MACQUARIE BANK MANAGEMENT DISCUSSION AND ANALYSIS

Year ended 31 March 2020

MACQUARIE BANK LIMITED ACN 008 583 542

Explanatory notes

Notice to readers

The purpose of this report is to provide information supplementary to the Macquarie Bank Limited Disclosure Report (U.S. Version) for the year ended 31 March 2020 and the Financial Report within the Macquarie Bank Limited Annual Report (the Financial Report) for the year ended 31 March 2020, including further detail in relation to key elements of Macquarie Bank Limited and its subsidiaries' (Macquarie Bank, the Consolidated Entity) financial performance and financial position. The report also outlines the funding and capital profile of the Consolidated Entity.

Certain financial information in this report is prepared on a different basis to that contained in the Financial Report, which is prepared in accordance with Australian Accounting Standards. Where financial information presented within this report does not comply with Australian Accounting Standards, a reconciliation to the statutory information is provided.

Date of this report

This report has been prepared for the year ended 31 March 2020 and is current as at 8 May 2020.

Comparative information and conventions

Where necessary, comparative figures have been restated to conform to changes in current year financial presentation and group structures. The financial information disclosed relates to the Consolidated Entity's continuing operations.

References to the prior year are to the 12 months ended 31 March 2019.

References to the first half are to the six months ended 30 September 2019.

References to the second half are to the six months ended 31 March 2020.

In the financial tables throughout this document '*' indicates that the absolute percentage change in the balance was greater than 300% or indicates the result was a gain in one period but a loss in another, or vice versa.

Independent auditor's report

This document should be read in conjunction with the Financial Report for the year ended 31 March 2020, which was subject to independent audit by PricewaterhouseCoopers.

PricewaterhouseCoopers' independent auditor's report to the members of Macquarie Bank Limited dated 8 May 2020 was unqualified.

Any additional financial information in this document which is not included in the Financial Report was not subject to independent audit by PricewaterhouseCoopers.

Cover image

Our banking clients get access to our award-winning digital banking app and cutting-edge digital tools.
Mozo Experts Choice Excellent Banking App 2020

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Result overview

Deanna and Chi –
I bank with Macquarie

To demonstrate Macquarie's support as a committed partner to the broker channel, Canberra based broker Deanna Ezzy and her client Chi featured in our new home loan campaign "Great home loans for good borrowers".

Macquarie Bank Limited
ABN 46 008 583 542 AFSL &
Australian Credit Licence 237502

1.1 Executive summary

FY2020 Net profit[1]

$A1,297m

↑22% on prior year

FY2020 Net operating income[1]

$A6,172m

↑4% on prior year

FY2020 Operating expenses[1]

$A4,277m

↓ 3% on prior year

FY2020 Net profit contribution[2] by Operating Group

Banking and Financial Services

$A767m

↑2% on prior year

- Growth in BFS deposits, loan portfolio and funds on platform average volumes
- Lower employment expenses due to a reduction in average headcount mainly due to the realignment of the wealth advice business to focus on the high net worth segment.

Partially offset by:

- Increased specific provision in Business banking and Vehicle Finance, together with increased credit impairment charges on the performing portfolios related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19
- Margin compression on deposits
- Lower wealth management fee income associated with realigning the wealth advice business to focus on the high net worth segment
- Increased costs associated with investment in technology to support business growth and to meet regulatory requirements.

Commodities and Global Markets

$A1,822m

↑8% on prior year

- Strength of global client contribution across all products and sectors including:
  - strong results across the commodities platform from client hedging activity
  - increased contribution in structured foreign exchange and interest rate products across all regions
  - improved equities performance, primarily due to increased contribution from client activity in Asia.

Partially offset by:

- Reduction in inventory management and trading income driven by reduced opportunities in North American Gas markets which were partially offset by the timing of income recognition, that increased revenue relating to transport agreements. The prior year included significant gains linked to supply and demand imbalances across natural gas markets in specific North American regions which were not repeated
- Increased impairment charges on a small number of counterparties in Futures and FI&C, together with increased credit impairment charges on the performing loan and lease portfolio related to a small number of loan facilities in the debt portfolio and a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

Operating Group updates

In the first half, all businesses of the Corporate and Asset Finance (CAF) Operating Group were aligned to other Operating Groups, where they have the greatest opportunities in terms of shared clients and complementary offerings as follows:

- CAF Asset Finance moved to CGM, reflecting a longstanding, shared focus on innovative financing solutions for corporates, some of which are already shared clients
- In addition, certain fiduciary businesses, such as the infrastructure debt business (MIDIS), moved from CAF Asset Finance in the Bank Group to Macquarie Asset Management (MAM) in the Non-Bank Group

Comparatives have been reclassified to reflect this reorganisation between the Operating Groups.

DISCONTINUED OPERATIONS

During the previous year, as part of an internal restructure by Macquarie Group Limited (refer Note 39 Discontinued operations of the Financial Report), the Company transferred the CAF Principal Finance and Transportation Finance businesses to Macquarie Financial Holdings Pty Limited (MFHPL) and its subsidiaries (entities under common control).

The agreement for the sale of the Transportation Finance business to MFHPL in the prior year required an adjustment to be paid to the Company, if:

- a binding third-party sale agreement of certain transferred assets was entered into within 18 months of 10 December 2018, being the original transfer effective date, and
- a premium to the amount paid by MFHPL under the original transfer is paid by the third-party to MFHPL.

The adjustment amount to be paid to the Company is determined based on the third-party sale price to the extent it reflects what reasonably would have been expected to have been paid by a third-party had it acquired the relevant assets on the original transfer effective date. In February 2020, a sale and purchase agreement was signed by MFHPL with a third party for the sale of certain assets and for which the Company has recognised a sales adjustment receivable from MFHPL at a fair value of $A102 million. This gain is presented as part of its discontinued operations. The actual adjustment will be determined and paid subsequent to the completion of the third-party sale transaction in accordance with the contractual provisions of the original sales agreement.

As part of the original sales agreement, MFHPL agreed to transfer to the Company any benefit that arose on the remeasurement of certain tax balances within 18 months of the original transfer date. Accordingly, the Company recorded a $A62 million tax benefit at 31 March 2020.

[1] From continuing operations only.

[2] Net profit contribution is management accounting profit before unallocated corporate costs, profit share and income tax.

Profit attributable to the ordinary equity holder

$A1,461m

↓ 28% on prior year

	HALF–YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Financial performance summary						
Net interest income	**1,059**	981	*8*	**2,040**	1,978	*3*
Fee and commission income	**591**	594	*(1)*	**1,185**	1,231	*(4)*
Net trading income	**1,181**	1,434	*(18)*	**2,615**	2,526	*4*
Net operating lease income	**211**	160	*32*	**371**	289	*28*
Share of net profits of associates and joint ventures	**21**	6	*250*	**27**	28	*(4)*
Net credit impairment charges	**(370)**	(81)	*	**(451)**	(131)	*244*
Other impairment charges	**(17)**	(4)	*	**(21)**	(116)	*(82)*
Other operating income and charges	**66**	340	*(81)*	**406**	106	*283*
Net operating income	**2,742**	3,430	*(20)*	**6,172**	5,911	*4*
Employment expenses	**(612)**	(735)	*(17)*	**(1,347)**	(1,448)	*(7)*
Brokerage, commission and trading-related expenses	**(289)**	(307)	*(6)*	**(596)**	(777)	*(23)*
Occupancy expenses	**(52)**	(52)	–	**(104)**	(117)	*(11)*
Non-salary technology expenses	**(85)**	(85)	–	**(170)**	(167)	*2*
Other operating expenses	**(1,131)**	(929)	*22*	**(2,060)**	(1,923)	*7*
Total operating expenses	**(2,169)**	(2,108)	*3*	**(4,277)**	(4,432)	*(3)*
Operating profit from continuing operations before income tax	**573**	1,322	*(57)*	**1,895**	1,479	*28*
Income tax expense from continuing operations	**(262)**	(324)	*(19)*	**(586)**	(394)	*49*
Profit from continuing operations after income tax	**311**	998	*(69)*	**1,309**	1,085	*21*
Profit from discontinued operations after income tax	**164**	–	*	**164**	956	*(83)*
Profit from continuing and discontinued operations after income tax	**475**	998	*(52)*	**1,473**	2,041	*(28)*
Profit attributable to non-controlling interests	**–**	–	–	**–**	(4)	*(100)*
Profit attributable to equity holders of Macquarie Bank Limited	**475**	998	*(52)*	**1,473**	2,037	*(28)*
Distribution paid or provided for on Macquarie Income Securities	**(6)**	(6)	–	**(12)**	(15)	*(20)*
Profit attributable to the ordinary equity holder of Macquarie Bank Limited	**469**	992	*(53)*	**1,461**	2,022	*(28)*
From continuing operations	**305**	992	*(69)*	**1,297**	1,066	*22*
From discontinued operations	**164**	–	*	**164**	956	*(83)*
Key metrics						
Expense to income ratio (%)	**79.1**	61.5		**69.3**	75.0	
Effective tax rate from continuing operations (%)	**45.7**	24.5		**30.9**	26.7	

Net operating income

Net operating income of $A6,172 million for the year ended 31 March 2020 increased 4% from $A5,911 million in the prior year, mainly driven by higher Other operating income and charges and Net interest and trading income. This was partially offset by higher Credit and other impairment charges.

Net interest and trading income

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
4,655	4,504

↑3% on prior year

- Increased contributions from client hedging activity, structured foreign exchange, interest rate and credit products as well as equities in CGM
- Growth in BFS deposits and loan portfolio average volumes in BFS.

Partially offset by:

- Reduced contributions from Inventory management and trading following a strong prior year and the impact of fair value adjustments in CGM
- Margin compression on deposits and the sale of an investment in Macquarie Pacific Funding (MPF) in BFS
- Lower earnings on capital driven by lower Australian dollar and United States dollar interest rates in Corporate.

Fee and commission income

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
1,185	1,231

↓4% on prior year

- Lower wealth management fee income associated with realigning the wealth advice business to focus on the high net worth segment in BFS
- Lower base fee income in the Bank Group from the infrastructure debt business (MIDIS) which moved to the Non-Bank Group during the year.

Partially offset by:

- Higher commissions in futures products due to increased client activity on the prior year in CGM.

Net operating lease income

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
371	289

↑28% on prior year

- Higher secondary income from the Technology, Media and Telecoms (TMT) portfolio within CGM.

Share of net profits of associates and joint ventures

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
27	28

↓4% on prior year

- Decrease reflecting performance of underlying investments.

Credit and other impairment charges

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
(472)	(247)

↑91% on prior year

- Higher impairment charges recognised across the Consolidated Entity primarily driven by a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

Other operating income and charges

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
406	106

↑ significantly on prior year

- The recognition of a gain in Corporate on the sale of Macquarie Specialised Investment Solutions (MSIS) fiduciary businesses to Macquarie Asset Management Holdings Pty Limited (MAMHPL), a related party of MBL, owned 100% by MGL.

1.1 Executive summary

Continued

Operating expenses

Total operating expenses of $A4,277 million for the year ended 31 March 2020 decreased 3% from $A4,432 million in the prior year, mainly driven by lower Brokerage, commission and trading-related expenses as well as lower Employment expenses. This was partially offset by higher Other operating expenses.

Employment expenses

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
1,347	1,448

↓7% on prior year

- Lower expenses due to a reduction in average headcount mainly due to the realignment of the wealth advice business to focus on the high net worth segment in BFS
- Lower performance-related profit share as a result of higher retention rates being applied.

Partially offset by:

- Higher share-based payments expense mainly driven by the accelerated amortisation of prior years' equity awards to retiring Key Management Personnel.

Brokerage, commission and trading-related expenses

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
596	777

↓23% on prior year

- Reduced brokerage, commission and trading-related expenses in CGM
- The sale of an investment in MPF in BFS.

Non-salary technology expenses

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
170	167

↑2% on prior year

- Broadly in line with the prior year.

Other operating expenses and Occupancy

FULL YEAR TO	
31 Mar 20 $Am	31 Mar 19 $Am
2,164	2,040

↑6% on prior year

- Increased support services due to higher business activity in the Bank Group.

Income tax expense

Income tax expense from continuing operations for the year ended 31 March 2020 of $A586 million increased 49% from $A394 million in the prior year. The effective tax rate for the year ended 31 March 2020 was 30.9%, up from 26.7% in the prior year.

The higher effective tax rate compared to prior year was mainly driven by the geographic composition and nature of earnings.

Note on adoption of new Australian Accounting Standards

The current year financial results reflect the adoption of AASB 16 *Leases* (AASB 16) on 1 April 2019. As permitted by AASB 16, the Consolidated Entity has not restated previously reported financial periods.

Refer to Note 1 *Summary of significant accounting policies* in the Financial Report for details regarding the Consolidated Entity's transition to AASB 16. No material transition adjustments arose following the adoption of AASB 16.

COVID-19 - Expected Credit Losses

Total credit and other impairment charges of $A472 million increased 91% from $A247 million in the prior year. This included $A451 million of net credit impairment charges, up from $A131 million in the prior year and including the impact of expected credit loss (ECL) charges, which reflects the uncertain macroeconomic outlook as a result of COVID-19. Certain additional overlays are held within the Corporate segment.

The ECL charge includes the impact of modelled expected future credit losses on positions that have not yet defaulted and the impact of defaults, predominately relating to the markets-facing businesses. Further details on the ECL charge are set out in section 2.5, page 14 of this document and Note 11 of the Macquarie Bank Limited Full Year 2020 Financial Report.

ECL calculation methodology and sensitivity

The ECL calculation probability weights three different forward-looking economic scenarios. The baseline and downside scenarios carried the highest weightings this year and required a large degree of management judgement given the uncertainty in the current macroeconomic environment.

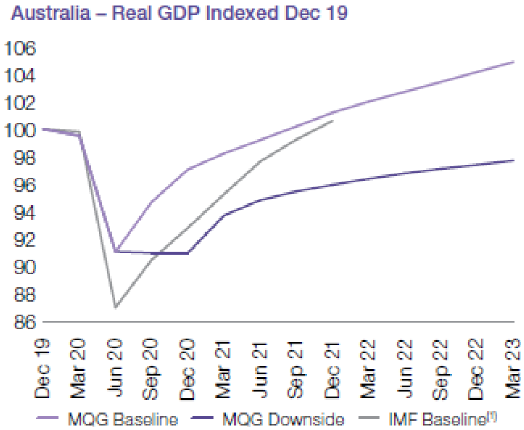
The scenarios reflect the different views held on the severity of the impact of COVID-19, the speed at which COVID-19 may be brought under control, and the time required for economic activity to return to previous levels. Whilst the outlook is uncertain, these outlooks reflect Macquarie's current view.

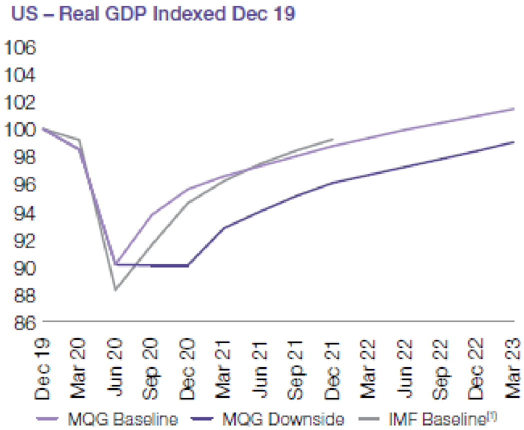
- **Baseline** – broadly assumes a recovery within 18 months. A 100% weighting to this scenario would result in total ECL provisions on the balance sheet of $A800 million (actual ECL provisions recognised at 31 March 2020 were $A852 million)
- **Downside** – assumes a more severe economic impact with the start of the recovery being delayed by half a year. The recovery period is ~18 months longer than the baseline, with some metrics such as unemployment in some regions remaining higher than pre-COVID-19 levels in 2023. Assuming a 100% weighting would have resulted in ECL provisions of $A1,150 million being recognised on the balance sheet as at 31 March 2020.

