MACQUARIE GROUP
2012 ANNUAL FINANCIAL REPORT

MACQUARIE

MACQUARIE GROUP LIMITED ACN 122 169 279

Corporate Governance Statement

Macquarie's approach to Corporate Governance

Macquarie's approach to governance, which has remained largely consistent over time, is to:

— promote the long term profitability of Macquarie while prudently managing risk

— drive superior and sustainable shareholder value over the long term through the alignment of the interests of shareholders and staff

— meet stakeholder expectations of sound corporate governance as part of Macquarie's broader responsibility to clients, shareholders, investors and the communities in which it operates.

Macquarie recognises that a key factor in delivering long term shareholder returns is providing superior services to clients. Macquarie recruits high quality staff and expects staff to uphold the company's *Goals and Values*.

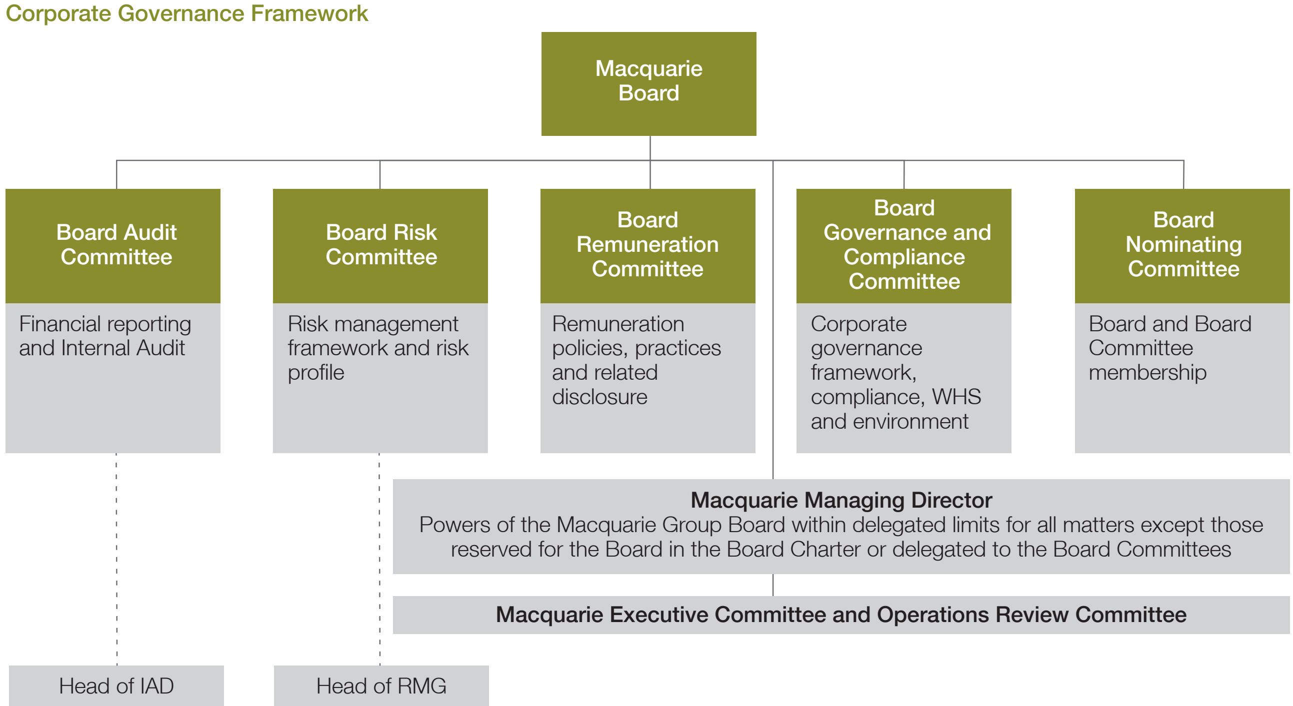
Macquarie Group Limited (Macquarie) is a global financial services specialist. Its shares are listed on the Australian Securities Exchange (ASX). ASX listed companies are required to report on the extent to which the company has followed the governance recommendations set by the ASX Corporate Governance Council (ASX Recommendations) during the reporting period. Macquarie considers that during the year it has followed the governance arrangements set out in the ASX Recommendations. A summary of the ASX Recommendations and reference to the applicable Macquarie governance practice is available on Macquarie's website at macquarie.com.au.

Macquarie is regulated by the Australian prudential regulator, APRA, as a non-operating holding company of a licensed Australian bank, Macquarie Bank Limited (Macquarie Bank). APRA's prudential standards include governance requirements. Macquarie also has subsidiaries that are supervised by regulators in the overseas jurisdictions in which they operate. The notes to Macquarie's financial statements include a list of material subsidiaries of the company.

During the year, Macquarie continued to monitor regulatory and corporate governance developments and their impact on Macquarie's businesses. The level of global regulation remains a key challenge.

On 19 May 2011, Diane Grady was appointed to the Boards of Macquarie and Macquarie Bank and on 21 December 2011, Greg Ward was appointed Deputy Managing Director of Macquarie and Chief Executive Officer and Managing Director of Macquarie Bank upon Richard Sheppard's retirement from those positions. Other than expanding the responsibilities of the Board Corporate Governance Committee (since renamed the Board Governance and Compliance Committee) to include oversight of work health and safety (WHS) and environmental matters on behalf of the Board in December 2011, Macquarie's corporate governance framework remained unchanged during the year.

Corporate Governance Framework



Board Oversight

The Macquarie Board consists of nine Voting Directors, eight of whom are independent. Nicholas Moore, Macquarie's Managing Director and Chief Executive Officer, is the only executive on the Board. The table below sets out the current composition of the Board and the membership of each Board Committee. Details of each Voting Director's experience is summarised in Schedule 1 of the Directors' Report contained in this Annual Financial Report. Schedule 1 also includes the date of each Voting Director's appointment to the Board.

Macquarie's Constitution includes requirements concerning the setting of board size, meetings, election of directors and powers and duties of directors. In accordance with the Constitution, the Board has resolved that the maximum number of Voting Directors is currently nine.

A copy of the *Constitution* is available on Macquarie's website.

The Board has reserved certain matters for its approval and has delegated specific authorities to its various Board Committees. The Managing Director, who is also Macquarie's Chief Executive Officer, has been granted general authority for those matters not reserved for the Board or Board Committees. Macquarie's Executive and Operations Review Committees operate as management committees pursuant to the Managing Director's delegated authority.

The *Board Charter*, which is available on Macquarie's website, details the Board's role and responsibilities and its relationship with management.

Board Committees

Macquarie's five standing Board Committees assist the Board in its oversight role. Each Board Committee has an independent Chairman. All Board members are sent Board Committee meeting agendas and may attend any Board Committee meeting. Subsequent to each Board Committee meeting, the minutes are included in the Board papers and presented to the Board by the respective Board Committee Chairmen.

All members of the Audit, Remuneration, Nominating and Governance and Compliance Committees are independent directors. The Board Risk Committee includes all members of the Board and the Managing Director of Macquarie Bank to focus appropriate attention on the oversight of risk. Members' attendance at Board and Board Committee meetings during the past year is set out at the beginning of the Directors' Report.

The *Board Committee Charters*, detailing the responsibilities of each Committee and how they exercise their authority, are available on Macquarie's website.

Board and Committee membership

	Macquarie Board	Audit	Governance and Compliance	Nominating	Remuneration	Risk
Macquarie Independent Directors						
Kevin McCann, AM	Chairman			Chairman	Member	Member
Michael Hawker, AM	Member	Member				Member
Peter Kirby	Member	Member	Member			Member
Catherine Livingstone, AO	Member	Chairman	Member	Member		Member
John Niland, AC	Member		Chairman		Member	Member
Helen Nugent, AO	Member			Member	Chairman	Member
Peter Warne	Member	Member	Member		Member	Chairman
Diane Grady, AM	Member				Member	Member
Macquarie Managing Director and Chief Executive Officer						
Nicholas Moore	Member					Member
Macquarie Bank Managing Director and Chief Executive Officer						
Greg Ward						Member

Corporate Governance Statement
continued

Allocation of responsibilities between Board Committees

Primary responsibility for ensuring an appropriate risk management framework, including the establishment of policies for the control of risk, lies with the **Board Risk Committee**. The Board Risk Committee receives information on the risk profile and policy framework of the Group and external developments which may have some impact on the effectiveness of the risk management framework. It also approves significant changes to risk management policies and the framework.

The **Board Audit Committee** (BAC) assists the Board with its oversight of the integrity of the financial statements including compliance with the requirements of the *Corporations Act 2001 (Cth)* (the Act) as well as other mandatory professional reporting requirements. In addition, it is responsible for reviewing the adequacy of the Group's APRA regulatory reporting control framework and monitoring the internal control environment. In this role, the BAC oversees the annual plans of the Internal Audit and Credit Assurance functions.

The **Board Remuneration Committee** (BRC) makes recommendations to the Board that promote appropriate remuneration policies and practices for the Macquarie Group consistent with Macquarie Group's risk management framework. The BRC is responsible for liaising with the Board Risk Committee to ensure there is effective coordination between the two Committees to assist in producing a properly integrated approach to remuneration that appropriately reflects risk. It is also responsible for liaising with the BAC in relation to remuneration related disclosures.

The **Board Governance and Compliance Committee** (BGCC) has responsibility for recommending to the Board the most appropriate corporate governance policies for the Macquarie Group and for assisting the Board in fulfilling its responsibility for oversight of the compliance practices of the Group. In addition, it has oversight of Macquarie's work health and safety practices and environmental policies, practices and reporting.

The **Board Nominating Committee** is responsible for assisting the Board in maintaining a diverse board which contributes to the successful oversight and stewardship of Macquarie and that has an appropriate mix of skills and experience to be an effective decision-making body.

Macquarie's *Policy on Board Renewal and Appointment of Directors* sets out the steps taken and fundamental factors relevant to the selection and appointment of new directors and is available on Macquarie's website. Under the policy, independent directors are appointed for a maximum term of the greater of 12 years or the end of their final three year term.

Kevin McCann voluntarily submitted himself for re-election at the 2011 Annual General Meeting having been appointed Chairman in March 2011 on the resignation of David Clarke from the Board due to illness. As the notice of meeting indicated, the appointment extended Mr McCann's tenure beyond Macquarie's Board renewal policy tenure limit.

Independent Directors

Macquarie recognises that independent directors are important in assuring shareholders that the Board is able to act in the best interests of Macquarie and independently of management. Eight of the Macquarie Board's nine members, including the Chairman, are independent directors.

The independence of directors is reviewed annually by the BGCC. Based on Macquarie's criteria for assessing director independence, each independent director is asked to confirm whether they have any interests or relationships that may impact either on their ability to act in the best interests of Macquarie or independently of management. Disclosed interests are reviewed by the BGCC to determine whether the interest would materially interfere with the exercise of a non-executive director's independent judgement. Materiality is assessed having regard to each individual director's circumstances, the circumstances of any associated supplier, customer or advisor and any other significant relationships with Macquarie or its subsidiaries.

