South African Reserve Bank

Office of the Acting Secretary of the Bank

To shareholders of the SA Reserve Bank

Shareholders of the SA Reserve Bank (the Bank) were given notice on 25 November 2010 of further business raised for discussion at the ordinary general meeting (OGM) of shareholders of the Bank held on 8 December 2010. This report serves to inform shareholders of the responses provided to such matters at the OGM.

A copy of the *Governor's Address* delivered at the OGM is also attached for the information of shareholders.

The ninety-first OGM of shareholders of the Bank will be held on Thursday, 30 June 2011 in Pretoria. A call to invite nominations for people to be considered for election by shareholders as non-executive directors on the Board of the Bank will be placed in newspapers by the middle of February 2011.

J J Rossouw
Acting Secretary of the Bank

Pretoria
18 January 2011

South African Reserve Bank

Report of further business discussed at the
Ordinary General Meeting 2010
of the
SA Reserve Bank, 8 December 2010

Shareholders of the SA Reserve Bank (the Bank) were given notice on 25 November 2010 of further business raised for discussion at the ordinary general meeting (OGM) of shareholders of the Bank on 8 December 2010. This report serves to inform shareholders of the responses provided to such matters at the meeting.

As the Bank had received correspondence enquiring about the legality of convening the OGM on 8 December 2010, and not on a later date, the Governor, who chaired the OGM, explained that:

- the Bank had been faced with a necessary amendment to its legislation to deal with, *inter alia*, the appointment of directors;
- this had necessitated the postponement of the OGM so as to give effect to the amended legislation;
- The Minister of Finance had agreed to postpone the OGM, stating that it should be held no later than 10 December 2010;
- the OGM had been convened in accordance with the requirements of recognised legal principles, which recognise that where there cannot be strict

compliance with time periods in respect of administrative actions, this will not result in the invalidity of such actions;

- no person had been prejudiced by the notice regarding the nominations for directors, the constitution of the Panel and the process followed; and
- legal opinion had been obtained which confirmed the lawfulness of the process followed.

On this basis it had therefore been decided to continue with the OGM on 8 December 2010.

In response to the first matter for discussion, namely whether the published consolidated financial statements of the Bank disclosed sufficient information and a request for an explanation of the legislation pertaining to the Corporation for Public Deposits (CPD), the Chairperson responded as follows:

"It is not normal practice to distribute the individual sets of financial statements of each subsidiary within a group of companies to shareholders. Their results are usually consolidated in the annual report. We will examine the consolidated report to ensure that transparent disclosure takes place. This review will also take account of the views of the boards of subsidiaries and of their external auditors.

The CPD Act provides for the establishment of the Corporation for Public Deposits for the investment of moneys held by, for or on behalf of the Government of the RSA and certain other bodies, councils, funds and accounts. It is a legal person with a share capital of R2 million which may be held only by the Bank. The affairs of the CPD are managed by a board, consisting of two persons from the Bank and two officials of the Treasury. The Minister designates one of the persons of the Bank as chairperson of the CPD board.

The persons of the Bank referred to may be a Governor, Deputy Governor or any officers of the SARB. Current Bank official members are Deputy Governor Daniel Mminele and Dr Roelf du Plooy. The Treasury officers are Mr Lungisa Fuzile and Ms Bulelwa Boqwana. The current chairperson of the CPD is Deputy Governor Mminele.

In accordance with the legislation, the *Annual Financial Statements* of the CPD are furnished to the Minister of Finance and tabled in Parliament. The statements for the 2009/10 financial year were tabled in Parliament on 12 August 2010."

In response to the second matter for discussion, namely whether the SA Reserve Bank should utilise and own an insurance company (SA Reserve Bank Captive Insurance Company (SARBCIC) Limited) as a subsidiary, the Chairperson responded as follows:

"The primary purpose of SARBCIC, as a licensed short-term captive insurer, is to provide an efficient and cost-effective risk transfer mechanism to the SARB Group. Its focus is on reducing the SARB Group's dependency on external insurers and to reduce the overall cost of insurance and risk over the long term. Economies of scale are achieved by virtue of the group insurance programme underwritten by SARBCIC.

During the 1990s, the Bank's consultants recommended on numerous occasions that it would be advisable from both an economic and risk management viewpoint to develop a group insurance program for the Bank, the SA Bank Note Company (Pty) Ltd, the SA Mint Company (Pty) Ltd, the CPD, the Pension Fund of the South African Reserve Bank and the South African Reserve Bank Retirement Fund.

