1H21

MACQUARIE BANK MANAGEMENT DISCUSSION AND ANALYSIS

Half year ended 30 September 2020

MACQUARIE BANK LIMITED ACN 008 583 542

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 half year ended 30 September 2020 and the Financial Report within the Macquarie Bank Limited Interim Report (the Financial Report) for the half year ended 30 September 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 half year ended 30 September 2020 and is current as at 6 November 2020.

Explanatory notes

Comparative information and conventions

Where necessary, comparative figures have been restated to conform to changes in current year financial presentation and group structures.

References to the prior corresponding period (pcp) are to the six months ended 30 September 2019.

References to the prior period are to the six months ended 31 March 2020.

References to the current period and current half year are to the six months ended 30 September 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 Review Report

This document should be read in conjunction with the Financial Report for the half year ended 30 September 2020, which was subject to independent review by PricewaterhouseCoopers.

PricewaterhouseCoopers' independent auditor's review report to the members of Macquarie Bank Limited dated 6 November 2020 was unqualified.

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

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Result Overview

1.1 Executive Summary

1H2021 Net profit

$A660m

↓33% on pcp

1H2021 Net operating income

$A2,943m

↓14% on pcp

1H2021 Operating expenses

$A2,103m

Broadly in line with pcp

1H2021 Net profit contribution[(1)] by Operating Group

Banking and Financial Services (BFS)

$A315m

↓18% on pcp

- Increased credit impairment charges driven by portfolio growth as well as a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period as a result of COVID-19
- Higher employment expenses including increased headcount to better support clients through the impacts of COVID-19 as well as increased costs associated with investment in technology to support business growth and to meet regulatory requirements.

Partially offset by:

- higher net interest and trading income driven by volume growth in BFS deposits and the loan portfolio, partially offset by margin compression on deposits and lower vehicle finance portfolio volumes.

Commodities and Global Markets (CGM)

$A924m

↓19% on pcp

- Reduced client contribution in the commodities sector on a strong prior corresponding period, predominantly due to lower activity in 2Q21
- Increased credit and other impairment charges reflecting a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period due to COVID-19, resulting in overlays for regional and industry specific risks as well as impairments taken on a small number of underperforming positions
- Reduced fee and commission income due to decreased demand for commodity risk premia products.

Partially offset by:

- consistent client and trading activity in foreign exchange, interest rate and credit products
- increased net operating lease income driven by higher secondary income from the asset financing portfolio.

Operating Group update

During the current period, certain activities of CGM's Cash Equities business, which operated within the Bank Group, were transferred to Macquarie Capital in the Non-Bank Group. The Cash Equities current period result and comparatives have been reclassified into the Corporate segment to reflect the reorganisation from CGM in the Bank Group.

Prior Period Discontinued Operations

On 10 December 2018, the Consolidated Entity disposed of its Corporate and Asset Finance's Principal Finance and Transportation Finance businesses (the businesses) to a related group entity, Macquarie Financial Holdings Pty Limited (MFHPL) and its subsidiaries.

Under terms of the agreement the Consolidated Entity recognises there is an adjustment to the sales consideration in certain situations following a subsequent sale of the transferred businesses by MFHPL and its subsidiaries. A gain of $A164 million was recognised in the period ended 31 March 2020 as a consequence of this provision.

(1) Net profit contribution is management accounting profit before unallocated corporate costs, profit share and income tax.

Profit attributable to the ordinary equity holder

$A660m

↓33% on prior corresponding period

	HALF YEAR TO			MOVEMENT	
	Sep 20	Mar 20	Sep 19	*Mar-20*	*Sep-19*
	$Am	$Am	$Am	*%*	*%*
Financial performance summary					
Net interest income	**1,005**	1,059	981	*(5)*	*2*
Fee and commission income	**516**	591	594	*(13)*	*(13)*
Net trading income	**1,374**	1,181	1,434	*16*	*(4)*
Net operating lease income	**206**	211	160	*(2)*	*29*
Share of net profits of associates and joint ventures	**12**	21	6	*(43)*	*100*
Net credit impairment charges	**(241)**	(370)	(81)	*(35)*	*198*
Other impairment (charges)/reversals	**(21)**	(17)	(4)	*24*	*
Other operating income and charges	**92**	66	340	*39*	*(73)*
Net operating income	**2,943**	2,742	3,430	*7*	*(14)*
Employment expenses	**(643)**	(612)	(735)	*5*	*(13)*
Brokerage, commission and trading-related expenses	**(296)**	(289)	(307)	*2*	*(4)*
Occupancy expenses	**(57)**	(52)	(52)	*10*	*10*
Non-salary technology expenses	**(88)**	(85)	(85)	*4*	*4*
Other operating expenses	**(1,019)**	(1,131)	(929)	*(10)*	*10*
Total operating expenses	**(2,103)**	(2,169)	(2,108)	*(3)*	*(<1)*
Operating profit from continuing operations before income tax	**840**	573	1,322	*47*	*(36)*
Income tax expense from continuing operations	**(180)**	(262)	(324)	*(31)*	*(44)*
Profit from continuing operations after income tax	**660**	311	998	*112*	*(34)*
Profit from discontinued operations after income tax	**–**	164	–	*(100)*	–
Profit from continuing and discontinued after income tax	**660**	475	998	*39*	*(34)*
Profit attributable to the equity holders of Macquarie Bank Limited	**660**	475	998	*39*	*(34)*
Distribution paid or provided for on Macquarie Income Securities	**–**	(6)	(6)	*(100)*	*(100)*
Profit attributable to the ordinary equity holder of Macquarie Bank Limited	**660**	469	992	*41*	*(33)*
From continuing operations	**660**	305	992	*116*	*(33)*
From discontinued operations	**–**	164	–	*(100)*	–
Key metrics					
Expense to income ratio (%)	**71.5**	79.1	61.5		
Effective tax rate (%)	**21.4**	45.7	24.5		

1.1 Executive Summary
Continued

Net operating income

Net operating income of $A2,943 million for the half year ended 30 September 2020 decreased 14% from $A3,430 million in the prior corresponding period, mainly driven by lower Other operating income and charges as well as higher Credit and Other impairment charges. This was partially offset by higher Net operating lease income.

Net interest and trading income

HALF YEAR TO		
30 Sep 20	31 Mar 20	30 Sep 19
$Am	$Am	$Am
2,379	2,240	2,415

↓1% on pcp

– Margin compression on deposits and lower vehicle finance portfolio volumes in BFS
– The CGM commodities platform was down on a strong pcp.

Partially offset by:

– growth in average BFS deposits and loan portfolio volumes in BFS
– impact of Cash Equities transfer to Macquarie Capital in the Non-Bank Group in the current period.

Fee and commission income

HALF YEAR TO		
30 Sep 20	31 Mar 20	30 Sep 19
$Am	$Am	$Am
516	591	594

↓13% on pcp

– Reduced demand for commodity risk premia products in CGM
– Reduction in income by supporting clients through COVID-19 in BFS
– Reduction in Cash Equities due to the transfer to Macquarie Capital in the Non-Bank Group in the current period.

Net operating lease income

HALF YEAR TO		
30 Sep 20	31 Mar 20	30 Sep 19
$Am	$Am	$Am
206	211	160

↑29% on pcp

– Higher secondary income from the asset financing portfolio in CGM.

Share of net profits of associates and joint ventures

HALF YEAR TO		
30 Sep 20	31 Mar 20	30 Sep 19
$Am	$Am	$Am
12	21	6

↑ significantly on pcp

– Increased overall performance of underlying assets across the Operating Groups.

Credit and Other impairment charges

HALF YEAR TO		
30 Sep 20	31 Mar 20	30 Sep 19
$Am	$Am	$Am
(262)	(387)	(85)

↑ significantly on pcp

– Higher credit impairment charges recognised across the Operating Groups primarily reflecting the economic impact of COVID-19 on our clients and customers, and new loans originated during the period
– Higher impairment charges in the prior period reflect the initial impact of COVID-19 on markets and its impact on the forward-looking economic outlook.

Other operating income and charges

HALF YEAR TO		
30 Sep 20	31 Mar 20	30 Sep 19
$Am	$Am	$Am
92	66	340

↓73% on pcp

– 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, in the prior corresponding period.

Operating expenses

Total operating expenses of $A2,103 million for the half year ended 30 September 2020 was broadly in line with $A2,108 million in the prior corresponding period, mainly driven by decreases across Employment expenses and Brokerage, commission and trading-related expenses, predominantly offset by Other operating expenses and Occupancy.

Employment expenses

HALF YEAR TO		
30 Sep 20 $Am	31 Mar 20 $Am	30 Sep 19 $Am
643	612	735

↓13% on pcp

- Decrease in performance-related profit share expense mainly as a result of lower performance in the Bank Group
- Lower share-based payments expense mainly driven by the non-recurrence of accelerated amortisation of equity awards relating to retiring Key Management Personnel recognised in the prior corresponding period.

Partially offset by:

- higher leave provisions due to less holiday entitlements being taken by staff driven by COVID-19.

Brokerage, commission and trading-related expenses

HALF YEAR TO		
30 Sep 20 $Am	31 Mar 20 $Am	30 Sep 19 $Am
296	289	307

↓4% on pcp

- The sale of an investment in Macquarie Pacific Funding in the prior corresponding period in BFS.

Non-salary technology expenses

HALF YEAR TO		
30 Sep 20 $Am	31 Mar 20 $Am	30 Sep 19 $Am
88	85	85

↑4% on pcp

- Higher technology expenses to support business growth and to meet regulatory requirements in BFS.

Other operating expenses and Occupancy

HALF YEAR TO		
30 Sep 20 $Am	31 Mar 20 $Am	30 Sep 19 $Am
1,076	1,183	981

↑10% on pcp

- Increased support services due to increasing compliance and regulatory requirements and higher business activity in the Bank Group
- The recognition of certain transaction related charges in Corporate.

Partially offset by:

- reduced travel and entertainment expenses across the Bank Group driven by COVID-19.