At its meeting in February 2012, the BGCC confirmed that Diane Grady, Michael Hawker, Peter Kirby, Catherine Livingstone, Kevin McCann, John Niland, Helen Nugent and Peter Warne continued to be independent directors.

The *criteria used to assess independence*, including guidance for determining materiality, are reviewed annually and are available on Macquarie's website.

Directors are able to consult independent experts at Macquarie's expense, subject to the estimated costs being approved by the Chairman in advance as being reasonable, and have unlimited access to senior management of Macquarie.

Board performance

A summary of the processes adopted by Macquarie for *Board and Key Executive Performance Review* is available on Macquarie's website.

The Board and Directors

All new Directors are involved in an induction program to familiarise themselves with Macquarie, its procedures and prudential requirements and Board practices. The Board reviews its performance and the performance of each director on an annual basis with a focus on directors standing for re-election at the next Annual General Meeting (AGM). The process for conducting the review is agreed by the Board and typically includes individual interviews by the Chairman or an external facilitator with each director and the use of a questionnaire to cover matters such as:

- the Board's contribution to developing strategy and policy
- the Board's performance relative to its objectives
- interaction between the Board and management and between Board members
- the Board's oversight of business performance and compliance, control risks and management
- Board composition, including consideration of relevant skills and structure
- the operation of the Board, including the conduct of Board meetings and group behaviours.

A nominated independent director or an external facilitator provides feedback to the Chairman on the Chairman's performance based on discussion with the other independent directors. A written report summarising the results, issues for discussion and recommendations is presented to the Board and discussed at a Board meeting. Additionally, Non-Executive Directors (NEDs) identify business awareness needs on an ongoing basis and regular board education sessions are held during the year.

In 2012, the Board's review is being undertaken in accordance with the process described above and with the assistance of an external facilitator.

Board Committees

Each Board Committee undertakes a periodic review of its performance, at least biennially. The process for the review also includes use of a questionnaire and discussion of the outcomes, including recommendations, led by the Chairmen of the Board Committees. During the year, four Board Committees undertook an evaluation of their performance.

Performance of key executives

Formal processes, summarised below, have been adopted by Macquarie to review the performance of Macquarie's most senior executives. As part of the review, the NEDs approve the remuneration of the Managing Director and Executive Committee members.

The Managing Director presents to the NEDs as part of his formal annual review. The NEDs review performance by considering a range of indicators including financial performance measures, strategic initiatives, risk management, governance and compliance, staff and human resources indicators, reputation management and monitoring, and community and social responsibility matters. A similar process is also followed to review the performance of the Managing Director of Macquarie Bank.

The Managing Director evaluates, at least annually, the performance of the Deputy Managing Director and the Operating Group Heads, including the Head of the Risk Management Group and the Chief Financial Officer. Performance criteria vary according to the individual's role. Factors relevant to assessing performance include (as appropriate) relative contributions to profits, capital usage, how business is done, including risk management, governance and compliance, people leadership and upholding Macquarie's *Goals and Values*. The Managing Director reports to the BRC on the performance of these key executives.

The Board and Management seek to ensure that remuneration for the Head of the Risk Management Group is determined in a way that preserves the independence of the function and maintains Macquarie's robust risk management framework. The performance and remuneration of the Head of Internal Audit is reviewed annually by the BAC.

A performance evaluation for senior executives has taken place during the year in accordance with the process described above. Further detail on the remuneration policy and performance review for Key Executives is found in the Remuneration Report in this Annual Financial Report.

Corporate Governance Statement
continued

Ethical and responsible decision making

Code of Conduct

Macquarie has adopted a *Code of Conduct*, which incorporates Macquarie's *Goals and Values (What We Stand For)*. The *Code of Conduct* is also reflected in, and supported by, a broad range of Macquarie's internal policies and practices.

The *Code of Conduct*, which is endorsed by the Board, is intended to help staff to understand their responsibility to uphold the following goals and values to which Macquarie aspires: Integrity, Client commitment, Strive for profitability, Fulfilment for our people, Teamwork and Highest standards. It also details standards and expectations around conflicts of interest, disclosure and corruption, to ensure that the highest standards are maintained and Macquarie's reputation is protected and enhanced.

A copy of the *Code of Conduct* is available on Macquarie's website.

Integrity office

Macquarie staff are expected to uphold, and are supported in, maintaining the highest standards.

Macquarie established the position of Integrity Officer in 1998. The Integrity Officer acts as an independent point of contact for staff on integrity issues and works to ensure, through training and awareness, that all Macquarie business is conducted in accordance with sound ethical practices and the *Goals and Values* of the organisation. Supporting the group-wide Integrity Officer are regional Integrity Officers located in key areas around the globe.

The group-wide Integrity Officer reports directly to the Chief Executive Officer and provides an annual report on the activities and developments of the Integrity Office to the BGCC and to the Board.

Further information about the role of the Integrity Officer and activities of the Integrity Office is provided in the Sustainability section of this Annual Financial Report.

Dealing with potential conflicts

Failure to identify a conflict of interest before entering into a transaction, undertaking any dealing (either directly with clients or otherwise), or undertaking any fiduciary role, can give rise to considerable harm to Macquarie's relationship with clients and its reputation.

Macquarie has systems and protocols in place to identify a conflict of interest and a framework for managing conflicts. It is the responsibility of each business head to ensure that conflicts of interest are adequately managed and that their business is conducted in accordance with applicable laws, regulations, rules and statements of regulatory policy.

Macquarie has adopted a variety of measures to manage conflicts of interest, including Macquarie-wide and divisional policies, systems, lists, information protocols and appropriate disclosures. The appropriate mechanism to manage a conflict will depend on the circumstances and nature of the conflict. Conflict management arrangements at Macquarie are subject to the oversight function of the Compliance division within the Risk Management Group.

The Board has guidelines for its members for declaring and dealing with potential conflicts of interest which include:

- Board members declaring their interests as required under the Act, the ASX Listing Rules and general law requirements
- Board members with a material personal interest in a matter not receiving the relevant Board paper and not being present at a Board meeting during the consideration of the matter and subsequent vote, unless the Board (excluding the relevant Board member) resolves otherwise
- Board members with a conflict not involving a material personal interest may be required to absent themselves from the relevant deliberations of the Board.

Macquarie Bank is a subsidiary of Macquarie, and the Macquarie Bank Board is ultimately responsible for the sound and prudent management of Macquarie Bank, with due consideration for the interests of deposit holders. Where potential conflicts arise, management will ensure that Directors of the relevant Board have sufficient information to manage conflicts appropriately.

Staff and Director trading

Macquarie's personal dealing policies apply to Directors and all Macquarie staff. They identify the principles by which Macquarie balances personal investment interests against Macquarie's responsibility to ensure that personal dealing and investment activities of Directors and staff in any financial product are conducted appropriately. Key aspects of Macquarie's personal dealing policies include:

- pre-clear securities trading: Directors and staff must pre-clear their securities trading with Macquarie
- trading windows: Generally, Directors and staff may only trade in Macquarie securities and related derivatives during designated trading windows. These are typically of three to five weeks duration and follow Macquarie's announcement of its interim and full year profits and after the Annual General Meeting (AGM)
- excluded dealings: Certain types of transactions such as acquisition of securities under an employee share plan or participation in the dividend reinvestment plan may be effected outside a trading window without pre-clearance

- trading prohibition while in possession of material non-public price-sensitive information: In all cases Macquarie prohibits Directors and staff from dealing in any security, including a Macquarie security, if they possess non-public price-sensitive information about or affecting the relevant security
- unvested options, retained shares and minimum shareholding requirements cannot be hedged: Staff are not permitted to undertake any action that is designed to limit their exposure to Macquarie shares which are subject to retention arrangements, or their unvested Macquarie options. NEDs may also not enter into a transaction that operates to limit the economic risk of their Macquarie shareholding below their minimum shareholding requirement
- net short positions not permitted: Directors and employees are not permitted to take net short positions in Macquarie shares or any securities in Macquarie-managed funds.

Macquarie has lodged its *Trading Policy*, which sets out the restrictions that apply to dealing in Macquarie securities by Macquarie staff, including Key Management Personnel, with the ASX.

A copy of Macquarie's *Trading Policy* is available on its website.

Each member of the Board is encouraged to consider positions in a Macquarie-related security as a long term investment and is not permitted to trade derivatives without the prior approval of the Chairman (or the Managing Director in the case of the Chairman). Board members and Executive Committee members are also required to annually disclose to Macquarie any financing arrangements relating to their Macquarie securities and manage their financing arrangements in accordance with Macquarie's policies.

Sustainability, diversity and the community

Macquarie's Board and management view the commitment to sustainability and Environmental, Social and Governance (ESG) performance as part of its broader responsibility to clients, shareholders and the communities in which it operates.

Macquarie's approach to sustainability is detailed in the Sustainability section of this Annual Financial Report. A Global Reporting Initiative (GRI) index is also provided. Macquarie has maintained its carbon neutral commitment and has pursued business opportunities aligned with its specialist expertise in renewable energy, energy efficiency, environmental investments, carbon markets and ESG research.

Macquarie is committed to the implementation of safe work practices and aims to provide an injury free workplace for all its employees.

The diversity of our people remains fundamental to Macquarie's success. Macquarie's *Workforce Diversity Policy* defines Macquarie's diversity commitment and the structures in place to facilitate its realisation. Our approach to diversity is detailed in the Diversity Report in this Annual Financial Report.

Macquarie engages in the wider community through the Macquarie Group Foundation (the Foundation). In the year to 31 March 2012, the Foundation and Macquarie staff contributed a total of $A21.3 million to hundreds of community organisations globally. There are also a number of Foundation-coordinated volunteer programs.

Details of Macquarie staff community initiatives and organisations supported by the Foundation and *Our Commitment to Workforce Diversity Statement* are available on Macquarie's website.

Financial reporting

On behalf of the Boards of Macquarie and Macquarie Bank, the BAC monitors:

- the integrity of Macquarie's financial reporting and, as part of this role, the operation of the financial reporting processes. The processes are aimed at providing assurance that the financial statements and related notes are complete, in accordance with applicable legal requirements and accounting standards, and give a true and fair view of Macquarie's financial position. During its review of Macquarie's interim and year-end financial reports the BAC meets with the external auditor in the absence of management
- the external auditor engagement. The BAC reviews the appointment, the terms of the engagement and the performance of the external auditor, prior to making recommendations to the Board on the appointment and removal of the external auditor
- the operation of the Internal Audit and Credit Assurance (CA) functions. The BAC reviews the appointment and performance of the Head of the Internal Audit Division (IAD), as well as the remuneration arrangements in place, to maintain the objectivity of the Internal Audit function. It also monitors the scope and implementation of the IAD and CA annual plans
- Macquarie's APRA regulatory reporting control framework and other banking regulatory reporting as relevant.