The Board of the Bank appointed a committee to investigate this aspect, comprising five Bank officials, namely Mr P H Bartleet (Chairperson), Adv J J de Jager, Mr W J Kamffer Mr G H Engelbrecht and Mr F G Wiehman, and Mr J L Luttig (Senior Partner, Werksmans Attorneys), Mr C Nortje (Managing Director, Alexander Forbes Risk Finance) and Mr R Fraser (Tax Partner, KPMG Financial Services) as external experts.

The committee concluded its investigation in March 2000 and recommended that a wholly owned short-term captive insurer would achieve the maximum benefit from the group insurance program. The main reason for this is that there is a legal impediment on a non-insurance entity to provide group deductibles (i.e. insurance) to other legal entities, even if they are in the same group. The bulk buying power harnessed through

SARBCIC ensures better negotiating power for more competitive rates and greater cover, as well as more advantageous arrangements with intermediaries (brokers). The captive facilitates the packaging and marketing of the individual company insurance portfolios into one single portfolio.

Cell captive insurance is a well-recognised and efficient method in which to manage large insurance risks.

SARBCIC annually obtains an actuarial report from Marsh Alternative Risk Solutions entitled: "Report on the Retention Structure and Preliminary Capital Requirements of the SARBCIC". In their report dated 28 April 2010, they estimate the annual savings in premium generated by SARBCIC, in favour of the SARB Group, as R9,89 million.

SARBCIC's *Annual Financial Statements* are lodged with the Company Intellectual Property Registration Office (CIPRO) and the Financial Services Board. CIPRO documentation is available to the public from them."

In response to the third matter for discussion, namely responsibility for the determination of the remuneration of directors and whether it should not be determined by shareholders, the Chairperson responded as follows:

"In terms of section 5(3) of the SA Reserve Bank Act the directors (including the Governor and Deputy Governors) hold office in terms of such conditions and remuneration (including allowances) as determined by the Board, and upon such other conditions as may be prescribed by regulation. The matter is therefore dealt with in terms of legislation in respect of which the Bank or the shareholders have no jurisdiction.

In terms of the *Annual Report* tabled before you, there is full disclosure of such remuneration. The Governor and Deputy Governors receive an annual salary, and do not receive a bonus or incentives of any kind. They are not permitted to hold any remunerated external position."

In response to the fourth matter for discussion, namely requirements emanating from the wording of regulation 23.1(a)(1) of the Regulations framed in terms of the SA Reserve Bank Act, which stipulates that the external auditors should report, *whether in their opinion, the financial statements and any supplementary information attached to them fairly represent in all material aspects the financial position of the Bank and the results of its operations and cash flow*, the Chairperson responded as follows:

"One shareholder sent questions directly to the Bank's external auditors. The auditors did not respond to the shareholder, but raised these questions with the Bank. This is one of the questions raised by the shareholder.

The financial statements of the Bank have been prepared in accordance with the Act and the accounting policies set out in note 1 of the annual financial statements (AFS). The SARB has chosen to use International Financial Reporting Standards (IFRS) as a guide in deciding the most appropriate accounting policies to adopt as well as a model for the presentation and disclosure framework followed in its financial statements. The Act is not prescriptive regarding the accounting framework that the SARB should adopt, except for sections 25 to 28 of the Act which deal with the accounting treatment of gold and foreign exchange transactions (these sections are in not in accordance with IFRS). As a result the SARB follows an "entity specific basis of accounting" which is set out in the notes to the AFS.

Consequently, the opinion of the external auditors is based on International Standards on Auditing (ISA) 800 (Special Purpose Frameworks) and SAAPs 2R (as issued by IRBA during September 2008). SAAPS 2 specifies that the auditor should not report that the financial statements present fairly (in circumstances as applicable to the SARB). In such circumstances the auditor's opinion should refer to the fact that "the financial statements have been prepared, in all material respects, in accordance with the basis of accounting as disclosed in the financial statements.

Given that the audit covers the 31 March 2010 year and the opinion was signed on 30 July 2010, it does not cover the SARB Amendment Act (No. 4 of 2010) and the related SARB Regulations 2010, promulgated by the Minister on 13 September 2010.

The 2010/11 audit will be done in terms of the Amended Act and Regulations."

In response to the fifth matter for discussion, namely the post-retirement medical aid payments of pensioners of the Bank as a contingent liability, the Chairperson responded as follows:

"Thank you for raising this matter, which is certainly one of concern and has already received the Bank's attention.

The post-retirement medical liability of the Bank has been examined by our external actuaries. The various options identified are being evaluated and will be submitted for further consideration to the Remuneration Committee of the Board early next year. We regard this matter as one that needs to treat employees fairly, while at the same time finding a way to cap the liability."

