MACQUARIE

Management Discussion and Analysis

Macquarie Bank Limited

Half-year ended 30 September 2017

NOTICE TO READERS

The purpose of this report is to provide information supplementary to the Macquarie Bank Limited Disclosure Report (U.S. Version) for the half-year ended 30 September 2017 and the Financial Report within the Macquarie Bank Limited Interim Financial Report ("the Financial Report") for the half-year ended 30 September 2017, including further detail in relation to key elements of Macquarie Bank Limited and its subsidiaries' ("Macquarie Bank", "the Consolidated Entity") financial performance and financial position. The report also outlines the funding and capital profile of the Consolidated Entity.

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

DATE OF THIS REPORT

This report has been prepared for the half-year ended 30 September 2017 and is current as at 27 October 2017.

COMPARATIVE INFORMATION AND CONVENTIONS

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

References to the prior corresponding period are to the six months ended 30 September 2016.

References to the prior period are to the six months ended 31 March 2017.

References to the current period and current half-year are to the six months ended 30 September 2017.

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

INDEPENDENT AUDITOR'S REPORT

This document should be read in conjunction with the Financial Report for the half-year ended 30 September 2017, which was subject to independent review by PricewaterhouseCoopers.

PricewaterhouseCoopers' independent auditor's review report to the members of Macquarie Bank Limited dated 27 October 2017 was unqualified.

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

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DISCLAIMER

RESULT OVERVIEW

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1.1 EXECUTIVE SUMMARY

Performance

Macquarie Bank's consolidated net profit attributable to ordinary equity holders of $A644 million for the half-year ended 30 September 2017 increased 11% from $A582 million in the prior corresponding period.

Macquarie Bank's annuity-style businesses

Macquarie Asset Management (MAM), Corporate and Asset Finance (CAF) and **Banking and Financial Services (BFS)** generated a combined net profit contribution for the half-year ended 30 September 2017 of $A969 million, up 18% on the prior corresponding period.

Key drivers included:

MAM	↑52% on 1H17

- the release of accruals related to legacy business activities
- higher fees from MSIS Retail.

Partially offset by:

- higher brokerage and commission expense from MSIS Retail.

CAF	↑19% on 1H17

- increased income from prepayments, realisations and investment-related income in the Principal Finance portfolio
- Asset Finance portfolio continued to perform well
- lower charges for provisions and impairments reflecting the partial reversal of collective provisions, driven by net loan repayments, and the improved credit performance of underlying portfolios.

Partially offset by:

- lower interest income as a result of the reduction in the Principal Finance portfolio size.

BFS	↑10% on 1H17

- volume growth in loan and deposit portfolios and improved margins
- the non-recurrence of expenses recognised in the prior corresponding period, including impairment charges predominately on certain equity positions and intangible assets and a change in approach to the capitalisation of software expenses in relation to the Core Banking platform.

Partially offset by:

- net overall gain on the disposal of Macquarie Life's risk insurance business to Zurich Australia Limited and the US mortgages portfolio in the prior corresponding period.

Macquarie Bank's capital markets facing businesses

Commodities and Global Markets (CGM) delivered a net profit contribution for the half-year ended 30 September 2017 of $A319 million, down 24% on the prior corresponding period.

Key drivers included:

CGM	↓24% on 1H17

- reduced income from the sale of investments, mainly in energy and related sectors
- lower volatility across the commodities platform resulting in reduced client activity and trading opportunities.

Partially offset by:

- strong client flows and revenues from interest rates and foreign exchange
- lower operating expenses reflecting reduced commodity-related trading activity, reduced average headcount and associated activity, and realisation of benefits from cost synergies following the merger of Commodities and Financial Markets (CFM) and Macquarie Securities Group (MSG).

1.1 EXECUTIVE SUMMARY CONTINUED

Profit attributable to ordinary equity holders

$A644m

11% on 1H17

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Financial performance summary					
Net interest income	**1,032**	1,105	1,065	*(7)*	*(3)*
Fee and commission income	**449**	451	369	*(<1)*	*22*
Net trading income	**805**	919	748	*(12)*	*8*
Net operating lease income	**469**	445	477	*5*	*(2)*
Share of net profits/(losses) of associates and joint ventures accounted for using the equity method	**9**	7	(26)	*29*	*
Other operating income and charges	**90**	19	242	*	*(63)*
Net operating income	**2,854**	2,946	2,875	*(3)*	*(1)*
Employment expenses	**(765)**	(711)	(776)	*8*	*(1)*
Brokerage, commission and trading-related expenses	**(316)**	(323)	(303)	*(2)*	*4*
Occupancy expenses	**(55)**	(57)	(61)	*(4)*	*(10)*
Non-salary technology expenses	**(65)**	(77)	(81)	*(16)*	*(20)*
Other operating expenses	**(798)**	(883)	(816)	*(10)*	*(2)*
Total operating expenses	**(1,999)**	(2,051)	(2,037)	*(3)*	*(2)*
Operating profit before income tax	**855**	895	838	*(4)*	*2*
Income tax expense	**(207)**	(254)	(255)	*(19)*	*(19)*
Profit after income tax	**648**	641	583	*1*	*11*
Loss attributable to non-controlling interests	**3**	5	7	*(40)*	*(57)*
Profit attributable to equity holders of Macquarie Bank Limited	**651**	646	590	*1*	*10*
Distribution paid or provided for on Macquarie Income Securities	**(7)**	(7)	(8)	-	*(13)*
Profit attributable to ordinary equity holders of Macquarie Bank Limited	**644**	639	582	*1*	*11*
Key metrics					
Expense to income ratio (%)	**70.0**	69.6	70.9		
Effective tax rate (%)	**24.1**	28.2	30.2		

1.1 EXECUTIVE SUMMARY CONTINUED

Net operating income

Net operating income of $A2,854 million for the half-year ended 30 September 2017 decreased 1% from $A2,875 million in the prior corresponding period. The decrease in other income was partially offset across fee and commission income, equity accounted income and net interest and trading income as well as lower charges for provisions and impairments.

Key drivers included:

Net interest and trading income

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
1,837	2,024	1,813

↑1% on prior corresponding period

- volume growth in loan and deposit portfolios and improved margins in BFS
- lower accounting volatility losses in Corporate.

Partially offset by:

- lower trading income in CGM as a result of lower market volatility.

Fee and commission income

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
449	451	369

↑22% on prior corresponding period

- decreased recovery of costs charged to the Consolidated Entity
- higher fees from MSIS Retail in MAM.

Partially offset by:

- reduced Life Insurance income in BFS after Macquarie Life's risk insurance business was sold to Zurich Australia Limited in September 2016.

Net operating lease income

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
469	445	477

↓2% on prior corresponding period

- improved underlying income in CAF from the Aviation, Energy and Technology portfolios, offset by foreign exchange movements.

Share of net profits/(losses) of associates and joint ventures accounted for using the equity method

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
9	7	(26)

↑ significantly on prior corresponding period

- increase in CGM and Corporate due to the non-recurrence of equity accounting losses recognised in the prior corresponding period.

Other operating income and charges

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
90	19	242

↓63% on prior corresponding period

- lower principal gains in CGM
- the prior corresponding period included BFS' gain on sale of Macquarie Life's risk insurance business to Zurich Australia Limited.

Partially offset by:

- higher income from MSIS Retail in MAM
- the release of accruals related to legacy business activities in MAM
- lower charges for provisions and impairments in CAF and BFS.

1.1 EXECUTIVE SUMMARY CONTINUED

Operating expenses

Total operating expenses of $A1,999 million for the half-year ended 30 September 2017 decreased 2% from $A2,037 million in the prior comparative period.

Key drivers included:

Employment expenses

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
765	711	776

↓1% on prior corresponding period

– lower average headcount
– favourable foreign currency movements.

Partially offset by:

– higher performance-related profit share expense, largely driven by the improved overall performance of the Operating Groups.

Brokerage, commission and trading-related expenses

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
316	323	303

↑4% on prior corresponding period

– higher brokerage and commission expense from MSIS Retail in MAM.

Non-salary technology expenses

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
65	77	81

↓20% on prior corresponding period

– the prior corresponding period included elevated project activity and a change in approach to the capitalisation of software expenses in relation to the Core Banking platform in BFS.

Occupancy and Other operating expenses

HALF-YEAR TO		
Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
853	940	877

↓3% on prior corresponding period

– reduction in Occupancy expenses
– other operating expenses broadly in line.

Income tax expense

Income tax expense of $A207 million for the half-year ended 30 September 2017 decreased 19% from $A255 million in the prior corresponding period.

The effective tax rate for the half-year ended 30 September 2017 was 24.1%, down from 30.2% in the prior corresponding period reflecting the geographic mix and nature of earnings.