Corporate Governance Statement
continued

Auditor independence

The BAC reports to the Board, prior to the approval of the interim and year-end financial report, on its monitoring of the independence of the external auditors in accordance with its obligations under the Act, Macquarie's *Auditor Independence Policy* and the *BAC Charter*.

Macquarie's *Auditor Independence Policy* requires BAC approval, or between meetings the approval of the BAC Chairman, for material non-audit work performed by its auditors. Also in accordance with the policy, Macquarie's audit engagement partner and review partner must be rotated every five years. Macquarie's lead audit engagement partner rotated at the conclusion of the 2008 financial reporting period.

The *BAC Charter* and an *External Auditor Policy Statement* contain key aspects of Macquarie's *Auditor Independence Policy* and external auditor selection process and are available on Macquarie's website.

Chief Executive Officer and Chief Financial Officer declaration

The Macquarie and Macquarie Bank Boards have each received written confirmation from their Chief Executive Officer and Chief Financial Officer that their statement given to the Board in accordance with section 295A of the Act is founded on a sound system of risk management and internal control and the system is operating effectively in all material respects in relation to financial reporting risks.

Macquarie's senior management has also reported to the Boards of Macquarie and Macquarie Bank on the effectiveness of the management of material business risks for the year ended 31 March 2012.

Commitment to shareholders and an informed market

Macquarie believes that shareholders, regulators, ratings agencies and the investment community should be informed of all major business events and risks that influence Macquarie in a factual, timely and widely available manner. Macquarie has a continuous disclosure policy which is incorporated in the *External Communications Policy*.

It is Macquarie's policy that any price-sensitive material for public announcement, including annual and interim profit announcements, release of financial reports, presentations to investors and analysts, and other prepared investor briefings for Macquarie and Macquarie Bank, will be:

— factual and reviewed internally before issue
— timely and expressed in a clear and objective manner
— lodged with the ASX as soon as practical.

An *External Communications Policy* summary is available on Macquarie's website.

Shareholder meetings

Macquarie typically holds its AGM in July of each year. Macquarie encourages shareholders to participate in general meetings and aims to choose a date, venue and time convenient to its shareholders. For shareholders who are unable to attend in person, Macquarie provides a webcast of its AGM and any other general meetings. The results of all meetings are also lodged with ASX after the meeting as soon as they are available.

This year Macquarie's AGM will be held in Sydney and the Macquarie Bank AGM will be held on the same day, after the Macquarie AGM. Other general meetings may be held as required during the year.

Macquarie's auditor is required to attend each AGM and be available to answer questions about the conduct of the audit, and the preparation and content of the auditor's report. Notices of meeting are accompanied by explanatory notes on the items of business and together they seek to clearly and accurately explain the nature of the business of the meeting.

Shareholders, if unable to attend the meeting, are encouraged to vote on the motions proposed by appointing a proxy. The proxy form included with a notice of meeting will clearly explain how the proxy form is to be completed and submitted.

Online proxy voting is also available to shareholders. Unless specifically stated in a notice of meeting, all holders of fully paid ordinary shares are eligible to vote on all resolutions. Holders of Macquarie Income Securities have the right to attend the Macquarie Bank AGM, at which they have limited voting rights, as set out in the terms of their issue, which are available on Macquarie's website.

A Shareholder Calendar is available on Macquarie's website.

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Risk Management Report

Introduction – Macquarie's risk management framework

Macquarie's risk management framework is well established and proven. Some refinements have been made to the framework as Macquarie's businesses have evolved over the past years. However, Macquarie's core risk management principles have remained stable and continue to be highly effective. These are:

Ownership of risk at the business level – Operating Group heads are responsible for identifying risks within their businesses and ensuring that they are managed appropriately. Before taking decisions, clear analysis of the risks is sought to ensure risks taken are consistent with the risk appetite and strategy of Macquarie. Business ownership of risk is an essential element in understanding and controlling risk.

Understanding worst case outcomes – Macquarie's risk management approach is based on examining the consequences of worst case outcomes and determining whether these are acceptable. This approach is adopted for all material risk types and is often achieved by stress testing. In particular, Macquarie's market risk framework is based primarily on the application of stress tests, rather than statistical models. This approach was tested over the recent past. Shocks observed in the markets generally remained within Macquarie's stress scenarios, resulting in very few of our worst case loss scenarios being exceeded. Whilst Macquarie operates a number of sophisticated quantitative risk management processes, the foundation of its risk management approach is the informed consideration of both quantitative and qualitative inputs by highly experienced professionals.

Requirement for an independent signoff by risk management – Macquarie places significant importance on having a strong independent Risk Management Group (RMG) which is charged with signing off all material risk acceptance decisions. It is essential RMG has the capability to do this effectively and hence RMG has invested in recruiting skilled professionals, many with previous trading or investment banking experience. For all material proposals, RMG's opinion is sought at an early stage in the decision making process and independent input from RMG on risk and return is included in the approval document submitted to senior management.

Macquarie determines its overall appetite for risk with reference to earnings and not just capital. Aggregate risk is expressed by setting a Global Risk Limit designed to ensure that in a prolonged and severe downturn, losses will be covered by earnings and surplus capital and market confidence in Macquarie is maintained.

Macquarie's risk culture is well established – Macquarie recognises that an effective risk management framework involves more than just robust controls. Macquarie's risk culture, which is less tangible, is equally as important and at Macquarie the risk culture remains strong, and controls are respected by staff. Key aspects supporting this culture include:

— **Macquarie's businesses are fundamentally client based.** Therefore, across Macquarie, greater emphasis is placed on fostering long-term relationships with our clients and building franchise businesses as opposed to short-term profits from proprietary trading.

— **Consideration of worst-case scenarios is part of everyday risk controls rather than supplementary to them.** Even though the worst case scenarios are often in excess of what has been historically observed, they play a major role in influencing and limiting positions particularly for extreme loss events.

We apply limits to contingent losses from a 40 per cent gap move in stock prices. This effectively constrains trading divisions from issuing well out of the money options and encourages hedging of extreme loss events. We have over 13,000 contingent loss limits that consider a variety of worst case scenarios.

— **The role of risk management staff is one of active engagement in risk-taking decisions.** In accordance with the principle of risk ownership, the primary risk analysis and initial decisions to reject or accept a transaction are taken by Operating Groups. In its review of a new proposal, RMG provides an independent confirmation of the risk acceptance decision. RMG works closely with the deal team and shares the goal of making the transaction successful by requiring improvements to the transaction terms where applicable. Strong emphasis is placed on transferring knowledge to transaction teams so that the same risk management principles are applied to future proposals from an early stage.

— **Macquarie's remuneration policy for senior management encourages a long-term view in decision making.** It discourages excessive risk taking as incentives are aligned with the long-term profitability of the firm through retention of remuneration and equity participation. The principles behind our current remuneration structure have been in place for many years.

Risk governance structure

Risk management is sponsored by the Macquarie Group Board (Board), and is a top priority for senior managers, starting with the Managing Director and CEO.

The Head of RMG, as Macquarie's Chief Risk Officer, is a member of Macquarie's Executive Committee and reports directly to the Managing Director and CEO. The Chief Risk Officer has a secondary reporting line to the Board Risk Committee which approves the replacement, appointment, reassignment or dismissal of the Chief Risk Officer.

The Board oversees the risk appetite and profile of Macquarie and ensures that business developments are consistent with the risk appetite and goals of Macquarie.

All Board members are members of the Board Risk Committee. The Board Risk Committee has responsibility for ensuring an appropriate risk management framework – including the establishment of policies for the control of risk – is in place. The Board Risk Committee receives information on the risk profile of Macquarie, breaches of the policy framework and external developments which may have some impact on the effectiveness of the risk management framework. It also approves significant changes to risk management policies and framework and approves Macquarie's risk appetite. The Board Risk Committee is assisted by the following Committees:

— The Board Audit Committee (BAC) monitors the effectiveness of internal controls with Macquarie's external auditor, management and the Head of Internal Audit. The BAC also monitors and reviews the effectiveness of the external auditors and the Internal Audit and Credit Assurance functions

— The Board Remuneration Committee liaises with the Board Risk Committee and the Chief Risk Officer to ensure there is a properly integrated approach to remuneration that appropriately reflects risk

— The Board Governance and Compliance Committee (BGCC) reviews Macquarie's corporate governance arrangements and compliance matters. The BGCC also has oversight of Work Health and Safety and environmental matters on behalf of the Board.

Committees exist at the executive management level to ensure that the necessary elements of expertise are focused on specific risk areas. The Macquarie and Macquarie Bank Executive Committees and the Macquarie Operations Review Committee focus on strategic issues, operational issues, material transactions and review the performance of Macquarie on a monthly basis. Beneath this level, there are other committees where senior specialists focus on specific risks as appropriate. The Market Risk Committee and Asset and Liability Committee are examples of these committees.

While committees oversee Macquarie's risk appetite and acceptance process, risk acceptance decisions are ultimately delegated to individuals to ensure that approvers are individually accountable when signing off on risk acceptance decisions.

Risk Management Group

RMG's oversight of risk is based on the following five principles:

Independence

RMG, which is responsible for assessing and monitoring risks across Macquarie, is independent of the operating areas of Macquarie, and the Head of RMG, as Macquarie's Chief Risk Officer, reports directly to the Managing Director and CEO with a secondary reporting line to the Board Risk Committee. RMG approval is required for all material risk acceptance decisions.

Centralised prudential management

RMG's responsibility covers the whole of Macquarie. Therefore, it can assess risks from a Macquarie-wide perspective and provide a consistent approach across all operating areas.

Approval of all new business activities

Operating areas cannot undertake new businesses or activities, offer new products, or enter new markets without first consulting RMG. RMG reviews and assesses risk and sets prudential limits. Where appropriate, these limits are approved by the Executive Committee and the Board.

Continuous assessment

RMG continually reviews risks to account for changes in market circumstances and developments within Macquarie's operating areas.

Frequent monitoring

Centralised systems exist to allow RMG to monitor credit and market risks daily. RMG staff liaise closely with operating and support divisions.

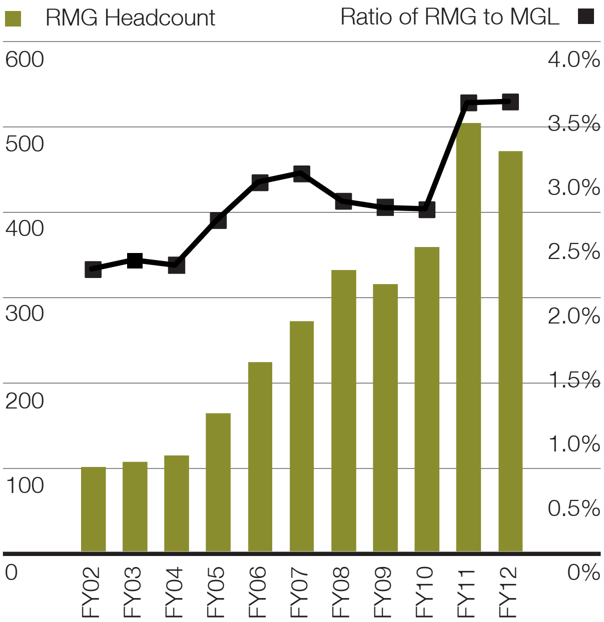
Risk Management Report
continued

RMG structure and resourcing

While RMG is structured into specialist teams as detailed below, we employ an integrated approach to risk analysis and management across risk classes. RMG's assessment and monitoring of risks involves a collaborative effort across the teams to ensure that a detailed analysis takes place both at the individual and aggregate risk level.