In response to the sixth matter for discussion, namely the legal limitation on the payment of dividends to shareholders and/or the legality of a capital distribution by the Bank to them, the Chairperson responded as follows:

"I would like to deal with these two matters separately.

Firstly, the question of dividends: Central banks worldwide are public entities that fulfil public interest roles. In practice, the pursuit of this role is not synonymous with the realisation of profits. Similarly, the SARB is required to conduct its activities in the public interest only, without any regard whatsoever to profit maximisation as a consideration. Thus, management of the SARB is tasked with managing the business of the Bank, not with a profit motive in mind, but with the ultimate goal of protecting the value of the currency in the interest of the general public.

An important factor which therefore signifies a major difference between the rights, powers and status of shareholders in an ordinary public company and those in a central bank, is the fundamental difference between the ultimate profit motive of commercial companies and the non-profit public interest purpose of central banks. This non-profit maximisation public interest role of the Bank necessitates a realignment of the rights, powers and status of shareholders in an ordinary company to suit those of shareholders in a central bank.

Considerations of public interest and fundamental principles of central banking militate against a central bank being owned and controlled by its private shareholders. The SARB is required to function independently, without regard for vested interests and not subject to undue pressure.

The dividend policy is determined by Section 24 of the Act, which provides for a fixed dividend of 10 per cent per share per annum. I wish to make a few remarks relating to this matter. This is not a new position, but 10 per cent dividend on nominal value has been a legal stipulation virtually since 1921, reconfirmed in the SARB Act of 1989. Therefore all shareholders, irrespective of when they bought their shares, were aware of, or should have been aware of, this legally imposed limit to the earnings per share.

Historically, holding shares in the Bank was a means of showing commitment to the Bank, and demonstrated a willingness to be part of the affairs of the Bank, as shareholders participated in the annual meetings which were regarded as prestigious events.

Let me now turn to the second part of the question: namely a demand that there be a capital distribution or an annual payment of 10 per cent of profits. As indicated above, Section 24 provides only for a fixed dividend be paid to shareholders on an annual basis. No legal authority or basis exists for any capital distribution to shareholders whatsoever. This demand should not be entertained at all.

In terms of Section 24 of the Act, 90 per cent of any surplus made by the Bank must be paid over to the Government, while the remaining 10 per cent is to be used to accumulate reserves by the Bank. Such reserves serve as a buffer for circumstances such as we currently find ourselves in, where the Bank is making a loss as a result of actions taken in the interests of the national economy. Over the years, this contingency reserve has been built up and today stands at R9 186 880 000, as evidenced on page 62 of the *Annual Report*. The sheer scale of this reserve indicates how ridiculous this demand is. The Bank stands firmly opposed to entertaining any such demand, from whatever quarter."

In response to the seventh matter for discussion, namely the basis for the payment of a dividend to shareholders in the 2010 financial year, despite the Bank making a loss in that year, the Chairperson responded as follows:

"Section 24(e) of the Act prescribes that dividends must be paid out of profits of the Bank. From the financial statements of the SARB, for the year ended 31 March 2010, it is apparent that the SARB has "accumulated profit" reserve of R1 126 412 000 (see page 62 of the annual financial statements). Accordingly, the payment to shareholders of a dividend, from the accumulated profit reserves, would constitute the payment of a dividend out of net profits. Ultimately, the decision to pay dividends was taken by the Board after it had taken legal advice and considered this matter."

In response to the eighth matter for discussion, namely the reasons why the Bank does not fall under the Companies Act, the Chairperson responded as follows:

"Conclusive support exists for the notion that the ultimate objective of companies (excluding companies not incorporated for gain) should be profit maximisation.

Based on the traditional view of a company, the premise is that the maximisation of profit is to ensure shareholders' wealth, since shareholders are regarded as the owners of the company who, by virtue of their ownership are entitled to control the company and have it serve their interests alone. The Companies Act is primarily based on these principles.

Initially, central banks also operated as commercially minded profit maximising companies. However, this turned out to be problematic, as two serious conflicts of interest arose as a result of their then profit maximising objective and commercial nature. The first related to their responsibility for managing the banking system and maintaining liquidity in the market, and the second related to their role of authority over the commercial banks, the very institutions it was at the same time competing with. This non-profit maximisation public interest role of the Bank necessitated a realignment of the rights, powers and status of shareholders in an ordinary company to suit the unique nature of shareholders in a central bank. Considerations of public interest and fundamental principles of central banking militated against a central bank being owned and controlled by its private shareholders.

Consequently, during the latter part of the 19th century, central banks were reformed, resulting in them reverting into non commercial and non profit maximising institutions that functioned in terms of their own legislation solely in the public interest.