The scenarios are used to forecast both the probability of customers defaulting on their obligations, and the loss Macquarie may incur if this was to occur. The key variables when determining the probability of defaults are generally GDP, unemployment rates, commodity prices and interest rates. The modelled values of collateral in the event of default are sensitive to property prices and share price index outlooks.

The graphs below show Macquarie's GDP outlook for both Australia and the United States, reflecting the two largest countries to which Macquarie's loan asset portfolio is exposed.

ECL Calculation Sensitivity





ECL calculations utilise scenarios rather than stress individual variables, reflecting the interplay between the variables. Each of the scenarios are different and the weightings applied to them are a matter of judgement. While it is possible to construct more severe outlooks, their plausibility seems remote at this time, noting the speed at which governments are acting to both limit the spread of COVID-19 and to seek to restart their economic activities.

It is important to note that while the forecasts are forward looking in respect of the economic outlook and their impact on collective provisioning, they do assume credit performance remains broadly consistent to the baseline. Where there is a significant increase in credit risk represented by higher arrears, re-rating of counterparties, or a higher level of defaults, additional ECL charges may be recognised in future periods.

[1] IMF GDP profiles are implied/estimated based on IMF year-ended and year average GDP forecasts.

02

Financial performance analysis

Macquarie wins 2019 Natural Gas/LNG House of the Year

Macquarie won the Natural Gas/LNG House of the Year in the highly regarded Energy Risk Awards, which recognise excellence across global commodity markets, reflecting CGM's increase in traded gas volumes, geographic expansion and customer reach.

2.1 Net interest and trading income

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Net interest income	**1,059**	981	*8*	2,040	1,978	*3*
Net trading income	**1,181**	1,434	*(18)*	2,615	2,526	*4*
Net interest and trading income	**2,240**	2,415	*(7)*	**4,655**	4,504	*3*

Net interest income and net trading income are recorded in accordance with Australian Accounting Standards, with net interest income brought to account using the effective interest method and net trading income predominately comprising gains and losses relating to trading activities.

For CGM, which predominately earns income from trading-related activities, the relative contribution of net interest income and net trading income from those activities can vary from period to period depending on the underlying trading strategies undertaken by the Consolidated Entity and its clients.

For businesses that predominately earn income from lending activities, derivatives that hedge interest rate risk are required to be measured at fair value. The changes in fair value (volatility) are recognised in net trading income unless hedge accounting is applied by the Consolidated Entity, where either the hedged item is revalued for changes in fair value that are attributable to the hedged risk to remove the volatility, or the fair value volatility on the derivative is deferred until the hedged transaction is recognised in the income statement. For segment reporting, derivatives are accounted for on an accrual basis in the results of the non-trading businesses, with changes in fair value recognised within the Corporate segment and managed via the application of hedge accounting.

The presentation of net interest income and net trading income separately can distort the analysis of the underlying activities and drivers. For example, within Specialised and Asset Finance (a business within CGM), interest rate swaps are entered into to hedge the interest rate risk associated with loan assets. The interest income and associated funding costs are recognised in net interest income, however the related swap is recognised in net trading income. Accordingly, net interest income and net trading income are presented and discussed below in aggregate for each Operating Group, which management believes presents a more consistent overview of business performance and allows for a better analysis of the underlying activities and drivers.

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
BFS	**890**	838	*6*	**1,728**	1,679	*3*
CGM						
Commodities	**748**	1,013	*(26)*	**1,761**	1,826	*(4)*
Foreign exchange, interest rates and credit	**327**	333	*(2)*	**660**	547	*21*
Equities	**104**	143	*(27)*	**247**	164	*51*
Specialised and Asset Finance	**84**	78	*8*	**162**	135	*20*
Corporate	**87**	10	*	**97**	153	*(37)*
Net interest and trading income	**2,240**	2,415	*(7)*	**4,655**	4,504	*3*

2.1 Net interest and trading income

Continued

Net interest and trading income of $A4,655 million for the year ended 31 March 2020 increased 3% from $A4,504 million in the prior year.

BFS

Net interest and trading income in BFS relates to interest income earned from the loan portfolio that primarily comprises home loans in Australia, loans to Australian businesses, vehicle leases, insurance premium funding and credit cards. BFS also generates income from deposits by way of a deposit premium received from Group Treasury, which uses the deposits as a source of funding for the Banking Group.

Net interest and trading income of $A1,728 million for the year ended 31 March 2020 increased 3% from $A1,679 million in the prior year due to a 10% increase in the average BFS deposit balance and a 10% increase in average loan and lease portfolio volumes, partially offset by margin compression on deposits and the sale of an investment in MPF in the current year.

As at 31 March 2020 the deposit and loan and lease portfolios included:

- BFS Deposits of $A63.9 billion, up 20% from $A53.4 billion as at 31 March 2019;
- Home loan volumes of $A52.1 billion, up 35% from $A38.5 billion as at 31 March 2019;
- Vehicle finance volumes of $A13.7 billion, down 10% from $A15.2 billion as at 31 March 2019; and
- Business banking loan volumes of $A9.0 billion, up 10% from $A8.2 billion as at 31 March 2019.

CGM

Commodities

Net interest and trading income from commodity related activities is generated from the provision of hedging and risk management services and loans and working capital finance to clients across a range of commodity sectors including metals, energy and agriculture.

Risk management products income is mainly driven by client volumes, which are influenced by the level of price volatility in the markets in which those clients operate. CGM enters into financial and physical contracts including exchange traded derivatives, over-the-counter (OTC) derivatives, storage contracts and transportation agreements as part of its commodities platform. These arrangements enable CGM to facilitate client transactions and provide CGM with trading opportunities where there is an imbalance between the supply and demand for commodities.

Revenue is dependent on a number of factors including the volume of transactions, the level of risk assumed and the volatility of price movements across commodity markets and products. Storage contracts and transportation agreements, which are managed on a fair value basis for financial and risk management purposes, are required to be accounted for on an accruals basis for statutory reporting purposes, which may result in some variability in the timing of reported income.

Lending and financing activities include interest income from the provision of loans and working capital finance to clients across a range of commodity sectors including metals, energy and agriculture. Commodities lending and financing activities are primarily secured against underlying assets and typically have associated hedging to protect against downside risk.

Net interest and trading income from commodities of $A1,761 million for the year ended 31 March 2020 decreased 4% from $A1,826 million in the prior year.

The current year result was impacted by the reduced contribution from inventory management and trading activities, primarily due to reduced opportunities in North American Gas markets following a strong prior year driven by demand and supply factors in specific American regions. The decreased trading contribution was partially offset by the timing of income recognition, which increased revenue relating to transport agreements.

The overall decrease in inventory management and trading activities was partially offset by strong results across the commodities platform due to increased client hedging activity in Global Oil, EMEA Gas and Power, Agriculture, and Metals and Mining compared to the prior year as a result of increased volatility and commodity price movements, partially offset by the impact of fair value adjustments.

In addition, lending and financing income increased on the prior year due to increased physical oil financing activity.

Foreign exchange, interest rates and credit

Net interest and trading income from foreign exchange, interest rates and credit related activities are generated from the provision of trading and hedging services to a range of corporate and institutional clients globally, in addition to making secondary markets in corporate debt securities, syndicated bank loans and middle market loans and providing specialty lending.

Net interest and trading income from foreign exchange, interest rates and credit related activities of $A660 million for the year ended 31 March 2020 increased 21% from $A547 million in the prior year. Increased income in the current year was driven by increased client activity in structured foreign exchange and interest rate products, primarily from corporates, generated across the Americas, EMEA and Asia-Pacific region.

Equities

Equities net interest and trading income is generated from the issue of derivative products in key locations, the provision of equity finance solutions to institutional clients and the conduct of risk management and trading activities.

Equities net interest and trading income of $A247 million for the year ended 31 March 2020 increased 51% from $A164 million in the prior year reflecting increased opportunities and client activity, primarily in Asian markets.

Specialised and Asset Finance (SAF)

Net interest and trading income in Specialised and Asset Finance predominantly relates to net income from the loan and finance lease portfolios (including ship finance, equipment and technology financing) and the funding costs associated with the operating lease portfolios (including energy, telecommunication and mining assets).

Net interest and trading income of $A162 million for the year ended 31 March 2020 increased 20% from $A135 million in the prior year. The increase was largely driven by the net proceeds from end of lease asset sales and favourable foreign exchange movements.

The loan and finance lease portfolio was $A6.1 billion as at 31 March 2020, an increase of 13% from $A5.4 billion as at 31 March 2019. The increase was largely due to the growth in funds products, partially offset by the equipment finance portfolio.

Corporate

Net interest and trading income in the Corporate segment includes the net result of managing Macquarie Bank's liquidity and funding requirements, earnings on capital, funding costs associated with non-core investments held centrally and accounting volatility arising from movements in underlying rates relating to economically hedged positions where hedge accounting in terms of AASB 9 is unable to be achieved.

Net interest and trading income of $A97 million for the year ended 31 March 2020 decreased 37% from $A153 million in the prior year primarily due to lower earnings on capital driven by lower Australian dollar and United States dollar interest rates.

2.2 Fee and commission income

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Brokerage and other trading-related income	**264**	237	*11*	**501**	532	*(6)*
Other fee and commission income[1]	**327**	357	*(8)*	**684**	699	*(2)*
Total fee and commission income	**591**	594	*(1)*	**1,185**	1,231	*(4)*

Fee and commission income comprises Brokerage and other trading-related income and Other fee and commission income. Brokerage and other trading-related income primarily includes brokerage income from the Equities and Futures businesses in CGM and brokerage income from the BFS Wrap and Vision platforms. Other fee and commission income includes fees earned on a range of BFS' products and services including the Wrap platform, provision of wealth services, home loans, vehicle finance, credit cards, business loans and deposits, while Other fee and commission income from CGM includes income from structured, index and retail products.

Total fee and commission income of $A1,185 million for the year ended 31 March 2020 decreased 4% from $A1,231 million in the prior year, primarily due to a reduction in BFS as the wealth advice business focused on the high net worth segment and lower fee income in the Bank Group from MIDIS which moved to the Non-Bank Group during the year. This was partially offset by CGM which primarily included higher commissions in futures products due to increased client activity on the prior year.

[1]Other fee and commission income includes Portfolio administration fees, Lending fees and Other fee and commission income as disclosed in Note 2 *Operating profit from continuing operations before income tax* of the Financial Report.

2.3 Net operating lease income

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20 $Am	Sep 19 $Am	*Movement %*	**Mar 20 $Am**	Mar 19 $Am	*Movement %*
Rental income	**583**	614	*(5)*	**1,197**	1,119	*7*
Depreciation on assets under operating lease	**(372)**	(454)	*(18)*	**(826)**	(830)	*(<1)*
Net operating lease income	**211**	160	*32*	**371**	289	*28*

Net operating lease income of $A371 million for the year ended 31 March 2020 increased 28% from $A289 million in the prior year. The movement was primarily driven by higher secondary income from the TMT portfolio in addition to favourable foreign exchange movements in CGM.

The total operating lease portfolio was $A2.2 billion as at 31 March 2020, a decrease of 8% from $A2.4 billion as at 31 March 2019.

2.4 Share of net profits of associates and joint ventures

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20 $Am	Sep 19 $Am	*Movement %*	**Mar 20 $Am**	Mar 19 $Am	*Movement %*
Share of net profits of associates and joint ventures	**21**	6	*250*	**27**	28	*(4)*

Share of net profits of associates and joint ventures of $A27 million for the year ended 31 March 2020 decreased 4% from $A28 million in the prior year, reflecting the performance of underlying investments.

2.5 Credit and Other impairment charges

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Net credit impairment charges						
Loan assets	**(231)**	(94)	*146*	**(325)**	(137)	*137*
Margin money and settlement assets	**(66)**	–	*	**(66)**	–	*
Financial investments, other assets, undrawn commitments, financial guarantees	**(71)**	(1)	*	**(72)**	(8)	*
Gross credit impairment charges	**(368)**	(95)	*287*	**(463)**	(145)	*219*
Recovery of loans previously written off	**(2)**	14	*	**12**	14	*(14)*
Total net credit impairment charges	**(370)**	(81)	*	**(451)**	(131)	*244*
Other impairment charges						
Interests in associates and joint ventures	**(7)**	–	*	**(7)**	(102)	*(93)*
Intangible assets and other non-financial assets	**(10)**	(4)	*150*	**(14)**	(14)	–
Total other impairment charges	**(17)**	(4)	*	**(21)**	(116)	*(82)*
Total credit and other impairment charges	**(387)**	(85)	*	**(472)**	(247)	*91*

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
BFS	**(108)**	(41)	*163*	**(149)**	(82)	*82*
CGM	**(207)**	(31)	*	**(238)**	(157)	*52*
Corporate	**(72)**	(13)	*	**(85)**	(8)	*
Total credit and other impairment charges	**(387)**	(85)	*	**(472)**	(247)	*91*

Total credit and other impairment charges of $A472 million for the year ended 31 March 2020 increased 91% from $A247 million in the prior year. This included $A451 million of net credit impairment charges, up from $A131 million in the prior year and including the impact of expected credit loss (ECL) charges, which reflects the uncertain macroeconomic outlook as a result of COVID-19.

BFS

Credit and other impairment charges of $A149 million for the year ended 31 March 2020 increased 82% from $A82 million in the prior year largely due to increased specific provisions in Business banking and Vehicle Finance together with increased credit impairment charges on the performing portfolios related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

CGM

Credit and other impairment charges of $A238 million for the year ended 31 March 2020 increased 52% from $A157 million in the prior year due to increased impairment charges on a small number of counterparties in Futures and FI&C, together with increased credit impairment charges on the performing loan and lease portfolio related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

Corporate

Credit and other impairment charges of $A85 million for the year ended 31 March 2020, increased significantly from $A8 million in the prior year driven by higher central overlay provisions for expected credit losses on the performing portfolio due to a higher weighting to the ECL downside scenario.

2.6 Other operating income and charges

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Investment income						
Net (loss)/gain on equity and debt investments	**(2)**	11	*	**9**	55	*(84)*
Net gain on the disposal of interests in associates and joint ventures	**9**	9	–	**18**	62	*(71)*
Net (loss)/gain on the disposal of businesses and subsidiaries held for sale	**(1)**	242	*	**241**	–	*
Net gain on change of control, joint control and/or significant influence	**–**	–	–	**–**	10	*(100)*
Total investment income	**6**	262	*(98)*	**268**	127	*111*
Other income and charges	**60**	78	*(23)*	**138**	(21)	*
Total other operating income and charges	**66**	340	*(81)*	**406**	106	*283*

Total other operating income and charges of $A406 million for the year ended 31 March 2020 increased significantly from $A106 million in the prior year, mainly driven by higher investment income in Corporate.