FINANCIAL PERFORMANCE ANALYSIS

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2.1 NET INTEREST AND TRADING INCOME

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Net interest income	**1,032**	1,105	1,065	*(7)*	*(3)*
Net trading income	**805**	919	748	*(12)*	*8*
Net interest and trading income	**1,837**	2,024	1,813	*(9)*	*1*

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

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

For businesses that predominately earn income from lending activities (CAF and BFS), derivatives that economically hedge interest rate risk are required to be carried at fair value through net trading income unless they form part of a qualifying hedge relationship. Hedge relationships are generally only recognised at a Consolidated Entity level; however for segment reporting, derivatives are accounted for on an accruals basis in the Operating Group segments and changes in fair value are recognised within the Corporate segment offset by the effect of hedge relationships at the Consolidated Entity level.

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

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
MAM	**60**	53	51	*13*	*18*
CAF	**330**	348	346	*(5)*	*(5)*
BFS	**584**	551	498	*6*	*17*
CGM					
Commodities	**388**	619	503	*(37)*	*(23)*
Credit, interest rates and foreign exchange	**270**	324	247	*(17)*	*9*
Equities	**164**	124	165	*32*	*(1)*
Corporate	**41**	5	3	*	*
Net interest and trading income	**1,837**	2,024	1,813	*(9)*	*1*

2.1 NET INTEREST AND TRADING INCOME CONTINUED

Net interest and trading income of $A1,837 million for the half-year ended 30 September 2017 was broadly in line with $A1,813 million in the prior corresponding period.

MAM

Net interest and trading income in MAM includes income on specialised retail products, interest income from the provision of financing facilities to external funds and their investors.

Net interest and trading income of $A60 million for the half-year ended 30 September 2017 increased 18% from a net income of $A51 million in the prior corresponding period due to higher volumes from new transactions and higher trading income.

CAF

Net interest and trading income in CAF predominately relates to net income from the loan and finance lease (including vehicles and equipment financing) portfolios and the funding costs associated with the operating lease portfolios (including aviation, mining and energy assets).

Net interest and trading income of $A330 million for the half-year ended 30 September 2017 decreased 5% from $A346 million in the prior corresponding period.

The decrease was a result of the reduction in the Principal Finance portfolio size, partially offset by increased income from prepayments and realisations.

The loan and finance lease portfolio was $A25.4 billion at 30 September 2017, a decrease of 3% from $A26.3 billion at 31 March 2017. The decrease was mainly in Principal Finance.

BFS

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

Net interest and trading income of $A584 million for the half-year ended 30 September 2017 increased 17% from $A498 million in the prior corresponding period due to a 3% growth in average Australian loan volumes, an 11% growth in the average deposit portfolio balance and improved margins across Australian mortgages, business lending and BFS deposits, compared to the prior corresponding period.

At 30 September 2017 the Australian loan and deposit portfolios included:

- Australian mortgage volumes of $A29.9 billion, up 4% from $A28.7 billion at 31 March 2017;
- business lending volumes of $A7.1 billion, up 9% from $A6.5 billion at 31 March 2017; and
- BFS deposits of $A46.4 billion, up 4% from $A44.5 billion at 31 March 2017.

The sale of the Canadian mortgages portfolio during the period has resulted in no remaining legacy loan portfolio at 30 September 2017 ($A0.5 billion at 31 March 2017).

2.1 NET INTEREST AND TRADING INCOME CONTINUED

CGM

Commodities

Net interest and trading income from commodity related activities is generated from the provision of hedging and risk management services and loans and working capital finance to clients across a range of commodity sectors including base and precious metals, energy and agriculture. CGM also enters into a number of tolling agreements, storage contracts and transportation agreements in order to facilitate client flow transactions as part of its commodities platform. These arrangements provide CGM with the ability to maximise opportunities where there is dislocation between the supply and demand for energy. Tolling agreements, storage contracts and transportation agreements, which are managed on a fair value basis for financial and risk management purposes, are required to be accounted for on an accruals basis for statutory reporting purposes, which may result in some volatility with timing of reported income.

Net interest and trading income from commodities $A388 million for the half-year ended 30 September 2017 decreased 23% from $A503 million in the prior corresponding period. The current period included mixed results across the platform. Volatility was lower in comparison to the prior corresponding period which impacted client hedging activity and trading results across Global Oil, North American Gas and Metals. These results were offset by stronger results in North American Power, Bulk Commodities, Investor Products and Agriculture. Commodities was also impacted by a reduction in income from residual Metals, Energy Capital and other legacy portfolios that are being wound down.

Credit, interest rates and foreign exchange

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

Net interest and trading income from credit, interest rates and foreign exchange products of $A270 million for the half-year ended 30 September 2017 increased 9% from $A247 million in the prior corresponding period. Increased income in the current half-year was underpinned by strong contributions from foreign exchange and interest rates markets in Japan, EMEA and North Americas. Credit remains subdued.

Equities

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

Equities net interest and trading income of $A164 million for the half-year ended 30 September 2017 was in line with the prior corresponding period.

Corporate

Net interest and trading income in the Corporate segment includes the net result of managing liquidity and funding for the Consolidated Entity, earnings on capital, funding costs associated with non-core investments held centrally and accounting volatility arising from movements in underlying rates relating to economically hedged positions where designated hedge accounting is unable to be achieved for accounting purposes.

Net interest and trading income of $A41 million for the half-year ended 30 September 2017 increased substantially from $A3 million in the prior corresponding period primarily due to the impact of accounting volatility on economically hedged positions that do not qualify for hedge accounting.

2.2 FEE AND COMMISSION INCOME

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Brokerage and commissions	**184**	179	190	*3*	*(3)*
Other fee and commission income	**265**	272	179	*(3)*	*48*
Total fee and commission income	**449**	451	369	*(<1)*	*22*

Total fee and commission income of $A449 million for the half-year ended 30 September 2017 increased 22% from $A369 million in the prior corresponding period.

Brokerage and commissions

Brokerage and commissions income of $A184 million for the half-year ended 30 September 2017 decreased 3% from $A190 million in the prior corresponding period, which included higher settlement income from closed-end funds in MAM.

Other fee and commission income

Other fee and commission income includes fees earned on a range of BFS' products and services including the Wrap and Vision platforms, deposits, provision of wealth services in Australia, mortgages, credit cards and business loans as well as distribution service fees, structuring fees and capital protection fees in MAM.

Other fee and commission income of $A265 million for the half-year ended 30 September 2017 increased 48% from $A179 million in the prior corresponding period due to a decrease in the recovery of costs charged to the Consolidated Entity from the Non-Bank Group in Corporate as well as higher fees from MSIS Retail in MAM and increased platform commissions from higher funds on the Wrap and Vision platforms, partially offset by lower Life insurance income due to the sale of Macquarie Life's risk insurance business to Zurich Australia Limited in September 2016 in BFS.

2.3 NET OPERATING LEASE INCOME

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	Mar 17 %	Sep 16 %
Rental income	909	822	844	11	8
Depreciation on operating lease assets	(440)	(377)	(367)	17	20
Net operating lease income	469	445	477	5	(2)

Net operating lease income, which is predominately earned by CAF, totalled $A469 million for the half-year ended 30 September 2017, down 2% from $A477 million in the prior corresponding period due to improved underlying income from the Aviation, Energy and Technology portfolios offset by foreign exchange movements.

CAF's operating lease portfolio was $A9.9 billion at 30 September 2017, broadly in line with $A10.0 billion at 31 March 2017 with depreciation and sales in the Aviation portfolio partially offset by growth in the Technology and Energy portfolios.

2.4 SHARE OF NET PROFITS OF ASSOCIATES AND JOINT VENTURES

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	Mar 17 %	Sep 16 %
Share of net profits/(losses) of associates and joint ventures accounted for using the equity method	9	7	(26)	29	*

Share of net profits of associates and joint ventures of $A9 million for the half-year ended 30 September 2017 compares to a loss of $A26 million in the prior corresponding period. The movement was primarily due to the non-recurrence of equity accounting losses recognised in the prior corresponding period in CGM and Corporate as well as the reclassification of non-core assets to investments held for sale in Corporate.

2.5 OTHER OPERATING INCOME AND CHARGES

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Investment income					
Net gains on sale of investment securities available for sale	**14**	12	27	*17*	*(48)*
Net gains on sale of interests in associates and joint ventures	**1**	7	103	*(86)*	*(99)*
Net gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale	**67**	143	234	*(53)*	*(71)*
Dividends/distributions received/receivable from investment securities available for sale	**1**	5	5	*(80)*	*(80)*
Total investment income	**83**	167	369	*(50)*	*(78)*
Impairment charges					
Impairment charge on investment securities available for sale	**(6)**	(13)	(19)	*(54)*	*(68)*
Impairment charge on interests in associates and joint ventures	**(5)**	(1)	(5)	*	-
Impairment charge on intangibles and other non-financial assets	**(16)**	(11)	(34)	*45*	*(53)*
Total impairment charges	**(27)**	(25)	(58)	*8*	*(53)*
Provisions					
Individually assessed provisions for impairments	**(42)**	(68)	(82)	*(38)*	*(49)*
Collective allowance for credit losses provided for during the period	**52**	-	-	*	*
Loans written off	**(67)**	(96)	(51)	*(30)*	*31*
Recovery of loans previously written off	**17**	29	15	*(41)*	*13*
Total loan impairments and provisions	**(40)**	(135)	(118)	*(70)*	*(66)*
Other income	**74**	12	49	*	*51*
Total other operating income and charges	**90**	19	242	*	*(63)*

2.5 OTHER OPERATING INCOME AND CHARGES CONTINUED

Total other operating income and charges of $A90 million for the half-year ended 30 September 2017 decreased 63% from $A242 million in the prior corresponding period, mainly driven by lower investment income, partially offset by higher other income and reduced charges for provisions and impairments.