In order to lessen concerns with regard to the sustainability of central banks, provisions were made for them to be left with a fixed sum of money each year to expunge costs and to provide for a return to their shareholders. The payment of a fixed dividend to shareholders became a norm which emphasised the absence of a profit motive and reflected the unique nature of shareholding in a central bank.

Central banks henceforth became non-competitive and unable to use their advantageous monopolistic position to their benefit and the detriment of competitors. From then on they could concentrate solely on their public interest roles with regard to the economies and health of the financial system in their respective jurisdictions.

In accordance with these internationally recognised principles relating to central banking, the Bank functions as an independent juristic person with a public interest non-profit maximising role of protecting the value of the currency in terms of its own Act and in accordance with the prescriptions of the Constitution."

In response to the ninth matter for discussion, namely cooling-off payments to the former Governor, Mr T T Mboweni, Ms N D Orleyn, previous Chairperson of the Remuneration Committee, responded as follows:

"The Board introduced a cooling-off period of six months for the former Governor, Mr T T Mboweni. The purpose of this arrangement is to prevent any possible conflicts of interest for a former Governor after retiring from the service of the Bank. Similar arrangements had been in place previously at the time of the retirement of deputy governors from the Bank, and cooling-off payments were therefore not a new arrangement.

The payments to the former Governor were made in terms of the *Governors' Handbook*, which comprises the conditions of employment and service benefits of the Governor and deputy governors. The payments to the former Governor reported on page 94 of the *Annual Report* include salary, certain one-off payments and long-service payments falling due at the time of retirement from the service of the Bank.

At the time of the retirement of the former Governor it transpired that certain aspects of the *Governors' Handbook* were not completely clear and were therefore subject to different interpretations. The *Handbook* was subsequently revised to ensure clarity of all matters covered. A revised draft of the *Handbook* has been considered by the Board and will be approved by the Board, subject to certain small editorial amendments, in the near future."

In response to the tenth matter for discussion, namely the use of the Gold and Foreign Exchange Contingency Reserve Account (GFECRA), established in terms of section 28 of the SA Reserve Bank Act, Deputy Governor Mminele responded as follows:

"The GFECRA is operated in terms of section 28 of the South African Reserve Bank Act, 1989. This account represents the net revaluation profits and losses incurred on gold and foreign exchange transactions which are for the account of Government. The GFECRA comprises of three sub-accounts, i.e:

- Gold Price Adjustment Account - all gold related profits and losses arising from the revaluation of gold;
- Foreign Exchange Adjustment Account - all foreign asset related profits and losses pertaining to revaluation of foreign assets;

- Foreign Exchange Contract Adjustment Account - all profits and losses related to liability transactions, with a focus on revaluation of foreign loans, deposits and forwards.

Settlement of the GFECRA account is subject to agreement, from time to time, between the Bank and Government. The current arrangement is that only transactions that have affected liquidity in the domestic money market will be settled.

The remainder of the transactions are in respect of the revaluation of gold and foreign exchange, and do not represent any cash flow. In terms of this agreement, the balance settled by government in respect of the 2009/10 financial year amounted to R168,8 million."

In response to the eleventh matter for discussion, namely the Bank's holding of gold reserves and their auditing, Deputy Governor Mminele responded as follows:

"The Bank held approximately 4 million foz, with a market value of US$ 5,511 billion, as at 30 November 2010. This constitutes 12,7 per cent of the official gross reserves. The last significant change to the Bank's gold holdings was the repayment of a US$500 million gold-denominated syndicated term loan facility in May 2003. Since then, the Bank's gold reserves have remained at approximately 4 million foz.

Where gold is stored and how it is managed is in keeping with international best practice and for reasons that should be self-evident to shareholders, this is confidential. Appropriate storage, security and insurance arrangements are in place and subject to periodic review by the Bank.

The Bank's gold reserves are managed passively due to the prevailing short term low rates of return earned on gold loans. The low correlation of gold with government bonds and money-market instruments makes it a valuable portfolio diversifier.

I now wish to turn to the specific question and the audit matter raised. The question was *do the auditors carry out an independent physical and assay identification and stock* *count (and/or weight) of gold bullion, precious metal coin (and other precious metals) on a subsidiary company and consolidated basis? Are precious metals encumbered in any way?*

Accepted international best practice of verification is followed by the auditors. The Bank does not hold any other precious metals nor are any of the Bank's holdings of gold encumbered."