Investment income

Investment income of $A268 million for the year ended 31 March 2020, a significant increase from $127 million in the prior year, mainly due to the recognition of a gain in Corporate on the sale of MSIS fiduciary businesses to MAMHPL, a related party of MBL, owned 100% by MGL. This was partially offset by unfavourable equity valuations in the current year while the prior year benefited from a significant sale in the commodity sector within CGM.

Other income

Other income of $A138 million for the year ended 31 March 2020 compared to charges of $A21 million in the prior year, primarily driven by Corporate which included consolidation adjustments recognised in the current year, in addition to a fair value adjustment within CGM on debt securities. The prior year included the impact of a structural change in funding between Bank and Non-Bank Groups in Corporate.

2.7 Operating expenses

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20 $Am	Sep 19 $Am	*Movement %*	**Mar 20 $Am**	Mar 19 $Am	*Movement %*
Employment expenses						
Salary and related costs including commissions, superannuation and performance-related profit share	**(532)**	(622)	*(14)*	**(1,154)**	(1,305)	*(12)*
Share-based payments	**(81)**	(111)	*(27)*	**(192)**	(144)	*33*
Reversal of/(Provision for) long service leave and annual leave	**1**	(2)	*	**(1)**	1	*
Total employment expenses	**(612)**	(735)	*(17)*	**(1,347)**	(1,448)	*(7)*
Brokerage, commission and trading-related expenses	**(289)**	(307)	*(6)*	**(596)**	(777)	*(23)*
Occupancy expenses	**(52)**	(52)	–	**(104)**	(117)	*(11)*
Non-salary technology expenses	**(85)**	(85)	–	**(170)**	(167)	*2*
Other operating expenses						
Service cost recoveries from related entities	**(926)**	(717)	*29*	**(1,643)**	(1,427)	*15*
Professional fees	**(76)**	(69)	*10*	**(145)**	(134)	*8*
Travel and entertainment expenses	**(19)**	(22)	*(14)*	**(41)**	(47)	*(13)*
Advertising and communication expenses	**(15)**	(15)	–	**(30)**	(31)	*(3)*
Amortisation of intangibles assets	**(11)**	(9)	*22*	**(20)**	(19)	*5*
Auditor's remuneration	**(12)**	(10)	*20*	**(22)**	(24)	*(8)*
Other expenses	**(72)**	(87)	*(17)*	**(159)**	(241)	*(34)*
Total other operating expenses	**(1,131)**	(929)	*22*	**(2,060)**	(1,923)	*7*
Total operating expenses	**(2,169)**	(2,108)	*3*	**(4,277)**	(4,432)	*(3)*

Total operating expenses of $A4,277 million for the year ended 31 March 2020 decreased 3% from $A4,432 million for the prior year, mainly due to a decrease in Brokerage, commission and trading-related expenses as well as Salary and related costs. This was partially offset by increased support services received by the Bank Group and higher share-based payments expense.

Key drivers of the movement included:

- Total employment expenses of $A1,347 million for the year ended 31 March 2020 decreased 7% from $A1,448 million in the prior year primarily driven by reduction in average headcount mainly due to the realignment of the wealth advice business to focus on the high net worth segment in BFS and lower performance-related profit share as a result of higher retention rates being applied. This was partially offset by higher share-based payments expense mainly driven by the accelerated amortisation of prior years' equity awards to retiring Key Management Personnel
- Brokerage, commission and trading-related expenses of $A596 million for the year ended 31 March 2020 decreased 23% from $A777 million in the prior year primarily due to the sale of an investment in MPF in the first half in BFS while the prior year included the recognition of certain legacy lending transaction-related expenses in CGM
- Total other operating expenses of $A2,060 million for the year ended 31 March 2020 increased 7% from $A1,923 million in the prior year mainly due to increased support services for higher business activity in the Bank Group, partially offset by Corporate which included the recognition of certain legacy-related expenses in the prior year.

2.8 Headcount

	AS AT			MOVEMENT	
				Sep 19	*Mar 19*
	Mar 20	Sep 19	Mar 19	*%*	*%*
Headcount by Operating Group[(1)]					
BFS	**2,646**	2,643	2,768	*<1*	*(4)*
CGM	**1,627**	1,673	1,676	*(3)*	*(3)*
Total headcount – Operating Groups	**4,273**	4,316	4,444	*(1)*	*(4)*
Total headcount – Discontinued Operations [(2)]	**–**	–	49	–	*(100)*
Total headcount – Corporate[(3)]	**6**	8	62	*(25)*	*(90)*
Total headcount	**4,279**	4,324	4,555	*(1)*	*(6)*
Headcount by region					
Australia[(4)]	**2,951**	2,962	3,106	*(<1)*	*(5)*
International:					
Americas	**448**	451	494	*(1)*	*(9)*
Asia	**227**	233	242	*(3)*	*(6)*
Europe, Middle East and Africa	**653**	678	713	*(4)*	*(8)*
Total headcount – International	**1,328**	1,362	1,449	*(2)*	*(8)*
Total headcount	**4,279**	4,324	4,555	*(1)*	*(6)*
International headcount ratio (%)	**31**	31	32		

Total headcount decreased 6% to 4,279 as at 31 March 2020 from 4,555 as at 31 March 2019, mainly driven by BFS due to the realignment of the wealth advice business to focus on the high net worth segment while CGM included the reorganisation of the CAF Asset Finance business. In addition, Corporate included the transfer of certain fiduciary businesses, such as MIDIS, to the Non-Bank Group during the year.

[1] Headcount numbers in this document includes certain staff employed in operationally segregated subsidiaries (OSS).
[2] The prior year included headcount relating to the Principal Finance business within CAF which was sold to MFHPL and its subsidiaries on 10 December 2018. These employees were subsequently transferred to MFHPL in May 2019.
[3] The prior year headcount number includes the headcount of the MSIS (MIDIS) Fiduciary businesses transferred from MBL CAF to MAM in the first half.
[4] Includes New Zealand.

2.9 Income tax expense

	FULL-YEAR TO	
	Mar 20	Mar 19
	$Am	$Am
Operating profit before income tax	**1,895**	1,479
Prima facie tax @ 30%	**569**	444
Income tax permanent differences	**17**	(50)
Income tax expense	**586**	394
Effective tax rate[1]	**30.9%**	26.7%

Income tax expense from continuing operations for the year ended 31 March 2020 of $A586 million increased 49% from $A394 million in the prior year. The effective tax rate for the year ended 31 March 2020 was 30.9%, up from 26.7% in the prior year.

The higher effective tax rate compared to prior year was mainly driven by the geographic composition and nature of earnings.

[1] The effective tax rate is calculated on Operating profit before income tax and after non-controlling interests. Non-controlling interests reduced operating profit before income tax by Nil for the year ended 31 March 2020 (31 March 2019: reduced operating profit before income tax by $A4 million).

03

Segment Analysis

**The Exarhos Family –
I bank with Macquarie**

The new home loan campaign “Great home loans for good borrowers” uses real Macquarie clients like the Exarhos family to illustrate our real customer stories and experiences.

*Macquarie Bank Limited
ABN 46 008 583 542 AFSL &
Australian Credit Licence 237502*

3.1 Basis of preparation

Operating Segments

AASB 8 *Operating Segments* requires the 'management approach' to disclosing information about the Consolidated Entity's reportable segments. The financial information is reported on the same basis as used internally by senior management for evaluating Operating Segment performance and for deciding how to allocate resources to Operating Segments. Such information may be produced using different measures to that used in preparing the statutory income statement.

For internal reporting, performance measurement and risk management purposes, the Consolidated Entity is divided into Operating Groups and a Corporate segment.

In the first half, the businesses operating in the CAF Operating Group were aligned to CGM, reflecting a longstanding, shared focus on innovative financing solutions for corporates, some of which are already shared clients.

In addition, certain fiduciary businesses, such as the infrastructure debt business (MIDIS), moved from CAF Asset Finance in the Bank Group to MAM in the Non-Bank Group.

Comparatives have been reclassified to reflect this reorganisation between the Operating Groups.

These segments have been set up based on the different core products and services offered. Following the reorganisation described above, the Operating Groups comprise:

- **BFS** provides a diverse range of personal banking, wealth management, business banking and vehicle finance products and services to retail clients, advisers, brokers and business clients
- **CGM** provides integrated, end-to-end offering across global markets including equities, fixed income, foreign exchange, commodities and technology, media and telecoms, as well as providing clients with risk and capital solutions across physical and financial markets. CGM also delivers a diverse range of tailored specialised asset finance solutions globally across a variety of industries and asset classes.

The financial information disclosed relates to the Consolidated Entity's continuing operations.

The Corporate segment, which is not considered an Operating Group, comprises head office and central service groups, including Group Treasury. As applicable, the Corporate segment holds certain legacy investments, assets and businesses that are no longer core for strategic reasons and are not allocated to any of the Operating Groups.

Items of income and expense within the Corporate segment include the net result of managing Macquarie Bank's liquidity and funding requirements, earnings on capital and the residual accounting volatility relating to economically hedged positions where hedge accounting is applied as well as accounting volatility for other economically hedged positions where hedge accounting is not applicable. Other items of income and expenses include earnings from investments, central credit and asset related impairments including certain additional central overlays on expected credit losses, unallocated head office costs and costs of central service groups, the Consolidated Entity's performance-related profit share and share-based payments expense, income tax expense and certain distributions attributable to certain non-controlling interests and holders of Macquarie Income Securities (MIS). The MIS were repaid on 15 April 2020, followed by a redemption on 16 April 2020.

Below is a selection of key policies applied in determining Operating Segment results.

Internal funding arrangements

Group Treasury has the responsibility for managing funding for the Consolidated Entity, and Operating Groups obtain their funding from Group Treasury. The interest rates charged by Group Treasury are determined by the currency and term of the funding. Break costs may be charged to Operating Groups for the early repayment of term funding.

Generally, Operating Groups may only source funding directly from external sources where the funding is secured by the Operating Group's assets. In such cases the Operating Group bears the funding costs directly and Group Treasury may levy additional charges where appropriate.

Deposits are a funding source for the Banking Group. BFS receives a deposit premium from Group Treasury on deposits that it generates. This deposit premium is included within Net interest and trading income for segment reporting purposes.

Transactions between Operating Segments

Operating Segments that enter into arrangements with other Operating Segments must do so on commercial terms or as agreed by the Consolidated Entity's Chief Executive Officer or Chief Financial Officer. There is a requirement for accounting symmetry in such transactions.

Internal transactions are recognised in each of the relevant categories of income and expense and eliminated on consolidation as appropriate.

Accounting for derivatives that economically hedge interest rate risk

For businesses that predominantly earn income from lending activities, derivatives that hedge interest rate risk are required to be measured at fair value. The changes in fair value (volatility) are recognised in net trading income unless hedge accounting is applied by the Consolidated Entity, where either the hedged item is revalued for changes in fair value that are attributable to the hedged risk to remove the volatility, or the fair value volatility on the derivative is deferred until the hedged transaction is recognised in the income statement. For segment reporting, derivatives are accounted for on an accrual basis in the results of the non-trading businesses, with changes in fair value recognised within the Corporate segment and managed via the application of hedge accounting.

Central service groups

The central service groups provide a range of functions supporting Macquarie Bank's Operating Groups, ensuring they have the appropriate workplace support and systems to operate effectively and the necessary resources to meet their regulatory, compliance, financial reporting, legal and risk management requirements.

Central service groups recover their costs from Operating Groups generally on either a time and effort allocation basis or a fee for service basis. Central service groups include the Corporate Operations Group (COG), Financial Management Group (FMG), Risk Management Group (RMG), Legal and Governance and Central Executive.

3.1 Basis of preparation
Continued

Performance-related profit share and share-based payments expense

Performance-related profit share and share-based payments expense relating to the Macquarie Group Employee Retained Equity Plan (MEREP) are recognised in the Corporate segment and not allocated to Operating Groups.

Income tax

Income tax expense and benefits are recognised in the Corporate segment and not allocated to the Operating Groups. However, to recognise an Operating Group's contribution to permanent income tax differences, the internal management revenue/charge category is used.

This internal management revenue/charges category, which is primarily used for permanent income tax differences generated by the Operating Groups, are offset by an equal and opposite amount recognised in the Corporate segment such that they are eliminated on consolidation.

Presentation of segment income statements

The income statements on the following pages for each of the reported segments are in some cases summarised by grouping non-material balances together. Where appropriate, all material or key balances have been reported separately to provide users with information relevant to the understanding of the Consolidated Entity's financial performance. The financial information disclosed relates to the Consolidated Entity's ordinary activities.

	BFS $Am	CGM $Am	Corporate $Am	Total $Am
Full-year ended 31 March 2020				
Net interest and trading income	1,728	2,830	97	**4,655**
Fee and commission income	441	731	13	**1,185**
Net operating lease income	–	360	11	**371**
Share of net profits/(losses) of associates and joint ventures	3	25	(1)	**27**
Other operating income and charges				
Credit and Other impairments charges	(149)	(238)	(85)	**(472)**
Other operating income and charges	9	82	315	**406**
Internal management revenue/(charge)	2	21	(23)	**–**
Net operating income	2,034	3,811	327	**6,172**
Total operating expenses	(1,267)	(1,989)	(1,021)	**(4,277)**
Operating profit/(loss) before income tax	767	1,822	(694)	**1,895**
Income tax expense	–	–	(586)	**(586)**
Operating profit/(loss) after income tax	767	1,822	(1,280)	**1,309**
Distributions paid or provided for on MIS	–	–	(12)	**(12)**
Net profit/(loss) attributable to ordinary equity holders from continuing operations	767	1,822	(1,292)	**1,297**
Full-year ended 31 March 2019				
Net interest and trading income	1,679	2,672	153	**4,504**
Fee and commission income	473	705	53	**1,231**
Net operating lease income	–	285	4	**289**
Share of net profits /(losses) of associates and joint ventures	8	21	(1)	**28**
Other operating income and charges				
Credit and Other impairments charges	(82)	(157)	(8)	**(247)**
Other operating income and charges	19	128	(41)	**106**
Internal management revenue/(charge)	2	14	(16)	**–**
Net operating income	2,099	3,668	144	**5,911**
Total operating expenses	(1,346)	(1,981)	(1,105)	**(4,432)**
Operating profit/(loss) before income tax	753	1,687	(961)	**1,479**
Income tax expense	–	–	(394)	**(394)**
Operating profit/(loss) after income tax	753	1,687	(1,355)	**1,085**
Profit attributable to non-controlling interests	–	(2)	(2)	**(4)**
Profit/(loss) attributable to equity holders	753	1,685	(1,357)	**1,081**
Distributions paid or provided for on MIS	–	–	(15)	**(15)**
Net profit/(loss) attributable to ordinary equity holders from continuing operations	753	1,685	(1,372)	**1,066**

3.2 BFS

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Net interest and trading income	**890**	838	*6*	**1,728**	1,679	*3*
Fee and commission income						
Wealth management fee income	**138**	142	*(3)*	**280**	312	*(10)*
Banking and leasing fee income	**79**	82	*(4)*	**161**	161	*–*
Total fee and commission income	**217**	224	*(3)*	**441**	473	*(7)*
Share of net profits/(losses) of associates and joint ventures	**6**	(3)	*	**3**	8	*(63)*
Other operating income and charges						
Credit and other impairment charges	**(108)**	(41)	*163*	**(149)**	(82)	*82*
Other income	**9**	–	*	**9**	19	*(53)*
Total other operating income and charges	**(99)**	(41)	*141*	**(140)**	(63)	*122*
Internal management revenue	**–**	2	*(100)*	**2**	2	*–*
Net operating income	**1,014**	1,020	*(1)*	**2,034**	2,099	*(3)*
Operating expenses						
Employment expenses	**(171)**	(183)	*(7)*	**(354)**	(421)	*(16)*
Brokerage, commission and trading-related expenses	**(85)**	(87)	*(2)*	**(172)**	(216)	*(20)*
Technology expenses[1]	**(183)**	(191)	*(4)*	**(374)**	(362)	*3*
Other operating expenses	**(192)**	(175)	*10*	**(367)**	(347)	*6*
Total operating expenses	**(631)**	(636)	*(1)*	**(1,267)**	(1,346)	*(6)*
Net profit contribution	**383**	384	*(<1)*	**767**	753	*2*
Non-GAAP metrics						
Funds on platform[2] ($Ab)	**79.1**	91.5	*(14)*	**79.1**	86.0	*(8)*
Loan and lease portfolio[3] ($Ab)	**75.3**	67.4	*12*	**75.3**	62.5	*20*
BFS deposits[4] ($Ab)	**63.9**	56.2	*14*	**63.9**	53.4	*20*
Headcount	**2,646**	2,643	*<1*	**2,646**	2,768	*(4)*

Net profit contribution of $A767 million for the year ended 31 March 2020, up 2% from the prior year:

- growth in BFS deposits, loan portfolio and funds on platform average volumes
- lower employment expenses due to a reduction in average headcount mainly due to the realignment of the wealth advice business to focus on the high net worth segment.