Income tax expense

Income tax expense for the half year ended 30 September 2020 was $A180 million, a 44% decrease from $A324 million in the prior corresponding period. The effective tax rate for the half year ended 30 September 2020 was 21.4%, down from 24.5% in the prior corresponding period and 45.7% in the prior period.

The lower effective tax rate compared to the prior corresponding period was mainly driven by the geographic composition and nature of earnings.

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Financial Performance Analysis

2.1 Net Interest and Trading Income

	HALF YEAR TO			*MOVEMENT*	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Net interest income	**1,005**	1,059	981	*(5)*	*2*
Net trading income	**1,374**	1,181	1,434	*16*	*(4)*
Net interest and trading income	**2,379**	2,240	2,415	*6*	*(1)*

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 predominantly comprising gains and losses relating to trading activities.

For CGM, which predominantly 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.

With respect to businesses that predominantly earn income from lending activities, derivatives that hedge interest rate risk are measured at fair value through profit or loss (FVTPL). Changes in fair value are presented in net trading income and gives rise to income statement volatility unless designated in a hedge accounting relationship, in which case the carrying value of the hedged item is adjusted for changes in fair value attributable to the hedged risk to reduce volatility in the income statement. If designated in a cash flow hedge accounting relationship, the effective portion of the derivative's fair value gains or losses is deferred in the cash flow hedge reserve as part of Other Comprehensive Income (OCI), and subsequently recognised in the income statement at the time at which the hedged item affects the income statement for the hedged risk. For segment reporting, derivatives are accounted for on an accrual basis in the results of the Operating Groups to the extent that the Corporate segment manages the derivative volatility, either through the application of hedge accounting or where the derivative volatility may offset the volatility of other positions managed within the Corporate segment.

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			*MOVEMENT*	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
BFS	**844**	890	838	*(5)*	*1*
CGM					
Commodities	**933**	748	1,013	*25*	*(8)*
Foreign exchange, interest rates and credit	**352**	327	333	*8*	*6*
Equities	**198**	158	193	*25*	*3*
Specialised and Asset Finance	**63**	83	78	*(24)*	*(19)*
Corporate	**(11)**	34	(40)	*	*(73)*
Net interest and trading income	**2,379**	2,240	2,415	*6*	*(1)*

2.1 Net Interest and Trading Income

Continued

Net interest and trading income of $A2,379 million for the half year ended 30 September 2020 decreased 1% from $A2,415 million in the prior corresponding period.

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 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 $A844 million for the half year ended 30 September 2020 increased 1% from $A838 million in the prior corresponding period due to a 32% increase in the average BFS deposit volumes and a 38% increase in average loan portfolio volumes, partially offset by margin compression on deposits and reduction in vehicle finance volumes.

As at 30 September 2020 the deposit and loan and lease portfolios included:

- BFS Deposits of $A74.4 billion, up 16% from $A63.9 billion as at 31 March 2020;
- Home loan volumes of $A57.4 billion, up 10% from $A52.1 billion as at 31 March 2020;
- Vehicle finance volumes of $A12.4 billion, down 9% from $A13.7 billion as at 31 March 2020; and
- Business banking loan volumes of $A8.9 billion, down 1% from $A9.0 billion as at 31 March 2020.

CGM

Net interest and trading income of $A1,546 million for the half year ended 30 September 2020 decreased 4% from $A1,617 million in the prior corresponding period.

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.

Income from risk management products is generated from the provision of hedging and risk management services to clients. 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.

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.

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.

Net interest and trading income from commodities of $A933 million for the half year ended 30 September 2020 decreased 8% from $A1,013 million in the prior corresponding period.

The current period included solid client activity across the commodities platform, primarily in 1Q21, due to client hedging activity in Resources, Agriculture, North American Gas & Power, Global Oil and EMEA Gas and Power. Elevated volatility in 1Q21 contributed to strong hedging activity with clients rebalancing portfolios.

Lending and financing income was driven by continued activity across Resources, Agricultural and Energy sectors.

The current period result also benefited from market dislocations across Precious Metals markets, elevated volatility in 1Q21 and the timing of income recognition on Oil and Gas storage contracts and transport agreements.

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 $A352 million for the half year ended 30 September 2020 increased 6% from $A333 million in the prior corresponding period. Income for the period was driven by consistent client activity in structured foreign exchange and interest rate products due to FX volatility and movement in spreads.

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 $A198 million for the half year ended 30 September 2020 increased 3% from $A193 million in the prior corresponding period due to an increased contribution from trading activities.

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 $A63 million for the half year ended 30 September 2020 decreased 19% from $A78 million in the prior corresponding period. The decrease was largely as a result of a stronger prior corresponding period which benefited from net proceeds from end of lease asset sales.

The loan and finance lease portfolio was $A4.7 billion as at 30 September 2020, a reduction of 22% from $A6.0 billion as at 31 March 2020. The reduction was largely due to reduced activity across funds finance and unfavourable foreign exchange movements.

2.1 Net Interest and Trading Income

Continued

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 and centrally held investments and accounting volatility arising from movements in underlying rates relating to economically hedged positions where hedge accounting under AASB 9 is unable to be achieved. In addition, the Corporate segment includes the Cash Equities business, which was transferred from Commodities and Global Markets to Macquarie Capital in the Non-Bank Group.

Net interest and trading income expense of $A11 million for the half year ended 30 September 2020 decreased 73% from an expense of $A40 million in the prior corresponding period primarily due to greater accounting volatility from changes in the fair value on economic hedges, increased transfer pricing recovery from Operating Groups and the reduction in Cash Equities as part of the transfer to Macquarie Capital in the Non-Bank Group in the current period. This was partially offset by lower earnings on capital driven by lower AUD and USD interest rates.

2.2 Fee and Commission Income

	HALF YEAR TO			*MOVEMENT*	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Brokerage and other trading-related income	**227**	264	237	*(14)*	*(4)*
Other fee and commission income	**289**	327	357	*(12)*	*(19)*
Total fee and commission income	**516**	591	594	*(13)*	*(13)*

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 Equity Derivatives and Trading and Futures businesses in CGM and brokerage income from the provision of wealth services in BFS. Other fee and commission income includes fees earned on a range of BFS' products and services including BFS Wrap and Vision platforms, 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 $A516 million for the half year ended 30 September 2020 decreased 13% from $A594 million in the prior corresponding period primarily due to reduced demand for commodity risk premia products in CGM, reduced income in BFS from supporting clients through COVID-19 and a reduction in Cash Equities due to the transfer to Macquarie Capital in the Non-Bank Group in the current period.

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2.3 Net Operating Lease Income

	HALF YEAR TO			MOVEMENT	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Rental income	**483**	583	614	*(17)*	*(21)*
Depreciation and other operating lease-related charges	**(277)**	(372)	(454)	*(26)*	*(39)*
Net operating lease income	**206**	211	160	*(2)*	*29*

Net operating lease income of $A206 million for the half year ended 30 September 2020 increased 29% from $A160 million in the prior corresponding period. The movement was primarily driven by higher secondary income from the asset financing portfolio in CGM.

2.4 Share of Net Profits of Associates and Joint Ventures

	HALF YEAR TO			MOVEMENT	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Share of net profits of associates and joint ventures	**12**	21	6	*(43)*	*100*

Share of net profits of associates and joint ventures of $A12 million for the half year ended 30 September 2020 increased significantly from $A6 million in the prior corresponding period as a result of increased overall performance of underlying assets across the Operating Groups.

2.5 Credit and Other Impairment Charges

	HALF YEAR TO			MOVEMENT	
	Sep 20 $Am	Mar 20 $Am	Sep 19 $Am	*Mar 20 %*	*Sep 19 %*
Net credit impairment charges					
Loan assets	**(193)**	(231)	(94)	*(16)*	*105*
Margin money and settlement assets	**(24)**	(66)	–	*(64)*	*
Financial investments, other assets, undrawn credit commitments and financial guarantees	**(26)**	(71)	(1)	*(63)*	*
Gross credit impairment charges	**(243)**	(368)	(95)	*(34)*	*156*
Recovery of loans previously written off	**2**	(2)	14	*	*(86)*
Total net credit impairment charges	**(241)**	(370)	(81)	*(35)*	*198*
Other impairment (charges)/reversal					
Interests in associates and joint ventures	**(10)**	(7)	–	*43*	*
Intangible assets and other non-financial assets	**(11)**	(10)	(4)	*10*	*175*
Total other impairment (charges)/reversal	**(21)**	(17)	(4)	*24*	*
Total credit and other impairment charges	**(262)**	(387)	(85)	*(32)*	*208*

	HALF YEAR TO			MOVEMENT	
	Sep 20 $Am	Mar 20 $Am	Sep 19 $Am	*Mar 20 %*	*Sep 19 %*
BFS	**(78)**	(108)	(41)	*(28)*	*90*
CGM	**(173)**	(207)	(31)	*(16)*	*
Corporate	**(11)**	(72)	(13)	*(85)*	*(15)*
Total credit and other impairment charges	**(262)**	(387)	(85)	*(32)*	*208*

Total credit and other impairment charges of $A262 million for the half year ended 30 September 2020 increased from $A85 million in the prior corresponding period reflecting the impact of COVID-19 in the current period. Included in this is $A241 million of total credit impairment charges, up from $A81 million in the prior corresponding period. This includes losses arising from defaulted positions and ECL charges calculated on a forward-looking basis using modelled outcomes as well as overlays reflecting regional and industry specific risks.

2.5 Credit and Other Impairment Charges

Continued

BFS

Credit and Other impairment charges of $A78 million for the half year ended 30 September 2020 increased 90% from $A41 million in prior corresponding period largely due to credit impairment charges driven by portfolio growth as well as a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period as a result of COVID-19.

CGM

Credit and Other impairment charges of $A173 million for the half year ended 30 September 2020 increased significantly from $A31 million in the prior corresponding period reflecting a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period due to COVID-19, resulting in overlays for regional and industry specific risks as well as impairments taken on a small number of underperforming positions.