In response to the twelfth matter for discussion, namely the loss incurred by the Bank in the 2009/10 financial year, the Governor responded as follows:

"During the 2009/10 financial year the Bank incurred an after-tax loss of R1,05 billion. The loss was largely attributable to a decline of R5 billion or approximately 58 per cent on the Bank's return on foreign assets, mainly owing to a significant reduction in global interest rates and adverse movements in international bond yields. In addition, given prevailing uncertainty during the review period, the Bank adopted a more defensive investment strategy in which capital preservation of investments received a higher priority at the expense of enhanced returns, which also led to lower investment returns.

The effect of the strengthening rand against major currencies compounded the reduction in investment income in foreign currency terms once converted to rand for purposes of the income statement.

Another factor contributing to the loss is the negative carry cost associated with the sterilisation of foreign reserve purchases. During the year under review, the gross reserves increased from US$34,1 billion to US$42,0 billion indicating that the Bank purchased relatively large amounts of foreign exchange in the domestic forex market, which had to be sterilised through various open market operations including the issuing of SARB debentures and reverse repo transactions. The interest rates paid on these operations are normally close to the Bank's repo rate (currently around 5,5 per cent) and significantly higher than the returns on its foreign investments (currently around 1 per cent). The negative spread between the sterilisation rate and the return on foreign assets was actually much larger for most of the year under review, given the fact that the repo rate stood at 9,5 per cent in April 2009.

These reserves are held by the Bank on behalf of the country and the continued build-up of reserves is in the best interest of the country."

In response to the thirteenth matter for discussion, namely media reports dealing with problems at the SA Bank Note Company (SABN), the Governor responded as follows:

"Along with all other subsidiaries and departments of the South African Reserve Bank, the SABN was subjected to a rigorous review of all procedures and controls following my assumption of office as Governor of the Bank at the end of last year. The uncovering of weaknesses at the SABN led to the suspension of the company's Managing Director. The suspended MD of the SABN is currently the subject of a disciplinary process.

Senior Deputy Governor Guma has taken on the duties of the chairperson of the SABN. An acting MD is in place who has tightened procedures and implemented the necessary checks and balances to ensure that the company provides the consistent levels of superior service expected of it.

The Bank has complete confidence in the integrity of South Africa's bank notes. South Africa's bank notes incorporate a range of the latest cutting edge security features which ensure that they meet the highest international security standards.

The Bank continues to encourage all South Africans and visitors to know their money. Anyone who is ever in doubt about a banknote should check the security features, which can be found on our website."

In response to the fourteenth matter for discussion, namely the Bank's approach to the King Code on corporate governance (King III), the Governor responded as follows:

"Recognising the importance of sound corporate governance, the Bank used a governance assessment instrument, developed by the Institute of Directors, to conduct a

Bankwide gap analysis. The outcome of the assessment was a 'BB', which denotes notable application of the principles and recommendations of the King III Report. The highest assessments in the main category were obtained for performance assessment, Board role and duties, as well as accountability, while the lowest was for group boards and room for improvement on integrated reporting and disclosure. There are also areas that are not applicable to the Bank, and others where the Bank follows an 'apply or explain' approach.

An example of this would be that the Board does not appoint the CEO – in the Bank's instance the Governor is appointed by the President. This is unlikely to change. Another example of non-compliance is that the Remuneration Committee does not regularly review incentive schemes, as such schemes are not part of the remuneration policy of the Bank.

This assessment has identified areas where the Bank has room for improvement. It will be completed annually in future."

In respect of the fifteenth matter, namely the structuring and oversight role of shareholders, the Chairperson stated that:

"Any change in the legal structure of the Bank requires amendments to the Act, which constitutes legislation of a national nature. National legislative authority vests in Parliament and only the Minister may introduce any potential amendments to the Act in Parliament. The SARB and its shareholders have therefore no authority in this regard. As evidenced by the events this year before the promulgation of the Amendment Act, proposed amendments to the Act are subject to publication in the *Government Gazette* and public debate in Parliament."

Regarding the sixteenth matter, namely the basis of the liability of the Bank for income tax and secondary tax on companies (STC), the Chairperson stated that:

"From an income tax perspective the Bank is treated as a normal corporate entity. There is no exemption for the SARB in the income tax legislation. In the same vein the Bank is also liable for secondary tax on companies (STC). This liability is calculated on the difference between local dividends received and paid by institutions. The cumulative STC position of the Bank was a net credit and therefore no provision was made for STC in the annual financial statements at 31 March 2010."

Gill Marcus
Governor

South African Reserve Bank

Governor's Address
at the ninetieth ordinary general meeting of shareholders
of the SA Reserve Bank
on Wednesday, 8 December 2010

Ladies and Gentlemen,

Today is an opportunity for us, together, to consider a very serious overview of where the Bank stands in terms of its internal organisation, its relationship with shareholders, and its role in the South African economy as we move into what will undoubtedly be a very challenging 2011 for the world and South Africa.