Partially offset by:

- increased specific provisions in Business banking and Vehicle Finance together with increased credit impairment charges on the performing portfolios related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19
- margin compression on deposits
- lower wealth management fee income associated with realigning the wealth advice business to focus on the high net worth segment
- increased costs associated with investment in technology to support business growth and to meet regulatory requirements.

[1] Technology expenses include technology staff expenses, depreciation of technology assets, amortisation of capitalised software and maintenance costs.
[2] Funds on platform includes Macquarie Wrap and Vision.
[3] The Loan and lease portfolio comprises home loans, loans to Australian businesses, vehicle finance and credit cards.
[4] BFS deposits excludes corporate/wholesale deposits.

Net interest and trading income

Net interest and trading income in BFS relates to interest income earned from the loan portfolio that primarily comprises home loans in Australia, loans to Australian businesses, vehicle leases, insurance premium funding and credit cards. BFS also generates income from deposits by way of a deposit premium received from Group Treasury, which uses the deposits as a source of funding for the Banking Group.

Net interest and trading income of $A1,728 million for the year ended 31 March 2020 increased 3% from $A1,679 million in the prior year due to a 10% increase in the average BFS deposit balance and a 10% increase in average loan and lease portfolio volumes, partially offset by margin compression on deposits and the sale of an investment in MPF in the current year.

As at 31 March 2020 the deposit and loan and lease portfolios included:

- BFS Deposits of $A63.9 billion, up 20% from $A53.4 billion as at 31 March 2019;
- Home loan volumes of $A52.1 billion, up 35% from $A38.5 billion as at 31 March 2019;
- Vehicle finance volumes of $A13.7 billion, down 10% from $A15.2 billion as at 31 March 2019; and
- Business banking loan volumes of $A9.0 billion, up 10% from $A8.2 billion as at 31 March 2019.

Wealth management fee income

Wealth management fee income relates to fees earned on a range of BFS' products and services including the Wrap and Vision platforms, deposits and the provision of wealth services in Australia.

Funds on platform closed at $A79.1 billion at 31 March 2020, from $A86.0 billion at 31 March 2019 representing strong client inflows offset by market movements during March.

Wealth management fee income of $A280 million for the year ended 31 March 2020 decreased 10% from $A312 million in the prior year due to lower brokerage income as the wealth advice business focused on the high net worth segment.

Banking and leasing fee income

Banking and leasing fee income relates to fees earned on a range of BFS' products including home loans, vehicle finance, credit cards, business loans and deposits.

Banking and leasing fee income of $A161 million for the year ended 31 March 2020 was in line with the prior year.

Credit and Other impairment charges

Credit and Other impairment charges of $A149 million for the year ended 31 March 2020 increased 82% from $A82 million in prior year largely due to increased specific provisions in Business banking and Vehicle Finance together with increased credit impairment charges on the performing portfolios related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

Other income

Other income of $A9 million for the year ended 31 March 2020 decreased 53% from $A19 million in prior year. The current year includes the gain on sale of an investment in MPF. The prior year included equity investment dividends and revaluations.

Operating expenses

Total operating expenses of $A1,267 million for the year ended 31 March 2020 decreased 6% from $A1,346 million in the prior year.

Employment expenses of $A354 million for the year ended 31 March 2020 decreased 16% from $A421 million in the prior year largely due to lower headcount as the wealth advice business focused on the high net worth segment.

Brokerage, commission and trading-related expenses of $A172 million for the year ended 31 March 2020 decreased 20% from $A216 million in the prior year largely due to the sale of an investment in MPF in the first half.

Technology expenses of $A374 million for the year ended 31 March 2020 increased 3% from $A362 million in the prior year to support business growth.

Other operating expenses of $A367 million for the year ended 31 March 2020 increased 6% from $A347 million in the prior year driven by increased risk and regulatory costs.

3.3 CGM

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20	Sep 19	*Movement*	**Mar 20**	Mar 19	*Movement*
	$Am	$Am	*%*	**$Am**	$Am	*%*
Net interest and trading income						
Commodities	**748**	1,013	(26)	**1,761**	1,826	(4)
Foreign exchange, interest rates and credit	**327**	333	(2)	**660**	547	21
Equities	**104**	143	(27)	**247**	164	51
Specialised and Asset Finance	**84**	78	8	**162**	135	20
Net interest and trading income	**1,263**	1,567	(19)	**2,830**	2,672	6
Fee and commission income						
Brokerage and other trading related income	**240**	212	13	**452**	464	(3)
Other fee and commission income	**128**	151	(15)	**279**	241	16
Total fee and commission income	**368**	363	1	**731**	705	4
Net operating lease income	**203**	157	29	**360**	285	26
Share of net profits of associates and joint ventures	**16**	9	78	**25**	21	19
Other operating income and charges						
Net income on equity and debt investments	**18**	12	50	**30**	72	(58)
Credit and Other impairment charges	**(207)**	(31)	*	**(238)**	(157)	52
Other income	**20**	32	(38)	**52**	56	(7)
Total other operating income and charges	**(169)**	13	*	**(156)**	(29)	*
Internal management revenue	**19**	2	*	**21**	14	50
Net operating income	**1,700**	2,111	(19)	**3,811**	3,668	4
Operating expenses						
Employment expenses	**(241)**	(208)	16	**(449)**	(443)	1
Brokerage, commission and trading-related expenses	**(203)**	(220)	(8)	**(423)**	(562)	(25)
Other operating expenses	**(579)**	(538)	8	**(1,117)**	(976)	14
Total operating expenses	**(1,023)**	(966)	6	**(1,989)**	(1,981)	<1
Non-controlling interests[(1)]	**–**	–	–	**–**	(2)	(100)
Net profit contribution	**677**	1,145	(41)	**1,822**	1,685	8
Non-GAAP metrics						
Headcount	**1,627**	1,673	(3)	**1,627**	1,676	(3)

Net profit contribution of $A1,822 million for the year ended 31 March 2020, up 8% from the prior year driven by:

- strength of global client contribution across all products and sectors including
  - strong results across the commodities platform from client hedging activity
  - increased contribution in structured foreign exchange and interest rate products across all regions
  - improved equities performance, primarily due to increased contribution from client activity in Asia.

Partially offset by:

- reduction in inventory management and trading income driven by reduced opportunities in North American Gas markets following a strong prior year that were partially offset by the timing of income recognition, which increased revenue relating to transport agreements. The prior year included significant gains linked to supply and demand imbalances across natural gas markets in specific North American regions which were not repeated
- increased impairment charges on a small number of counterparties in Futures and FI&C, together with increased credit impairment charges on the performing loan and lease portfolio related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

[1] 'Non-controlling interests' adjusts reported consolidated profit or loss for the share that is attributable to non-controlling interests, such that the net profit contribution represents the net profit attributable to ordinary equity holders.

Net interest and trading income

Net interest and trading income of $A2,830 million increased 6% from $A2,672 million in the prior year.

Commodities net interest and trading income

Net interest and trading income from commodity related activities is generated from the provision of hedging and risk management services and loans and working capital finance to clients across a range of commodity sectors including metals, energy and agriculture.

Risk management products income is mainly driven by client volumes, which are influenced by the level of price volatility in the markets in which those clients operate. CGM enters into financial and physical contracts including exchange traded derivatives, OTC derivatives, storage contracts and transportation agreements as part of its commodities platform. These arrangements enable CGM to facilitate client transactions and provide CGM with trading opportunities where there is an imbalance between the supply and demand for commodities.

Revenue is dependent on a number of factors including the volume of transactions, the level of risk assumed and the volatility of price movements across commodity markets and products. Storage contracts and transportation agreements, which are managed on a fair value basis for financial and risk management purposes, are required to be accounted for on an accruals basis for statutory reporting purposes, which may result in some variability in the timing of reported income.

Lending and financing activities include interest income from the provision of loans and working capital finance to clients across a range of commodity sectors including metals, energy and agriculture. Commodities lending and financing activities are primarily secured against underlying assets and typically have associated hedging to protect against downside risk.

Net interest and trading income from commodities of $A1,761 million for the year ended 31 March 2020 decreased 4% from $A1,826 million in the prior year.

The current year result was impacted by the reduced contribution from inventory management and trading activities, primarily due to reduced opportunities in North American Gas markets following a strong prior year driven by demand and supply factors in specific American regions. The decreased trading contribution was partially offset by the timing of income recognition, which increased revenue relating to transport agreements.

The overall decrease in inventory management and trading activities was partially offset by strong results across the commodities platform due to increased client hedging activity in Global Oil, EMEA Gas and Power, Agriculture, and Metals and Mining compared to the prior year as a result of increased volatility and commodity price movements, partially offset by the impact of fair value adjustments.

In addition, lending and financing income increased on the prior year due to increased physical oil financing activity.

Foreign exchange, interest rates and credit net interest and trading income

Net interest and trading income from foreign exchange, interest rates and credit related activities are generated from the provision of trading and hedging services to a range of corporate and institutional clients globally, in addition to making secondary markets in corporate debt securities, syndicated bank loans and middle market loans and providing specialty lending.

Net interest and trading income from foreign exchange, interest rates and credit related activities of $A660 million for the year ended 31 March 2020 increased 21% from $A547 million in the prior year. Increased income in the current year was driven by increased client activity in structured foreign exchange and interest rate products, primarily from corporates, generated across the Americas, EMEA and Asia-Pacific region.

Equities net interest and trading income

Equities net interest and trading income is generated from the issue of derivative products in key locations, the provision of equity finance solutions to institutional clients and the conduct of risk management and trading activities.

Equities net interest and trading income of $A247 million for the year ended 31 March 2020 increased 51% from $A164 million in the prior year reflecting increased opportunities and client activity, primarily in Asian markets.

Specialised and Asset Finance net interest and trading income

Net interest and trading income in Specialised and Asset Finance predominantly relates to net income from the loan and finance lease portfolios (including ship finance, equipment and technology financing) and the funding costs associated with the operating lease portfolios (including energy, telecommunication and mining assets).

Net interest and trading income of $A162 million for the year ended 31 March 2020 increased 20% from $A135 million in the prior year. The increase was largely driven by the net proceeds from end of lease asset sales and favourable foreign exchange movements.

The loan and finance lease portfolio was $A6.1 billion as at 31 March 2020, an increase of 13% from $A5.4 billion as at 31 March 2019. The increase was largely due to the growth in funds products, partially offset by the equipment finance portfolio.

Fee and commission income

Fee and commission income of $A731 million for the year ended 31 March 2020 increased 4% on $705 million in the prior year. The increase relates to higher commissions in futures products due to increased client activity on the prior year.

3.3 CGM

Continued

Net operating lease income

Net operating lease income of $A360 million for the year ended 31 March 2020 increased 26% from $A285 million in the prior year. The movement was primarily driven by higher secondary income from the Technology, Media and Telecoms portfolio in addition to favourable foreign exchange movements.

The operating lease portfolio was $A2.2 billion as at 31 March 2020, down 8% from $A2.4 billion as at 31 March 2019.

Net income on equity and debt investments

Net income on equity and debt investments of $A30 million for the year ended 31 March 2020 decreased 58% from $A72 million in the prior year which benefited from a significant sale in the commodity sector.

Credit and Other impairment charges

Credit and Other impairment charges of $A238 million for the year ended 31 March 2020 increased 52% from $A157 million in the prior year due to increased impairment charges on a small number of counterparties in Futures and FI&C, together with increased credit impairment charges on the performing loan and lease portfolio related to a deterioration in current and expected macroeconomic conditions as a result of COVID-19.

Operating expenses

Total operating expenses of $A1,989 million for the year ended 31 March 2020 were broadly in line with $A1,981 million in the prior year.

Employment expenses of $A449 million for the year ended 31 March 2020 were broadly in line with $A443 million in the prior year.

Brokerage, commission and trading-related expenses include fees paid in relation to trading-related activities. Brokerage, commission and trading-related expenses of $A423 million for the year ended 31 March 2020 decreased 25% from $A562 million in the prior year which included the recognition of certain legacy lending transaction-related expenses.

Other operating expenses of $A1,117 million for the year ended 31 March 2020 increased 14% from $A976 million in the prior year, driven by increased expenditure on technology infrastructure, increasing compliance and regulatory requirements and the impact of foreign exchange movements.

3.4 Corporate

	HALF-YEAR TO			FULL-YEAR TO		
	Mar 20 $Am	Sep 19 $Am	*Movement %*	**Mar 20 $Am**	Mar 19 $Am	*Movement %*
Net interest and trading income	**87**	10	*	**97**	153	*(37)*
Fee and commission income	**6**	7	*(14)*	**13**	53	*(75)*
Net operating lease income	**8**	3	*167*	**11**	4	*175*
Share of net losses of associates and joint ventures	**(1)**	–	*	**(1)**	(1)	–
Other operating income and charges						
Net (loss)/income on equity and debt investments	**(3)**	242	*	**239**	5	*
Credit and Other impairment charges	**(72)**	(13)	*	**(85)**	(8)	*
Other income and charges	**22**	54	*(59)*	**76**	(46)	*
Total other operating income and charges	**(53)**	283	*	**230**	(49)	*
Internal management charge	**(19)**	(4)	*	**(23)**	(16)	*44*
Net operating income and charges	**28**	299	*(91)*	**327**	144	*127*
Operating expenses						
Employment expenses	**(200)**	(344)	*(42)*	**(544)**	(584)	*(7)*
Brokerage, commission and trading-related expenses	**(1)**	–	*	**(1)**	1	*
Other operating expenses	**(314)**	(162)	*94*	**(476)**	(522)	*(9)*
Total operating expenses	**(515)**	(506)	*2*	**(1,021)**	(1,105)	*(8)*
Income tax expense	**(262)**	(324)	*(19)*	**(586)**	(394)	*49*
Macquarie Income Securities	**(6)**	(6)	–	**(12)**	(15)	*(20)*
Non-controlling interests[1]	**–**	–	–	**–**	(2)	*(100)*
Net loss contribution	**(755)**	(537)	*41*	**(1,292)**	(1,372)	*(6)*
Non-GAAP metrics						
Headcount[2]	**6**	8	*(25)*	**6**	62	*(90)*

The Corporate segment comprises head office and certain investments that are neither core for strategic reasons nor aligned to an Operating Group. The Corporate segment also includes costs that are not allocated to the Operating Groups, including performance-related profit share and share-based payments expense, income tax expense and the net result of managing Macquarie Bank's liquidity and funding requirements.