Investment income

Investment income totalled $A83 million for the half-year ended 30 September 2017, down from $A369 million in the prior corresponding period.

The prior corresponding period included gains on BFS' sale of Macquarie Life's risk insurance business to Zurich Australia Limited as well as the sale of a number of investments in CGM in energy and related sectors.

Investment income in the current period included gains on reclassification of an investment in a toll road in the UK by the CAF Principal Finance business.

Impairment charges

Impairment charges totalled $A27 million for the half-year ended 30 September 2017, a decrease of 53% from $A58 million in the prior corresponding period. The decrease predominately relates to the non-recurrence of impairment charges in BFS, with the prior corresponding period impacted by the underperformance of certain equity positions and impairments of intangibles relating to the Core Banking platform.

Provisions

Provisions for credit losses and write-offs of $A40 million for the half-year ended 30 September 2017 decreased 66% from $A118 million in the prior corresponding period. The decrease was largest in CAF which included the partial reversal of collective provisions driven by net loan repayments, and the improved credit performance of underlying portfolios.

Other income

Other income of $A74 million for the half-year ended 30 September 2017 increased 51% from $A49 million in the prior corresponding period. The increase predominately relates to income from MSIS Retail and the release of accruals related to legacy businesses in MAM.

2.6 OPERATING EXPENSES

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Employment expenses					
Salary and related costs including commissions, superannuation and performance-related profit share	**(677)**	(636)	(683)	*6*	*(1)*
Share-based payments	**(84)**	(73)	(90)	*15*	*(7)*
Provision for long service leave and annual leave	**(4)**	(2)	(3)	*100*	*33*
Total compensation expenses	**(765)**	(711)	(776)	*8*	*(1)*
Other employment expenses including on-costs, staff procurement and staff training	**-**	-	-	-	-
Total employment expenses	**(765)**	(711)	(776)	*8*	*(1)*
Brokerage, commission and trading-related expenses	**(316)**	(323)	(303)	*(2)*	*4*
Occupancy expenses	**(55)**	(57)	(61)	*(4)*	*(10)*
Non-salary technology expenses	**(65)**	(77)	(81)	*(16)*	*(20)*
Other operating expenses					
Professional fees	**(89)**	(100)	(85)	*(11)*	*5*
Auditor's remuneration	**(11)**	(10)	(12)	*10*	*(8)*
Travel and entertainment expenses	**(26)**	(25)	(26)	*4*	*-*
Advertising and communication expenses	**(20)**	(16)	(15)	*25*	*33*
Amortisation of intangible assets	**(10)**	(6)	(5)	*67*	*100*
Other expenses	**(642)**	(726)	(673)	*(12)*	*(5)*
Total other operating expenses	**(798)**	(883)	(816)	*(10)*	*(2)*
Total operating expenses	**(1,999)**	(2,051)	(2,037)	*(3)*	*(2)*

Total operating expenses of $A1,999 million for the half-year ended 30 September 2017 decreased 2% from $A2,037 million in the prior corresponding period mainly due to reduced project activity in BFS, lower average headcount across the Consolidated Entity and the impact of favourable foreign currency movements, partially offset by higher brokerage and commission expense from MSIS Retail in MAM.

Key drivers of the movement included:

- Total employment expenses of $A765 million for the half-year ended 30 September 2017 decreased 1% from $A776 million in the prior corresponding period mainly due to lower average headcount across the Consolidated Entity and favourable foreign currency movements, partially offset by higher performance-related profit share expense driven by improved overall performance of the Operating Groups.
- Brokerage, commission and trading-related expenses of $A316 million for the half-year ended 30 September 2017 increased 4% from $A303 million in the prior corresponding period mainly due to higher expenses from MSIS Retail in MAM.
- Occupancy expenses of $A55 million for the half-year ended 30 September 2017 decreased 10% from $A61 million in the prior corresponding period mainly due to the consolidation of leased office space and favourable foreign currency movements.
- Non-salary technology expenses of $A65 million for the half-year ended 30 September 2017 decreased 20% from $A81 million in the prior corresponding period, which was impacted by elevated project activity and a change in approach to the capitalisation of software expenses in relation to the Core Banking platform in BFS.
- Total other operating expenses of $A798 million for the half-year ended 30 September 2017 were broadly in line with $A816 million in the prior corresponding period.

2.7 HEADCOUNT

	AS AT			MOVEMENT	
	Sep 17	Mar 17	Sep 16	Mar 17 %	Sep 16 %
Headcount by Operating Group					
MAM	123	124	115	(<1)	7
CAF	1,259	1,254	1,342	<1	(6)
BFS	2,075	1,990	2,049	4	1
CGM	936	908	927	3	<1
Total headcount - Operating Groups	4,393	4,276	4,433	3	(<1)
Total headcount — Discontinued Operations[1]	68	59	91	15	(25)
Total headcount – Corporate	26	31	41	(16)	(37)
Total headcount	4,487	4,366	4,565	3	(2)
Headcount by region					
Australia[2]	3,215	3,108	3,249	3	(1)
International:					
Americas	503	496	505	1	(<1)
Asia	304	304	325	-	(6)
Europe, Middle East and Africa	465	458	486	2	(4)
Total headcount - International	1,272	1,258	1,316	1	(3)
Total headcount	4,487	4,366	4,565	3	(2)
International headcount ratio (%)	28	29	29		

1. Headcount relating to the Macquarie Investment Management business within MAM relates to the business sold to Macquarie Financial Holdings Pty Limited and its subsidiaries on 15 April 2015. The employees are yet to be transferred to Macquarie Financial Holdings Pty Limited, however their employment related costs are reflected in Macquarie Financial Holdings Pty Limited and its subsidiaries.
2. Includes New Zealand

Total headcount decreased 2% to 4,487 at 30 September 2017 from 4,565 at 30 September 2016 mainly due to the realisation of efficiencies in the Consolidated Entity. This was partially offset by an increase in MAM and BFS to support business growth.

2.8 INCOME TAX EXPENSE

	HALF-YEAR TO		
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am
Operating profit before income tax	**855**	895	838
Prima facie tax @ 30%	**257**	269	251
Income tax permanent differences	**(50)**	(15)	4
Income tax expense	**207**	254	255
Effective tax rate[1]	**24.1%**	28.2%	30.2%

1. The effective tax rate is calculated on Operating profit before income tax and after non-controlling interests. Non-controlling interests increased operating profit before income tax by $A3 million for the half-year ended 30 September 2017 (30 September 2016: increased operating profit before income tax by $A7 million).

Income tax expense for the half-year ended 30 September 2017 was $A207 million, a 19% decrease from $A255 million in the prior corresponding period.

The effective tax rate for the half-year ended 30 September 2017 was 24.1%, down from 30.2% in the prior corresponding period reflecting the geographic mix and nature of earnings.

SEGMENT ANALYSIS

3

3.1 BASIS OF PREPARATION

Operating Segments

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

For internal reporting, performance measurement and risk management purposes, the Consolidated Entity is divided into four Operating Groups and a Corporate segment. These segments have been set up based on the different core products and services offered. There were previously five Operating Groups, and during the prior period Commodities and Financial Markets merged with Macquarie Securities to form CGM. Segment information has been prepared in accordance with the basis of preparation described below.

The Operating Groups comprise:

- **MAM** offers a range of investment solutions with an alternate fixed income focus, for its fiduciary clients within the infrastructure debt sector and balance sheet lending to shipping, export credit agency backed debt, hedge funds and private equity investors.
- **CAF** operates in selected international markets, providing specialist financing, investing and asset management solutions. CAF has expertise in flexible primary financing, secondary market investing and asset finance including aircraft, vehicles, technology, healthcare, manufacturing, industrial, energy, rail and mining equipment
- **BFS** provides a diverse range of personal banking, wealth management and business banking products and services to retail customers, advisers, brokers and business clients
- **CGM** provides clients with an integrated, end-to-end offering across global markets including equities, fixed income, foreign exchange and commodities.