The change in staffing levels within RMG is in line with the changes in staffing overall at Macquarie. RMG staff numbers as at 31 March 2012 were 471 which is a 7 per cent decrease over the year.

Ratio of RMG headcount to total Macquarie[1]



[1] Headcount numbers only include permanent, active staff (full-time and part-time). Historical figures have not been restated to include business compliance staff who joined RMG in FY2011.

Effective risk management is not only a function of disciplined processes but also of imaginative analysis by talented individuals.

RMG attracts high calibre candidates. It recruits experienced individuals both from within Macquarie and externally and is a source of talent for Macquarie's Operating Groups when recruiting.

To ensure that, on a global basis, risks are managed in a controlled manner, 52 per cent of total RMG staff as at 31 March 2012 were based outside of Australia. All offices are subject to the same risk management controls and standards. This is supported by regular staff communication and visits to international offices.

Consistent with the concept of Operating Groups owning risk, specific day-to-day operations are more appropriately discharged and embedded within the Operating Groups. The majority of operational risk and compliance functions are therefore discharged within the Operating Groups. Business-aligned compliance staff ensure that day-to-day compliance obligations are discharged at the business level whilst Business Operational Risk Managers are appointed by the Operating Group Heads to be their representative on operational risk management matters, and act as their delegate in ensuring that operational risk and standards are addressed appropriately within their division. All business-aligned compliance staff have a reporting line to the regional Head of Compliance, and ultimately to the RMG divisional Head of Compliance; whilst divisional operational risk staff have functional reporting lines to the RMG divisional head of Operational Risk.

New business and acquisitions

Innovation is encouraged across Macquarie's businesses and activities. Therefore, it is important that all elements of new business initiatives are well understood before commencement.

All new business initiatives must be signed off by RMG prior to commencement.

The formal new business approval process requires all relevant risks (market, credit, equity, legal, compliance, taxation, accounting, operational and systems are examples) to be reviewed, to ensure that all risks are identified, and addressed prior to implementation (including ongoing risk monitoring processes). The approval of RMG, Finance Division, Taxation Division, Group Legal and other relevant stakeholders within Macquarie is obtained. RMG also checks that all necessary internal approvals are obtained prior to commencement.

For all material transactions, independent input from RMG on the risk and return of the transaction is included in the approval document submitted to senior management.

The Operational Risk function within RMG oversees the new product and business approval process.

RMG Internal Audit performs an audit of the operations of any significant new businesses based on an assessment of the associated risk faced by Macquarie. The audit typically takes place within six to 12 months following acquisition or launch and includes confirmation that operations are in line with the new product approval document.

Risk management and monitoring

The risk management framework incorporates active management and monitoring of market, credit, equity, liquidity, operational, compliance, regulatory and legal risks. It is designed to ensure policies and procedures are in place to manage the risks arising within each division. Application varies in detail from one part of Macquarie to another; however, the same risk management framework applies across all business activities.

Equity risk

Equity risk is the risk of loss arising from banking book equity-type exposures. These exposures include:

- holdings in specialised funds managed by Macquarie
- principal exposures taken by Macquarie Capital, including direct investments in entities external to Macquarie
- property equity, including property trusts and direct property investments
- lease residuals
- other equity, including investments in resource companies.

Equity Risk Limit

All of the above equity risk positions are subject to an aggregate Equity Risk Limit (ERL). The ERL is set by the Board with reference to the Risk Appetite Test which is described further in the economic capital section. In setting the limit, consideration is also given to the level of earnings, capital and market conditions. The limit is reviewed on a semi-annual basis by RMG and the results of the review are reported to the Operations Review Committee and the Board Risk Committee.

Concentrations within the equity portfolio are managed by a number of additional limits approved by the Executive Committee and/or the Board. These include limits on:

- property equity investments
- investments in the resources sector
- lease residuals (by type of leased asset)
- co-investments and other assets of Macquarie Capital.

Transaction review and approval process

The division executing the transaction is responsible for due diligence and risk analysis of each equity investment. For material deals, RMG undertakes shadow due diligence and performs a comprehensive analysis of all risks and potential losses associated with the acquisition such as:

- market and credit risks
- regulatory, capital, liquidity and compliance requirements
- business, operational and reputation risks.

All material equity risk positions are subject to approval by RMG and by the Managing Director and CEO, Executive Committee and the Board, depending on the size and nature of the risk. RMG ensures that the transaction is correctly represented to the relevant approvers.

Risk Management Report
continued

Credit risk

Credit Risk is defined as the risk of a counterparty failing to complete its contractual obligations when they fall due. The consequent loss is either the amount of the loan not paid back or the loss incurred in replicating a trading contract with a new counterparty.

The RMG Credit team maintains a comprehensive and robust framework for the identification, analysis and monitoring of credit risks arising within each business. Key aspects of this framework are discussed below.

Analysis and approval of exposures

The Macquarie and Macquarie Bank Boards are responsible for establishing the framework for approving credit exposures. The Boards delegate discretions to approve credit exposure to designated individuals within Macquarie whose capacity to exercise authority prudently has been assessed.

Operating Groups are assigned modest levels of credit discretions. Credit exposures above these levels are assessed independently by RMG and approved by senior RMG staff, the CEO and the Boards as required.

Macquarie enforces a strict 'no limit, no dealing' rule; all proposed transactions are analysed and approved by designated individuals before they can proceed.

All credit exposures are reviewed at least once a year, or more frequently if required.

Independent analysis

The RMG Credit team provides independent analysis of credit risk exposures. The team works closely with the Operating Groups to identify the risks inherent in Macquarie's businesses, and apply analysis commensurate to the level and nature of risks.

Credit risk analysis is focused on ensuring that risks have been fully identified and that the downside risk is properly understood so that a balanced assessment can be made of the worst case outcome against the expected rewards. Downside analysis includes stress testing and scenario analysis.

Macquarie does not rely on quantitative models to assess credit risk in our wholesale portfolio, but uses fundamental credit analysis to make credit risk acceptance decisions.

Macquarie Group ratings

Macquarie relies on its own independent assessment of credit risk. Third party credit assessments are considered as an input into the analysis but are not considered to be a sufficient basis for decision making.

Macquarie has established a proprietary internal credit rating framework to assess counterparty credit risk. Macquarie ratings are used to estimate the likelihood of the rated entity defaulting on financial obligations. The Macquarie ratings system ensures a consistent assessment of borrower and transaction characteristics across Macquarie and provides the mechanism for meaningful differentiation of credit risk.

Each Macquarie rating is assigned a Probability of Default estimate. Credit limits and exposures are also allocated a Loss Given Default ratio reflecting the estimated economic loss in the event of default occurring.

All customer limits and exposures are allocated a Macquarie rating on a 1–17 scale, which broadly corresponds to Standard & Poors' and Moody's Investor Services credit ratings.

Macquarie has a Credit Assurance function within RMG which independently verifies the effectiveness of Macquarie's credit risk management.

Measuring and monitoring exposures

Credit exposures for loans are evaluated as the full face value or acquisition cost when acquired in the secondary market.

Credit exposures for derivatives are a function of potential market movements and are assessed by assuming that low probability stressed market movements occur and that Macquarie has to go to the market to replace a defaulting deal at the worst possible time during the term of the transaction. RMG Credit Analytics proposes and reviews the stresses which are applied in order to determine high confidence level counterparty exposures. These stresses are back-tested to ensure that they would have provided the required confidence level over a representative historic period. Credit stresses are determined using a combination of fundamental and technical analysis.

Where trading gives rise to settlement risk, this exposure is assessed as the full face value of the settlement amount.

All credit exposures are monitored regularly against limits. Credit exposures which fluctuate through time are updated daily. These include off-balance sheet exposures such as swaps, forward contracts and options, which are assessed using sophisticated valuation techniques.

To mitigate credit risk, Macquarie makes use of margining and other forms of collateral or credit enhancement techniques (including guarantees and letters of credit, the purchase of credit default swaps and mortgage insurance) where appropriate.

On and off-balance sheet exposures are considered together and treated identically for approval, monitoring and reporting purposes.

A review of the credit portfolio which involves analysing credit concentrations by counterparty, country, risk type, industry and credit quality is carried out and reported to Macquarie's Operations Review Committee quarterly and Board semi-annually. Policies are in place to manage credit risk and avoid unacceptable concentrations to any counterparty or country.

Loan impairment review

All exposures are subject to recurring review and assessment for possible impairment. Provisions for loan losses are based on an incurred loss model, which recognises a provision where there is objective evidence of impairment at each balance date, and is calculated based on the discounted values of expected future cash flows.

Specific provisions are recognised where specific impairment is identified. The rest of the loans are placed into pools of assets with similar risk profiles and collectively assessed for losses that have been incurred but not yet identified.

Impaired assets continue to decline from the past year, driven by a combination of write-backs, write-downs and foreign currency movements.

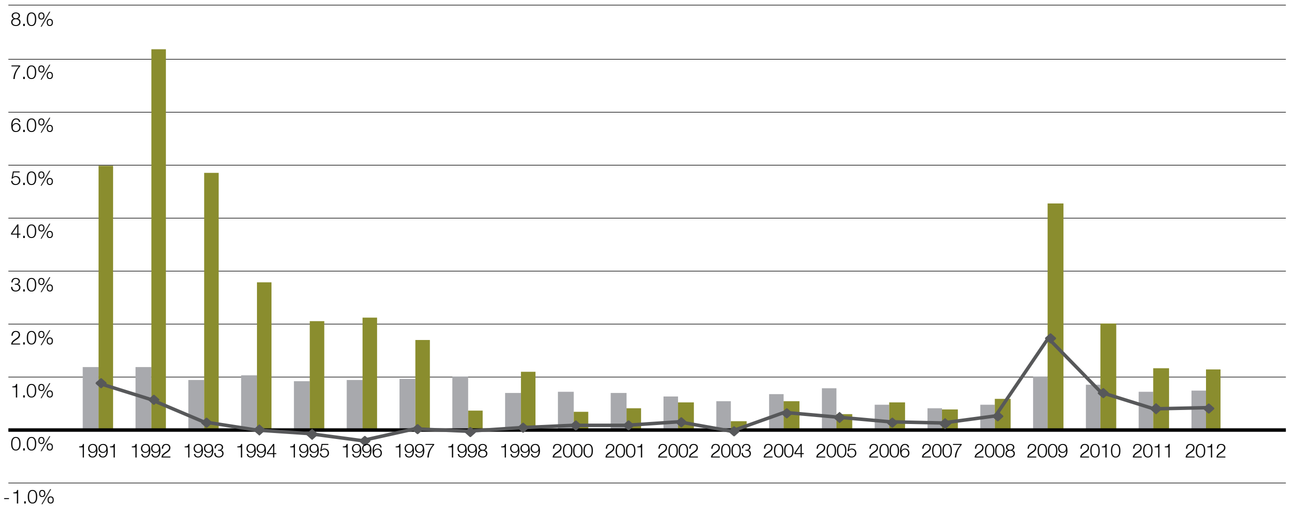
Country risk

Country risk is defined as losses arising from events in a country which include an act of government, war, terrorism, civil strife or economic crisis.