[1] "Non-controlling interests" adjusts reported consolidated profit or loss for the share that is attributable to non-controlling interests, such that the net profit contribution represents the net profit attributable to ordinary equity holders.
[2] The prior year headcount number includes the headcount of the MSIS (MIDIS) Fiduciary businesses transferred from MBL CAF to MAM in the first half.

3.4 Corporate

Continued

Net interest and trading income

Net interest and trading income in the Corporate segment includes the net result of managing Macquarie Bank's liquidity and funding requirements, earnings on capital, funding costs associated with non-core investments held centrally and accounting volatility arising from movements in underlying rates relating to economically hedged positions where hedge accounting in terms of AASB 9 is unable to be achieved.

Net interest and trading income of $A97 million for the year ended 31 March 2020 decreased 37% from $A153 million in the prior year primarily due to lower earnings on capital driven by lower Australian dollar and United States dollar interest rates.

Fee and commission income

Fee and commission income in the Corporate segment primarily comprises internal transactions between Corporate and other segments within the Bank Group and transactions between the Bank and Non-Bank Groups.

Fee and commission income of $A13 million for the year ended 31 March 2020 decreased 75% from $A53 million in the prior year. The prior year also included income from non-core businesses.

Net (loss)/income on equity and debt investments

Net income on equity and debt investments was $A239 million for the year ended 31 March 2020, driven by a gain on the sale of MSIS fiduciary businesses to MAMHPL, a related party of MBL, owned 100% by MGL.

Credit and other impairment charges

Credit and other impairment charges of $A85 million for the year ended 31 March 2020, increased significantly from $A8 million in the prior year driven by higher central overlay provisions for expected credit losses on the performing portfolio due to a higher weighting to the ECL downside scenario.

Other income and charges

Other income of $A76 million for the year ended 31 March 2020, compared to a charge of $A46 million in the prior year due to consolidation adjustments recognised in the current period. The prior year included the impact of a structural change in funding between the Bank and Non-Bank Groups.

Employment expenses

Employment expenses relate to the Consolidated Entity's head office costs, as well as expenses associated with the Consolidated Entity's profit share and retention plans.

Employment expenses of $A544 million for the year ended 31 March 2020 decreased 7% from $A584 million in the prior year as a result of lower performance-related profit share as a result of higher retention rates being applied, partially offset by higher share-based payments expense mainly driven by the accelerated amortisation of prior years' equity awards to retiring Key Management Personnel.

Other operating expenses

Other operating expenses in the Corporate segment includes non-employment related operating costs of central service groups, and certain transactions between the Bank and Non-Bank Groups.

Other operating expenses of $A476 million for the year ended 31 March 2020 decreased 9% from $A522 million in the prior year which included the recognition of certain legacy-related expenses.

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04

Balance sheet

CGM facilitates smart meter roll-out with challenger UK energy supplier

CGM has agreed to provide a £20 million facility to award-winning energy supplier So Energy Trading Limited, enabling its smart meter roll-out to UK customers over the next three years.

4.1 Statement of financial position

	AS AT		MOVEMENT
	Mar 20	Mar 19[1]	Mar 19
	$Am	$Am	%
Assets			
Cash and bank balances	**7,847**	6,550	*20*
Cash collateral on securities borrowed and reverse repurchase agreements	**37,708**	29,671	*27*
Trading assets	**16,251**	16,277	*(<1)*
Margin money and settlement assets	**12,183**	9,091	*34*
Derivative assets	**44,845**	14,022	*220*
Financial investments	**7,484**	5,470	*37*
Other assets	**3,267**	4,637	*(30)*
Loan assets	**87,719**	73,158	*20*
Due from other related body corporate entities	**5,278**	1,548	*241*
Property, plant and equipment and right-of-use assets	**2,598**	2,738	*(5)*
Interests in associates and joint ventures	**251**	219	*15*
Intangible assets	**185**	177	*5*
Deferred tax assets	**520**	441	*18*
Total assets	**226,136**	163,999	*38*
Liabilities			
Cash collateral on securities lent and repurchase agreements	**2,322**	4,216	*(45)*
Trading liabilities	**5,363**	6,557	*(18)*
Margin money and settlement liabilities	**19,052**	12,222	*56*
Derivative liabilities	**37,823**	12,523	*202*
Deposits	**67,253**	56,120	*20*
Other liabilities	**2,946**	3,296	*(11)*
Borrowings	**3,047**	1,560	*95*
Due to other related body corporate entities	**22,115**	16,794	*32*
Debt issued	**46,922**	34,787	*35*
Deferred tax liabilities	**69**	134	*(49)*
Total liabilities excluding loan capital	**206,912**	148,209	*40*
Loan capital	**4,997**	4,550	*10*
Total liabilities	**211,909**	152,759	*39*
Net assets	**14,227**	11,240	*27*
Equity			
Contributed equity	**8,899**	7,898	*13*
Reserves	**991**	516	*92*
Retained earnings	**4,336**	2,824	*54*
Total capital and reserves attributable to the ordinary equity holder of Macquarie Bank Limited	**14,226**	11,238	*27*
Non-controlling interests	**1**	2	*(50)*
Total equity	**14,227**	11,240	*27*

[1] Refer Note 1(i) *Basis of preparation* in the Financial report for an explanation of the re-presentation of certain comparative financial information.

4.1 Statement of financial position

Continued

Assets

Total assets of $A226.1 billion as at 31 March 2020 increased 38% from $A164.0 billion as at 31 March 2019 mainly due to an increase in Derivative assets, Loan assets, Cash collateral on securities borrowed and reverse repurchase agreements, Margin money and settlement assets and Financial investments. These increases were partially offset by a decrease in Other assets.

- Derivative assets of $A44.8 billion as at 31 March 2020 increased 220% from $A14.0 billion as at 31 March 2019 following an increase in client trade volumes and mark-to-market movements in energy markets, interest rate and foreign exchange products in CGM largely driven by recent volatility in financial markets
- Loan assets of $A87.7 billion as at 31 March 2020 increased 20% from $A73.2 billion as at 31 March 2019 primarily due to growth in Home Loans and Business Banking Loans in BFS
- Cash collateral on securities borrowed and reverse repurchase agreements of $A37.7 billion as at 31 March 2020 increased 27% from $A29.7 billion as at 31 March 2019 following increased client flows and positions to maintain the Bank Group's HQLA requirements
- Margin money and settlement assets of $A12.2 billion as at 31 March 2020 increased 34% from $A9.1 billion as at 31 March 2019 primarily due to an increase in call margin placed with financial institutions
- Financial investments of $A7.5 billion as at 31 March 2020 increased 37% from $A5.5 billion as at 31 March 2019 primarily due to the acquisition of liquid investments as part of Treasury's liquidity management activities
- Other assets of $A3.3 billion as at 31 March 2020 decreased 30% from $A4.6 billion as at 31 March 2019 following a decrease in commodity-related receivables in CGM.

Liabilities

Total liabilities of $A211.9 billion as at 31 March 2020 increased 39% from $A152.8 billion as at 31 March 2019 mainly driven by an increase in Derivative liabilities, Debt issued, Deposits, Margin money and settlement liabilities and Borrowings. These increases were partially offset by a decrease in Cash collateral on securities lent and repurchase agreements.

- Derivative liabilities of $A37.8 billion as at 31 March 2020 increased 202% from $A12.5 billion as at 31 March 2019 following an increase in client trade volumes and mark-to-market movements in energy markets, interest rate and foreign exchange products in CGM largely driven by recent volatility in financial markets
- Debt issued of $A46.9 billion as at 31 March 2020 increased 35% from $A34.8 billion as at 31 March 2019 primarily due to the issue of long-term debt by Treasury to manage the Bank Group's funding and liquidity, securitisation issuances in BFS and foreign exchange movements following the depreciation of the Australian dollar against major currencies
- Deposits of $A67.3 billion as at 31 March 2020 increased 20% from $A56.1 billion as at 31 March 2019 primarily due to an increase in customer deposits in BFS
- Margin money and settlement liabilities of $A19.1 billion as at 31 March 2020 increased 56% from $A12.2 billion as at 31 March 2019 primarily due to an increase in call margin placed by financial institutions and commodity trade settlement balances in CGM
- Borrowings of $A3.0 billion as at 31 March 2020 increased 95% from $A1.6 billion as at 31 March 2019 primarily driven by oil finance transactions in CGM and Treasury's liquidity management activities
- Cash collateral on securities lent and repurchase agreements of $A2.3 billion as at 31 March 2020 decreased 45% from $A4.2 billion as at 31 March 2019 primarily due to a decrease in repurchase agreements executed and stock lending trades in CGM.

Equity

Total equity increased 27% to $A14.2 billion as at 31 March 2020 from $A11.2 billion as at 31 March 2019.

The increase in the Consolidated Entity's equity was attributable to the issuance of Contributed equity of $A1.0 billion, earnings of $A1.5 billion generated during the period, and an increase in the foreign currency and net investment hedge reserve of $A0.6 billion.

4.2 Loan assets

Reconciliation between the statement of financial position and the funded balance sheet:

	AS AT			MOVEMENT	
	Mar 20	Sep 19	Mar 19	*Sep 19*	*Mar 19*
	$Ab	$Ab	$Ab	*%*	*%*
Loan assets per the statement of financial position	**87.7**	79.4	73.2	*10*	*20*
Operating lease assets	**2.2**	2.3	2.3	*(4)*	*(4)*
Other reclassifications(1)	**0.3**	0.6	0.4	*(50)*	*(25)*
Less: loans held by consolidated SPEs which are available as security to noteholders and debt providers(2)	**(12.8)**	(8.6)	(7.2)	*49*	*78*
Total loan assets including operating lease assets per the funded balance sheet(3)	**77.4**	73.7	68.7	*5*	*13*

[1] Reclassification between loan assets and other funded balance sheet categories.
[2] Excludes notes held by Macquarie in consolidated Special Purpose Entities (SPE).
[3] Total loan assets including operating lease assets per the funded balance sheet includes self-securitised assets.

4.2 Loan assets

Continued

Loan assets[1] including operating lease assets by Operating Group per the funded balance sheet are shown in further detail below:

		AS AT			MOVEMENT	
		Mar 20	Sep 19	Mar 19	*Sep 19*	*Mar 19*
	Notes	**$Ab**	$Ab	$Ab	*%*	*%*
BFS						
Home loans	1	**43.2**	38.8	35.6	*11*	*21*
Business banking	2	**9.4**	9.0	8.7	*4*	*8*
Vehicle finance	3	**10.6**	11.9	11.5	*(11)*	*(8)*
Total BFS		**63.2**	59.7	55.8	*6*	*13*
CGM						
Asset Finance:	4	**8.2**	7.8	7.8	*5*	*5*
Loans and finance lease assets		**6.0**	5.5	5.5	*9*	*9*
Operating lease assets		**2.2**	2.3	2.3	*(4)*	*(4)*
Resources and commodities	5	**3.0**	3.6	2.6	*(17)*	*15*
Other	6	**3.0**	2.6	2.5	*15*	*20*
Total CGM		**14.2**	14.0	12.9	*1*	*10*
Total		**77.4**	73.7	68.7	*5*	*13*

[1] Total loan assets including operating lease assets per the funded balance sheet includes self-securitised assets.

Explanatory notes concerning asset security of funded loan asset portfolio

1. Home loans

Secured by Australian residential property.

2. Business banking

Secured relationship managed loan portfolio secured largely by working capital, business cash flows and real property.

3. Vehicle finance

Secured by Australian motor vehicles.

4. Asset Finance

Predominantly secured by underlying financed assets.

5. Resources and commodities

Diversified loan portfolio primarily to the resources sector that are secured by the underlying assets with associated price hedging to mitigate risk.

6. CGM Other

Predominantly relates to recourse loans to financial institutions, as well as financing for other sectors.

4.3 Equity investments

Equity investments are reported in the following categories in the statement of financial position:

- Financial investments; and
- Interests in associates and joint ventures.

Equity investments reconciliation

	AS AT		MOVEMENT
	Mar 20	Mar 19	*Mar 19*
	$Ab	$Ab	*%*
Equity investments			
Statement of financial position			
Equity investments at fair value	**0.2**	0.3	*(33)*
Interests in associates and joint ventures	**0.2**	0.2	–
Total equity investments per statement of financial position	**0.4**	0.5	*(20)*
Adjustment for funded balance sheet			
Equity hedge positions(1)	**–**	(0.1)	*(100)*
Total funded equity investments	**0.4**	0.4	–

[1] These relate to assets held for the purposes of economically hedging Macquarie Bank's fair valued liabilities to external parties arising from various equity-linked instruments except investment in associates. Consequently, these have been excluded from the analysis of equity investment exposures.

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05

Funding and liquidity

The first commercial floating LiDAR system in South Korea

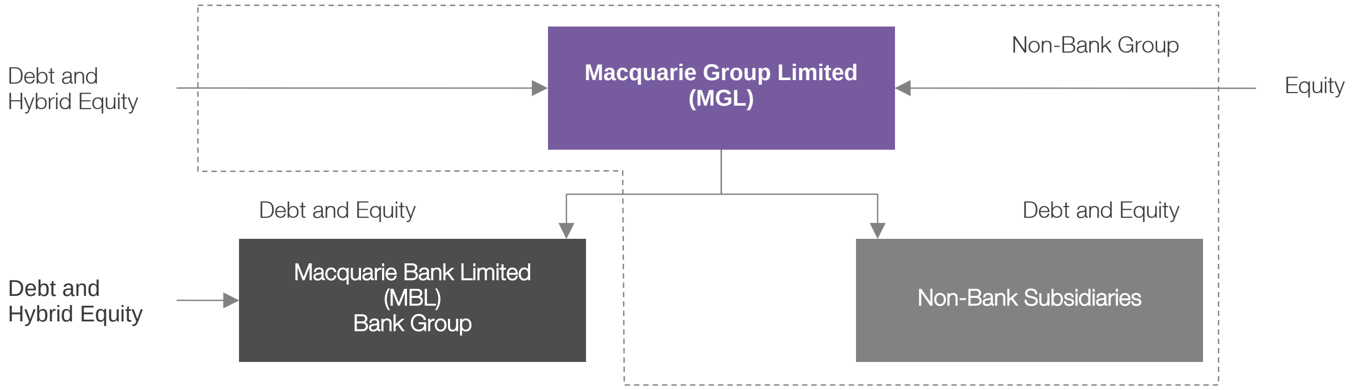
The installation of the first floating LiDAR system in South Korea will collect wind resource data and marks a critical step in the development of Green Investment Group's (GIG) first floating offshore wind project located off the coast of Ulsan City.

5.1 Liquidity risk governance and management framework

Governance and oversight

Macquarie Group's two primary external funding vehicles are Macquarie Group Limited (MGL) and Macquarie Bank Limited (MBL). MGL provides funding predominantly to the Non-Bank Group and limited funding to some MBL subsidiaries. MBL provides funding to the Bank Group.

The high-level funding structure of the Group is shown below:



Macquarie Bank's liquidity risk management framework is designed to ensure that it is able to meet its funding requirements as they fall due under a range of market conditions.