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

Items of income and expense within the Corporate segment include the net impact of managing liquidity for the Consolidated Entity, earnings on capital, non-trading derivative volatility, earnings from investments, central overlay on impairment, provisions or valuation of assets, unallocated head office costs and costs of central service groups, the Consolidated Entity's performance-related profit share and share-based payments expense, income tax expense and certain distributions attributable to non-controlling interests and holders of loan capital.

All transactions and transfers between segments are generally determined on an arm's length basis and are included within the relevant categories of income or expense. These transactions eliminate on aggregation/consolidation.

Below is a selection of key policies applied in determining operating segment results.

Internal funding arrangements

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

Generally, Operating Groups may only source funding directly from external sources when there is recourse only to the assets being funded and not to the Consolidated Entity.

Deposits are a funding source for the Consolidated Entity. BFS receives a deposit premium from Group Treasury on deposits they generate. This deposit premium is included within net interest and trading income for segment reporting purposes.

Transactions between Operating Groups

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

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

Accounting for derivatives that economically hedge interest rate risk

For businesses that predominately earn income from lending activities (CAF and BFS), derivatives that economically hedge interest rate risk are required to be carried at fair value through net trading income unless they form part of a qualifying hedge relationship. Hedge relationships are generally only recognised at a Consolidated Entity level; however for segment reporting, derivatives are accounted for on an accruals basis in the Operating Group segments and changes in fair value are recognised within the Corporate segment offset by the effect of hedge relationships at the total Consolidated Entity level.

Central service groups

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

Performance-related profit share and share-based payments expense

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

3.1 BASIS OF PREPARATION CONTINUED

Income tax

Income tax expense and benefits are recognised in the Corporate segment and not allocated to Operating Groups. However, to recognise an Operating Group's contribution to permanent income tax differences, an internal management revenue/charge is used. These internal management revenue/charges are offset by an equal and opposite amount recognised in the Corporate segment such that they are eliminated on aggregation.

Presentation of segment income statements

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

3.1 BASIS OF PREPARATION CONTINUED

	MAM $Am	CAF $Am	BFS $Am
Half-year ended 30 September 2017			
Net interest and trading income	60	330	584
Fee and commission income/(expense)	43	23	233
Net operating lease income	1	465	-
Share of net profits of associates and joint ventures accounted for using the equity method	-	-	-
Other operating income and charges			
Impairment charges, write-offs and provisions, net of recoveries	1	1	(8)
Other operating income and charges	48	105	6
Internal management revenue/(charge)	-	1	3
Net operating income/(charge)	153	925	818
Total operating expenses	(83)	(310)	(534)
Operating profit/(loss) before income tax	70	615	284
Income tax expense	-	-	-
Profit/(loss) after Income Tax	70	615	284
Loss attributable to non-controlling interests	-	-	-
Profit/(loss) attributable to equity holders	70	615	284
Distributions paid or provided for on MIS	-	-	-
Net profit/(loss) contribution	**70**	**615**	**284**
Half-year ended 31 March 2017			
Net interest and trading income	53	348	551
Fee and commission income/(expense)	36	35	215
Net operating lease income	7	437	-
Share of net profits of associates and joint ventures accounted for using the equity method	-	-	5
Other operating income and charges			
Impairment charges, write-offs and provisions, net of recoveries	-	(50)	(13)
Other operating income and charges	(25)	182	4
Internal management revenue/(charge)	1	37	4
Net operating income	72	989	766
Total operating expenses	(64)	(317)	(515)
Operating profit/(loss) before income tax	8	672	251
Income tax expense	-	-	-
Profit/(loss) after Income Tax	8	672	251
Loss attributable to non-controlling interests	-	-	-
Profit/(loss) attributable to equity holders	8	672	251
Distributions paid or provided for on MIS	-	-	-
Net profit/(loss) contribution	**8**	**672**	**251**
Half-year ended 30 September 2016			
Net interest and trading income	51	346	498
Fee and commission income/(expense)	29	23	254
Net operating lease income	6	467	-
Share of net profits/(losses) of associates and joint ventures accounted for using the equity method	-	-	1
Other operating income and charges			
Impairment charges, write-offs and provisions, net of recoveries	1	(61)	(78)
Other operating income and charges	12	51	201
Internal management revenue/(charge)	-	3	1
Net operating income/(charge)	99	829	877
Total operating expenses	(53)	(314)	(618)
Operating profit/(loss) before income tax	46	515	259
Income tax expense	-	-	-
Profit/(loss) after Income Tax	46	515	259
Loss/(profit) attributable to non-controlling interests	-	1	-
Profit/(loss) attributable to equity holders	46	516	259
Distributions paid or provided for on MIS	-	-	-
Net profit/(loss) contribution	**46**	**516**	**259**

Annuity-Style Businesses $Am	CGM $Am	Capital Markets Facing Businesses $Am	Corporate $Am	Total $Am
974	822	**822**	41	**1,837**
299	182	**182**	(32)	**449**
466	-	**-**	3	**469**
-	8	**8**	1	**9**
(6)	(56)	**(56)**	(5)	**(67)**
159	15	**15**	(17)	**157**
4	5	**5**	(9)	**-**
1,896	976	**976**	(18)	**2,854**
(927)	(657)	**(657)**	(415)	**(1,999)**
969	319	**319**	(433)	**855**
-	-	**-**	(207)	**(207)**
969	319	**319**	(640)	**648**
-	-	**-**	3	**3**
969	319	**319**	(637)	**651**
-	-	**-**	(7)	**(7)**
969	**319**	**319**	**(644)**	**644**
952	1,067	1,067	5	2,024
286	169	169	(4)	451
444	-	-	1	445
5	10	10	(8)	7
(63)	(105)	(105)	9	(159)
161	29	29	(12)	178
42	5	5	(47)	-
1,827	1,175	1,175	(56)	2,946
(896)	(719)	(719)	(436)	(2,051)
931	456	456	(492)	895
-	-	-	(254)	(254)
931	456	456	(746)	641
-	-	-	5	5
931	456	456	(741)	646
-	-	-	(7)	(7)
931	**456**	**456**	**(748)**	**639**
895	915	915	3	1,813
306	170	170	(107)	369
473	-	-	4	477
1	(10)	(10)	(17)	(26)
(138)	(52)	(52)	13	(177)
264	119	119	36	419
4	6	6	(10)	-
1,805	1,148	1,148	(78)	2,875
(985)	(728)	(728)	(324)	(2,037)
820	420	420	(402)	838
-	-	-	(255)	(255)
820	420	420	(657)	583
1	(1)	(1)	7	7
821	419	419	(650)	590
-	-	-	(8)	(8)
821	**419**	**419**	**(658)**	**582**

3.2 MAM

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Net interest and trading income	**60**	53	51	*13*	*18*
Fee and commission income					
Base fees	**20**	21	18	*(5)*	*11*
Other fee and commission income	**23**	15	11	*53*	*109*
Total fee and commission income	**43**	36	29	*19*	*48*
Net operating lease income	**1**	7	6	*(86)*	*(83)*
Other operating income and charges	**49**	(25)	13	*	*277*
Internal management revenue	**-**	1	-	*	-
Net operating income	**153**	72	99	*113*	*55*
Operating expenses					
Employment expenses	**(16)**	(13)	(14)	*23*	*14*
Brokerage, commission and trading-related expenses	**(40)**	(19)	(8)	*111*	*
Other operating expenses	**(27)**	(32)	(31)	*(16)*	*(13)*
Total operating expenses	**(83)**	(64)	(53)	*30*	*57*
Net profit contribution	**70**	8	46	*	*52*
Non-GAAP metrics					
MAM assets under management ($A billion)	**5.3**	5.5	4.2	*(4)*	*26*
Headcount	**123**	124	115	*(1)*	*7*

Net profit contribution of $A70 million for the half-year ended 30 September 2017, up 52% from the prior corresponding period:

– Other operating income includes the release of accruals relating to legacy business activities
– Higher other fee income from MSIS retail

Partially offset by

– Higher brokerage and commission expense from MSIS Retail

3.2 MAM CONTINUED

Net interest and trading income

Net interest and trading income includes income on specialised retail products, interest income from the provision of financing facilities to external funds and their investors.

Net interest and trading income of $A60 million for the half-year ended 30 September 2017 increased from a net income of $A51 million in the prior corresponding period due to higher volumes from new transactions and higher trading income.

Base fees

Base fee income of $A20 million for the half-year ended 30 September 2017 was slightly higher than base fee income of $A18 million in the prior corresponding period. Base fee income benefited from growth in the MSIS Infrastructure Debt business.

Other fee and commission income

Other fee and commission income includes distribution service fees, structuring fees, capital protection fees, brokerage and commission income. Distribution service fees and brokerage and commission income are offset by associated expenses that, for accounting purposes, are recognised in brokerage, commission and trading-related expenses.

Other fee and commission income of $A23 million for the half-year ended 30 September 2017 increased from $11 million in the prior corresponding period due to higher fees from MSIS Retail, partially offset by lower settlement income from closed-end funds.