In the proceedings so far today we have endeavoured to address the questions you have asked as they relate to the work of the Bank and arising from the *Annual Report* and Financial Statements. While there are still a number of matters that will be addressed towards the end of the agenda, we trust that the open interaction marks a new beginning in the relationship with Bank shareholders who, in our view, have a vital role to play in ensuring independence, good governance and accountability.

I wish to assure everyone here today of two things:

- firstly, that this meeting is compliant and in line with the regulations governing Ordinary General Meetings of the Bank, as elaborated upon earlier, and

- the Board, Executive and staff of the Bank will continue to act in the best interests of South Africa without fear or favour, and do so professionally, upholding the highest standards of governance and ethics.

We are very grateful and express our appreciation to a number of people and institutions for the professional and highly committed manner in which the amendments to the SARB Act, which led to the postponement of this year's OGM, were drafted, taken through an elaborate process of open and thorough consultation, and enacted into law.

Allow me specifically to mention in this connection the Minister of Finance, Pravin Gordhan, the National Treasury led by Lesetja Kganyago, and Parliament, the chairperson of the standing committee on finance, Thaba Mufamadi and the chairperson of the select committee of finance in the NCOP, Charel de Beer, and their members."

By passing these amendments, Parliament – as the democratically elected representative of the people of South Africa – has made it unequivocally clear that it regards the South African Reserve Bank as a national asset with an indispensable role in serving the economy and the people of our country. In so doing, Parliament has underlined that the Reserve Bank is and must remain independent, and able to work in the interests of South Africa and of all South Africans.

These are very significant signals to all who believe that the long term stability of our economy is central to what we must achieve to ensure that South Africa continues to develop, thereby offering steadily increasing numbers of our people the realistic prospects of a better life. This reconfirms that a better life for ever- increasing numbers of South Africans in a prosperous and stable country is a goal worth pursuing each and every day.

To those of us who pursue that goal via an association with the South African Reserve Bank – whether as serious minded shareholders, members of the Board, or employees of the Bank – Parliament's faith in the SARB as signaled by the amendments to the Act also represent a very grave responsibility.

Ladies and Gentlemen,

We at the Bank intend to continue to take that responsibility very seriously. In everything we do. Not least because of our understanding of the significant ongoing challenges facing the global economy, and with it the challenges facing the South African economy as we move into 2011.

We as South Africans have not been and are still not immune to those challenges and to the international situation because we are not an island. We are part of the global economic system and the serious difficulties facing many countries become – in one way or another – our challenges too.

While the annual general meeting would normally be the occasion for a detailed analysis of all of the elements affecting the South African economy, we do not plan to do so today. We felt it more appropriate to use this occasion to lay a firm foundation on which we can build our interaction for the future.

It is nevertheless appropriate to look at some of the economic issues which have faced us in the year since President Zuma appointed me to this position, and which are likely to face us in the years ahead.

Analysing the economic environment in which we operate also provides the essential backdrop against which we can look at and more clearly define the role the Bank must play as the international community works to emerge from the greatest economic crisis since the Crash of 1929.

The context in which the Bank had to conduct its operations in the past year remained extremely challenging. During 2009, the world economy began to emerge from the widespread recession that began in the latter part of 2008. After a promising start to the year, the recovery in the advanced economies has become more hesitant, following the withdrawal of the fiscal stimulus in the United States (US), the sovereign debt crisis in the euro area, and widespread fiscal consolidation in the region.

The current uncertainties in Ireland continue to raise questions about the outlook for euro area growth (noting that the region grew by only 0,4 per cent in the third quarter of 2010) and concerns about systemic risk in the banking sector. The international environment therefore remains characterised by heightened risk and uncertainty, and these developments indicate that we have not yet emerged from the crisis.

The economic and political ramifications of fiscal austerity programmes are of particular concern, not only because of their potential to derail the recovery in other regions, but also because of South Africa's close and significant trading relationship with Europe. It appears that growth in the US is likely to remain low for longer as monetary policy actions attempt to combat the threat of deflation and persistently high unemployment. The global banking system has improved somewhat, but serious risks remain.

By contrast, the emerging market economies, particularly in Asia and Latin America, appear to have recovered from the crisis. In a number of instances the strong growth in demand, coupled with pressures from higher commodity prices, has resulted in a reappearance of inflationary pressures. As a consequence, the monetary policy stance in a number of emerging markets has moved into tightening mode. But it is as yet unclear whether the strong growth in these regions can be sustained against the backdrop of weak growth in the industrialised economies.