Liquidity management is performed centrally by Group Treasury, with oversight from the Asset and Liability Committee (ALCO) and the Risk Management Group (RMG). Macquarie Bank's liquidity policy is approved by the MBL Board after endorsement by the ALCO and liquidity reporting is provided to the Boards on a regular basis. The ALCO includes the MGL Chief Executive Officer, MBL Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Group Treasurer, Head of Balance Sheet Management and Operating Group Heads.

RMG provides independent oversight of liquidity risk management, including ownership of liquidity policies and key limits and approval of material liquidity scenario assumptions.

Liquidity policy and risk appetite

The MBL liquidity policy is designed so that the Bank Group maintains sufficient liquidity to meet its obligations as they fall due. In some cases, certain entities within the Bank Group may also be required to have a standalone liquidity policy. In these cases, the principles applied within the entity-specific liquidity policies are consistent with those applied in the broader MBL policy.

Macquarie Bank establishes a liquidity risk appetite, which is approved by the MBL Board, and represents an articulation of the nature and level of liquidity risk that is acceptable in the context of achieving Macquarie Bank's strategic objectives.

Macquarie Bank's liquidity risk appetite is intended to ensure that Macquarie Bank is able to meet all of its liquidity obligations during a period of liquidity stress: a twelve month period with constrained access to funding markets and with only a limited reduction in Macquarie Bank's franchise businesses.

MBL is an Authorised Deposit-taking Institution (ADI) and is funded mainly with capital, long-term liabilities and deposits.

5.1 Liquidity risk governance and management framework

Continued

Liquidity risk tolerance and principles

Macquarie Bank's liquidity risk appetite is supported by a number of risk tolerances and principles applied to managing liquidity risk.

Risk tolerances

- term assets must be funded by term liabilities and short-term assets must exceed short-term wholesale liabilities
- cash and liquid assets must be sufficient to cover the expected outflow under a twelve-month stress scenario and meet minimum regulatory requirements
- cash and liquid assets held to cover stress scenarios and regulatory minimums must be high quality unencumbered liquid assets and cash
- diversity and stability of funding sources is a key priority
- balance sheet currency mismatches are managed within set tolerances
- funding and liquidity exposures between entities within Macquarie Bank are subject to constraints where required.

Liquidity management principles

- Macquarie Bank has a centralised approach to liquidity management
- liquidity risk is managed through stress scenario analysis and setting limits on the composition and maturity of assets and liabilities
- a regional liquidity framework is maintained that outlines Macquarie Bank's approach to managing funding and liquidity requirements in offshore subsidiaries and branches
- the liquidity position is managed to ensure all obligations can be met as required on an intraday basis
- a liquidity contingency plan is maintained that provides an action plan in the event of a liquidity 'crisis'
- a funding strategy is prepared annually and monitored on a regular basis
- internal pricing allocates liquidity costs, benefits and risks to areas responsible for generating them
- strong relationships are maintained to assist with managing confidence and liquidity
- the MGL Board, MBL Board and Senior Management receive regular reporting on Macquarie Bank's liquidity position, including compliance with liquidity policy and regulatory requirements.

Liquidity contingency plan

Group Treasury maintains a liquidity contingency plan, which outlines how a liquidity crisis would be managed. The plan defines roles and responsibilities and actions to be taken in a liquidity event, including identifying key information requirements and appropriate communication plans with both internal and external parties.

Specifically, the plan details factors that may constitute a crisis, the officer responsible for enacting the contingency management, a committee of senior executives responsible for managing a crisis, the information required to effectively manage a crisis, a communications strategy, a high level checklist of possible actions to conserve or raise additional liquidity and contact lists to facilitate prompt communication with all key internal and external stakeholders. The plan also incorporates a retail run management plan (RRMP) that outlines the bank's processes and operational plans for managing a significant increase in customer withdrawals during a potential deposit 'run' on Macquarie Bank.

In addition, Group Treasury monitors a range of early warning indicators on a daily basis that might assist in identifying emerging risks in Macquarie Bank's liquidity position. These indicators are reviewed by Senior Management and are used to inform any decisions regarding invoking the plan.

The liquidity contingency plan is subject to regular review by both Group Treasury and RMG. It is submitted to the ALCO and MGL and MBL Boards for approval.

Macquarie Bank is a global financial institution, with branches and subsidiaries in a variety of countries. Regulations in certain countries may require some branches or subsidiaries to have specific local contingency plans. Where that is the case, the liquidity contingency plan contains either a supplement or a reference to a separate document, providing the specific information required for those branches or subsidiaries.

Funding strategy

Macquarie Bank prepares a funding strategy on an annual basis and monitors progress against the strategy throughout the year. The funding strategy aims to maintain Macquarie Bank's diversity of current and projected funding sources, ensure ongoing compliance with all liquidity requirements and facilitate forecast asset growth. The funding strategy is reviewed by the ALCO and approved by the respective Boards.

5.2 Management of liquidity risk

Scenario analysis

Scenario analysis is central to Macquarie Bank's liquidity risk management framework. In addition to regulatory defined scenarios, Group Treasury models additional liquidity scenarios covering both market-wide and Macquarie Bank name-specific crises. Scenario analysis performs a range of functions within the liquidity risk management framework, including being a basis for:

– monitoring compliance with internal liquidity risk appetite statements by ensuring all repayment obligations can be met in the corresponding scenarios
– determining a minimum level of cash and liquid assets
– determining an appropriate minimum tenor of funding for Macquarie Bank's assets; and
– determining the overall capacity for future asset growth.

A range of assumptions Macquarie Bank intends to be conservative are used regarding the level of access to capital markets, deposit outflows, contingent funding requirements and asset sales.

As an example, one internal scenario projects the expected cash and liquid asset position during a combined market-wide and Macquarie Bank name-specific crisis over a twelve-month timeframe. This scenario assumes no access to wholesale funding markets, a significant loss of customer deposits and contingent funding outflows resulting from undrawn commitments, market moves impacting derivatives and other margined positions combined with a multiple notch credit rating downgrade. Macquarie Bank's cash and liquid asset portfolio must exceed the minimum requirement as calculated in this scenario at all times.

Liquid asset holdings

Group Treasury centrally maintains a portfolio of highly liquid unencumbered assets in the Bank Group to ensure adequate liquidity is available under a range of market conditions. The minimum level of cash and liquid assets is calculated with reference to internal scenario projections and regulatory requirements.

The cash and liquid asset portfolio contains only unencumbered assets that can be relied on to maintain their liquidity in a crisis scenario. Specifically, cash and liquid assets held to meet minimum internal and regulatory requirements must be held in cash (including central bank reserves and overnight lending to financial institutions), qualifying High Quality Liquid Assets (HQLA) or be eligible as collateral in the Reserve Bank of Australia's (RBA) Committed Liquidity Facility (CLF) – so called 'Alternative Liquid Assets' (ALA). Composition constraints are also applied to ensure appropriate diversity and quality of the assets in the portfolio.

The cash and liquid asset portfolio is held in a range of currencies to ensure Macquarie Bank's liquidity requirements are broadly matched by currency. Certain other operating segments also hold cash and liquid assets as part of their operations. The Bank Group had $A33.6 billion cash and liquid assets as at 31 March 2020 (31 March 2019: $A24.3 billion).

Funds transfer pricing

An internal funds transfer pricing framework is in place that has been designed to produce appropriate incentives for business decision-making by reflecting the true funding costs arising from business actions. Under this framework, each business is allocated the full cost of the funding required to support its products and business lines, recognising the actual and contingent funding-related exposures their activities create for Macquarie Bank as a whole. Businesses that raise funding are compensated at a level that is appropriate for the liquidity benefit provided by the funding.

5.2 Management of liquidity risk

Continued

Credit ratings[1] as at 31 March 2020

	MACQUARIE BANK LIMITED		
	Short-term rating	Long-term rating	Outlook
Moody's Investors Service	P-1	A2	Stable
Standard and Poor's[2]	A-1	A+	Stable[3]
Fitch Ratings	F-1	A	Stable

Regulatory developments

The Australian Prudential Regulation Authority's (APRA) liquidity standard (APS 210) details the local implementation of the Basel III liquidity framework for Australian banks. In addition to a range of qualitative requirements, the standard incorporates the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). The LCR and NSFR apply specifically to Macquarie Bank as the regulated ADI in Macquarie Group. Separate quantitative requirements are imposed internally by the ALCO and the Board.

Liquidity coverage ratio

The LCR requires unencumbered liquid assets be held to cover expected net cash outflows under a combined 'idiosyncratic' and market-wide stress scenario lasting 30 calendar days. Under APS 210, liquid assets include cash, balances held with central banks, Australian dollar Commonwealth Government and semi-government securities, any CLF allocation as well as foreign currency HQLA securities.

Macquarie Bank's three-month average LCR to 31 March 2020 was 173% (average based on daily observations). For a detailed breakdown of Macquarie Bank's LCR, please refer to Macquarie Bank's regulatory disclosures (available on Macquarie's website).

Net stable funding ratio

The NSFR is a twelve-month structural funding metric, requiring that 'available stable funding' be sufficient to cover 'required stable funding', where 'stable' funding has an actual or assumed maturity of greater than twelve months. Macquarie Bank's NSFR as at 31 March 2020 was 118%. For a detailed breakdown of Macquarie Bank's NSFR, please refer to Macquarie's regulatory disclosures (available on Macquarie's website).

[1] A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by an assigning rating agency and any rating should be evaluated independently of any other information.
[2] Standard and Poor's (S&P) does not place outlook statements on short-term ratings.
[3] On 8 April 2020, S&P placed Australia's sovereign credit rating on a negative outlook. As a result of this outlook change, S&P changed the outlook for MBL to negative.

5.3 Funded Balance Sheet

The Bank Group's statement of financial position is prepared based on Australian Accounting Standards and includes certain accounting gross-ups and non-recourse self-funded assets that do not represent a funding requirement to the Bank Group.

The table below reconciles the reported assets of the Bank Group to the net funded assets as at 31 March 2020.

		AS AT	
		Mar 20	Mar 19
	Notes	**$Ab**	$Ab
Total assets per the Bank Group's statement of financial position		**226.1**	164.0
Accounting deductions:			
Self-funded trading assets	1	**(16.5)**	(15.6)
Derivative revaluation accounting gross-ups	2	**(37.4)**	(12.4)
Segregated funds	3	**(7.0)**	(4.6)
Outstanding trade settlement balances	4	**(3.4)**	(3.1)
Short-term working capital assets	5	**(3.4)**	(3.7)
Intercompany gross-ups	6	**(22.1)**	(16.8)
Non-recourse funded assets:			
Securitised assets and other non-recourse funding	7	**(12.8)**	(7.2)
Net funded assets		**123.5**	100.6

Explanatory notes concerning net funded assets

1. Self-funded trading assets

The Bank Group enters into stock borrowing and lending as well as repurchase agreements and reverse repurchase agreements in the normal course of trading activity that it conducts with its clients and counterparties. Also as part of its trading activities, the Bank Group pays and receives margin collateral on its outstanding derivative positions. These trading-related asset and liability positions are presented gross on the statement of financial position but are viewed as being self-funded to the extent that they offset one another and, therefore, are netted as part of this adjustment.

2. Derivative revaluation accounting gross-ups

The Bank Group's derivative activities are mostly client driven with client positions hedged by offsetting positions with a variety of counterparties. The derivatives are largely matched and this adjustment reflects that the matched positions do not require funding.

3. Segregated funds

These represent the assets and liabilities that are recognised where the Bank Group provides products such as investment-linked policy contracts or where the Bank Group holds segregated client monies. The policy (contract) liability and client monies will be matched by assets held to the same amount.

4. Outstanding trade settlement balances

At any particular time the Bank Group will have outstanding trades to be settled as part of its brokering business and trading activities. These amounts (payables) can be offset in terms of funding by amounts that the Bank Group is owed on other trades (receivables).

5. Short-term working capital assets

As with the outstanding trade settlement balances above, the Bank Group through its day-to-day operations generates working capital assets (e.g. receivables and prepayments) and working capital liabilities (e.g. creditors and accruals) that produce a 'net balance' that either requires or provides funding.

6. Intercompany gross-ups

These represent balances related to the net payable position between the Bank Group and Non-Bank Group arising out of intragroup transactions, loans and deposits. The majority of this is the Non-Bank Group deposit with MBL shown in the Bank Group funded balance sheet.

7. Securitised assets and other non-recourse funding

These include assets funded by third party debt with no recourse to the Bank Group beyond the borrowing entity and lending assets (mortgages and leasing) sold down into external securitisation entities.

5.4 Funding profile

Funded balance sheet

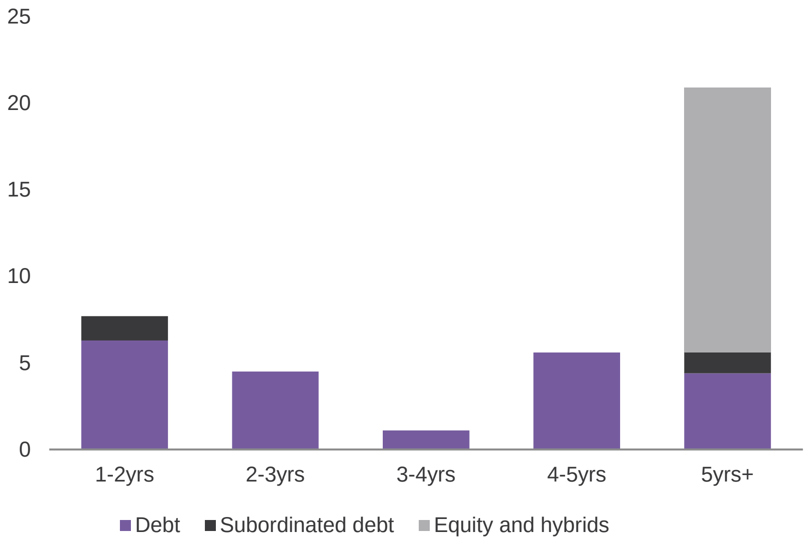
	Notes	AS AT Mar 20 $Ab	Mar 19 $Ab
Funding sources			
Wholesale issued paper:	1		
Certificates of deposit		**0.6**	1.0
Commercial paper		**5.0**	6.3
Net trade creditors	2	**1.1**	1.1
Structured notes	3	**1.9**	2.2
Secured funding	4	**3.2**	1.4
Bonds	5	**24.4**	16.1
Other loans	6	**0.9**	0.7
Customer deposits	7	**67.1**	56.0
Subordinated debt	8	**3.5**	3.0
Equity and hybrids	9	**15.8**	12.8
Total		**123.5**	100.6
Funded assets			
Cash and liquid assets	10	**33.6**	24.3
Self-securitisation	11	**23.5**	21.1
Net trading assets	12	**22.0**	20.3
Loan assets including operating lease assets less than one year	13	**12.2**	12.6
Loan assets including operating lease assets greater than one year	13	**41.7**	35.0
Debt investment securities	14	**1.7**	1.1
Non-Bank Group deposit with MBL		**(12.2)**	(14.8)
Co-investment in Macquarie-managed funds and other equity investments	15	**0.4**	0.4
Property, plant and equipment and intangibles		**0.6**	0.6
Total		**123.5**	100.6

See section 5.5 for notes 1–15.