Corporate

Credit and Other impairment charges of $A11 million for the half year ended 30 September 2020, decreased 15% from $A13 million in the prior corresponding period and decreased 85% from $A72 million in the prior period. The higher impairment charges in the prior period was due to the recognition of a central overlay provision reflecting the initial impact of COVID-19.

For further information on the Consolidated Entity's determination of its expected credit losses, please refer to Note 11 *Expected credit losses* in the Financial Report.

2.6 Other Operating Income and Charges

	HALF YEAR TO			MOVEMENT	
	Sep 20 $Am	Mar 20 $Am	Sep 19 $Am	Mar 20 %	Sep 19 %
Investment income					
Net gain/(loss) on equity investments and debt investments	52	(2)	11	*	*
Net gain on interests in associates and joint ventures	–	9	9	(100)	(100)
Net (loss)/gain on disposal of businesses and subsidiaries held for sale	–	(1)	242	(100)	(100)
Total investment income	52	6	262	*	(80)
Net other income	40	60	78	(33)	(49)
Total other operating income and charges	92	66	340	39	(73)

Total other operating income and charges of $A92 million for the half year ended 30 September 2020 decreased 73% from $A340 million in the prior corresponding period, mainly due to lower investment income in Corporate.

Investment income

Investment income totalled $A52 million for the half year ended 30 September 2020. The prior corresponding period gain of $A262 million was primarily driven by the gain on sale in Corporate of MSIS fiduciary businesses to MAMHPL, a related party of MBL, owned 100% by MGL. The current period included gains on listed equity investments in the commodities sector in CGM and the revaluation of an equity investment in BFS.

Net other income

Net other income of $A40 million for the half year ended 30 September 2020 decreased 49% from $A78 million in the prior corresponding period which included certain consolidation adjustments in Corporate.

2.7 Operating Expenses

	HALF YEAR TO			*MOVEMENT*	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Employment expenses					
Salary and related costs including commissions, superannuation and performance-related profit share	**(551)**	(532)	(622)	*4*	*(11)*
Share-based payments	**(73)**	(81)	(111)	*(10)*	*(34)*
(Provision for)/reversal of long service and annual leave	**(19)**	1	(2)	*	*
Total employment expenses	**(643)**	(612)	(735)	*5*	*(13)*
Brokerage, commission and trading-related expenses	**(296)**	(289)	(307)	*2*	*(4)*
Occupancy expenses	**(57)**	(52)	(52)	*10*	*10*
Non-salary technology expenses	**(88)**	(85)	(85)	*4*	*4*
Other operating expenses					
Service cost recoveries by related entities	**(825)**	(885)	(758)	*(7)*	*9*
Professional fees	**(67)**	(76)	(69)	*(12)*	*(3)*
Travel and entertainment expenses	**(2)**	(19)	(22)	*(89)*	*(91)*
Advertising and communication expenses	**(16)**	(15)	(15)	*7*	*7*
Amortisation of intangibles assets	**(11)**	(11)	(9)	-	*22*
Auditor's remuneration	**(15)**	(12)	(10)	*25*	*50*
Other expenses	**(83)**	(113)	(46)	*(27)*	*80*
Total other operating expenses	**(1,019)**	(1,131)	(929)	*(10)*	*10*
Total operating expenses	**(2,103)**	(2,169)	(2,108)	*(3)*	*(<1)*

Total operating expenses of $A2,103 million for the half year ended 30 September 2020 were broadly in line with $A2,108 million in the prior corresponding period, mainly driven by decreases across Employment expenses and Brokerage, commission and trading-related expenses, predominantly offset by Other operating expenses.

Key drivers of the movements included:

– Total employment expenses of $A643 million for the half year ended 30 September 2020 decreased 13% from $A735 million in the prior corresponding period mainly driven by lower performance-related profit share expense mainly as a result of lower performance in the Bank Group and a decrease in share-based payment expense primarily due to the non-recurrence of accelerated amortisation of equity awards for retiring Key Management Personnel recognised in the prior corresponding period. This was partially offset by higher leave provisions due to less holiday entitlements being taken by staff across the Consolidated Entity driven by COVID-19

– Brokerage, commission and trading-related expenses of $A296 million for the half year ended 30 September 2020 decreased 4% from $A307 million in the prior corresponding period primarily due to the sale of an investment in Macquarie Pacific Funding (MPF) in BFS in the prior corresponding period

– Non-salary technology expenses of $A88 million for the half year ended 30 September 2020 increased 4% from $A85 million in the prior corresponding period primarily due to higher technology infrastructure costs to support business growth and to meet regulatory requirements in BFS

– Total other operating expenses of $A1,019 million for the half year ended 30 September 2020 increased 10% from $A929 million in the prior corresponding period primarily due to increased support services driven by increasing compliance and regulatory requirements and higher business activity in the Bank Group as well as the recognition of certain transaction related charges in Corporate. This was partially offset by reduced travel and entertainment expenses across the Bank Group driven by COVID-19.

2.8 Headcount

	AS AT			MOVEMENT	
				Mar 20	*Sep 19*
	Sep 20	Mar 20	Sep 19	*%*	*%*
Headcount by Operating Group(1)					
BFS	**2,876**	2,646	2,643	*9*	*9*
CGM(2)	**1,591**	1,586	1,633	*<1*	*(3)*
Total headcount – Operating Groups	**4,467**	4,232	4,276	*6*	*4*
Total headcount – Corporate(2)	**9**	47	48	*(81)*	*(81)*
Total headcount	**4,476**	4,279	4,324	*5*	*4*
Headcount by region					
Australia(3)	**3,185**	2,951	2,962	*8*	*8*
International:					
Americas	**447**	448	451	*(<1)*	*(<1)*
Asia	**190**	227	233	*(16)*	*(18)*
Europe, Middle East and Africa	**654**	653	678	*<1*	*(4)*
Total headcount – International	**1,291**	1,328	1,362	*(3)*	*(5)*
Total headcount	**4,476**	4,279	4,324	*5*	*4*
International headcount ratio (%)	**29**	31	31		

Total headcount of 4,476 as at 30 September 2020 increased 4% from 4,324 as at 30 September 2019, mainly due to an increase in headcount in BFS as additional resources were required to support customers impacted by COVID-19, partially offset by the wind down of a legacy business in the SAF division within CGM in the prior period. In addition, the reduction in Corporate headcount includes the transfer of the Cash Equities business to the Non-Bank Group in the current period.

Result Overview | Financial Performance Analysis | Segment Analysis | Balance Sheet | Funding and Liquidity | Capital | Glossary

(1) Headcount numbers in this document includes certain staff employed in operationally segregated subsidiaries (OSS).
(2) Headcount as at 31 March 2020 and 30 September 2019 has been restated to reflect the transfer of Cash Equities in the current period from CGM to Corporate in the Bank Group.
(3) Includes New Zealand.

2.9 Income Tax Expense

	HALF YEAR TO		
	Sep 20	Mar 20	Sep 19
	$Am	$Am	$Am
Operating profit before income tax	**840**	573	1,322
Prima facie tax @ 30%	**252**	172	397
Income tax permanent differences	**(72)**	90	(73)
Income tax expense	**180**	262	324
Effective tax rate[1]	**21.4%**	45.7%	24.5%

Income tax expense for the half year ended 30 September 2020 was $A180 million, a 44% decrease from $A324 million in the prior corresponding period. The effective tax rate for the half year ended 30 September 2020 was 21.4%, down from 24.5% in the prior corresponding period and 45.7% in the prior period.

The lower effective tax rate compared to the prior corresponding period 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.

03

Segment Analysis

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 two Operating Groups and a Corporate segment (Reportable Segments).

During the current period, certain activities of CGM's Cash Equities business which operated within the Bank Group were transferred to Macquarie Capital in the Non-Bank Group. Comparatives have been reclassified to reflect this reorganisation.

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

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 an 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 range of tailored specialised asset finance solutions across a variety of industries and asset classes.

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 and strategic investments, assets and businesses that are not allocated to any of the Operating Groups. Consequent to a group internal restructuring, any balances pertaining to an operating segment that are not individually material are also reported as part of the Corporate segment.

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. Central overlays for expected credit losses and impairments representing adjustments to modelled results which are not allocated to specific Operating Groups are presented as part of the Corporate segment. Other items of income and expenses include earnings from investments, 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.

Below is a selection of key policies applied in determining the 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.

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

Accounting for derivatives that hedge interest rate risk

With respect to businesses that predominantly earn income from lending activities, derivatives that hedge interest rate risk are measured at fair value through profit or loss (FVTPL). Changes in fair value are presented in net trading income and gives rise to income statement volatility unless designated in a hedge accounting relationship, in which case the carrying value of the hedged item is adjusted for changes in fair value attributable to the hedged risk to reduce volatility in the income statement. If designated in a cash flow hedge accounting relationship, the effective portion of the derivative's fair value gains or losses is deferred in the cash flow hedge reserve as part of Other comprehensive income (OCI), and subsequently recognised in the income statement at the time at which the hedged item affects the income statement for the hedged risk. For segment reporting, derivatives are accounted for on an accrual basis in the results of the Operating Groups to the extent that the Corporate segment manages the derivative volatility, either through the application of hedge accounting or where the derivative volatility may offset the volatility of other positions managed within the Corporate segment.

Central service groups

The central service groups provide a range of functions supporting Macquarie'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.

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 are not allocated to Operating Groups.

Income tax

Income tax expense and benefits are recognised in the Corporate segment and are 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/charge 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.