Other operating income and charges

Net other operating income and charges of $A49 million for the half-year ended 30 September 2017 increased from $A13 million in the prior corresponding period. The current period includes income from MSIS Retail and a release of accruals relating to legacy business activities.

Operating expenses

Total operating expenses of $A83 million for the half-year ended 30 September 2017 increased from $A53 million in the prior corresponding period. The current period included higher brokerage and commission expense from MSIS retail.

3.3 CAF

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	Mar 17 %	Sep 16 %
Net interest and trading income	**330**	348	346	*(5)*	*(5)*
Fee and commission income	**23**	35	23	*(34)*	-
Net operating lease income	**465**	437	467	*6*	*(<1)*
Share of net profits of associates and joint ventures accounted for using the equity method	**-**	-	-	-	-
Other operating income and charges					
Impairment charge on equity investments, intangibles and other non-financial assets	**(11)**	(11)	(17)	-	*(35)*
Gain on disposal of operating lease assets	**6**	1	15	*	*(60)*
Net gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale	**66**	140	-	*(53)*	*
Provisions for impairment, write-offs and collective allowance for credit losses	**12**	(39)	(44)	*	*
Other income	**33**	41	36	*(20)*	*(8)*
Total other operating income and charges	**106**	132	(10)	*(20)*	*
Internal management revenue	**1**	37	3	*(97)*	*(67)*
Net operating income	**925**	989	829	*(6)*	*12*
Operating expenses					
Employment expenses	**(131)**	(131)	(134)	-	*(2)*
Brokerage, commission and trading-related expenses	**(3)**	(5)	(4)	*(40)*	*(25)*
Other operating expenses	**(176)**	(181)	(176)	*(3)*	-
Total operating expenses	**(310)**	(317)	(314)	*(2)*	*(1)*
Non-controlling interests[1]	**-**	-	1	-	*(100)*
Net profit contribution	**615**	672	516	*(8)*	*19*
Non-GAAP metrics					
Loan and finance lease portfolio[2] ($A billion)	**25.4**	26.3	28.0	*(3)*	*(9)*
Operating lease portfolio ($A billion)	**9.9**	10.0	10.0	*(1)*	*(1)*
Headcount	**1,259**	1,254	1,342	*<1*	*(6)*

1. "Non-controlling interests" adjusts reported consolidated profit or loss for the share that is attributable to non-controlling interests, such that the net profit contribution represents the net profit attributable to ordinary equity holders.
2. Includes equity portfolio of $A0.4 billion (March 2017: $A0.4 billion, September 2016: $A0.3 billion)

Net profit contribution of $A615 million for the half-year ended 30 September 2017, up 19% on the prior corresponding period:

- Increased income from prepayments, realisations and investment-related income in the Principal Finance portfolio
- Asset Finance portfolio continued to perform well
- Lower charges for provisions and impairments reflecting the partial reversal of collective provisions, driven by net loan repayments, and the improved credit performance of underlying portfolios

Partially offset by:

- Lower interest income as a result of the reduction in the Principal Finance portfolio size

3.3 CAF CONTINUED

Net interest and trading income

Net interest and trading income in CAF predominately relates to net income from the loan and finance lease (including vehicles and equipment financing) portfolios and the funding costs associated with the operating lease portfolios (including aviation, mining and energy assets).

Net interest and trading income of $A330 million for the half-year ended 30 September 2017 decreased 5% from $A346 million in the prior corresponding period.

The decrease was a result of the reduction in the Principal Finance portfolio size, partially offset by increased income from prepayments and realisations.

The loan and finance lease portfolio was $A25.4 billion at 30 September 2017, a decrease of 3% from $A26.3 billion at 31 March 2017. The decrease was mainly in Principal Finance.

Net operating lease income

Net operating lease income of $A465 million for the half-year ended 30 September 2017 was broadly in line with $A467 million in the prior corresponding period. Improved underlying income from the Aviation, Energy and Technology portfolios was offset by foreign exchange movements.

The operating lease portfolio was $A9.9 billion at 30 September 2017, broadly in line with $A10.0 billion at 31 March 2017 with depreciation and sales in the Aviation portfolio partially offset by growth in the Technology and Energy portfolios.

Impairment charge on equity investments, intangibles and other non-financial assets

The impairment charge on equity investments, intangibles and other non-financial assets of $A11 million for the half-year ended 30 September 2017 predominately related to the impairment of a legacy Asset Finance business.

Gain on disposal of operating lease assets

The gain on disposal of operating lease assets of $A6 million for the half-year ended 30 September 2017 predominately related to gains recognised on the sale of three aircraft.

Net gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale

The gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale of $A66 million for the half-year ended 30 September 2017 primarily related to a gain on reclassification of an investment in a UK toll road following an increase in ownership by the Principal Finance business. The prior period result of $A140 million primarily related to a gain realised on the sale of an interest in a toll road in the US by the Principal Finance business.

Provisions for impairment, write-offs and collective allowance for credit losses

Provisions for impairment, write-offs and collective allowance for credit losses was a gain of $A12 million for the half-year ended 30 September 2017. The improvement from the $A44 million provision expense in the prior corresponding period was due to the partial reversal of collective provisions, driven by net loan repayments, and the improved credit performance of underlying portfolios.

Operating expenses

Total operating expenses of $A310 million for the half-year ended 30 September 2017 decreased 1% from $A314 million in the prior corresponding period.

3.4 BFS

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	Mar 17 %	Sep 16 %
Net interest and trading income	**584**	551	498	*6*	*17*
Fee and commission income					
Wealth management fee income	**167**	153	157	*9*	*6*
Banking fee income	**66**	62	70	*6*	*(6)*
Life insurance income	**-**	-	27	-	*(100)*
Total fee and commission income	**233**	215	254	*8*	*(8)*
Share of net profits of associates and joint ventures accounted for using the equity method	**-**	5	1	*(100)*	*(100)*
Other operating income and charges					
Impairment charge on equity investments, intangibles and other non-financial assets	**-**	(7)	(46)	*(100)*	*(100)*
Net gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale	**1**	-	192	*	*(99)*
Provisions for impairment, write-offs and collective allowance for credit losses	**(8)**	(6)	(32)	*33*	*(75)*
Other income	**5**	4	9	*25*	*(44)*
Total other operating income and charges	**(2)**	(9)	123	*(78)*	*
Internal management revenue	**3**	4	1	*(25)*	*200*
Net operating income	**818**	766	877	*7*	*(7)*
Operating expenses					
Employment expenses	**(158)**	(155)	(171)	*2*	*(8)*
Brokerage, commission and trading-related expenses	**(104)**	(103)	(105)	*1*	*(1)*
Technology expenses[1]	**(135)**	(132)	(189)	*2*	*(29)*
Other operating expenses	**(137)**	(125)	(153)	*10*	*(10)*
Total operating expenses	**(534)**	(515)	(618)	*4*	*(14)*
Net profit contribution	**284**	251	259	*13*	*10*
Non-GAAP metrics					
Funds on platform[2] ($A billion)	**78.9**	72.2	62.1	*9*	*27*
Australian loan portfolio[3] ($A billion)	**37.6**	35.8	35.6	*5*	*6*
Legacy loan portfolios[4] ($A billion)	**-**	0.5	0.6	*	*
BFS deposits[5] ($A billion)	**46.4**	44.5	42.2	*4*	*10*
Headcount[6]	**2,075**	1,990	1,952	*4*	*6*

1. Technology expenses include technology staff expenses, depreciation of technology assets, amortisation of capitalised software and maintenance costs.
2. Funds on platform includes Macquarie Wrap and Vision.
3. The Australian loan portfolio comprises residential mortgages, loans to businesses, insurance premium funding and credit cards.
4. The legacy loan portfolios primarily comprise residential mortgages in Canada and the US.
5. BFS Deposits excludes corporate/wholesale deposits.
6. Headcount at 30 September 2016 excludes 97 staff relating to the sale of the Macquarie Life business.

Net profit contribution of $A284 million for the half-year ended 30 September 2017, up 10% from the prior corresponding period:

– Volume growth in loan and deposit portfolios and improved margins
– The non-recurrence of expenses recognised in the prior corresponding period, including impairment charges predominately on certain equity positions and intangible assets and a change in approach to the capitalisation of software expenses in relation to the Core Banking platform

Partially offset by:

– Net overall gain on the disposal of Macquarie Life's risk insurance business to Zurich Australia Limited and the US mortgages portfolio in the prior corresponding period

3.4 BFS CONTINUED

Net interest and trading income

Net interest and trading income of $A584 million for the half-year ended 30 September 2017 increased 17% from $A498 million in the prior corresponding period due to a 3% growth in average Australian loan volumes, an 11% growth in the average deposit portfolio balance and improved margins across Australian mortgages, business lending and BFS deposits, compared to the prior corresponding period.