Term funding profile

Detail of drawn funding maturing beyond one year

$A billion



	AS AT MAR 20 1–2yrs $Ab	2–3yrs $Ab	3–4yrs $Ab	4–5yrs $Ab	5yrs+ $Ab	Total $Ab
Structured notes[1]	–	0.1	–	0.2	1.6	**1.9**
Secured funding	1.0	–	0.2	–	–	**1.2**
Bonds	5.2	4.4	0.9	5.4	2.8	**18.7**
Other loans	0.1	–	–	–	–	**0.1**
Total debt	**6.3**	**4.5**	**1.1**	**5.6**	**4.4**	**21.9**
Subordinated debt[2]	1.4	–	–	–	1.2	**2.6**
Equity and hybrids[2]	–	–	–	–	15.4	**15.4**
Total funding sources drawn	**7.7**	**4.5**	**1.1**	**5.6**	**21.0**	**39.9**
Undrawn	–	–	–	–	–	**–**
Total funding sources drawn and undrawn	**7.7**	**4.5**	**1.1**	**5.6**	**21.0**	**39.9**

Macquarie Bank has diversity of funding by both source and maturity. The weighted average term to maturity of term funding maturing beyond one year (excluding equity which is a permanent source of funding, and securitisations) was 3.8 years as at 31 March 2020.

As at 31 March 2020, customer deposits represented $A67.1 billion, or 54% of the Bank Group's total funding, short-term (maturing in less than 12 months) wholesale issued paper represented $A5.6 billion, or 5% of total funding, and other debt funding maturing within 12 months[(3)] and net trade creditors represented $A10.9 billion, or 9% of total funding.

[1] Structured notes are profiled using a behavioural maturity profile.
[2] Included in this balance are securities with conditional repayment obligations. These securities are disclosed using the earlier repricing dates instead of contractual maturity.
[3] Includes hybrids maturing in the next 12 months.

5.4 Funding profile

Continued

Term funding initiatives

The Bank Group has a liability driven approach to balance sheet management, where funding is raised prior to assets being taken on to the balance sheet. Since 1 April 2019, the Bank Group has continued to raise term wholesale funding across various products and currencies.

Details of term funding raised between 1 April 2019 and 31 March 2020:

		Bank Group $Ab
Issued paper	– Senior unsecured	12.4
Secured funding	– Term securitisation and other secured finance	11.1
Total		**23.5**

The Bank Group has continued to develop its major funding markets and products during the year ended 31 March 2020

From 1 April 2019 to 30 March 2020, the Bank Group raised $A23.5 billion[(1)] of term funding including:

- $A12.4 billion of term wholesale issued paper comprising of $A8.4 billion of senior unsecured debt issuance, $A3.9 billion of private placements and $A0.1 billion of structured notes
- $A8.5 billion of PUMA RMBS public and warehouse securitisation issuance
- $A1.0 billion of SMART ABS warehouse securitisation issuance; and
- $A1.6 billion of secured trade finance facilities.

[1] Issuances cover a range of tenors, currencies and product types and are Australian dollar equivalent based on FX rates at the time of issuance and include undrawn facilities.

The key tools used for raising debt funding for MBL, which primarily funds the Bank Group are as follows:

– $US25 billion Regulation S Debt Instrument Program, including Euro Commercial Paper, Euro Certificate of Deposit, Euro Medium-Term Notes, senior and subordinated fixed/floating rate notes, and Transferable Deposits. The Debt Instrument Program had $US8.9 billion debt securities outstanding as at 31 March 2020
– $US15 billion Commercial Paper Program under which $US2.9 billion of debt securities were outstanding as at 31 March 2020
– $US20 billion US Rule 144A/Regulation S Medium-Term Note Program under which $US8.3 billion of issuances were outstanding as at 31 March 2020
– $US1.1 billion Secured Trade Finance Facility(1) of which $US1.0 billion was drawn as at 31 March 2020
– $US5 billion Structured Note Program under which $US1.2 billion of funding from structured notes was outstanding as at 31 March 2020; and
– $A5 billion Covered Bond Programme under which $A0.9 billion of debt securities were outstanding as at 31 March 2020.

Macquarie Bank accesses the Australian capital markets through the issuance of Negotiable Certificates of Deposit. As at 31 March 2020, Macquarie Bank had $A0.6 billion of these securities outstanding.

As at 31 March 2020, Macquarie Bank had internally securitised $A23.5 billion of its own Australian assets (predominantly mortgages and motor vehicles).

Macquarie Bank, as an ADI, has access to liquidity from the RBA daily market operations.

Deposit strategy

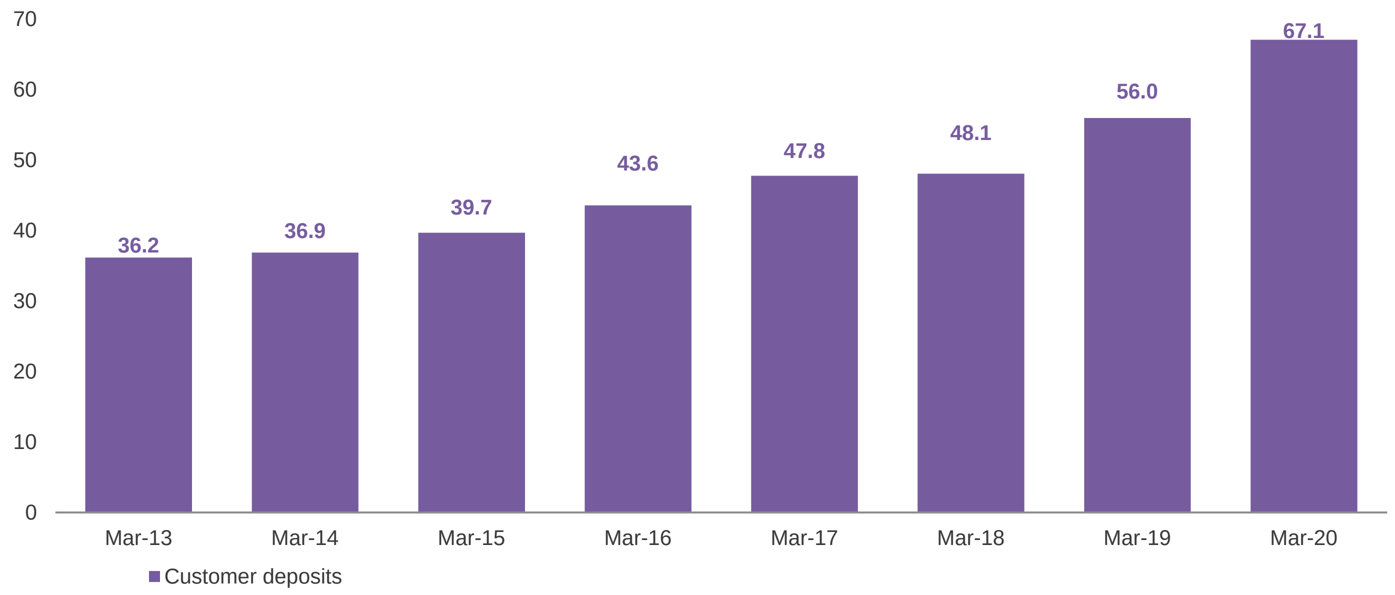
MBL continues to pursue a deposit strategy that is consistent with the core liquidity management tolerance of achieving diversity and stability of funding sources. The strategy is focused on growing the BFS deposit base, which represents a stable and reliable source of funding and reduces Macquarie's reliance on wholesale funding markets.

In particular, MBL is focused on the quality and composition of the deposit base, targeting transactional and relationship based deposits. The Financial Claims Scheme (FCS) is an Australian Government scheme that provides protection to depositors up to a limit of $A250,000 per account holder. The majority of MBL's deposits are covered by the FCS.

The chart below illustrates the customer deposit growth since 31 March 2013.

Deposit trend

$A billion



[1] $US1.1b Secured Trade Finance Facility can be at either the MBL or MGL level but is currently drawn out of MBL.

5.5 Explanatory notes concerning funding sources and funded assets

1. Wholesale issued paper

Unsecured short-term wholesale funding comprised of both Certificates of Deposit and Commercial Paper.

2. Net trade creditors

Short-term working capital balances (debtors and creditors) are created through the Bank Group's day-to-day operations. A net funding use (or source) will result due to timing differences in cash flows.

3. Structured notes

Includes debt instruments on which the return is linked to a number of variables including interest rates, currencies, equities and credit. They are generally issued as part of structured transactions with clients and are hedged with positions in underlying assets or derivative instruments.

4. Secured funding

Certain funding arrangements secured against an asset (or pool of assets).

5. Bonds

Unsecured long-term wholesale funding.

6. Other loans

Unsecured loans provided by financial institutions and other counterparties.

7. Customer deposits

Unsecured funding from BFS, corporate and wholesale depositors. The Australian Government Financial Claims Scheme covers eligible deposits in Macquarie Bank.

8. Subordinated debt

Long-term subordinated debt.

9. Equity and hybrids

Equity balances are comprised of issued capital, retained earnings and reserves. Hybrid instruments include MIS, MACS and BCN.

10. Cash and liquid assets

Cash and liquid assets generally consist of amounts due from banks and liquid debt investment securities. Liquid assets are almost entirely repo eligible with central banks or are very short dated.

11. Self-securitisation

This represents Australian assets which have been internally securitised and is a form of collateral on the RBA's list of eligible securities for repurchase agreements. Macquarie Bank can utilise a portion of this as collateral in the Reserve Bank of Australia's Committed Liquidity Facility.

12. Net trading assets

The net trading asset balance consists of financial markets, commodities and equity trading assets including the net derivative position, any trading related receivables or payables and margin or collateral balances.

13. Loan assets including operating lease assets

This represents loans provided to retail and wholesale borrowers, as well as assets held under operating leases.

See section 4.2 for further information.

14. Debt investment securities

These can include various categories of debt securities including asset backed securities, bonds, commercial mortgage backed securities and residential mortgage backed securities.

15. Co-investment in Macquarie-managed funds and other equity investments

These include co-investments in Macquarie-managed funds.

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06

Capital

Tantanoola, Australia

Macquarie is one of the largest agricultural investment managers in the world. Located in Western Australia, the Tantanoola property – operated by Macquarie-managed Viridis Ag – grows grains such as wheat, barley, lupins and canola.

6.1 Overview

As an Australian Prudential Regulation Authority (APRA) authorised and regulated Non-Operating Holding Company, MGL is required to hold adequate regulatory capital to cover the risks for Macquarie Group, including the Non-Bank Group. MGL and APRA have agreed a capital adequacy framework for Macquarie Group, based on APRA's capital standards for ADIs and Macquarie Group's Board-approved Economic Capital Adequacy Model (ECAM).

Macquarie Group's capital adequacy framework requires it to maintain minimum regulatory capital requirements calculated as the sum of:

- The Bank Group's minimum Tier 1 capital requirement, based on a percentage of risk-weighted assets plus Tier 1 deductions using prevailing APRA ADI Prudential Standards and
- The Non-Bank Group's capital requirement, calculated using Macquarie Group's ECAM. Transactions internal to Macquarie Group are eliminated.

Eligible regulatory capital of Macquarie Group consists of ordinary share capital, retained earnings and certain reserves plus eligible hybrid instruments. Eligible hybrid instruments as at 31 March 2020 include the Macquarie Income Securities (MIS), Macquarie Additional Capital Securities (MACS), Macquarie Group Capital Notes 2 (MCN2), Macquarie Group Capital Notes 3 (MCN3) and Macquarie Group Capital Notes 4 (MCN4).

Capital disclosures in this section include Harmonised Basel III[(1)] and APRA Basel III[(2)]. The former is relevant for comparison with banks regulated by regulators other than APRA, whereas the latter reflects Macquarie Group's regulatory requirements under APRA Basel III rules.

Pillar 3

The APRA ADI Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information (Pillar 3) details the market disclosure requirements for Australian domiciled banks. APS 330 requires qualitative and quantitative disclosure of risk management practices and capital adequacy. Pillar 3 documents are available on Macquarie's website.

[1] Harmonised Basel III relates to the Basel III guidelines defined by the Basel Committee on Banking Supervision, documented in the following: 'Basel III: a global regulatory framework for more resilient banks and banking systems', published December 2010 (revised June 2011) by the Bank for International Settlements (BIS) and further updated by BCBS 279 'The standardised approach for measuring counterparty credit risk exposures'.
[2] APRA Basel III relates to the ADI Prudential Standards released by APRA for the period effective from 1 January 2013.

6.2 Bank Group capital

The Bank Group is accredited by APRA under the Basel Foundation Internal Ratings Based approach (FIRB) for credit risk, the Advanced Measurement Approach (AMA) for operational risk, the internal model approach for market risk and the internal model approach for interest rate risk in the banking book (IRRBB).

These advanced approaches place a higher reliance on a bank's internal capital measures and therefore require a more sophisticated level of risk management and risk measurement practices.

Common Equity Tier 1 capital

The Bank Group's Common Equity Tier 1 capital under Basel III consists of ordinary share capital, retained earnings and certain reserves. $A1,000 million of additional ordinary shares were issued by Macquarie Bank Limited to its parent entity of Macquarie B.H.Pty Ltd in March 2020.

Tier 1 capital

Tier 1 capital consists of Common Equity Tier 1 capital and Additional Tier 1 capital (hybrids). Additional Tier 1 capital as at 31 March 2020 consists of MIS and MACS. MBL periodically pays dividends to MGL and is recapitalised by MGL as required to support projected business growth.

MIS are a perpetual instrument with no ordinary equity conversion rights. MIS were listed for trading on the Australian Stock Exchange (now known as the Australian Securities Exchange) in 1999. MIS distributions are paid quarterly at a floating rate of BBSW plus 1.7% per annum and payment is subject to certain conditions including profitability of the Bank. MIS are included in Additional Tier 1 capital under Basel III transitional rules. MIS were repaid on 15 April 2020, followed by a redemption on 16 April 2020.

MACS were issued by MBL, acting through its London Branch in March 2017. MACS are subordinated, unsecured notes that pay discretionary, non-cumulative, semi-annual fixed rate cash distributions. Subject to certain conditions the MACS may be redeemed on 8 March 2027, or every fifth anniversary thereafter. MACS can be exchanged for a variable number of fully paid MGL ordinary shares on an acquisition event (where a person acquires control of MBL or MGL), where MBL's common equity Tier 1 capital ratio falls below 5.125%, or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).

BCN were issued by MBL in October 2014 and are quoted on the Australian Securities Exchange. The BCN pay discretionary, semi-annual floating rate cash distributions equal to six month BBSW plus 3.30% per annum margin, adjusted for franking credits. These instruments are non-cumulative and unsecured and may be redeemed at face value on 24 March 2020, 24 September 2020 and 24 March 2021 (subject to certain conditions being satisfied) or earlier in specified circumstances. The BCN can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 24 March 2023; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL or MBL); or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support). On 24 March 2020, MBL redeemed the BCN. No BCN were exchanged during the period before their redemption.