The *Country Risk Policy* guides the management of Macquarie's country risk. Countries are grouped into categories based on the country's risk profile. Before any exposure is taken in a country which is considered to be high risk, a review of the economic, political and operating environment is undertaken to determine the level of exposure that is considered to be acceptable. Where appropriate, measures to mitigate country risk are put in place.

Ratio of provisions and impaired assets to loans, advances and leases

Collective provision to loans, advances and leases (Balance sheet)
Net impaired assets to loans, advances and leases (Balance sheet)
Net credit losses to loans, advances and leases (Income statement) –



Notes:

— Loan assets exclude securitised mortgages, securitised Macquarie Capital loans/leases, segregated future funds and receivables in the form of fees.
— Net impaired assets and net losses exclude investment securities.
— Collective provision (as per Note 12 of the Financial Report) is intended to cover losses inherent in the existing overall credit portfolio which are not yet specifically identifiable.
— Net credit losses represent total profit and loss impact in the stated period due to additional specific provisions and direct write-offs net of any write-backs.
— Please refer to Note 13 of the Financial Report for further information on impaired assets.

Risk Management Report
continued

Operational risk

Macquarie defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Macquarie has established procedures and controls to manage market, credit, reputation and strategic risks. The potential for failure or inadequacy in these procedures and controls would be classified as an operational risk. Operational risk failures could lead to reputation damage, financial loss or regulatory consequences.

RMG is responsible for ensuring an appropriate framework exists to identify, assess and manage operational risk and that resources are available to support it. RMG is also responsible for Macquarie's operational risk capital measurement methodology.

In general, changes in Macquarie's operational risk profile are the net result of greater innovation and growth. This is offset by constant gradual adaptation and development of the control environment to accommodate new risks.

Operational Risk Management framework

Macquarie's Operational Risk Management Framework (ORMF) is designed to identify, assess and manage operational risks within the organisation. The key objectives of the framework are as follows:

— risk identification, analysis and acceptance

— execution and monitoring of risk management practices

— reporting and escalation of risk information on a routine and exception basis.

Businesses carry out elements of the ORMF in a manner that is tailored to their specific operational risk profile. However, to ensure consistency and minimum standards the framework includes the following mandatory elements:

— a robust change management process to ensure operational risks in new activities or products are identified, addressed and managed prior to implementation

— a semi-annual operational risk self assessment process to identify operational risks at the business level, assess controls and develop action plans to address deficiencies

— recording of operational risk incidents into a centralised reporting system. Incidents are analysed to identify trends and establish lessons learnt on the effectiveness of controls

— allocation of operational risk capital to all Macquarie businesses as a tool to further encourage positive behavior in Macquarie's day-to-day management of operational risk

— Macquarie-wide policies which require a consistent approach and minimum standards on specific operational risk matters

— embedded operational risk representatives in Operating Groups who act as delegates of the business manager. These representatives ensure operational risks are addressed appropriately and that the ORMF is executed within their area.

Macquarie's operational risk capital framework

Macquarie's framework for operational risk capital has two main elements:

— an annual scenario approach for modelling operational risk losses and to determine operational risk capital

— a quarterly scorecard analysis which is used to update operational risk capital between scenario analyses, and as a basis for updating the allocation of capital to businesses.

Operational risk scenarios identify key risks that, while very low in probability, may result in very high impact losses. In identifying the potential for such losses consideration is given to the individual statistical distribution for each scenario, external loss data, internal loss data, risk and control factors determined by the operational risk self assessments, and the contribution of expert opinion from businesses. Results are then modelled to determine the operational risk component of regulatory capital required to be held by Macquarie at the 99.9th percentile level. Monte Carlo techniques are used to aggregate these individual distributions to determine a Macquarie-wide operational risk loss distribution.

Over time operational risk capital changes to reflect:

— new business activity, businesses growth and significant change in activity which may require new or increased loss scenarios and/or an increased loss probability

— decreases in the probability of loss as business changes bed down and the control environment continues to mature, reducing the capital requirement

— changes in the external environment such as new regulations or movements in the economic cycle that also influence scenario estimates.

Macquarie allocates capital to individual businesses. The capital allocation effectively rewards positive risk behaviour, and penalises increased risks. This is done using scorecards which measure changes in a number of key factors such as the size and complexity of the business, risk and control assessments, incident and exception management and governance. The quarterly change in the sum of divisional capital is also used as an estimate to update the Macquarie capital requirement between annual assessments.

Market risk

Market risk is the exposure to adverse changes in the value of Macquarie's trading portfolios as a result of changes in market prices or volatility. Macquarie is exposed to the following risks in each of the major markets in which it trades:

- **foreign exchange and bullion** – changes in spot and forward exchange rates and bullion prices and the volatility of exchange rates and bullion prices
- **interest rates and debt securities** – changes in the level, shape and volatility of yield curves, the basis between different debt securities and derivatives and credit margins
- **equities** – changes in the price and volatility of individual equities, equity baskets and equity indices, including the risks arising from equity underwriting activity
- **commodities and energy** – changes in the price and volatility of base metals, agricultural commodities and energy products.

Macquarie is also exposed to the correlation of market prices and rates within and across markets.

All trading activities contain calculated elements of risk taking. Macquarie is prepared to accept such risks provided they are within agreed limits, independently and correctly identified, calculated and monitored by RMG, and reported to senior management on a regular basis.

Trading market risk

RMG monitors positions within Macquarie according to a limit structure which sets limits for all exposures in all markets. Limits are applied at a granular level to individual trading desks, through increasing levels of aggregation to divisions and Operating Groups, and ultimately, Macquarie. This approach removes the need for future correlations or scenarios to be precisely predicted as all risks are stressed to the extreme and accounted for within the risk profile agreed for each business and Macquarie in aggregate.

Limits are approved by senior management with appropriate authority for the size and nature of the risk, and Macquarie adheres to a strict 'no limit, no dealing' policy. If a product or position has not been authorised and given a limit structure by RMG, then it cannot be traded. Material breaches of the approved limit structure are communicated monthly to the Macquarie and Macquarie Bank Boards. RMG sets three complementary limit structures:

- **contingent loss limits** – worst case scenarios that shock prices and volatilities by more than has occurred historically. Multiple scenarios are set for each market to capture the non-linearity and complexity of exposures arising from derivatives
- **position limits** – volume, maturity and open position limits are set on a large number of market instruments and securities in order to constrain concentration risk and to avoid the accumulation of risky, illiquid positions
- **Value-at-Risk (VaR) Limits** – statistical measure that determines the potential loss in trading value at both a business and aggregate level.

The risk of loss from incorrect or inappropriate pricing and hedging models is mitigated by the requirement for all new pricing models to be independently tested by the specialist Quantitative Applications Division within RMG.

Aggregate measures of market risk

Aggregate market risk is constrained by two risk measures, VaR and the Macro-Economic-Linkages (MEL) stress scenarios. The VaR model predicts the maximum likely loss in Macquarie's trading portfolio due to adverse movements in global markets over holding periods of one and 10 days. The MEL scenario utilises the contingent loss approach to capture simultaneous, worst case movements across all major markets. Whereas MEL focuses on extreme price movements, VaR focuses on unexceptional changes in price so that it does not account for losses that could occur beyond the 99 per cent level of confidence. For this reason, stress testing remains the predominant focus of RMG as it is considered to be the most effective mechanism to reduce Macquarie's exposure to unexpected market events.

Macquarie has long favoured transparent scenario analysis over complex statistical modelling as the cornerstone of risk measurement.

Risk Management Report
continued

Macro-Economic-Linkages

MEL calculates Macquarie's total market risk exposure to global market stress test scenarios extrapolated from historical crisis events and global market correlations. Each stress test scenario includes a primary shock to either equity or energy markets as well as cross-market effects in corporate margins, metals, foreign exchange, interest rates and commodities. MEL is Macquarie's preferred internal measure of aggregate market risk because of the severity of the shocks applied and the ability for scenarios to develop with changing market dynamics. MEL is monitored and reported to senior management daily and regularly reviewed by RMG to ensure the measure remains appropriate for changing market conditions and the risks to which Macquarie is exposed.

The 'Market Contagion' scenario, typically the most conservative of the MEL stress test scenarios, accounts for all the significant markets to which Macquarie is exposed. The assumptions in this scenario are considerably more severe than the conditions that have prevailed throughout the Global Financial Crisis. The 'Market Contagion' scenario measures the impact of an instantaneous equity market crash of 15 to 30 per cent as well as additional shocks to foreign exchange, metals, interest rate, energy, agricultural commodity and credit markets. Macquarie's exposure to the 'Market Contagion' stress test scenario decreased over the financial year as trading businesses de-risked in light of deteriorating market conditions resulting from macroeconomic concerns. The average exposure to the MEL stress test scenario represents less than 4 per cent of total equity.

Value-at-Risk

VaR provides a statistically based summary of overall market risk in Macquarie. The magnitude of VaR reflects changes in positions as well as changes in market volatility and correlations and enhancements to the model. The integrity of the VaR model is tested regularly against daily profit and loss.

VaR remains modest in comparison to total capital and earnings and continues to represent less than 0.2 per cent of total equity.