At 30 September 2017 the Australian loan and deposit portfolios included:

- Australian mortgage volumes of $A29.9 billion, up 4% from $A28.7 billion at 31 March 2017;
- business lending volumes of $A7.1 billion, up 9% from $A6.5 billion at 31 March 2017; and
- BFS deposits of $A46.4 billion, up 4% from $A44.5 billion at 31 March 2017.

The sale of the Canadian mortgages portfolio during the period has resulted in no remaining legacy loan portfolio at 30 September 2017 ($A0.5 billion at 31 March 2017).

Wealth management fee income

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

Wealth management fee income of $A167 million for the half-year ended 30 September 2017 increased 6% from $A157 million in the prior corresponding period mainly due to increased platform commissions from higher funds on the Wrap and Vision platforms. Advice fees remained broadly in line.

Funds on platform closed at $A78.9 billion at 30 September 2017, an increase of 9% from $A72.2 billion at 31 March 2017 largely due to the successful migration of full service broking accounts onto the Vision platform.

Banking fee income

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

Banking fee income of $A66 million for the half-year ended 30 September 2017 decreased 6% from $A70 million in the prior corresponding period.

Life insurance income

Macquarie Life's risk insurance business was sold to Zurich Australia Limited in September 2016.

Impairment charge on equity investments, intangibles and other non-financial assets

The impairment charge on equity investments, intangibles and other non-financial assets of $A46 million in the prior corresponding period related to the underperformance of certain equity positions and impairments of intangibles relating to the Core Banking platform. There were no impairment charges for the half-year ended 30 September 2017.

Gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale

The gain on acquiring, disposing, reclassification and change in ownership interests of investments, subsidiaries and businesses held for sale of $A1 million for the half-year ended 30 September 2017 decreased from $A192 million in the prior corresponding period, which included the sale of Macquarie Life's risk insurance business to Zurich Australia Limited, partially offset by losses on the sale of the US mortgages portfolio. There were no significant items in the current period.

Provisions for impairment, write-offs and collective allowance for credit losses

Provisions for impairment, write-offs and collective allowance for credit losses of $A8 million for the half-year ended 30 September 2017 decreased 75% from $A32 million in the prior corresponding period, which included higher business lending provisions on a small number of loans.

Operating expenses

Total operating expenses of $A534 million for the half-year ended 30 September 2017 decreased 14% from $A618 million in the prior corresponding period.

Employment expenses of $A158 million for the half-year ended 30 September 2017 decreased 8% from $A171 million in the prior corresponding period driven by lower average headcount from the realisation of efficiencies and the sale of Macquarie Life's risk insurance business.

Brokerage, commission and trading-related expenses of $A104 million for the half-year ended 30 September 2017 were broadly in line with the prior corresponding period.

Technology expenses of $A135 million for the half-year ended 30 September 2017 decreased 29% from $A189 million in the prior corresponding period. The prior corresponding period included elevated project activity and a change in approach to the capitalisation of software expenses in relation to the Core Banking platform.

Other operating expenses of $A137 million for the half-year ended 30 September 2017 decreased 10% from $A153 million in the prior corresponding period driven by lower professional fees and occupancy costs.

3.5 CGM

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Net interest and trading income					
Commodities	**388**	619	503	*(37)*	*(23)*
Credit, interest rates and foreign exchange	**270**	324	247	*(17)*	*9*
Equities	**164**	124	165	*32*	*(1)*
Net interest and trading income	**822**	1,067	915	*(23)*	*(10)*
Fee and commission income					
Brokerage and commissions	**142**	137	137	*4*	*4*
Other fee and commission income	**40**	32	33	*25*	*21*
Total fee and commission income	**182**	169	170	*8*	*7*
Share of net profits/(losses) of associates and joint ventures accounted for using the equity method	**8**	10	(10)	*(20)*	***
Other operating income and charges					
Net gains on sale of equity and debt investments	**12**	16	104	*(25)*	*(88)*
Impairment charge on equity investments, intangibles and other non-financial assets	**(11)**	(8)	(11)	*38*	-
Provisions for impairment and collective allowance for credit losses	**(45)**	(97)	(41)	*(54)*	*10*
Other income	**3**	13	15	*(77)*	*(80)*
Total other operating income and charges	**(41)**	(76)	67	*(46)*	***
Internal management revenue	**5**	5	6	-	*(17)*
Net operating income	**976**	1,175	1,148	*(17)*	*(15)*
Operating expenses					
Employment expenses	**(140)**	(142)	(153)	*(1)*	*(8)*
Brokerage, commission and trading-related expenses	**(169)**	(195)	(184)	*(13)*	*(8)*
Other operating expenses	**(348)**	(382)	(391)	*(9)*	*(11)*
Total operating expenses	**(657)**	(719)	(728)	*(9)*	*(10)*
Non-controlling interests[1]	**-**	-	(1)	-	*(100)*
Net profit contribution	**319**	456	419	*(30)*	*(24)*
Non-GAAP metrics					
Headcount	**936**	908	927	*3*	*1*

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

Net profit contribution of $A319 million for the half-year ended 30 September 2017, down 24% from the prior corresponding period:
- Reduced income from the sale of investments, mainly in energy and related sectors
- Lower volatility across the commodities platform resulting in reduced client activity and trading opportunities

Partially offset by:
- Strong client flows and revenues from interest rates and foreign exchange
- Lower operating expenses reflecting reduced commodity-related trading activity, reduced average headcount and associated activity, and realisation of benefits from cost synergies following the merger of CFM and MSG

3.5 CGM CONTINUED

Commodities net interest and trading income

Net interest and trading income from commodity related activities is generated from the provision of hedging and risk management services and loans and working capital finance to clients across a range of commodity sectors including base and precious metals, energy and agriculture. CGM also enters into a number of tolling agreements, storage contracts and transportation agreements in order to facilitate client flow transactions as part of its commodities platform. These arrangements provide CGM with the ability to maximise opportunities where there is dislocation between the supply and demand for energy. Tolling agreements, storage contracts and transportation agreements, which are managed on a fair value basis for financial and risk management purposes, are required to be accounted for on an accruals basis for statutory reporting purposes, which may result in some volatility with timing of reported income.

Net interest and trading income from commodities $A388 million for the half-year ended 30 September 2017 decreased 23% from $A503 million in the prior corresponding period. The current period included mixed results across the platform. Volatility was lower in comparison to the prior corresponding period which impacted client hedging activity and trading results across Global Oil, North American Gas and Metals. These results were offset by stronger results in North American Power, Bulk Commodities, Investor Products and Agriculture. Commodities was also impacted by a reduction in income from residual Metals, Energy Capital and other legacy portfolios that are being wound down.

Credit, interest rates and foreign exchange net interest and trading income

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

Net interest and trading income from credit, interest rates and foreign exchange products of $A270 million for the half-year ended 30 September 2017 increased 9% from $A247 million in the prior corresponding period. Increased income in the current half-year was underpinned by strong contributions from foreign exchange and interest rates markets in Japan, EMEA and North Americas. Credit remains subdued.

Equities net interest and trading income

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

Equities net interest and trading income of $A164 million for the half-year ended 30 September 2017 was in line with the prior corresponding period.

Fee and commission income

Fee and commission income of $A182 million for the half-year ended 30 September 2017 increased 7% from $A170 million in the prior corresponding period. The increase was mainly in fee and commission income from commodity related activities.

Net gains on sale of equity and debt investments

Net gains on sale of equity and debt investments of $A12 million for the half-year ended 30 September 2017 decreased 88% from $A104 million in the prior corresponding period, which included gains on the sale of a number of investments, in energy and related sectors.

Impairment charge on equity investments, intangibles and other non-financial assets

The impairment charge on equity investments, intangibles and other non-financial assets of $A11 million for the half-year ended is in line with the prior corresponding period. Impairments in the current half-year relate to certain metals and mining positions.

Provisions for impairment and collective allowance for credit losses

Provisions for impairment and collective allowance for credit losses of $A45 million for the half-year ended 30 September 2017 increased 10% from $A41 million in the prior corresponding period with further write downs recognised on previously impaired underperforming commodity-related loans.

Operating expenses

Total operating expenses of $A657 million for the half-year ended 30 September 2017 decreased 10% from $A728 million in the prior corresponding period.

Employment expenses of $A140 million for the half-year ended 30 September 2017 decreased 8% from $A153 million in the prior corresponding period mainly due to lower average headcount.

Brokerage, commission and trading-related expenses include fees paid in relation to trading-related activities. Brokerage, commission and trading-related expenses of $A169 million for the half-year ended 30 September 2017 decreased 8% from $A184 million in the prior corresponding period mainly due to reduced commodities-related trading activity.

Other operating expenses of $A348 million for the half-year ended 30 September 2017 decreased 11% from $A391 million in the prior corresponding period, reflecting realisation of benefits from cost synergies following the merger of CFM and MSG.