Bank Group Basel III Tier 1 Capital

	AS AT MAR 20		AS AT SEP 19		MOVEMENT	
	Harmonised Basel III $Am	APRA Basel III $Am	Harmonised Basel III $Am	APRA Basel III $Am	Harmonised Basel III %	APRA Basel III %
Common Equity Tier 1 capital						
Paid-up ordinary share capital	**8,508**	**8,508**	7,507	7,507	*13*	*13*
Retained earnings	**4,350**	**4,350**	3,824	3,824	*14*	*14*
Reserves	**990**	**990**	637	637	*55*	*55*
Gross Common Equity Tier 1 capital	**13,848**	**13,848**	11,968	11,968	*16*	*16*
Regulatory adjustments to Common Equity Tier 1 capital:						
Goodwill	**47**	**47**	44	44	*7*	*7*
Deferred tax assets	**69**	**489**	67	437	*3*	*12*
Net other fair value adjustments	**(12)**	**(12)**	(131)	(131)	*(91)*	*(91)*
Intangible component of investments in subsidiaries and other entities	**53**	**53**	52	52	*2*	*2*
Loan and lease origination fees and commissions paid to mortgage originators and brokers	**–**	**441**	–	415	*–*	*6*
Shortfall in provisions for credit losses	**278**	**317**	315	350	*(12)*	*(9)*
Equity exposures	**–**	**588**	–	565	*–*	*4*
Capitalised software	**69**	**69**	75	75	*(8)*	*(8)*
Other Common Equity Tier 1 capital deductions	**155**	**203**	86	126	*80*	*61*
Total Common Equity Tier 1 capital deductions	**659**	**2,195**	508	1,933	*30*	*14*
Net Common Equity Tier 1 capital	**13,189**	**11,653**	11,460	10,035	*15*	*16*
Additional Tier 1 Capital						
Additional Tier 1 capital instruments	**1,315**	**1,315**	1,681	1,681	*(22)*	*(22)*
Gross Additional Tier 1 capital	**1,315**	**1,315**	1,681	1,681	*(22)*	*(22)*
Deduction from Additional Tier 1 capital	**–**	**–**	–	–	*–*	*–*
Net Additional Tier 1 capital	**1,315**	**1,315**	1,681	1,681	*(22)*	*(22)*
Total Net Tier 1 capital	**14,504**	**12,968**	13,141	11,716	*10*	*11*

6.2 Bank Group capital
Continued

Bank Group Basel III Risk-Weighted Assets (RWA)

	AS AT MAR 20		AS AT SEP 19		MOVEMENT	
	Harmonised Basel III $Am	APRA Basel III $Am	Harmonised Basel III $Am	APRA Basel III $Am	Harmonised Basel III %	APRA Basel III %
Credit risk						
Subject to IRB approach:						
Corporate	**29,246**	**29,246**	24,927	24,927	*17*	*17*
SME Corporate	**3,581**	**3,581**	3,573	3,573	*<1*	*<1*
Sovereign	**382**	**382**	199	199	*92*	*92*
Bank	**1,499**	**1,499**	1,535	1,535	*(2)*	*(2)*
Residential mortgage	**7,416**	**17,757**	6,839	15,948	*8*	*11*
Other retail	**4,220**	**4,220**	4,373	4,373	*(3)*	*(3)*
Retail SME	**3,508**	**3,515**	3,584	3,591	*(2)*	*(2)*
Total RWA subject to IRB approach	**49,852**	**60,200**	45,030	54,146	*11*	*11*
Specialised lending exposures subject to slotting criteria[1]	**6,545**	**6,545**	6,079	6,079	*8*	*8*
Subject to Standardised approach:						
Corporate	**262**	**262**	320	320	*(18)*	*(18)*
Residential mortgage	**740**	**740**	762	762	*(3)*	*(3)*
Other Retail	**1,928**	**1,928**	2,240	2,240	*(14)*	*(14)*
Total RWA subject to Standardised approach	**2,930**	**2,930**	3,322	3,322	*(12)*	*(12)*
Credit risk RWA for securitisation exposures	**758**	**758**	740	740	*2*	*2*
Credit Valuation Adjustment RWA	**7,635**	**7,635**	5,343	5,343	*43*	*43*
Exposures to Central Counterparties RWA	**835**	**835**	716	716	*17*	*17*
RWA for Other Assets	**3,580**	**2,089**	3,766	2,426	*(5)*	*(14)*
Total Credit risk RWA	**72,135**	**80,992**	64,996	72,772	*11*	*11*
Equity risk exposures RWA	**1,877**	**–**	1,770	–	*6*	*–*
Market risk RWA	**3,971**	**3,971**	4,934	4,934	*(20)*	*(20)*
Operational risk RWA	**10,655**	**10,655**	10,386	10,386	*3*	*3*
Interest rate risk in banking book RWA	**–**	**–**	–	–	*–*	*–*
Total Bank Group RWA	**88,638**	**95,618**	82,086	88,092	*8*	*9*
Capital ratios						
Bank Group Common Equity Tier 1 capital ratio (%)	**14.9**	**12.2**	14.0	11.4		
Bank Group Tier 1 capital ratio (%)	**16.4**	**13.6**	16.0	13.3		

[1] Specialised lending exposures subject to supervisory slotting criteria are measured using APRA determined risk weightings.

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07

Glossary

Silvertown Tunnel Project, London

Development of the UK's first major crossing across the River Thames in almost 30 years. The project involves the construction of a 1.4km twin-bore road tunnel under the River Thames in East London, which will improve traffic congestion and environmental emissions in the area.

7.1 Glossary

AASB	Australian Accounting Standards Board.
ABS	Asset Backed Securities.
ADI	Authorised Deposit-taking Institution.
Additional Tier 1 Capital	A capital measure defined by APRA comprising high quality components of capital that satisfy the following essential characteristics: – provide a permanent and unrestricted commitment of funds; – are freely available to absorb losses; – rank behind the claims of depositors and other more senior creditors in the event of winding up of the issuer; and – provide for fully discretionary capital distributions.
Additional Tier 1 Deductions	An amount deducted in determining Additional Tier 1 Capital, as defined in Prudential Standard APS 111 *Capital Adequacy: Measurement of Capital*.
ALCO	The Asset and Liability Committee.
AMA	Advanced Measurement Approach (for determining operational risk).
ANZ	Australia and New Zealand.
APRA	Australian Prudential Regulation Authority.
Associates	Associates are entities over which Macquarie has significant influence, but not control. Investments in associates may be further classified as Held for sale (HFS) associates. HFS associates are those that have a high probability of being sold within 12 months to external parties. Associates that are not held for sale are carried at cost and equity-accounted. Macquarie's share of the investment's post-acquisition profits and losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised within equity.
Bank Group	MBL and its subsidiaries.
Bank Group Capital	Level 2 regulatory group capital.
Banking Group	The Banking Group comprises of BFS and certain activities of CGM.
Basel III IRB Formula	A formula to calculate RWA, as defined in Prudential Standard APS 113 *Capital Adequacy: Internal Ratings-based Approach to Credit Risk*.
BCN	On 8 October 2014, MBL issued 4.3 million Macquarie Bank Capital Notes (BCN) at face value of $A100 each. BCN were subordinated, unsecured notes that pay discretionary, non-cumulative, semi-annual floating rate cash distributions. BCN were redeemed on 24 March 2020.
BBSW	Bank Bill Swap Rate.
BFS	Banking and Financial Services.
BFS deposits	BFS deposits are those placed with Banking and Financial Services and include products such as the Cash Management Account, Term Deposits and Relationship Banking deposits. Counterparties primarily consist of individuals, self-managed super funds and small-medium enterprises.
BIS	Bank for International Settlements.
CAF	Corporate and Asset Finance.
CCB	Capital Conservation Buffer.
Central service groups	The central service groups consist of the Corporate Operations Group, Financial Management Group, Risk Management Group, Legal and Governance and Central Executive.
CGM	Commodities and Global Markets.
CLF	Committed Liquidity Facility.
CMA	Cash Management Account.

7.1 Glossary

Continued

Common Equity Tier 1 Capital	A capital measure defined by APRA, comprising the highest quality components of capital that fully satisfy all the following essential characteristics: – provide a permanent and unrestricted commitment of funds; – are freely available to absorb losses; – do not impose any unavoidable servicing charge against earnings; and – rank behind the claims of depositors and other creditors in the event of winding up. Common Equity Tier 1 Capital comprises paid up capital, Retained earnings, and certain reserves.
Common Equity Tier 1 Capital Ratio	Common Equity Tier 1 Capital net of Common Equity Tier 1 Deductions expressed as a percentage of RWA.
Common Equity Tier 1 Deductions	An amount deducted in determining Common Equity Tier 1 Capital, as defined in Prudential Standard APS 111 *Capital Adequacy: Measurement of Capital*.
Consolidated Entity	Macquarie Bank Limited and its subsidiaries.
Directors' Profit Share (DPS)	The DPS plan comprises exposure to a notional portfolio of Macquarie-managed funds. Retained amounts for Executive Directors are notionally invested over the retention period. This investment is described as 'notional' because Executive Directors do not directly hold securities in relation to this investment. However, the value of the retained amounts will vary as if these amounts were directly invested in actual securities, giving the Executive Directors an effective economic exposure to the performance of the securities. If the notional investment results in a notional loss, this loss will be offset against any future notional income until the loss is completely offset.
Earnings on capital and certain corporate income items	Net operating income includes the income generated by Macquarie's Operating Groups, income from the investment of Macquarie's capital, and certain items of operating income not attributed to Macquarie's Operating Groups. Earnings on capital and certain corporate income items is net operating income less the net operating income generated by Macquarie's Operating Groups.
ECAM	Economic Capital Adequacy Model.
Effective tax rate	The income tax expense as a percentage of the profit before income tax, both adjusted for amounts attributable to non-controlling interests. The effective tax rate differs from the Australian company tax rate due to permanent differences arising from the income tax treatment of certain income and expenses as well as tax rate differentials on some of the income earned offshore.
Expense/Income ratio	Total operating expenses expressed as a percentage of Net operating income.
FI&C	Fixed Income & Currencies, a division within Commodities and Global Markets
Financial Report	The Financial Report within the Macquarie Bank Limited Annual Report.
FIRB	Foundation Internal Ratings Based Approach (for determining credit risk).
FY19	The year ended 31 March 2019.
FY2020	The year ended 31 March 2020.
FVOCI	Fair value through other comprehensive income.
FVTPL	Fair value through profit or loss.
Headcount	Headcount represents Macquarie Bank's active permanent and variable workforce, and includes Macquarie Bank's employees (permanent and casual) and its contingent workers (contractors, agency workers and secondees). Macquarie's non-executive directors are not included.
HQLA	High-quality liquid assets.
LGD	Loss given default is defined as the economic loss which arises upon default of the obligor.
Macquarie Bank, the Consolidated Entity	Macquarie Bank Limited and its subsidiaries.
Macquarie Group	MGL and its subsidiaries
Macquarie Income Securities (MIS)	Macquarie Income Securities (MIS) were perpetual, subordinated instruments that had no conversion rights to ordinary shares and discretionary distributions paid quarterly. They are treated as equity in the statement of financial position. MIS were repaid on 15 April 2020.

MACS	On 8 March 2017, MBL, acting through its London Branch, issued $US750 million of Macquarie Additional Capital Securities (MACS). MACS are subordinated, unsecured notes that pay discretionary, non-cumulative, semi-annual fixed rate cash distributions. Subject to certain conditions the MACS may be redeemed on 8 March 2027, or every 5th anniversary thereafter. MACS can be exchanged for a variable number of fully paid MGL ordinary shares on an acquisition event (where a person acquires control of MBL or MGL), where MBL's common equity Tier 1 capital ratio falls below 5.125%, or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MAM	Macquarie Asset Management.
MAMHPL	Macquarie Asset Management Holdings Pty Ltd.
MBL	Macquarie Bank Limited ABN 46 008 583 542.
MCN2	On 18 December 2015, MGL issued 5.3 million Macquarie Group Capital Notes 2 (MCN2) at a face value of $A100 each. MCN2 are subordinated, non-cumulative, unsecured notes that pay discretionary, non-cumulative, semi-annual floating rate cash distributions and may be redeemed at face value on 17 March 2021, 17 September 2021 or 17 March 2022 (subject to certain conditions being satisfied) or earlier in specified circumstances. MCN2 can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 18 March 2024; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL); or where APRA determines MGL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MCN3	On 7 June 2018, MGL issued 10 million Macquarie Group Capital Notes 3 (MCN3) at a face value of $A100 each. MCN3 are subordinated, non-cumulative, unsecured notes that pay discretionary, non-cumulative, quarterly floating rate cash distributions and may be redeemed at face value on 16 December 2024, 16 June 2025 or 15 December 2025 (subject to certain conditions being satisfied) or earlier in specified circumstances. MCN3 can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 15 December 2027; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL); or where APRA determines MGL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MCN4	On 27 March 2019, MGL issued 9.1 million Macquarie Group Capital Notes 4 (MCN4) at a face value of $A100 each. MCN4 are subordinated, non-cumulative, unsecured notes that pay discretionary, non-cumulative, quarterly floating rate cash distributions and may be redeemed at face value on 10 September 2026, 10 March 2027 or 10 September 2027 (subject to certain conditions being satisfied) or earlier in specified circumstances. MCN4 can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 10 September 2029; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL); or where APRA determines MGL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MEREP	Macquarie Group Employee Retained Equity Plan.
MFHPL	Macquarie Financial Holdings Pty Limited.
MGL, the Company	Macquarie Group Limited ABN 94 122 169 279.
Net loan losses	The impact on the income statement of loan amounts provided for or written-off during the period, net of the recovery of any such amounts which were previously written-off or provided for in the income statement.
Net tangible assets per ordinary share	(Total equity less Macquarie Income Securities less Non-controlling interest less the Future Income Tax Benefit plus the Deferred Tax Liability less Intangible assets) divided by the number of ordinary shares on issue at the end of the period.
Net Trading Income	Income that comprises gains and losses related to trading assets and liabilities and includes all realised and unrealised fair value changes and foreign exchange differences.
Non-Bank Group	MGL, MFHPL and its subsidiaries, MAMHPL and its subsidiaries.
Non-Banking Group	The Non-Banking Group comprises Macquarie Capital, MAM and some business activities of CGM that use certain offshore regulated entities of the Non-Banking Group.
Non-GAAP metrics	Non-GAAP metrics include financial measures, ratios and other information that are neither required nor defined under Australian Accounting Standards.

7.1 Glossary
Continued

Operating Groups	The Operating Groups consist of BFS and CGM.
RBA	Reserve Bank of Australia.
Risk-weighted assets (RWA)	A risk-based measure of an entity's exposures, which is used in assessing its overall capital adequacy.
RMBS	Residential Mortgage-Backed Securities.
Specialised and Asset Finance (SAF)	SAF is a global provider of specialist finance and asset management solutions across: Technology, Media & Telecoms; Energy, Renewables & Sustainability; Fund Finance; Resources; Structured Lending; and Shipping & Export Credit Agencies.
SPEs	Special purpose entities.
Subordinated debt	Debt issued by Macquarie for which agreements between Macquarie and the lenders provide, in the event of liquidation, that the entitlement of such lenders to repayment of the principal sum and interest thereon is and shall at all times be and remain subordinated to the rights of all other present and future creditors of Macquarie. Subordinated debt is classified as liabilities in the Macquarie financial statements and may be included in Tier 2 Capital.
Tier 1 Capital	Tier 1 Capital comprises of (i) Common Equity Tier 1 Capital; and (ii) Additional Tier 1 Capital.
Tier 1 Capital Deductions	Tier 1 Capital Deductions comprises of (i) Common Equity Tier 1 Capital Deductions; and (ii) Additional Tier 1 Capital Deductions.
Tier 1 Capital Ratio	Tier 1 Capital net of Tier 1 Capital Deductions expressed as a percentage of RWA.
True Index products	True Index products deliver clients pre-tax index returns (before buy/sell spreads on transactions). Any under-performance is compensated by Macquarie Bank and conversely, any out-performance is retained by Macquarie Bank.
UK	The United Kingdom.
US	The United States of America.

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