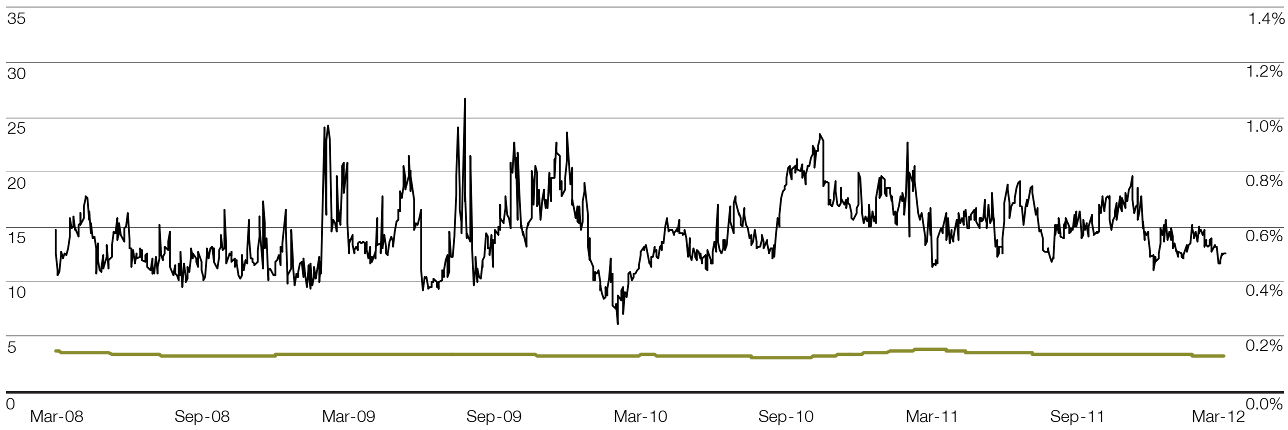
The VaR model uses a Monte Carlo simulation to generate normally distributed price and volatility paths for approximately 1,400 benchmarks, using volatilities and correlations based on three years of historical data. Emphasis is placed on more recent market movements to more accurately reflect current conditions. Each benchmark represents an asset at a specific maturity, for example one year crude oil futures or spot gold. The benchmarks provide a high level of granularity in assessing risk, covering a range of points on yield curves and forward price curves, and distinguishing between similar but distinct assets; for example crude oil as opposed to heating oil, or gas traded in different locations. Exposures to individual equities within a national market are captured by specific risk modelling incorporated directly into the VaR model.

Macquarie's market risk, as measured by VaR, moderately decreased over the financial year as de-risking in trading businesses was partially offset by increases in market volatility. VaR remains modest in comparison to capital and earnings and continues to represent less than 0.2 per cent of total equity. The graph below shows the daily VaR and the six month average VaR as a percentage of total equity.

Aggregate VaR

VaR (1-day 99% confidence interval) – $A million

Average VaR to total equity – %



VaR figures for year ended 31 March 2012

	2012 Average $Am	2012 Maximum $Am	2012 Minimum $Am	2011 Average $Am	2011 Maximum $Am	2011 Minimum $Am
Equities	7.26	10.03	4.26	9.53	19.30	4.35
Interest rates	10.91	14.72	8.00	5.83	10.72	3.67
Foreign exchange and bullion	2.36	6.22	0.86	3.61	10.55	1.08
Commodities and energy	9.53	15.11	6.41	11.64	16.34	7.63
Aggregate	14.99	19.57	11.07	16.00	23.50	11.04

Trading revenue

The effectiveness of Macquarie's risk management methodology can be measured by Macquarie's daily trading results. In light of expanded trading activity, the small quantity and magnitude of daily losses incurred by Macquarie are indicative of both an effective risk management framework and business operations focused on servicing client needs.

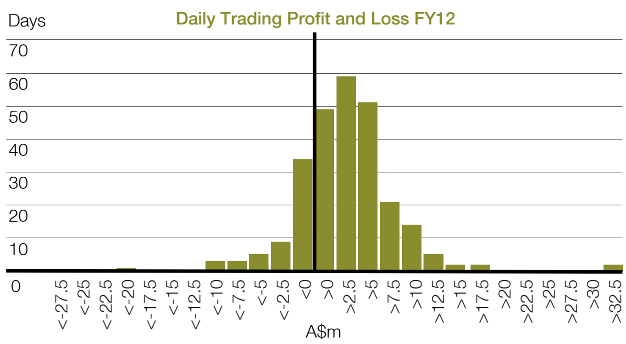
Macquarie's market risk activities continue to be based on earning income from spreads, franchise businesses and client flows. The majority of trading income is derived from client franchise activities rather than outright proprietary trading activity.

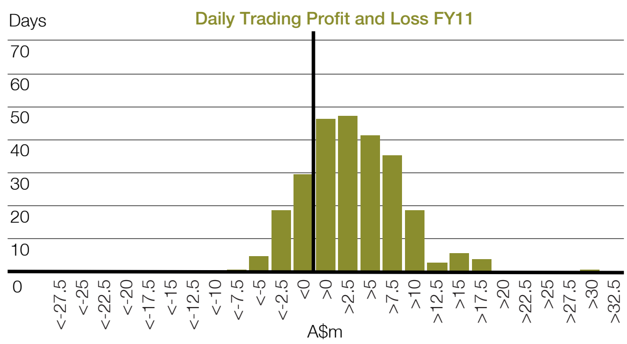
Macquarie's trading approach has shown consistent profits and low volatility in trading results over time. This is evident in the histograms below, and reflects the client-based nature of trading activities. In FY2012 Macquarie made a net trading profit on 205 out of the 260 trading days (2011 results: 206 out of 261 trading days).

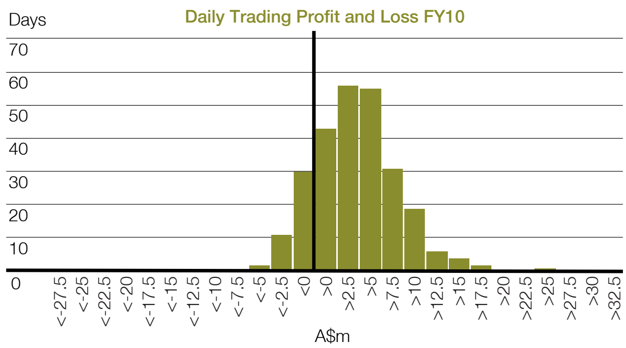
Non-traded market risk

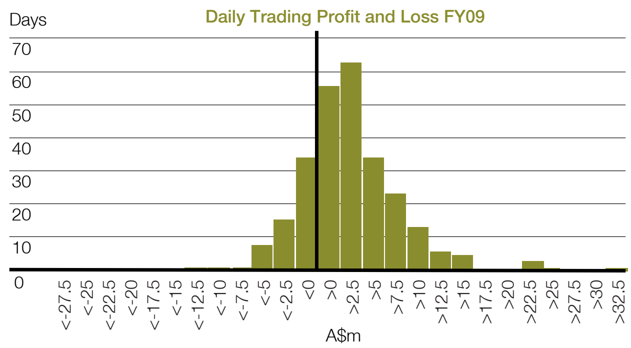
Macquarie also has exposure to non-traded interest rate risk, generated by banking products such as loans and deposits. Interest rate exposures, where possible, are transferred into the trading books of FICC and Group Treasury and managed under market risk limits. However, some residual interest rate risks remain in the banking book due to factors outside the interest rate market or due to timing differences in accumulating exposures large enough to hedge. These residual risks in the banking book are not material but are nevertheless monitored and controlled by RMG and reported to senior management regularly.

Macquarie's trading approach has shown consistent profits and low volatility in trading results over time. Trading activities generated a net profit on 205 out of the 260 trading days in the financial year to 31 March 2012.









Risk Management Report
continued

Economic capital

Macquarie has developed an economic capital model that quantifies Macquarie's aggregate level of risk.

The economic capital framework complements the management of specific risk types such as equity, credit, market and operational risk by providing an aggregate view of Macquarie's risk profile.

The economic capital model is used to support business decision-making and has three main applications:

— capital adequacy assessment
— risk appetite setting
— risk-adjusted performance measurement.

Capital adequacy assessment

Macquarie assesses capital adequacy for both Macquarie Group and Macquarie Bank. In each case, capital adequacy is assessed on a regulatory basis and on an economic basis, with capital requirements assessed as follows:

	Economic	Regulatory
Macquarie Bank	Bank internal model, covering exposures of the Banking Group	Capital to cover risk-weighted assets and regulatory deductions, according to APRA's banking prudential standards
Macquarie Group	Internal model, covering all exposures of Macquarie Group	Bank regulatory capital requirement as above plus economic capital requirement of the non-banking entities

Economic capital adequacy means an internal assessment of capital adequacy, designed to ensure Macquarie has sufficient capital to absorb potential losses and provide creditors with the required degree of protection.

Potential losses are quantified using the Economic Capital Adequacy Model (ECAM). These potential losses are compared to the capital resources available to absorb loss, consisting of book equity and eligible hybrid equity. Earnings are also available to absorb losses, however only a fraction of potential earnings are recognised as a buffer against losses.

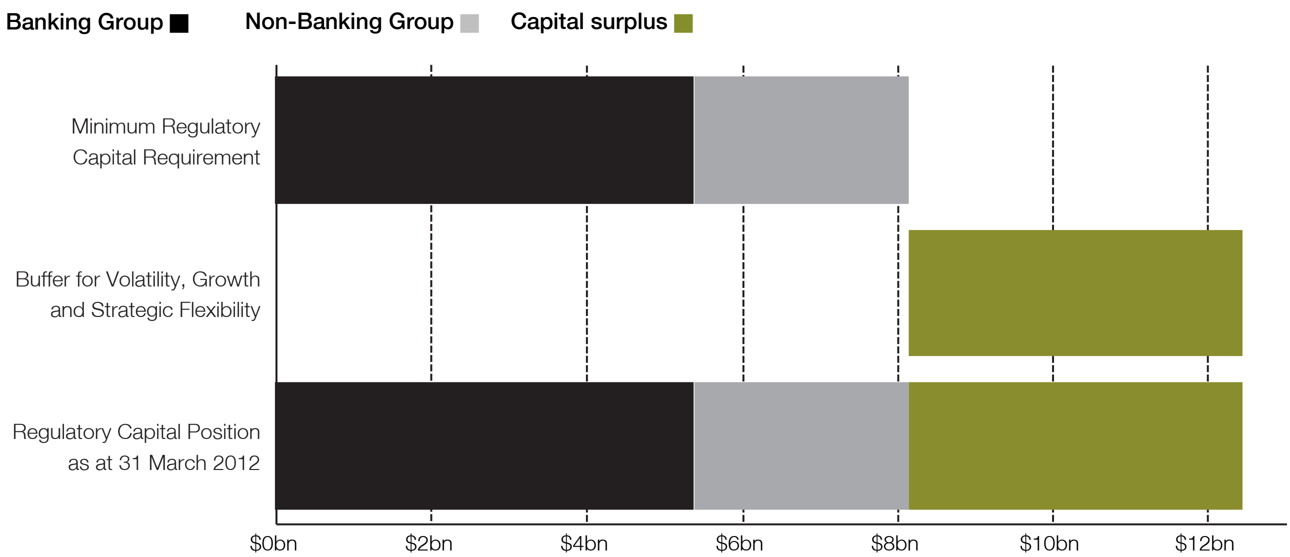
The ECAM quantifies the following types of risk:

— equity risk
— credit risk
— operational risk
— traded market risk.

The ECAM also covers insurance underwriting risk, non-traded interest rate risk and the risk on assets held as part of business operations, e.g. fixed assets, goodwill, intangible assets, capitalised expenses and certain minority stakes in associated companies or stakes in joint ventures.

The regulatory capital requirement of Macquarie's non-banking entities as agreed with APRA is determined by the ECAM. Macquarie's regulatory capital position as at 31 March 2012 is set out below.

