against life insurance companies, including Liberty Life, by the Pension Fund Adjudicator (PFA) and the associated negative sentiment led to an industry-wide rethink of business models. Encouragingly, in spite of the negative perceptions, Liberty Life managed to deliver a strong financial performance for the year.

In April 2005, Liberty Life concluded the acquisition of Capital Alliance Holdings Limited (CAHL), and for the rest of the year a major focus was to ensure the swift and smooth merging of the businesses. CAHL employees were moved from their head office into Liberty Centre with the process being managed carefully to limit disruption and employee concerns. The integration provided the opportunity to restructure Liberty Life's business model to position the company to serve both intermediaries and policyholders more effectively and efficiently into the future.

We took the decision to consider the disposal of our offshore asset manager, Liberty Ermitage, and the Australian life insurance business, Prefsure, which was included in the acquisition of CAHL. Liberty Life also disposed of Hightree, a small UK distribution business, during the year.

Liberty Active was launched during the year, and subsequently integrated with CAHL to offer a simple, streamlined range of value-for-money risk products at the lower end of the market.

Another milestone for Liberty was that it became the first South African life insurer to issue a listed corporate bond. Applications for the bond outstripped initial expectations and R2,0 billion was raised at a very competitive long-term rate of 8,93%. This will be used primarily to fund working capital requirements.

Liberty Life won both categories of the South African Financial Services Intermediaries Association (SAFSIA) awards for life insurers (individual and corporate). This is the first time that SAFSIA, the largest intermediary body, has given both awards to one company in the same year.

Stanlib had its best year since it was formed in 2002. Its performance in equity markets continued to improve both in absolute terms and relative to its peers. The Alexander Forbes Global Manager Watch survey placed Stanlib third for 2005, with

its preferred asset portfolio returning 34,6% for the year. Costs were well controlled.

New chief executive of Liberty Life

During February 2006 it was announced that Myles Ruck, chief executive of Liberty Life, wished to retire as chief executive, for personal reasons, after his service retention agreement expires on 31 May 2006. Bruce Hemphill, currently chief executive of Stanlib, will succeed Myles with effect from 1 June 2006. Myles has been invited to remain on the board of the Standard Bank Group as a non-executive director.

Securing sustainability by committing to change

Whilst there were aspects of the PFA rulings that we disagreed with, many of the issues dealt with and rulings made were valid. However, for Liberty Life whether or not the rulings were legally defensible was of secondary importance. We were more concerned about the fairness of past practices in the industry, particularly in light of the way circumstances have changed since the products were first developed.

To bring about meaningful change, industry-wide consensus was needed. Under the auspices of the Life Offices Association (LOA), extensive discussions on reforming savings products took place internally and externally with parties such as the National Treasury and the Financial Services Board. The complex challenge was to find solutions that took into account future business, existing in-force books as well as business on the books that had already been terminated prior to the maturity of the contracts. The multi-lateral process culminated in a December meeting and signing of a Statement of Intent between the five largest members of the LOA and the Minister of Finance.

It is important to note that the issues raised in the settlement relate to a small and specific part of a life insurer's business. In general, it has been shown that customers who take out and maintain a retirement or endowment product to maturity will have invested wisely and at reasonable cost to themselves – although the choice of investment asset may impact that return. It has been primarily in situations where policies have been prematurely or partially terminated where the perceived high costs have been contentious. It is hoped that this has now been dealt with and we look forward to continuing to give our policyholders peace of mind in planning for the future.

Strategy

Becoming the life insurer and investment manager of choice

Our strategy is simple – we intend to become the South African life insurer and investment manager of choice for those who wish to buy and to sell life insurance and investment products. To do this we need to offer products that are relevant, easy to understand and provide real value for money.

We are reassessing the relevance of all products provided by Liberty Life and Stanlib, and will discontinue any we find to be no longer suitable for the markets we operate in. Similarly, where we find that inappropriate advice is being given or product sold – be it through our tied agency force or independent brokers – we will remove the party's contract to sell our products.

In addition, to be the life insurer and investment manager of choice means that we provide service excellence and put the customer at the forefront of everything we do.

The life insurance operations have made good progress but understand that they still have a long way to go. The decision to move the back office onto one delivery platform over the next few years will go some way towards helping us deliver on our service promise.

In the life insurance operations, we will also continue to focus on extending our distribution reach. Specifically, in the coming year we will ensure the efficient distribution of our Liberty Active products. In keeping with our philosophy of providing the right products for the right markets, we have discontinued selling savings products into the lower end of the market, as we believe they do not offer sufficient value for money when compared to alternatives such as unit trusts or bank savings accounts.

To be competitive, profitable and provide value for money means that we cannot be complacent when it comes to costs. We are constantly evaluating our processes to streamline them and extract value from cost efficiencies wherever possible.

Financial performance

Investment Management & Life Insurance comprises 7% of the group's headline earnings, and grew normalised headline earnings in 2005 by 51%. The division achieved a ROE of 24,1%, grew funds under management by 27% and grew normalised embedded value by 16%.

Liberty Life had a very good year and increased normalised headline earnings by 47%, notwithstanding a once-off R321 million after tax provision for the Statement of Intent relating to the PFA rulings. Significant gains on investments held in the shareholders' portfolio more than offset this provision. These gains were previously accounted for directly in equity.

The strong growth enjoyed in the South African investment markets during the latter half of 2004 continued throughout 2005. Liberty Life and Stanlib were beneficiaries of this growth in a number of areas. Indexed new business grew by 12% over 2004, from R4,3 billion to R4,9 billion, albeit at a slightly lower margin compared with 2004. Investment management fees earned grew by 14%.

Net cash inflows from insurance operations were up from R3,2 billion in 2004 to R5,7 billion, and net inflows into Stanlib amounted to a further R13 billion.

In the insurance operations, policy expense increases of a recurring nature were in line with actuarial assumptions (4,25% per annum) for the third year in a row although non-recurring items were considerably higher than 2004, due mainly to the restructuring and integration costs incurred with respect to the restructuring into three main divisions and the integration of CAHL. The capital adequacy requirement ratio remained strong at 2,0 times cover.

Stanlib's profit before tax was R348 million and third-party assets under management grew by 27% to R186 billion as at 31 December 2005.

Focus areas for 2006

Investment Management & Life Insurance earnings may be lower in 2006 due to the potential impact of a lower assumed equity and bond market performance although real growth in embedded value should be achieved.

Specific focus areas in 2006 will include:

- Continuing to refine our new business model and implement our strategy to become the life insurer of choice.

- Driving the distribution of Liberty Active products.

- Bringing out the best in our people.

- Improving and expanding Stanlib's equity business.