3.1 Basis of Preparation
Continued

	BFS $Am	CGM $Am	Corporate $Am	**Total $Am**
Half year ended 30 September 2020				
Net interest and trading income/(expense)	844	1,546	(11)	**2,379**
Fee and commission income	201	225	90	**516**
Net operating lease income	–	198	8	**206**
Share of net (losses)/profits of associates and joint ventures	(1)	13	–	**12**
Other operating income and charges				
Credit and Other impairment charges	(78)	(173)	(11)	**(262)**
Other operating income and charges	16	57	19	**92**
Internal management revenue/(charge)	1	1	(2)	**–**
Net operating income	983	1,867	93	**2,943**
Total operating expenses	(668)	(943)	(492)	**(2,103)**
Operating profit/(loss) before income tax	315	924	(399)	**840**
Income tax expense	–	–	(180)	**(180)**
Distributions paid or provided for on MIS	–	–	–	**–**
Net profit/(loss) contribution from continuing operations	315	924	(579)	**660**
Half year ended 31 March 2020				
Net interest and trading income	890	1,316	34	**2,240**
Fee and commission income	217	257	117	**591**
Net operating lease income	–	203	8	**211**
Share of net profits/(losses) of associates and joint ventures	6	16	(1)	**21**
Other operating income and charges				
Credit and Other impairment charges	(108)	(207)	(72)	**(387)**
Other operating income and charges	9	34	23	**66**
Internal management revenue/(charge)	–	22	(22)	**–**
Net operating income	1,014	1,641	87	**2,742**
Total operating expenses	(631)	(961)	(577)	**(2,169)**
Operating profit/(loss) before income tax	383	680	(490)	**573**
Income tax expense	–	–	(262)	**(262)**
Distributions paid or provided for on MIS	–	–	(6)	**(6)**
Net profit/(loss) contribution from continuing operations	383	680	(758)	**305**
Half year ended 30 September 2019				
Net interest and trading income/(expense)	**838**	**1,617**	**(40)**	2,415
Fee and commission income	224	254	116	**594**
Net operating lease income	–	157	3	**160**
Share of net (losses)/profits of associates and joint ventures	(3)	9	–	**6**
Other operating income and charges				**–**
Credit and Other impairment charges	(41)	(31)	(13)	**(85)**
Other operating income and charges	–	41	299	**340**
Internal management revenue/(charge)	2	2	(4)	**–**
Net operating income	1,020	2,049	361	**3,430**
Total operating expenses	(636)	(909)	(563)	**(2,108)**
Operating profit/(loss) before income tax	384	1,140	(202)	**1,322**
Income tax expense	–	–	(324)	**(324)**
Distributions paid or provided for on MIS	–	–	(6)	**(6)**
Net profit/(loss) contribution from continuing operations	384	1,140	(532)	**992**

3.2 BFS

	HALF YEAR TO			MOVEMENT	
	Sep 20 $Am	Mar 20 $Am	Sep 19 $Am	*Mar 20 %*	*Sep 19 %*
Net interest and trading income	**844**	890	838	*(5)*	*1*
Fee and commission income					
Wealth management fee income	**134**	138	142	*(3)*	*(6)*
Banking and leasing fee income	**67**	79	82	*(15)*	*(18)*
Total fee and commission income	**201**	217	224	*(7)*	*(10)*
Share of net (losses)/profits of associates and joint ventures	**(1)**	6	(3)	*	*(67)*
Other operating income and charges					
Credit and Other impairment charges	**(78)**	(108)	(41)	*(28)*	*90*
Other income	**16**	9	–	*78*	*
Total other operating income and charges	**(62)**	(99)	(41)	*(37)*	*51*
Internal management revenue	**1**	–	2	*	*(50)*
Net operating income	**983**	1,014	1,020	*(3)*	*(4)*
Operating expenses					
Employment expenses	**(196)**	(171)	(183)	*15*	*7*
Brokerage, commission and trading-related expenses	**(81)**	(85)	(87)	*(5)*	*(7)*
Technology expenses[1]	**(202)**	(183)	(191)	*10*	*6*
Other operating expenses	**(189)**	(192)	(175)	*(2)*	*8*
Total operating expenses	**(668)**	(631)	(636)	*6*	*5*
Net profit contribution	**315**	383	384	*(18)*	*(18)*
Non-GAAP metrics					
Funds on platform[2] ($Ab)	**89.3**	79.1	91.5	*13*	*(2)*
Loan and lease portfolio[3] ($Ab)	**79.1**	75.3	67.4	*5*	*17*
BFS deposits[4] ($Ab)	**74.4**	63.9	56.2	*16*	*32*
Headcount	**2,876**	2,646	2,643	*9*	*9*

Net profit contribution of $A315 million for the half year ended 30 September 2020, down 18% from the prior corresponding period due to:

- increased credit impairment charges driven by portfolio growth as well as deterioration in current and expected macroeconomic conditions compared to the prior corresponding period as a result of COVID-19
- higher employment expenses including increased headcount to better support clients through the impacts of COVID-19, as well as increased costs associated with investment in technology to support business growth and to meet regulatory requirements.

Partially offset by:

- higher net interest and trading income driven by volume growth in BFS deposits and the loan portfolio, partially offset by margin compression on deposits and lower vehicle finance portfolio volumes.

(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 businesses, vehicle finance and credit cards.
(4) BFS deposits excludes corporate/wholesale deposits.

3.2 BFS
Continued

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 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 $A844 million for the half year ended 30 September 2020 increased 1% from $A838 million in the prior corresponding period due to a 32% increase in the average BFS deposit volumes and a 38% increase in average loan portfolio volumes, offset by margin compression on deposits and reduction in vehicle finance volumes.

As at 30 September 2020 the deposit and loan and lease portfolios included:

- BFS Deposits of $A74.4 billion, up 16% from $A63.9 billion as at 31 March 2020;
- Home loan volumes of $A57.4 billion, up 10% from $A52.1 billion as at 31 March 2020;
- Vehicle finance volumes of $A12.4 billion, down 9% from $A13.7 billion as at 31 March 2020; and
- Business banking loan volumes of $A8.9 billion, down 1% from $A9.0 billion as at 31 March 2020.

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, and the provision of wealth services

Funds on platform closed at $A89.3 billion at 30 September 2020, from $A79.1 billion at 31 March 2020 and $A91.5 billion at 30 September 2019. The movements were reflective of strong client inflows as well as market movements during the year.

Wealth management fee income of $A134 million for the half year ended 30 September 2020 decreased 6% from $A142 million in the prior corresponding period due to lower advisor fees in the current environment and higher deposit origination costs.

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 $A67 million for the half year ended 30 September 2020 decreased 18% from $A82 million in the prior corresponding period driven by the impact of supporting clients through COVID-19.

Credit and Other impairment charges

Credit and Other impairment charges of $A78 million for the half year ended 30 September 2020 increased 90% from $A41 million in prior corresponding period largely due to credit impairment charges driven by portfolio growth as well as a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period as a result of COVID-19.

Other income

Other income of $A16 million for the half year ended 30 September 2020 was mainly driven by the revaluation of an equity investment.

Operating expenses

Total operating expenses of $A668 million for the half year ended 30 September 2020 increased 5% from $A636 million in the prior corresponding period.

Employment expenses of $A196 million for the half year ended 30 September 2020 increased 7% from $A183 million in the prior corresponding period largely due to higher leave provisions driven by less holiday entitlements being taken by staff and higher headcount as additional resources were required to support customers impacted by COVID-19.

Brokerage, commission and trading-related expenses of $A81 million for the half year ended 30 September 2020 decreased 7% from $A87 million in the prior corresponding period largely due to the sale of an investment in MPF in the prior corresponding period.

Technology expenses of $A202 million for the half year ended 30 September 2020 increased 6% from $A191 million in the prior corresponding period to support business growth and to meet regulatory requirements.

Other operating expenses of $A189 million for the half year ended 30 September 2020 increased 8% from $A175 million in the prior corresponding period included increased risk, regulatory and other business related costs.

3.3 CGM

	HALF YEAR TO			MOVEMENT	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Net interest and trading income					
Commodities	**933**	748	1,013	*25*	*(8)*
Foreign exchange, interest rates and credit	**352**	327	333	*8*	*6*
Equities	**198**	158	193	*25*	*3*
Specialised and Asset Finance	**63**	83	78	*(24)*	*(19)*
Net interest and trading income	**1,546**	1,316	1,617	*17*	*(4)*
Fee and commission income					
Brokerage and other trading-related income	**108**	135	109	*(20)*	*(1)*
Other fee and commission income	**117**	122	145	*(4)*	*(19)*
Total fee and commission income	**225**	257	254	*(12)*	*(11)*
Net operating lease income	**198**	203	157	*(2)*	*26*
Share of net profits of associates and joint ventures	**13**	16	9	*(19)*	*44*
Other operating income and charges					
Net income on equity and debt investments	**37**	14	9	*164*	*
Credit and Other impairment charges	**(173)**	(207)	(31)	*(16)*	*
Other income	**20**	20	32	-	*(38)*
Total other operating income and charges	**(116)**	(173)	10	*(33)*	*
Internal management revenue	**1**	22	2	*(95)*	*(50)*
Net operating income	**1,867**	1,641	2,049	*14*	*(9)*
Operating expenses					
Employment expenses	**(217)**	(232)	(201)	*(6)*	*8*
Brokerage, commission and trading-related expenses	**(203)**	(188)	(205)	*8*	*(1)*
Other operating expenses	**(523)**	(541)	(503)	*(3)*	*4*
Total operating expenses	**(943)**	(961)	(909)	*(2)*	*4*
Net profit contribution	**924**	680	1,140	*36*	*(19)*
Non-GAAP metrics					
Headcount	**1,591**	1,586	1,633	*<1*	*(3)*

Net profit contribution of $A924 million for the half year ended 30 September 2020, down 19% on prior corresponding period.

Result reflective of:

– reduced client contribution in the commodities sector on a strong prior corresponding period, predominantly due to lower activity in 2Q21

– increased credit and other impairment charges reflecting a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period due to COVID-19, resulting in overlays for regional and industry specific risks as well as impairments taken on a small number of underperforming positions

– reduced fee and commission income due to decreased demand for commodity risk premia products.

Partially offset by:

– consistent client and trading activity in foreign exchange, interest rate and credit products

– increased net operating lease income driven by higher secondary income from the asset financing portfolio.

Net interest and trading income

Net interest and trading income of $A1,546 million for the half year ended 30 September 2020 decreased 4% from $A1,617 million in the prior corresponding period.

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.