Macquarie Group Limited regulatory capital position 31 March 2012



Macquarie is currently well capitalised – a substantial regulatory capital surplus exists. An element of this surplus is set aside as a buffer against volatility in the drivers of capital adequacy. The remaining capital surplus is available to support growth and provide strategic flexibility.

In order to reduce volatility in Macquarie's capital adequacy, Macquarie actively manages the sensitivity of its capital position to foreign currency movements. This is achieved by leaving specific investments in core foreign operations exposed to foreign currency translation movements. The resultant change in the Australian dollar value of the foreign investment is captured in the Foreign Currency Translation Reserve, a component of regulatory capital. This offsets the corresponding movement in the capital requirements of these investments.

The Tier 1 and total capital ratios for the Banking Group as at 31 March 2012 were 13.8 per cent and 16.6 per cent respectively.

The capital adequacy results are reported to the Board and senior management on a regular basis, together with projections of capital adequacy under a range of scenarios.

Risk appetite setting

Risk appetite is the nature and amount of risk that the Group is willing to accept. At Macquarie, this is expressed through the Board approved aggregate and specific risk limits, relevant policies, and requirement to consider risk adjusted returns.

The Board reviews Macquarie's risk appetite and approves the Global Risk Limit as part of the annual corporate strategy review process.

1 Limits

These consist of specific risk limits given to various businesses and products or industry sectors and also a Global Risk Limit which constrains Macquarie's aggregate level of risk. The Global Risk Limit is set to protect earnings and ensure we emerge from a severe downturn with sufficient capital to operate. The Risk Appetite Test, which is discussed below, measures usage against this limit.

In accordance with Macquarie's 'no limits, no dealing' approach, individual credit and equity exposures must also fit within approved counterparty limits. Market risk exposures are governed by a suite of individual and portfolio limits.

2 Relevant policies

There are numerous Macquarie-wide policies which set out the principles that govern the acceptance and management of risks. A key policy is the *New Product and Business Approval Policy* which ensures that the proposed transaction or operation can be managed properly and will not create unknown or unwanted risks for Macquarie in the future.

3 Requirement to consider risk-adjusted returns

At Macquarie, proposals for all significant new deals, products and businesses must contain an analysis of risk-adjusted returns.

Risk capacity is allocated to activities which earn an appropriate reward for the risk. This is a binding discipline on risk acceptance to ensure the risk-return trade-off does not deteriorate. The level of acceptable return for any proposal must also account for strategic fit and broader risk analysis (for example tail risk and concentration).

Existing businesses are subject to regular risk-return monitoring and reporting.

The Risk Appetite Test – an aggregate stress test

The key tool that the Board uses to quantify aggregate risk appetite is the Risk Appetite Test. This is a Macquarie-wide stress test which considers losses and earnings under a severe economic downturn scenario.

The Risk Appetite Test asserts that potential losses must be less than the Global Risk Limit which comprises underlying earnings that Macquarie can achieve in a three year downturn (downturn forward earnings capacity) plus surplus regulatory capital. Consideration is also given to the year by year outcome of the modelled downturn scenario to ensure that market confidence is maintained.

The key tool that the Board uses to quantify aggregate risk appetite is the Risk Appetite Test. This is a Macquarie-wide stress test which considers losses and earnings under a severe economic downturn scenario.

Downturn forward earnings capacity is estimated by the Operating Groups and divisions with reference to a three year downturn scenario provided to them by RMG.

Aggregate risk can be therefore broken down into two categories:

- Business risk – meaning decline in earnings through deterioration in volumes and margins due to market conditions
- Potential losses – including potential credit losses, write-downs of equity investments, operational risk losses and losses on trading positions.

Risk Management Report
continued

Business risk is captured by the difference in base case and downturn forward earnings estimates. Potential losses are quantified using a version of the economic capital model. A principal use of the Risk Appetite Test is in setting the Equity Risk Limit (ERL). This limit constrains Macquarie's aggregate level of risk arising from principal equity positions, managed fund holdings, property equity investments, lease residuals and other equity investments. Any changes to the ERL are sized to ensure that even under full utilisation of this limit, and allowing for growth in other risk types, the requirements of the Risk Appetite Test will be met.

Risk-adjusted performance measurement

As well as measuring risk-adjusted returns for deals as noted previously, risk-adjusted performance metrics for each division are prepared on a regular basis and distributed to Operations Review Committee, the Board and the divisions. Risk-adjusted performance metrics for each division are a significant input into performance based remuneration.

Liquidity risk

Liquidity management

The two primary external funding vehicles for Macquarie are MGL and MBL. MGL provides funding principally to the Non-Banking Group and limited funding to some MBL subsidiaries. MBL provides funding to the Banking Group.

The high level funding relationships of Macquarie are shown below.

Macquarie's liquidity risk management framework is designed to ensure that both MGL and MBL are able to meet their 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 and RMG. MGL and MBL liquidity policies are approved by the respective Boards after endorsement by the Asset and Liability Committee and liquidity reporting is provided to the MGL and MBL Boards on a monthly basis.

The Asset and Liability Committee includes the Managing Director and CEO, CFO, Chief Risk Officer, Group Treasurer and Operating Group Heads.

RMG provides independent prudential oversight of liquidity risk management, including the independent validation of liquidity scenario assumptions, liquidity policies, and the required funding maturity profile.

Liquidity policy and principles

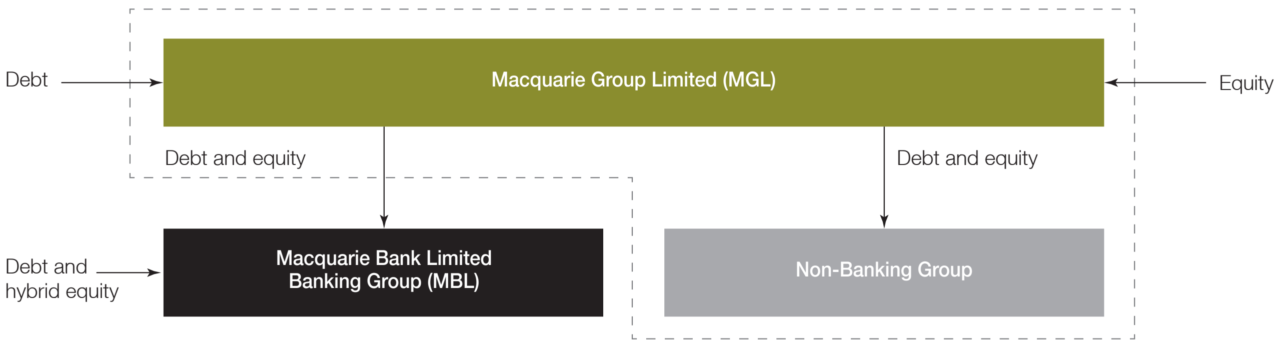
MGL provides funding predominantly to the Non-Banking Group. As such, the MGL *Liquidity Policy* outlines the liquidity requirements for the Non-Banking Group. The key requirement of the policy is that MGL is able to meet all of its liquidity obligations on a daily basis and during a period of liquidity stress: a 12 month period with no access to funding markets and with only a limited impact on franchise businesses.

Reflecting the longer term nature of the Non-Banking Group asset profile, MGL is funded predominantly with a mixture of capital and long-term wholesale funding.

The MBL *Liquidity Policy* outlines the liquidity requirements for the Banking Group. The key requirement of the policy is that MBL is able to meet all of its liquidity obligations on a daily basis and during a period of liquidity stress: a 12 month period of constrained access to funding markets and with only a limited impact on franchise businesses.

MBL is funded mainly by capital, long-term liabilities and deposits.

Macquarie Group – high level funding relationships



The liquidity management principles apply to both MGL and MBL and include the following:

Liquidity and funding management

- all liquidity requirements are managed centrally by Group Treasury
- liquidity risk is managed through setting limits on the maturity profile of assets and liabilities
- a Liquidity Contingency Plan is approved by the Board and reviewed periodically
- a funding strategy is prepared annually and the funding position is monitored throughout the year
- internal pricing incorporates liquidity costs, benefits and risks to align risk-taking activities with liquidity risk exposures
- diversity and stability of funding sources is a key priority.

Liquidity limits

- term assets must be funded by term liabilities
- cash and liquid assets are sufficient to cover a 12 month stress scenario
- cash and liquid assets held to meet stress scenarios must be unencumbered, high quality liquid assets and cash
- short-term assets exceed short-term wholesale liabilities.

Scenario analysis

Scenario analysis is central to Macquarie's liquidity risk management framework. Group Treasury models a number of liquidity scenarios covering both marketwide crises and firm-specific crises. The objective of this modelling is to ensure the ability of MGL and MBL to meet all repayment obligations under each scenario and determine the capacity for asset growth.

The scenarios separately consider the requirements of the banking group, non-banking group and the consolidated group. They are run over a number of timeframes and a range of conservative assumptions are used regarding access to capital markets, deposit outflows, contingent funding requirements and asset sales.

Liquid asset holdings

Group Treasury maintains a portfolio of highly liquid unencumbered assets in both MGL and MBL to ensure adequate liquidity is available in all funding environments, including worst case conditions. The minimum liquid asset requirement is calculated from scenario projections and also complies with regulatory minimum requirements.

To determine the minimum level of liquid assets, reference is made to the expected minimum cash requirement during a combined market-wide and firm-specific crisis scenario over a 12 month timeframe. This scenario assumes no access to new funding sources, a significant loss of deposits and contingent funding outflows resulting from undrawn commitments, market moves on derivatives and other margined positions. The size of the liquid asset portfolio must always exceed the minimum cash requirement as calculated in this model.

The liquid asset portfolio contains only unencumbered assets that can be relied on to maintain their liquidity in a crisis scenario. At least 90 per cent of the liquid assets portfolio held to meet the minimum liquid asset requirement must be eligible collateral for a repurchase facility with a central bank (repo eligible). The remainder must be approved by Group Treasury and RMG before inclusion in the liquid asset portfolio. As at 31 March 2012, 99 per cent of the liquid asset portfolio was repo eligible.

The liquid asset portfolio typically includes unencumbered cash and central bank repo eligible government, semi-government, supranational, government guaranteed bank and unguaranteed bank securities and AAA rated Australian residential mortgage backed securities. In addition, the portfolio includes other very short dated, high quality liquid assets such as A-1+ rated Australian residential mortgage backed commercial paper.

The liquid asset portfolio is largely denominated and held in Australian dollars and to a lesser extent in US dollars or other currencies where appropriate.

Liquidity contingency plan

Group Treasury maintains a liquidity contingency plan. The liquidity contingency plan applies to the entire Macquarie Group and defines roles and responsibilities and actions to be taken in a liquidity event. This includes identification of 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 who would be responsible for managing a crisis, the information required to effectively manage a crisis, a public relations strategy, a high level check list of actions to be taken, and contact lists to facilitate prompt communication with all key internal and external stakeholders. The liquidity contingency plan is subject to regular review (at least annually) by both Group Treasury and RMG and is submitted to the Board for approval.