3.6 CORPORATE

	HALF-YEAR TO			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Net interest and trading income	**41**	5	3	*	*
Fee and commission expense	**(32)**	(4)	(107)	*	*(70)*
Net operating lease income	**3**	1	4	*200*	*(25)*
Share of net losses of associates and joint ventures accounted for using the equity method	**1**	(8)	(17)	*	*
Other operating income and charges					
Net gains on sale and reclassification of debt and equity securities	**(4)**	2	46	*	*
Impairment (charge)/write back on investments, intangibles and other non-financial assets, and provisions for impairment and collective allowance for credit losses	**(5)**	9	13	*	*
Other income and charges	**(13)**	(14)	(10)	*(7)*	*30*
Total other operating income and charges	**(22)**	(3)	49	*	*
Internal management charge	**(9)**	(47)	(10)	*(81)*	*(10)*
Net operating income	**(18)**	(56)	(78)	*(68)*	*(77)*
Operating expenses					
Employment expenses	**(320)**	(270)	(304)	*19*	*5*
Brokerage, commission and trading-related expenses	**(1)**	(1)	(2)	-	*(50)*
Other operating expenses	**(94)**	(165)	(18)	*(43)*	*
Total operating expenses	**(415)**	(436)	(324)	*(5)*	*28*
Income tax expense	**(207)**	(254)	(255)	*(19)*	*(19)*
Macquarie Income Securities	**(7)**	(7)	(8)	-	*(13)*
Non-controlling interests[1]	**3**	5	7	*(40)*	*(57)*
Net loss contribution	**(644)**	(748)	(658)	*(14)*	*(2)*
Non-GAAP metrics					
Headcount	**26**	31	41	*(16)*	*(37)*

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

The Corporate segment comprises head office and central service groups, including Group Treasury, certain legacy investments, assets and businesses that are no longer core for strategic reasons and costs that are not allocated to Operating Groups, including performance-related profit share and share-based payments expense, and income tax expense.

3.6 CORPORATE CONTINUED

Net interest and trading income

Net interest and trading income in the Corporate segment includes the net result of managing liquidity and funding for the Consolidated Entity, earnings on capital, funding costs associated with non-core investments held centrally and accounting volatility arising from movements in underlying rates relating to economically hedged positions where designated hedge accounting is unable to be achieved for accounting purposes.

Net interest and trading income of $A41 million for the half-year ended 30 September 2017 increased substantially from $A3 million in the prior corresponding period primarily due to the impact of accounting volatility on economically hedged positions that do not qualify for hedge accounting.

Fee and commission expense

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

Fee and commission expense of $A32 million for the half-year ended 30 September 2017 decreased from $A107 million in the prior corresponding period. This was primarily due to a decrease in the recovery of costs charged to the Consolidated Entity from the Non-Bank Group and is partially offset in Other operating expenses.

Share of net losses of associates and joint ventures accounted for using the equity method

Share of net gains of associates and joint ventures of $A1 million for the half-year ended 30 September 2017 increased from a net loss of $A17 million in the prior corresponding period. The movement reflects the reclassification of non-core assets to investments held for sale.

Net gains on sale and reclassification of debt and equity securities

Net losses on sale and reclassification of debt and equity securities were $A4 million for the half-year ended 30 September 2017, decreased from net gains of $A46 million in the prior corresponding period. The gain in the prior corresponding period resulted from the disposal of legacy assets and a number of investments held for the purposes of managing the Group's liquidity.

Impairment (charge)/write back on investments, intangibles and other non-financial assets, and provisions for impairment and collective allowance for credit losses

Impairment charges on investments, intangibles and other non-financial assets, and provisions for impairment and collective allowance for credit losses was $A5 million for the half-year ended 30 September 2017, compared to net gains of $A13 million in the prior corresponding period. The current period includes impairment recognised upon disposal of a held for sale asset. The prior corresponding period reflects changes in the underlying performance of central investments, which include certain legacy and other non-core assets.

Employment expenses

Employment expenses in the Corporate segment relate to employment costs associated with the Consolidated Entity's Central Service Groups including COG, FMG, RMG, Legal and Governance, and Central Executive, as well as performance-related profit share and share-based payments expense for the Consolidated Entity and the impact of fair value adjustments to Directors' Profit Share liabilities.

Employment expenses of $A320 million for the half-year ended 30 September 2017 increased 5% from $A304 million in the prior corresponding period. This was primarily due to higher performance-related profit share expense, largely driven by the improved overall performance of the operating groups.

Other operating expenses

Other operating expenses in the Corporate segment include operating costs of central support functions, offset by the recovery of central support function costs from the operating groups including transactions between the Bank and Non-Bank Group.

Other operating expenses of $A94 million for the half-year ended 30 September 2017 increased from $A18 million in the prior corresponding period. This primarily reflected increased fees for services provided by entities outside of the Consolidated Entity and is partially offset in Fee and Commission expense.

BALANCE SHEET

4

4.1 STATEMENT OF FINANCIAL POSITION

	AS AT			MOVEMENT	
	Sep 17 $Am	Mar 17 $Am	Sep 16 $Am	*Mar 17 %*	*Sep 16 %*
Assets					
Receivables from financial institutions	**38,360**	25,565	30,679	*50*	*25*
Trading portfolio assets	**18,179**	26,637	27,029	*(32)*	*(33)*
Derivative assets	**12,161**	12,067	15,211	*1*	*(20)*
Investment securities available for sale	**3,909**	5,182	5,314	*(25)*	*(26)*
Other assets	**9,335**	8,646	8,102	*8*	*15*
Loan assets held at amortised cost	**75,833**	75,550	76,672	*<1*	*(1)*
Other financial assets at fair value through profit or loss	**692**	760	768	*(9)*	*(10)*
Due from related body corporate entities	**1,075**	1,733	1,544	*(38)*	*(30)*
Property, plant and equipment	**10,673**	10,743	10,735	*(1)*	*(1)*
Interests in associates and joint ventures accounted for using the equity method	**579**	203	243	*185*	*138*
Intangible assets	**242**	193	189	*25*	*28*
Deferred tax assets	**179**	162	155	*10*	*15*
Total assets	**171,217**	167,441	176,641	*2*	*(3)*
Liabilities					
Trading portfolio liabilities	**7,209**	4,922	5,051	*46*	*43*
Derivative liabilities	**10,663**	11,101	12,908	*(4)*	*(17)*
Deposits	**58,987**	57,682	55,433	*2*	*6*
Other liabilities	**9,211**	9,375	7,576	*(2)*	*22*
Payables to financial institutions	**15,341**	14,236	20,826	*8*	*(26)*
Due from related body corporate entities	**5,101**	7,367	6,600	*(31)*	*(23)*
Debt issued at amortised cost	**45,648**	43,137	48,978	*6*	*(7)*
Other financial liabilities at fair value through profit or loss	**1,789**	1,934	2,591	*(7)*	*(31)*
Deferred tax liabilities	**461**	484	372	*(5)*	*24*
Total liabilities excluding loan capital	**154,410**	150,238	160,335	*3*	*(4)*
Loan capital	**4,246**	4,615	3,811	*(8)*	*11*
Total liabilities	**158,656**	154,853	164,146	*2*	*(3)*
Net assets	**12,561**	12,588	12,495	*(<1)*	*1*
Equity					
Contributed equity	**9,915**	9,911	9,891	*<1*	*<1*
Reserves	**312**	373	330	*(16)*	*(5)*
Retained earnings	**2,329**	2,296	2,270	*1*	*3*
Total capital and reserves attributable to ordinary equity holders of Macquarie Bank Limited	**12,556**	12,580	12,491	*(<1)*	*1*
Non-controlling interests	**5**	8	4	*(38)*	*25*
Total equity	**12,561**	12,588	12,495	*(<1)*	*1*

4.1 STATEMENT OF FINANCIAL POSITION CONTINUED

The Consolidated Entity's balance sheet has been impacted by changes in business activities and Treasury management initiatives during the half-year ended 30 September 2017.

Assets

Total assets of $A171.2 billion at 30 September 2017 increased 2% from $A167.4 billion at 31 March 2017 mainly due to an increase in Receivables from financial institutions, Other assets and Interests in associates and joint ventures accounted for using the equity method. These increases were partially offset by decreases in Trading portfolio assets and Investment securities available for sale.