Income from risk management products is generated from the provision of hedging and risk management services to clients. 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.

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.

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.

Net interest and trading income from commodities of $A933 million for the half year ended 30 September 2020 reduced 8% from $A1,013 million in the prior corresponding period.

The current period included solid client activity across the commodities platform, primarily in 1Q21, due to client hedging activity in Resources, Agriculture, North American Gas & Power, Global Oil and EMEA Gas and Power. Elevated volatility in 1Q21 contributed to strong hedging activity with clients rebalancing portfolios.

Lending and financing income was driven by continued activity across Resources, Agricultural and Energy sectors.

The current period result also benefited from market dislocations across Precious Metals markets, elevated volatility in 1Q21 and the timing of income recognition on Oil and Gas storage contracts and transport agreements.

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 $A352 million for the half year ended 30 September 2020 increased 6% from $A333 million in the prior corresponding period. Income for the period was driven by consistent client activity in structured foreign exchange and interest rate products due to FX volatility and movement in spreads.

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 $A198 million for the half year ended 30 September 2020 increased 3% from $A193 million in the prior corresponding period due to an increased contribution from trading activities.

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 $A63 million for the half year ended 30 September 2020 decreased 19% from $A78 million in the prior corresponding period. The decrease was largely as a result of a stronger prior corresponding period which benefited from net proceeds from end of lease asset sales.

The loan and finance lease portfolio was $A4.7 billion as at 30 September 2020, a reduction of 22% from $A6.0 billion as at 31 March 2020. The reduction was largely due to reduced activity across funds finance and unfavourable foreign exchange movements.

Fee and commission income

Fee and commission income of $A225 million for the half year ended 30 September 2020 decreased 11% from $A254 million in the prior corresponding period.

The decrease primarily relates to reduced demand for commodity risk premia products.

3.3 CGM
Continued

Net operating lease income

Net operating lease income of $A198 million for the half year ended 30 September 2020 increased 26% from $A157 million in the prior corresponding period. The movement was primarily driven by higher secondary income from the asset financing portfolio.

Net income on equity and debt investments

Net income on equity and debt investments of $A37 million for the half year ended 30 September 2020 was up significantly on the prior corresponding period. The current period reflected gains on listed equity investments in the commodities sector.

Credit and Other impairment charges

Credit and other impairment charges of $A173 million for the half year ended 30 September 2020 increased significantly from $A31 million in the prior corresponding period reflecting a deterioration in current and expected macroeconomic conditions compared to the prior corresponding period due to COVID-19, resulting in overlays for regional and industry specific risks as well as impairments taken on a small number of underperforming positions.

Operating expenses

Total operating expenses of $A943 million for the half year ended 30 September 2020 increased 4% from $A909 million in the prior corresponding period.

Employment expenses of $A217 million for the half year ended 30 September 2020 increased 8% from $A201 million in the prior corresponding period primarily driven by higher leave provisions due to less holiday entitlements being taken by staff.

Brokerage, commission and trading-related expenses include fees paid in relation to trading-related activities. Brokerage, commission and trading-related expenses of $A203 million for the half year ended 30 September 2020 were broadly in line with the prior corresponding period.

Other operating expenses of $A523 million for the half year ended 30 September 2020 increased 4% from $A503 million in the prior corresponding period, driven by expenditure on technology infrastructure as well as increasing compliance and regulatory requirements.

3.4 Corporate

	HALF YEAR TO			*MOVEMENT*	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Net interest and trading income	**(11)**	34	(40)	*	*(73)*
Fee and commission income	**90**	117	116	*(23)*	*(22)*
Net operating lease income	**8**	8	3	–	*167*
Share of net losses of associates and joint ventures	**–**	(1)	–	*(100)*	–
Other operating income and charges					
Net income/(loss) on equity and debt investments	**2**	3	245	*(33)*	*(99)*
Credit and Other impairment charges	**(11)**	(72)	(13)	*(85)*	*(15)*
Other income and charges	**17**	20	54	*(15)*	*(69)*
Total other operating income and charges	**8**	(49)	286	*	*(97)*
Internal management charge	**(2)**	(22)	(4)	*(91)*	*(50)*
Net operating income	**93**	87	361	*7*	*(74)*
Operating expenses					
Employment expenses	**(230)**	(209)	(351)	*10*	*(34)*
Brokerage, commission and trading-related expenses	**(12)**	(16)	(15)	*(25)*	*(20)*
Other operating expenses	**(250)**	(352)	(197)	*(29)*	*27*
Total operating expenses	**(492)**	(577)	(563)	*(15)*	*(13)*
Income tax expense	**(180)**	(262)	(324)	*(31)*	*(44)*
Macquarie Income Securities	**–**	(6)	(6)	*(100)*	*(100)*
Non-controlling interests[1]	**–**	–	–	–	–
Net loss contribution	**(579)**	(758)	(532)	*(24)*	*9*
Non-GAAP metrics					
Headcount	**9**	47	48	*(81)*	*(81)*

The Corporate segment comprises head office and central service groups including Group Treasury, and non-core and centrally held investments that are not 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.

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 and centrally held investments and accounting volatility arising from movements in underlying rates relating to economically hedged positions where hedge accounting under AASB 9 is unable to be achieved. In addition, the Corporate segment includes the Cash Equities business, which was transferred from Commodities and Global Markets to Macquarie Capital in the Non-Bank Group.

Net interest and trading income expense of $A11 million for the half year ended 30 September 2020 decreased 73% from an expense of $A40 million in the prior corresponding period primarily due to greater accounting volatility from changes in the fair value on economic hedges, increased transfer pricing recovery from Operating Groups and the reduction in Cash Equities as part of the transfer to Macquarie Capital in the Non-Bank Group in the current period. This was partially offset by lower earnings on capital driven by lower AUD and USD 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, transactions between the Bank and Non-Bank Groups and includes the Cash Equities business, which was transferred from Commodities and Global Markets to Macquarie Capital in the Non-Bank Group.

Fee and commission income of $A90 million for the half year ended 30 September 2020 decreased 22% from $A116 million in the prior corresponding period primarily as a result of the transfer of Cash Equities to Macquarie Capital in the Non-Bank Group in the current period.

Net income on equity and debt investments

Net income on equity and debt investments was $A2 million for the half year ended 30 September 2020. The prior corresponding period's gain of $A245 million was driven by the gain on 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 $A11 million for the half year ended 30 September 2020, decreased 15% from $A13 million in the prior corresponding period and decreased 85% from $A72 million in the prior period. The higher impairment charges in the prior period was due to the recognition of a central overlay provision reflecting the initial impact of COVID-19.

Other income and charges

Other income of $A17 million for the half year ended 30 September 2020 decreased 69% from $A54 million in the prior corresponding period which included certain consolidation adjustments.

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 $A230 million for the half year ended 30 September 2020 decreased 34% from $A351 million in the prior corresponding period as a result of lower performance-related profit share mainly driven by the overall performance of the Operating Groups in the current period and lower share-based payments expense mainly driven by the accelerated amortisation of prior years' equity awards to retiring Key Management Personnel in the prior corresponding period.

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 $A250 million for the half year ended 30 September 2020 increased 27% from $A197 million in the prior corresponding period. The current period includes the recognition of certain transaction related charges.

Macquarie Income Securities (MIS)

MIS was redeemed on 16 April 2020.

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04

Balance Sheet

4.1 Statement of Financial Position

	AS AT			MOVEMENT	
	Sep 20	Mar 20	Sep 19[1]	*Mar 20*	*Sep 19*
	$Am	$Am	$Am	*%*	*%*
Assets					
Cash and bank balances	**6,869**	7,847	6,551	*(12)*	*5*
Cash collateral on securities borrowed and reverse repurchase agreements	**42,933**	37,708	29,910	*14*	*44*
Trading assets	**18,518**	16,251	21,981	*14*	*(16)*
Margin money and settlement assets	**9,162**	12,183	9,935	*(25)*	*(8)*
Derivative assets	**21,618**	44,845	17,606	*(52)*	*23*
Financial investments	**7,575**	7,484	6,360	*1*	*19*
Held for sale and other assets	**3,712**	3,267	3,763	*14*	*(1)*
Due from related body corporate entities	**4,525**	5,278	1,259	*(14)*	*259*
Loan assets	**87,737**	87,719	78,472	-	*12*
Interests in associates and joint ventures	**227**	251	219	*(10)*	*4*
Property, plant and equipment and right-of-use assets	**2,239**	2,598	2,668	*(14)*	*(16)*
Intangible assets	**162**	185	179	*(12)*	*(9)*
Deferred tax assets	**577**	520	460	*11*	*25*
Total assets	**205,854**	226,136	179,363	*(9)*	*15*
Liabilities					
Cash collateral on securities lent and repurchase agreements	**4,954**	2,322	5,494	*113*	*(10)*
Trading liabilities	**5,971**	5,363	6,514	*11*	*(8)*
Margin money and settlement liabilities	**16,746**	19,052	15,145	*(12)*	*11*
Derivative liabilities	**16,139**	37,823	14,057	*(57)*	*15*
Deposits	**77,186**	67,253	58,965	*15*	*31*
Held for sale and other liabilities	**2,464**	2,946	2,725	*(16)*	*(10)*
Due to related body corporate entities	**19,647**	22,115	16,266	*(11)*	*21*
Borrowings	**2,256**	3,047	2,611	*(26)*	*(14)*
Debt issued	**40,618**	46,922	40,411	*(13)*	*1*
Deferred tax liabilities	**45**	69	10	*(35)*	*
Total liabilities excluding loan capital	**186,026**	206,912	162,198	*(10)*	*15*
Loan capital	**5,985**	4,997	4,828	*20*	*24*
Total liabilities	**192,011**	211,909	167,026	*(9)*	*15*
Net assets	**13,843**	14,227	12,337	*(3)*	*12*
Equity					
Contributed equity	**8,501**	8,899	7,900	*(4)*	*8*
Reserves	**424**	991	637	*(57)*	*(33)*
Retained earnings	**4,918**	4,336	3,799	*13*	*29*
Total capital and reserves attributable to the ordinary equity holders of Macquarie Bank Limited	**13,843**	14,226	12,336	*(3)*	*12*
Non-controlling interests	**–**	1	1	*(100)*	*(100)*
Total equity	**13,843**	14,227	12,337	*(3)*	*12*

(1) Refer to Note 1(ii) *Comparatives* of the Financial Report for an explanation of the re-presentation of certain comparative financial information.