Domestically, the recovery has been fragile, with disappointing growth despite the boost from the Fifa World Cup, and growth is expected to average below 3 per cent in 2010. Although household consumption expenditure is showing signs of recovery, growth in private sector gross fixed capital formation remains extremely subdued.

During the third quarter of 2010 the mining sector rebounded from its marked second quarter contraction, but both the manufacturing and construction sectors remained under pressure.

Monetary policy remained accommodating during the past financial year against the backdrop of an improved inflation outlook and the relatively weak domestic economy. Headline consumer price inflation returned to within the inflation target range of 3 to 6 per cent in the first quarter of 2010, and declined to 3,2 per cent in September before increasing to 3,4 per cent in October. The Bank's forecast is for inflation to remain within the target range for the remainder of the forecast period until the end of 2012. Since the onset of the crisis, the repurchase (repo) rate has been reduced by 650 basis points. The most recent change was a 50 basis point reduction in November 2010, when the improved inflation environment provided some space for an additional monetary stimulus to the economy without jeopardising the achievement of the inflation target.

The Bank remains committed to pursuing its objective of price stability within a flexible inflation targeting framework in the interest of balanced and sustainable economic growth and employment in South Africa.

The global environment has had a pervasive impact on many of the activities of the Bank, as well as on its strategic direction.

The recent crisis has demonstrated the need for central banks to have a clear focus on issues related to financial stability, in addition to a focus on inflation. The Bank has participated in discussions in international forums, and these interactions have highlighted the fact that while the need to have a financial stability focus is agreed upon, the modalities of intervention are not clear-cut. During the year, financial stability also became an explicit focus of the deliberations of the Monetary Policy Committee (MPC). In order to ensure coherence and co-ordination with monetary policy actions, the membership of the Financial Stability Committee was reconstituted and the mandate of the Committee enhanced.

Reforms of the supervisory and regulatory environment of the banking sector have also received increased attention at the global level, and these developments will impact on the domestic banking system. The Bank has participated in the deliberations of the IMF, World Bank, G20 and the Basel Committee on Banking Supervision (Basel Committee), which is drafting amendments to the existing *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), the working groups of the Financial Stability Board at the Bank for International Settlements (BIS), and the regular bimonthly meetings of central bank governors held at the BIS.

The South African banking system was one of the few that did not experience a crisis in 2008, mainly due to appropriate regulation, and monitoring and supervision of the sector.

South African banks remain well capitalised, and capital adequacy ratios are currently in excess of the minimum proposed in the new reforms. The proposals pertaining to liquidity may be challenging, but are not insurmountable.

The past year has also seen a significant flow of capital to emerging-market economies in the face of persistently low policy interest rates in advanced economies. This trend was reinforced by rising commodity prices and a decline in global risk aversion in general. South Africa was also a beneficiary of these flows, which has resulted in a marked appreciation of the trade-weighted rand exchange rate.

The Bank took advantage of these inflows to add to its foreign-exchange reserves which, although at historically high levels, are still relatively low compared with other emerging-market countries. However, the need to sterilise the impact of these purchases of foreign exchange on domestic liquidity resulted in the Bank reporting an after-tax loss of R1,05 billion during the financial year under consideration.

Thus, in essence, we are seeing a fragile global economy that is experiencing significant stresses and strains. Domestically, the economic landscape is one of the lowest real interest rates in 30 years, inflation that looks likely to remain in the target band to the end of the forecast period of 2012, a currency that has continued to appreciate on a trade-weighted basis, the export-led sectors remaining under pressure, slow growth and significant unemployment. Working to ensure a cohesive, co-ordinated macro-economic policy is part of the challenge as we enter the second decade of the 21st century.

Ladies and Gentlemen,

The international and domestic economic climate makes it very clear that the Bank must focus all of its energies and all of its human capacity on the job at hand –

making the SARB's unique and indispensable contribution to the management of the economy.

This is a time to focus on ensuring that our internal policies and procedures are in place and functioning in such a way as to provide maximum support and guidance for our day to day operations.

But it is particularly a time to focus on our core business at the heart of the economy. Which is why it is very pleasing indeed to be able to report to you that this has been an intense and demanding year of reviews, of assessments of weaknesses and strengths, and of realignment of our internal policies, procedures, and structures. We have also worked to strengthen the relationship and interaction with the Minister of Finance and the National Treasury.

Allow me to illustrate some of the organisational milestones that the Bank has achieved over the past year.

- We have not only reviewed and updated all board policies, but agreed that this will be an annual exercise to ensure that we remain up to date with best practice and that we constantly evaluate our effectiveness and compliance.