Macquarie is a global financial institution, with bank branches, operating subsidiaries and regulated banking subsidiaries in a variety of countries. Regulations in certain countries may require some branches or subsidiaries to have a local contingency plan specific to that region. Where that is the case, the liquidity contingency plan contains a supplement providing the necessary region-specific information required for those branches or subsidiaries.

Funding transfer pricing

An internal funding transfer pricing framework is in place which aims to align businesses with the overall funding strategy of Macquarie. Under this framework the costs of long and short-term funding are charged out, and credits are made to divisions that provide long-term stable funding.

Risk Management Report
continued

Regulatory and compliance risk

Macquarie actively manages regulatory and compliance risks to its businesses globally, including the risk of breaches of applicable laws, regulations, rules, statements and regulatory policy.

Regulatory and compliance risk are assessed from a Macquarie-wide perspective to ensure regulatory and compliance risks are identified and appropriate standards are applied consistently to manage these risks. The development of new businesses and regulatory changes, domestically and internationally, are key areas of focus within this role.

Legal risk

Legal risk includes the risk that:

— transactions are not capable of being enforced as expected

— business does not adequately understand the legal and regulatory framework in which it operates

— the organisation may be found to be responsible for a claim based on a breach of contract, law or regulation.

Legal risk is managed through identification and assessment of legal risk, and by minimising or mitigating legal risk as far as reasonably practical. Responsibility for legal risk lies with Macquarie's businesses in conjunction with Group Legal. The head of Group Legal, the General Counsel, is a member of Macquarie's Operational Review Committee and reports directly to the Managing Director and CEO. The General Counsel has access to the Board and any Board committees. Each Macquarie Operating Group has a General Counsel who reports to the General Counsel and to the relevant Operating Group Head.

Reputation risk

All activities have embedded elements of reputation risk. Managing reputation risk is an essential role of senior management as it has the potential to impact both earnings and access to capital. Macquarie seeks to manage and minimise reputation risk through its corporate governance structure and risk management framework.

Macquarie operates under a strong corporate governance structure consistent with the regulatory requirements of various regulators including the Australian Securities & Investments Commission (ASIC), the ASX and APRA. *Goals and Values* incorporating a clear code of ethics are communicated to all staff and regional Integrity Officers deal with potential issues of integrity.

Operating Groups take ownership of risk, including reputation risk. In addition, a robust, independent risk management framework incorporates active management and monitoring of risks arising within Macquarie. The operation of this framework and oversight by RMG are major mitigants to reputation risk.

The various policies, procedures and practices in place aim to minimise reputation risk. Regular reporting to the Operation Review Committees and Boards includes detail on reputation risk issues as appropriate.

The direct financial losses arising from reputation risk (such as breach of mandates and regulatory fines) are taken into account in the operational risk capital model.

Internal Audit

Internal Audit provides independent assurance to senior management and the Board on the quality and effectiveness of Macquarie's financial and risk management framework. Internal Audit forms an independent and objective assessment as to whether risks have been adequately identified; adequate internal controls are in place to manage those risks; and whether those controls are working effectively. Internal Audit is independent of both business management and the activities it reviews.

The Head of Internal Audit is jointly accountable to the BAC and the Chief Risk Officer. The BAC approves the appointment and removal of the Head of Internal Audit who has unlimited access to the BAC.

Basel II

Macquarie Bank is accredited under the Foundation Internal Ratings Based Approach (FIRB) for credit risk, the Advanced Measurement Approach (AMA) for operational risk, the internal model approach for market risk[1] and the internal model approach for interest rate risk in the banking book.

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.

[1] Standard approach applied for specific risk on debt securities.

Regulatory developments

RMG is responsible for coordinating Macquarie's evaluation and response to both current and forthcoming regulatory developments and provides updates to the Board on a monthly basis.

The Basel Committee on Banking Supervision released the final text of the Basel III framework in December 2010. Basel III sets out revised capital rules, a new liquidity framework, a minimum leverage ratio and two new capital 'buffers' that oblige banks to hold additional capital on top of the minimum capital ratios.

APRA is requiring Australian banks to follow an accelerated Basel III implementation compared to the Basel Committee's gradual phase-in of Basel III, with a minimum Common Equity Tier 1 (CET1) ratio of 4.5% required by Jan 2013 and immediate phase in of additional CET1 deductions. In addition, APRA has also added more conservative overlays ('super-equivalence') to the Basel Committee's Basel III capital requirements.

Macquarie meets the APRA 2016 Basel III requirements today, i.e. minimum ratios plus capital conservation buffer. Macquarie will continue to report both the APRA Basel III capital position as well as the Harmonised Basel III position using the Basel Committee's Basel III rules.

All new transactions considered are now evaluated on a fully implemented Basel III basis, and all businesses are operating cognisant of Basel III.

Global regulators are in various stages of implementing G20 initiatives to develop regulatory infrastructure to meet the objective of central clearing and reporting of standardised, over-the-counter (OTC) derivative transactions. Through the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States and similar legislative change in many markets within which Macquarie operates, including Australia, the conduct of OTC business is undergoing significant reform. Macquarie's expectation is that much of the change will occur through 2012 and beyond, as structural change and practice permeates the industry in an endeavour to better manage the systemic risks inherent in financial businesses.

Glossary

AASB	Australian Accounting Standards Board
the Act	*Corporations Act 2001 (Cth)*
ADI	authorised deposit-taking institution
AGM	Annual General Meeting
AMA	Advanced Measurement Approach
Annual Financial Report	One component of Macquarie Group Limited's 2012 Annual Report which contains the Corporate Governance Statement, Diversity Report, Sustainability Report, Risk Report and Financial Report
Annual Review	One component of Macquarie Group Limited's 2012 Annual Report which contains key financial details, the Chairman and Managing Directors' Report and information about Macquarie's operating Groups and Divisions
ANZ	Australia and New Zealand
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities & Investments Commission
ASX	Australian Securities Exchange or ASX Limited ABN 98 008 624 691 and the market operated by ASX Limited
ASX Recommendations	ASX Corporate Governance Council Principles & Recommendations
BAC	Board Audit Committee
Banking Group	the Banking Group comprises Banking and Financial Services Group (BFS), Corporate and Asset Finance Group (CAF), Fixed Income, Currencies and Commodities (FICC), Macquarie Funds Group (MFG) and the trading activities of the Macquarie Securities Group (MSG). There is also one division within the Banking Group; Real Estate Banking Division (REB)
BBSW	Australian Financial Markets Association's bank-bill rate, published daily on AAP Reuters webpage. The Australian equivalent of LIBOR, SIBOR etc
BGCC	Board Governance and Compliance Committee
the Board	the Board of Voting Directors of Macquarie Group Limited
BRC	Board Remuneration Committee
BREEAM Excellent	UK Building Research Establishment Environmental Assessment Method's highest standard of environmental performance in an office building.
CAGR	compound annual growth rate
CAMAC	Corporations and Markets Advisory Committee
CDP	Carbon Disclosure Project
CET1	Common Equity Tier 1
CEO	Chief Executive Officer
CFO	Chief Financial Officer
the Company	Macquarie Group Limited
the Consolidated Entity	Macquarie Group Limited and its subsidiaries
CRO	Chief Risk Officer
CVA	credit valuation adjustments
Directors	the Voting Directors of Macquarie Group Limited (unless the context indicates otherwise)
Dodd-Frank	Dodd-Frank Wall Street Reform and Consumer Protection Act

DRP	Dividend Reinvestment Plan
DSU	Deferred Share Unit issued under the MEREP
DVA	debit valuation adjustments
ECAM	Economic Capital Adequacy Model
EMEA	Europe, Middle East and Africa
Environmental Management Plan (EMP)	Macquarie's internal framework of actions and targets to manage and reduce the environmental impact of its direct operations. The Plan covers Macquarie's corporate offices and associated corporate activities such as travel and procurement
EPS	earnings per share
ERL	Equity Risk Limit
ESP	Macquarie Group Employee Share Plan
ESG	Environmental, Social and Governance
Executive Key Management Personnel – (Executive KMP)	Members of the Executive Committee of Macquarie Group Limited
FIRB	Foundation Internal Ratings Based Approach
FX, Forex	Foreign Exchange
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
IRESS	a share market information system
Key Management Personnel (KMP)	all Voting Directors and members of the Executive Committee of Macquarie Group Limited
Macquarie Bank, MBL	Macquarie Bank Limited ABN 46 008 583 542
Macquarie Board, the Board	the Board of Voting Directors of Macquarie Group Limited
Macquarie CPS	Macquarie Convertible Preference Securities
Macquarie ECS, ECS	Macquarie Exchangeable Capital Securities
Macquarie ordinary shares	Macquarie Group Limited fully paid ordinary shares
Macquarie, MGL, Macquarie Group or Group	Macquarie Group Limited and its subsidiaries
Macquarie PMI	Macquarie Preferred Membership Interests
Malus	the discretion of the Board (from 2012) to reduce or eliminate unvested profit share amounts where it determines that an employee's action or inaction has caused Macquarie significant reputational harm, caused a significant or unexpected financial loss or caused Macquarie to make a material financial restatement
MBEDSAP	Macquarie Bank Executive Director Share Acquisition Plan
MBL	Macquarie Bank Limited

Glossary
continued

MBSSAP	Macquarie Bank Staff Share Acquisition Plan
MEL	Macro-Economic-Linkages
MEREP	Macquarie Group Employee Retained Equity Plan
MGEDSAP	Macquarie Group Executive Director Share Acquisition Plan
MGESOP	Macquarie Group Employee Share Option Plan
MGL	Macquarie Group Limited ABN 94 122 169 279
MGSSAP	Macquarie Group Staff Share Acquisition Plan
MIPS	Macquarie Income Preferred Securities
MIS	Macquarie Income Securities
NCD	negotiable certificates of deposit
NCI	non-controlling interests
NED	Non-Executive Director
NEDSAP	Non-Executive Director Share Acquisition Plan
NOHC	non-operating holding company
Non-Banking Group	the Non-Banking Group comprises Macquarie Capital and some business activities of MSG, MFG and FICC that use certain offshore regulated entities of the Non-Banking Group
NPAT	net profit after tax
OECD	Organisation for Economic Co-operation and Development
ORMF	Operational Risk Management Framework
OTC	over-the-counter
PSU	Performance Share Unit issued under the MEREP
PwC	PricewaterhouseCoopers
RMG	Risk Management Group
ROE	return on equity
RSU	Restricted Share Unit issued under the MEREP
RWA	risk-weighted assets
S&P	Standard & Poor's
SPE	Special Purpose Entity
tCO_2-e (Carbon dioxide equivalent in tonnes)	metric measure used to compare the emissions from various greenhouse gases based upon their global warming potential (US Environment Protection Agency)
TJ	terajoules
TSR	total shareholder return
VaR	Value-at-Risk
Voting Directors	the Voting Directors of Macquarie Group Limited
WHS	Work Health and Safety

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