Statement of Financial Position

The Consolidated Entity's statement of financial position has been impacted during the period ended 30 September 2020 by changes resulting from business activities, Group Treasury management initiatives, developments with respect to COVID-19 and macroeconomic factors including the appreciation of the Australian dollar against major currencies.

Assets

Total assets of $A205.9 billion as at 30 September 2020 decreased 9% from $A226.1 billion as at 31 March 2020. In addition to the appreciation of the Australian dollar against major currencies which contributed to the decrease in total assets, the principal drivers for the decrease in the Consolidated Entity's total assets were as follows:

– derivative assets of $A21.6 billion as at 30 September 2020 decreased 52% from $A44.8 billion as at 31 March 2020 primarily due to a decrease in client trade volumes and mark to market movements in energy markets, interest rate and foreign exchange products in CGM
– margin money and settlement assets of $A9.2 billion as at 30 September 2020 decreased 25% from $A12.2 billion as at 31 March 2020 primarily due to lower trade volumes resulting in a decrease in margins placed with financial institutions by CGM.

These decreases were partially offset by:

– cash collateral on securities borrowed and reverse repurchase agreements of $A42.9 billion as at 30 September 2020 increased 14% from $A37.7 billion as at 31 March 2020, primarily driven by an increase in reverse repurchase agreements in CGM and an increase in Group Treasury reverse repurchase agreements following lower Operating Group funding requirements
– trading assets of $A18.5 billion as at 30 September 2020 increased 13% from $A16.3 billion as at 31 March 2020 primarily due to an increase in oil and precious metals inventories, and trading and equity positions held as hedges in CGM, partially offset by a decrease in certain bond and treasury bills.

Liabilities

Total liabilities of $A192.0 billion as at 30 September 2020 decreased 9% from $A211.9 billion as at 31 March 2020. In addition to the appreciation of the Australian dollar against major currencies which contributed to the decrease in total liabilities, the principal drivers for the decrease in the Consolidated Entity's total liabilities were as follows:

– derivative liabilities of $A16.1 billion as at 30 September 2020 decreased 57% from $A37.8 billion as at 31 March 2020 primarily due to a decrease in client trade volumes and mark to market movements in energy markets, interest rate and foreign exchange products in CGM
– debt issued of $A40.6 billion as at 30 September 2020 decreased 13% from $A46.9 billion as at 31 March 2020 driven by maturity of debt positions and repayment of notes
– margin money and settlement liabilities of $A16.7 billion as at 30 September 2020 decreased 13% from $A19.1 billion as at 31 March 2020 primarily due to lower trade volumes resulting in a decrease in call margins placed by financial institutions with CGM.

These decreases were partially offset by:

– deposits of $A77.2 billion as at 30 September 2020 increased 15% from $A67.3 billion as at 31 March 2020 primarily due to an increase in retail and business banking deposits in BFS
– cash collateral on securities lent and repurchase agreements of $A5 billion as at 30 September 2020 increased significantly from $A2.3 billion as at 31 March 2020 primarily due to the initial draw down of the new Term Funding Facility from the Reserve Bank of Australia by Group Treasury and increased stock lending agreements in CGM.

Equity

Total equity of $A13.8 billion as at 30 September 2020 decreased 3% from $A14.2 billion as at 31 March 2020.

The decrease in the Consolidated Entity's equity was attributable to the decrease in the foreign currency translation and net investment hedge reserve of $A0.6 billion following the appreciation of the Australian dollar against major currencies and redemption of the Macquarie Income Securities of $A0.4 billion, partially offset by an increase in retained earnings of $A0.7 billion during the period.

4.2 Loan Assets

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

	AS AT			MOVEMENT	
	Sep 20	Mar 20	Sep 19[1]	*Mar 20*	*Sep 19*
	$Ab	$Ab	$Ab	*%*	*%*
Loan assets per the statement of financial position	**87.7**	87.7	78.5	-	*12*
Operating lease assets	**1.8**	2.2	2.3	*(18)*	*(22)*
Other reclassifications[1]	**0.8**	0.3	0.5	*167*	*60*
Less: loans held by consolidated SPEs which are available as security to noteholders and debt providers[2]	**(11.9)**	(12.8)	(8.6)	*(7)*	*38*
Total loan assets including operating lease assets per the funded balance sheet[3]	**78.4**	77.4	72.7	*1*	*8*

Loan assets[4] including operating lease assets by Operating Group per the funded balance sheet are shown in further detail below:

		AS AT			MOVEMENT	
		Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	Notes	$Ab	$Ab	$Ab	*%*	*%*
BFS						
Home loans	1	**48.8**	43.2	38.8	*13*	*26*
Business banking	2	**9.2**	9.4	9.0	*(2)*	*2*
Vehicle finance	3	**9.7**	10.6	11.9	*(8)*	*(18)*
Total BFS		**67.7**	63.2	59.7	*7*	*13*
CGM						
Loans and finance lease assets		**4.7**	6.0	5.5	*(22)*	*(15)*
Operating lease assets		**1.8**	2.2	2.3	*(18)*	*(22)*
Specialised and Asset Finance	4	**6.5**	8.2	7.8	*(21)*	*(17)*
Resources and commodities	5	**2.0**	3.0	2.6	*(33)*	*(23)*
Foreign exchange, interest rate and credit	6	**2.2**	3.0	2.6	*(27)*	*(15)*
Total CGM		**10.7**	14.2	13.0	*(25)*	*(18)*
Total		**78.4**	77.4	72.7	*1*	*8*

(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) 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

Loan portfolio secured largely by working capital, business cash flows and real property.

3. Vehicle finance

Secured by Australian motor vehicles.

4. Specialised and 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. Foreign exchange, interest rate and credit

Diversified lending predominantly consisting of loans which are secured by other loan collateral, assets including rights and receivables and warehoused security from mortgages and auto loans.

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	
	Sep 20	Mar 20	Sep 19	*Mar 20*	*Sep 19*
	$Ab	$Ab	$Ab	*%*	*%*
Equity investments					
Statement of financial position					
Equity investments at fair value	**0.2**	0.2	0.2	–	–
Interests in associates and joint ventures	**0.2**	0.2	0.2	–	–
Total equity investments per statement of financial position	**0.4**	0.4	0.4	–	–
Total funded equity investments	**0.4**	0.4	0.4	–	–

05

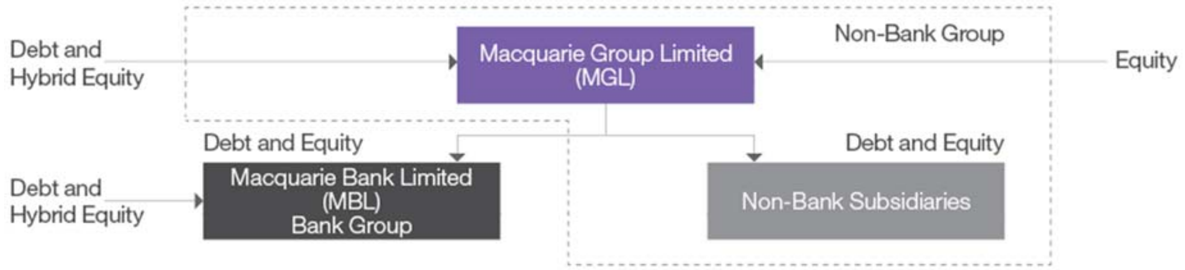
Funding and Liquidity

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 Board 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.

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 MBL Board.

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 which are intended 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) facilities such as the 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 consistent with the distribution of liquidity needs by currency, allowing for an acceptable level of currency mismatches. Certain other Operating Segments also hold cash and liquid assets as part of their operations. The Bank Group had $A31.8 billion cash and liquid assets as at 30 September 2020 (31 March 2020: $A33.6 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.

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	A-1	A+	Negative
Fitch Ratings	F-1	A	Negative

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 30 September 2020 was 176% (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 30 September 2020 was 121%. For a detailed breakdown of Macquarie Bank's NSFR, please refer to Macquarie Bank's regulatory disclosures (available on Macquarie's website).

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(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.

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 30 September 2020.

		AS AT	
		Sep 20	Mar 20
	Notes	**$Ab**	$Ab
Total assets per the Bank Group's statement of financial position		**205.9**	226.1
Accounting deductions:			
Self-funded trading assets	1	**(16.2)**	(16.5)
Derivative revaluation accounting gross-ups	2	**(16.1)**	(37.4)
Segregated funds	3	**(7.4)**	(7.0)
Outstanding trade settlement balances	4	**(2.4)**	(3.4)
Short-term working capital assets	5	**(3.5)**	(3.4)
Intercompany gross-ups	6	**(19.6)**	(22.1)
Non-recourse funded assets:			
Securitised assets and other non-recourse funding	7	**(11.9)**	(12.8)
Net funded assets		**128.8**	123.5

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. The associated margins paid and received are included as part of self-funded trading assets.

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. This includes 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 Sep 20 $Ab	Mar 20 $Ab
Funding sources			
Wholesale issued paper:	1		
Certificates of deposit		**0.4**	0.6
Commercial paper		**5.7**	5.0
Net trade creditors	2	**0.1**	1.1
Structured notes	3	**1.3**	1.9
Secured funding	4	**4.1**	3.2
Bonds	5	**19.3**	24.4
Other loans	6	**0.9**	0.9
Customer deposits	7	**77.1**	67.1
Subordinated debt	8	**4.2**	3.5
Equity and hybrids	9	**15.7**	15.8
Total		**128.8**	123.5
Funded assets			
Cash and liquid assets	10	**31.8**	33.6
Self-securitisation	11	**23.1**	23.5
Net trading assets	12	**25.7**	22.0
Loan assets including operating lease assets less than one year	13	**11.2**	12.2
Loan assets including operating lease assets greater than one year	13	**44.1**	41.7
Debt investment securities	14	**1.8**	1.7
Non-Bank Group deposit with MBL		**(9.9)**	(12.2)
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		**128.8**	123.5

See section 5.5 for Notes 1–15.