- We are in the process of reviewing the Bank's internal policies, with our human resource policies at the heart of this process.

- We have instituted a new Board Risk and Compliance Committee, specifically tasked with oversight of all aspects of risk and compliance which might affect the Bank.

- Within the Bank we have created a new Risk Management and Compliance Department to mirror this responsibility for managing our risk and ensuring compliance.

- The executive and Board have examined the Bank's practices and procedures against the backdrop of the King III Code of Governance Principles.

- This led to an assessment of where we meet the criteria embodied in the Code, where we do not yet meet them, where we need to take measures to improve our ability to comply, as well as where we should not meet them because of the legal specifications in the SARB Act or the specific nature of our work as accepted practice in central banking internationally. In such instances the Bank will adopt the approach of comply or explain.

- We have also finalised an ethics policy and are in the process of taking it through a series of discussions with staff. At the same time we are developing a common understanding of the values that all of us working in the SARB aspire and commit to. We will be finalising both of these processes in the first months of the new year.

- We have restructured the Bank's communications component and upgraded it to a full Department, which includes responsibility and significant capacity for strategy development. This will give us the capacity to ensure that our regular engagements with shareholders can be more frequent and productive than hitherto. Among other things, we will be expanding our annual shareholder road show next year to include Durban.

- If significant numbers of shareholders believe it would be useful to do so, we are very open to considering a second annual shareholders' road show

- The creation of the communications and strategy department ensures that we have the intellectual and implementation capacity to drive, among other things, organisational design and change management.

- Perhaps most importantly of all within our review process, we have initiated a thorough assessment and realignment of our systems for planning and managing succession. This is because it is crystal clear how very dependant an organisation of this nature is on its people. And allow me to take this opportunity to express appreciation for the sterling work the employees of the Bank are doing. By and large, they are the epitome of professionalism, dedication and competence.

- Because we stand or fall with our people, we are acutely aware of the centrality to our long term viability of strategies which
    - build on recruitment best practices able to establish and keep freshly supplied a talent pool with sufficient depth
    - includes consistent training and mentoring
    - encompasses highly competent career planning for every individual
    - ensures an approach to retention which motivates the very best to make their long term careers with the Bank, and
    - centres on ensuring that the Bank remains a workplace and career of choice, able to attract and keep the right people.

Ladies and Gentlemen,

I hope that you will agree with me that we are on the right road, taking the steps necessary to ensure that the Bank, its policies, and its practices are in line with international central banking best practice.

We are making this major effort because we believe that having the right structures, the right people, and the right approaches are and will continue to be essential elements of our ability and capacity to fulfil our mandate, and ensure stability during a time of significant uncertainty and the current global economic difficulties.

You will find more detail on our new structures and many of the other measures we are taking to strengthen the Bank's capacity in the *Annual Report*. Everyone should have received a copy, at the latest when you arrived here today. Please let a staff member know during the break if you have not received one, and we will ensure that you do.

Reading the *Annual Report*, you will notice that we have changed its design and content from previous years. We have done this in a further effort to ensure that our structures, our approaches, and our work can be more easily understood by and transparent to as wide a cross section of South Africans as possible.

You, the shareholders, have been a particular focus of our rethink of the *Annual Report*. We would be very grateful to have your views and feedback on the new approach, in particular ways in which we can constantly improve the information made available to you.

The focus on openness and transparency which becomes visible in the newly designed *Annual Report* is something we are working to entrench across the board in the Bank's dealings with shareholders, with stakeholders, and with everyone else who has a legitimate interest in what we do and how we do it.

While matters arising from the annual financial statements have been addressed earlier today, there are a number of specific issues that have been raised by shareholders that I shall deal with after the scrutineers report and the results of the election have been presented.

I would like to acknowledge a number of people, who have supported the Bank in the year under review.

I wish to thank President Zuma and the Presidency, the Government and Parliament for their continued support. The Bank has maintained a sound working relationship with the National Treasury and I wish to thank Finance Minister Pravin Gordhan, Deputy Minister Nhlanhla Nene, Lesetja Kganyago, the Director-General of the National Treasury, and all his staff for their ongoing support and co-operation.

Sincere thanks are also due to the members of the Board of the Bank for their tireless efforts in ensuring appropriate corporate governance. The successes achieved in dealing with the challenges of the past year are due to the continued dedication and commitment of the deputy governors, management and staff of the Bank. I wish to thank them all for their contributions and I am confident that these efforts will ensure that the challenges we face in the coming year will be met with the professionalism, skill and hard work required.

I also wish to thank Dr Renosi Mokate, who retired as Deputy Governor on 31 July 2010, for her service to the Bank.