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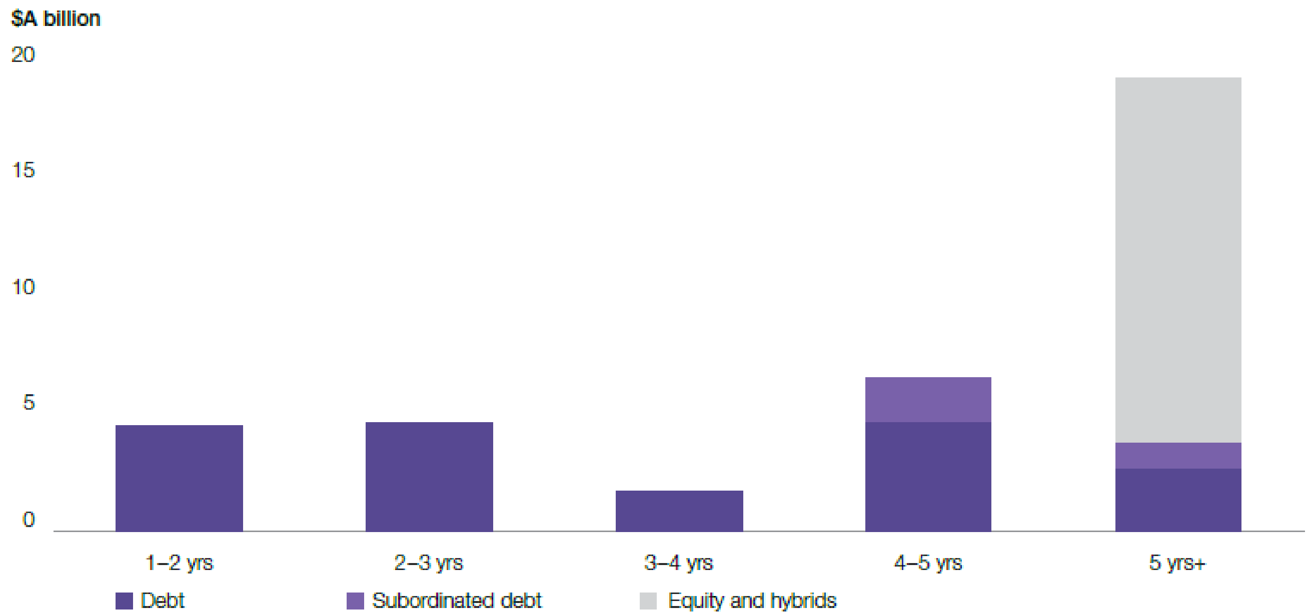
5.4 Funding profile

Continued

Term funding profile

Detail of drawn funding maturing beyond one year



	AS AT SEP 20					
	1–2yrs $Ab	2–3yrs $Ab	3–4yrs $Ab	4–5yrs $Ab	5yrs+ $Ab	**Total $Ab**
Structured notes[1]	–	0.1	–	0.2	1.0	**1.3**
Secured funding[2]	0.3	2.0	–	–	–	**2.3**
Bonds	4.0	2.6	1.7	4.5	1.7	**14.5**
Other loans	0.2	–	–	–	–	**0.2**
Total debt	**4.5**	**4.7**	**1.7**	**4.7**	**2.7**	**18.3**
Subordinated debt[3]	–	–	–	1.9	1.1	**3.0**
Equity and hybrids[3]	–	–	–	–	15.7	**15.7**
Total funding sources drawn	**4.5**	**4.7**	**1.7**	**6.6**	**19.5**	**37.0**
Undrawn[4]	0.3	–	–	–	–	**0.3**
Total funding sources drawn and undrawn	**4.8**	**4.7**	**1.7**	**6.6**	**19.5**	**37.3**

Macquarie Bank has diversity of funding by both source and maturity. The weighted average term to maturity of term funding maturing beyond one year[5] was 4.1 years as at 30 September 2020.

As at 30 September 2020, customer deposits represented $A77.1 billion, or 60% of the Bank Group's total funding, short-term (maturing in less than 12 months) wholesale issued paper represented $A6.1 billion, or 5% of total funding, and other debt funding maturing within 12 months and net trade creditors represented $A8.6 billion, or 7% of total funding.

(1) Structured notes are profiled using a behavioural maturity profile.
(2) Includes drawn RBA Term Funding Facility (TFF) Initial Allowance of $A1.7 billion.
(3) Included in this balance are securities with conditional repayment obligations. These securities are disclosed using the earlier repricing dates instead of contractual maturity.
(4) Does not include undrawn accessible TFF Allowances.
(5) Including drawn TFF, excluding equity which is a permanent source of funding, and securitisations.

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 2020, the Bank Group has continued to raise term wholesale funding across various products and currencies.

Details of term funding raised between 1 April 2020 and 30 September 2020:

		Bank Group $Ab
Issued paper	– Senior and subordinated	1.9
Secured funding	– Term securitisation and other secured finance	1.9
	– RBA Term Funding Facility(1)	1.7
Hybrids	– Hybrid instruments	0.6
Total		**6.1**

The Bank Group has continued to develop its major funding markets and products during the half-year ended 30 September 2020.

From 1 April 2020 to 30 September 2020, the Bank Group raised $A6.1 billion(2) of term funding including:

- $A1.9 billion of subordinated unsecured debt issuance
- $A1.6 billion refinance of secured trade finance facilities
- $A1.7 billion draw down of the RBA Term Funding Facility(1)
- $A0.6 billion of Macquarie Bank Capital Notes 2 issuance; and
- $A0.3 billion of PUMA RMBS securitisation issuance.

(1) Initial Allowance drawn as at 30 September 2020. MBL has $A1.3 billion of undrawn TFF Supplementary Allowance. MBL has access to the TFF Additional Allowance, the volume of which will be determined by business lending growth to April 2021.
(2) 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 (does not include undrawn accessible TFF Allowances).

5.4 Funding profile

Continued

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 $US8.5 billion debt securities outstanding as at 30 September 2020
- $US15 billion Commercial Paper Program under which $US4 billion of debt securities were outstanding as at 30 September 2020
- $US20 billion US Rule 144A/Regulation S Medium-Term Note Program under which $US7.1 billion of issuances were outstanding as at 30 September 2020
- $US1 billion Secured Trade Finance Facility[(1)] of which $US0.8 billion was drawn as at 30 September 2020
- $US5 billion Structured Note Program under which $US0.9 billion of funding from structured notes was outstanding as at 30 September 2020
- $A5 billion Covered Bond Programme under which $A0.8 billion of debt securities were outstanding as at 30 September 2020; and
- Access to the RBA Term Funding Facility of which $A1.7 billion was drawn as at 30 September 2020.

Macquarie Bank accesses the Australian capital markets through the issuance of Negotiable Certificates of Deposit. As at 30 September 2020, Macquarie Bank had $A0.4 billion of these securities outstanding.

As at 30 September 2020, Macquarie Bank had internally securitised $A23.1 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.

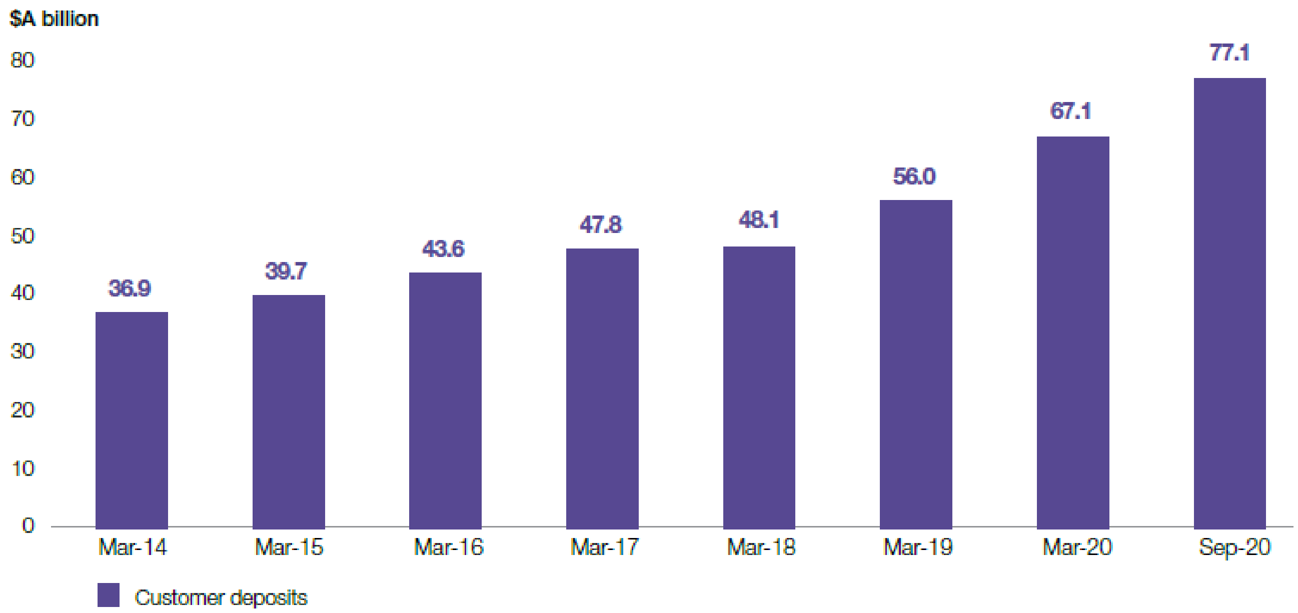
Deposit strategy

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. MBL is covered by the Financial Claims Scheme (FCS), an Australian Government scheme that provides protection to depositors up to a limit of $A250,000 per account holder per ADI.

The chart below illustrates the customer deposit growth since 31 March 2014.

Deposit trend



(1) $US1.0 billion 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 at 30 September 2020 include MACS and BCN2.

10. Cash and liquid assets
Cash and liquid assets are held as cash balances (including central bank reserves and overnight lending to financial institutions), qualifying High Quality Liquid Assets (HQLA) or as assets eligible as collateral in the RBA's facilities such as the Committed Liquidity Facility (CLF) – so called 'Alternative Liquid Assets' (ALA).

11. Self-securitisation
This represents Australian assets which have been internally securitised by Macquarie Bank. A portion of these assets can be utilised as collateral in the RBA's CLF and TFF.

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 equity investments at fair value, interests in associates and joint ventures and other equity investments.

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06

Capital

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 30 September 2020 include the Bank Capital Notes 2 (BCN2), 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.

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 30 September 2020 consists of MACS and BCN2. MBL periodically pays dividends to MGL and is recapitalised by MGL as required to support projected business growth.

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).

BCN2 were issued by MBL in June 2020 and are quoted on the Australian Securities Exchange. The BCN2 pay discretionary, quarterly floating rate cash distributions equal to three month BBSW plus 4.70% per annum margin, adjusted for franking credits. These instruments are non-cumulative and unsecured and may be redeemed at face value on 21 December 2025, 21 June 2026 or 21 December 2026 (subject to certain conditions being satisfied) or earlier in specified circumstances. The BCN2 can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 21 December 2028; 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).

MIS were repaid on 15 April 2020, followed by a redemption on 16 April 2020. MIS were 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 were paid quarterly at a floating rate of BBSW plus 1.7% per annum and payment was subject to certain conditions including profitability of the Bank. MIS were included in Additional Tier 1 capital under Basel III transitional rules.

6.2 Bank Group Capital

Continued

Bank Group Basel III Tier 1 Capital

	AS AT SEP 20		AS AT MAR 20		*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	**8,501**	**8,501**	8,508	8,508	*(<1)*	*(<1)*
Retained earnings	**4,923**	**4,923**	4,350	4,350	*13*	*13*
Reserves	**423**	**423**	990	990	*(57)*	*(57)*
Gross Common Equity Tier 1 capital	**13,847**	**13,847**	13,848	13,848	*(<1)*	*(<1)*
Regulatory adjustments to Common Equity Tier 1 capital:						
Goodwill	**41**	**41**	47	47	*(13)*	*(13)*
Deferred tax assets	**32**	**527**	69	489	*(54)*	*8*
Net other fair value adjustments	**(172)**	**(172)**	(12)	(12)	*	*
Intangible component of investments in subsidiaries and other entities	**36**	**36**	53	53	*(32)*	*(32)*
Loan and lease origination fees and commissions paid to mortgage originators and brokers	**–**	**458**	–	441	–	*4*
Shortfall in provisions for credit losses	**40**	**80**	278	317	*(86)*	*(75)*
Equity exposures	**–**	**613**	–	588	–	*4*
Capitalised software	**62**	**62**	69	69	*(10)*	*(10)*
Other Common Equity Tier 1 capital deductions	**145**	**191**	155	203	*(6)*	*(6)*
Total Common Equity Tier 1 capital deductions	**184**	**1,836**	659	2,195	*(72)*	*(16)*
Net Common Equity Tier 1 capital	**13,663**	**12,011**	13,189	11,653	*4*	*3*
Additional Tier 1 Capital						
Additional Tier 1 capital instruments	**1,688**	**1,688**	1,315	1,315	*28*	*28*
Gross Additional Tier 1 capital	**1,688**	**1,688**	1,315	1,315	*28*	*28*
Deduction from Additional Tier 1 capital	**–**	**–**	–	–	–	–
Net Additional Tier 1 capital	**1,688**	**1,688**	1,315	1,315	*28*	*28*
Total Net Tier 1 capital	**15,351**	**13,699**	14,504	12,968	*6*	*6*

6.2 Bank Group Capital
Continued

Bank Group Basel III Risk-Weighted Assets (RWA)

	AS AT SEP 20		AS AT MAR 20		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	**23,603**	**23,603**	29,246	29,246	*(19)*	*(19)*
SME Corporate	**4,383**	**4,383**	3,581	3,581	*22*	*22*
Sovereign	**491**	**491**	382	382	*29*	*29*
Bank	**1,349**	**1,349**	1,499	1,499	*(10)*	*(10)*
Residential mortgage	**7,977**	**19,030**	7,416	17,757	*8*	*7*
Other retail	**3,725**	**3,725**	4,220	4,220	*(12)*	*(12)*
Retail SME	**3,134**	**3,143**	3,508	3,515	*(11)*	*(11)*
Total RWA subject to IRB approach	**44,662**	**55,724**	49,852	60,200	*(10)*	*(7)*
Specialised lending exposures subject to slotting criteria[1]	**6,114**	**6,114**	6,545	6,545	*(7)*	*(7)*
Subject to Standardised approach:						
Corporate	**225**	**225**	262	262	*(14)*	*(14)*
Residential mortgage	**705**	**705**	740	740	*(5)*	*(5)*
Other Retail	**1,463**	**1,463**	1,928	1,928	*(24)*	*(24)*
Total RWA subject to Standardised approach	**2,393**	**2,393**	2,930	2,930	*(18)*	*(18)*
Credit risk RWA for securitisation exposures	**705**	**705**	758	758	*(7)*	*(7)*
Credit Valuation Adjustment RWA	**6,033**	**6,033**	7,635	7,635	*(21)*	*(21)*
Exposures to Central Counterparties RWA	**752**	**752**	835	835	*(10)*	*(10)*
RWA for Other Assets	**3,940**	**2,245**	3,580	2,089	*10*	*7*
Total Credit risk RWA	**64,599**	**73,966**	72,135	80,992	*(10)*	*(9)*
Equity risk exposures RWA	**1,888**	**–**	1,877	–	*1*	–
Market risk RWA	**4,280**	**4,280**	3,971	3,971	*8*	*8*
Operational risk RWA	**10,521**	**10,521**	10,655	10,655	*(1)*	*(1)*
Interest rate risk in banking book RWA	**–**	**–**	–	–	–	–
Total Bank Group RWA	**81,288**	**88,767**	88,638	95,618	*(8)*	*(7)*
Capital ratios						
Bank Group Common Equity Tier 1 capital ratio (%)	**16.8**	**13.5**	14.9	12.2		
Bank Group Tier 1 capital ratio (%)	**18.9**	**15.4**	16.4	13.6		

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

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07

Glossary

7.1 Glossary

Defined term	Definition
1H20	The half year ended 30 September 2019.
2H20	The half year ended 31 March 2020.
1H21	The half year ended 30 September 2020.
1Q21	The three months ended 30 June 2020.
2Q21	The three months ended 30 September 2020.
A	
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.
B	
BCBS	Basel Committee on Banking Supervision.
Bank Group	MBL and its subsidiaries.
Bank Group Capital	Level 2 regulatory group capital.
Banking Group	The Banking Group primarily comprises of BFS, certain activities of CGM and certain activities of the Equities business.
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*.
BCN2	On 2 June 2020, MBL issued 6.4 million Macquarie Bank Capital Notes 2 (BCN2) at a face value of $A100 each. BCN2 are unsecured, subordinated notes that pay discretionary, quarterly floating rate cash distributions and may be redeemed at face value on 21 December 2025, 21 June 2026 or 21 December 2026 (subject to certain conditions being satisfied) or earlier in specified circumstances. BCN2 can be converted into a variable number of MGL ordinary shares (subject to certain conditions) on these redemption dates; mandatorily exchanged on 21 December 2028; exchanged earlier upon an acquisition event (with the acquirer gaining 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).
BBSW	Bank Bill Swap Rate.
BFS	Banking and Financial Services.

Defined term	Definition
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.
C	
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	Reserve Bank of Australia Committed Liquidity Facility.
CMA	Cash Management Account.
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*.
Compensation ratio	The ratio of Compensation expense to Net operating income.
Consolidated Entity	Macquarie Bank Limited and its subsidiaries.
D	
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.
E	
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.
Earnings per share	A performance measure that measures earnings attributable to each ordinary share, defined in AASB 133 *Earnings Per Share*.
ECAM	Economic Capital Adequacy Model.
ECL	Expected Credit Losses as defined and measured in terms of AASB 9: *Financial Instruments.*
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.

7.1 Glossary

Continued

Defined term	Definition
F	
Financial Report	Macquarie Bank Limited Interim Financial Report.
FIRB	Foundation Internal Ratings Based Approach (for determining credit risk).
FVOCI	Fair value through other comprehensive income.
FVTPL	Fair value through profit or loss.
H	
Headcount	Headcount represents Macquarie's active permanent and variable workforce and includes Macquarie 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.
L	
LGD	Loss given default is defined as the economic loss which arises upon default of the obligor.
M	
Macquarie Bank, the Consolidated Entity	Macquarie Bank Limited and its subsidiaries.
Macquarie Bank	MBL 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 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.

Defined term	Definition
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.
N	
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, and MAMHPL and its subsidiaries.
Non-Banking Group	The Non-Banking Group comprises Macquarie Capital (excluding certain activities of the Equities business), MAM and some business activities of CGM that use certain offshore regulated entities.
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

Defined term	Definition
O	
Operating Groups	The Operating Groups consist of BFS and CGM.
R	
RBA	Reserve Bank of Australia.
Return on equity	The profit after income tax attributable to Macquarie's ordinary shareholders expressed as an annualised percentage of the average ordinary equity over the relevant period, less the average balances of FVOCI, share of associate and cash flow hedging reserves.
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.
S	
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.
SYD distribution	In specie distribution of Sydney Airport stapled securities to Macquarie ordinary shareholders in January 2014.
T	
TFF	Reserve Bank of Australia Term Funding Facility.
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 and conversely, any out-performance is retained by Macquarie.
U	
UK	The United Kingdom.
US	The United States of America.

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