- Receivables from financial institutions of $A38.4 billion at 30 September 2017 increased 50% from $A25.6 billion at 31 March 2017 mainly due to an increase in reverse repurchase and stock borrowing activity in CGM, and Treasury's funding and liquidity management activities during the half-year ended 30 September 2017
- Other assets of $A9.3 billion at 30 September 2017 increased 8% from $8.6 billion at 31 March 2017 mainly due to an increase in unsettled trade balances in CGM, partially offset by the sale of the Canadian mortgages portfolio in BFS
- Interests in associates and joint ventures accounted for using the equity method of $A0.6 billion increased 185% from $A0.2 billion at 31 March 2017 mainly due to a reclassification of an investment in CAF from Available for sale to Associates
- Trading portfolio assets of $A18.2 billion at 30 September 2017 decreased 32% from $A26.6 billion at 31 March 2017 mainly due to a decline in long equity positions and a reduction in the holdings of physical commodities, particularly metals
- Investment securities available for sale of $A3.9 billion at 30 September 2017 decreased 25% from $A5.2 billion at 31 March 2017 mainly due to Treasury's liquidity management activities and the reclassification of the investment in CAF from Available for sale to Associates
- Loan assets held at amortised cost of $A75.8 billion at 30 September 2017 slightly increased from $A75.6 billion at 31 March 2017 mainly due to net new loans written in BFS' mortgages and business lending portfolios, partially offset by a reduction in volumes in:
  - CGM's short and long term lending in structured commodity finance and reduced positions held with exchanges and clearing institutions; and
  - CAF's loan and finance lease portfolio decreasing 3% to $A25.4 billion at 30 September 2017 from $A26.3 billion at 31 March 2017 primarily due to repayments in corporate lending deals.

Liabilities

Total liabilities of $A154.4 billion at 30 September 2017 increased 3% from $A150.2 billion at 31 March 2017 mainly driven by an increase in Debt Issued at amortised cost, Trading portfolio liabilities, Deposits and Payables to financial institutions. These increases were partially offset by a decrease in Loan capital.

- Debt issued at amortised cost of $A45.6 billion at 30 September 2017 increased 6% from $A43.1 billion at 31 March 2017, mainly driven by Treasury's funding and liquidity management activities which included new commercial paper issuances, partially offset by the repayment of long-term debt
- Trading portfolio liabilities of $A7.2 billion at 30 September 2017 increased 46% from $A4.9billion at 31 March 2017 mainly due to an increase in certain equities-related trading activities and the revaluation of hedge positions
- Payables to financial institutions of $A15.3 billion at 30 September 2017 increased 8% from $A14.2 billion at 31 March 2017 mainly due to an increase in stock lending activity, partially offset by repayment of funding facilities
- Deposits of $A59.0 billion at 30 September 2017 increased 2% from $A57.7 billion at 31 March 2017 mainly due to an increase in retail cash management deposits in BFS
- Loan capital of $A4.2 billion decreased 8% from $A4.6 billion mainly due to the redemption of Exchangeable Capital Securities notes during the period.

Equity

Total equity remained broadly in line with 31 March 2017. The payment of the 2017 final dividend of $A0.6 billion was offset by the profit of the half-year ended 30 September 2017.

4.2 LOAN ASSETS

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

	AS AT			MOVEMENT	
	Sep 17 $Ab	Mar 17 $Ab	Sep 16 $Ab	*Mar 17 %*	*Sep 16 %*
Loan assets at amortised cost per the statement of financial position	**75.8**	75.6	76.7	*<1*	*(1)*
Other loans held at fair value[1]	**0.1**	0.2	0.1	*(50)*	-
Operating lease assets	**9.9**	10.0	9.9	*(1)*	-
Other reclassifications[2]	**1.2**	1.1	1.6	*9*	*(25)*
Less: loans held by consolidated SPEs which are available as security to noteholders and debt providers[3]	**(11.4)**	(13.4)	(14.7)	*(15)*	*(22)*
Less: segregated funds[4]	**(5.2)**	(4.6)	(5.0)	*13*	*4*
Less: margin balances (reclassed to trading)[5]	**(1.4)**	(2.7)	(1.7)	*(48)*	*(18)*
Total loan assets including operating lease assets per the funded balance sheet[6]	**69.0**	66.2	66.9	*4*	*3*

1. Excludes other loans held at fair value that are self-funded.
2. Reclassification between loan assets and other funded balance sheet categories.
3. Excludes notes held by Macquarie Bank in consolidated Special Purpose Entities (SPE).
4. These represent the assets and liabilities that are recognised where Macquarie Bank holds segregated client monies. The client monies will be matched by assets held to the same amount and hence does not require funding.
5. For the purposes of the funded balance sheet, margin balances are treated as trading assets rather than loan assets.
6. Total loan assets including operating lease assets per the funded balance sheet includes self-securitised assets.

4.2 LOAN ASSETS CONTINUED

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

	Notes	AS AT Sep 17 $Ab	Mar 17 $Ab	Sep 16 $Ab	MOVEMENT Mar 17 %	Sep 16 %
CAF						
Asset Finance:	1					
Finance lease assets		**13.4**	12.0	13.1	*12*	*2*
Operating lease assets		**9.9**	10.0	9.9	*(1)*	-
Total Asset Finance		**23.3**	22.0	23.0	*6*	*1*
Principal Finance	2	**5.7**	6.5	8.0	*(12)*	*(29)*
Total CAF		**29.0**	28.5	31.0	*2*	*(6)*
BFS						
Retail Mortgages:	3					
Australia[2]		**25.4**	23.0	22.0	*10*	*15*
Canada, US and Other		**-**	0.5	0.6	*(100)*	*(100)*
Total Retail Mortgages		**25.4**	23.5	22.6	*8*	*12*
Business banking[2]	4	**7.7**	7.1	6.9	*8*	*12*
Total BFS		**33.1**	30.6	29.5	*8*	*12*
CGM						
Resources and commodities	5	**2.6**	2.5	2.4	*4*	*8*
Other	6	**2.1**	2.6	2.7	*(19)*	*(22)*
Total CGM		**4.7**	5.1	5.1	*(8)*	*(8)*
MAM						
Structured investments	7	**2.2**	2.0	1.3	*10*	*69*
Total		**69.0**	66.2	66.9	*4*	*3*

1. Total loan assets including operating lease assets per the funded balance sheet includes self-securitised assets.
2. Securitised business banking portfolio with underlying residential mortgages was included in Retail Mortgages: Australia and has been reclassed to business banking and restated accordingly in September 2016 and March 2017.

4.2 LOAN ASSETS CONTINUED

Explanatory notes concerning asset security of funded loan asset portfolio

1. Asset Finance

Secured by underlying financed assets.

2. Principal Finance

Diversified corporate and real estate lending portfolio, predominately consisting of loans which are senior, secured, well covenanted and with a hold to maturity horizon.

3. Retail Mortgages

Secured by residential property and predominately supported by mortgage insurance.

4. Business banking

Secured relationship managed loan portfolio to professional and financial services firms, real estate industry clients, insurance premium funding, mortgages to business banking clients and other small business clients. Secured largely by real estate, working capital, business cash flows and credit insurance. The portfolio also includes other retail lending including credit cards.

5. Resources and commodities

Diversified loan portfolio primarily to the resources sector that are secured by the underlying assets.

6. CGM Other

Predominately relates to recourse loans to financial institutions, as well as financing for real estate and other sectors.

7. Structured investments

Loans to retail and wholesale counterparties that are secured against equities, investment funds or cash, or are protected by capital guarantees at maturity.

4.3 EQUITY INVESTMENTS

Equity investments are reported in the following categories in the statement of financial position:
- other financial assets at fair value through profit or loss;
- investment securities available for sale;
- interests in associates and joint ventures; and
- other assets.

Equity investments reconciliation

	AS AT			MOVEMENT	
	Sep 17 $Ab	Mar 17 $Ab	Sep 16 $Ab	*Mar 17 %*	*Sep 16 %*
Equity investments					
Statement of financial position					
Equity investments within other financial assets at fair value through profit or loss	**0.3**	0.4	0.4	*25*	*25*
Equity investments within investment securities available for sale	**0.2**	0.6	0.4	*(67)*	*(50)*
Interests in associates and joint ventures accounted for using the equity method	**0.6**	0.2	0.2	*200*	*200*
Held for sale equity investments within other assets	**–**	–	0.2	–	*(100)*
Total equity investments per statement of financial position	**1.1**	1.2	1.2	*(8)*	*(8)*
Adjustment for funded balance sheet					
Equity hedge positions[1]	**(0.3)**	(0.4)	(0.4)	*(25)*	*(25)*
Total funded equity investments	**0.8**	0.8	0.8	–	–
Adjustments for equity investments analysis					
Available for sale and associates' reserves[2]	**(0.1)**	(0.1)	(0.1)	–	–
Total adjusted equity investments[3]	**0.7**	0.7	0.7	–	–

1. These relate to assets held for the purposes of economically hedging Macquarie Bank's fair valued liabilities to external parties arising from various equity linked instruments. Consequently, these have been excluded from the analysis of equity investment exposures.
2. Available for sale reserve on equity investments (gross of tax) that will be released to income upon realisation of the investment, excluding investments in which Macquarie Bank has no economic exposure; Associates' reserves (gross of tax) that will be released to income upon realisation of the investment.
3. The adjusted book value represents the total net exposure to Macquarie Bank.

FUNDING AND LIQUIDITY

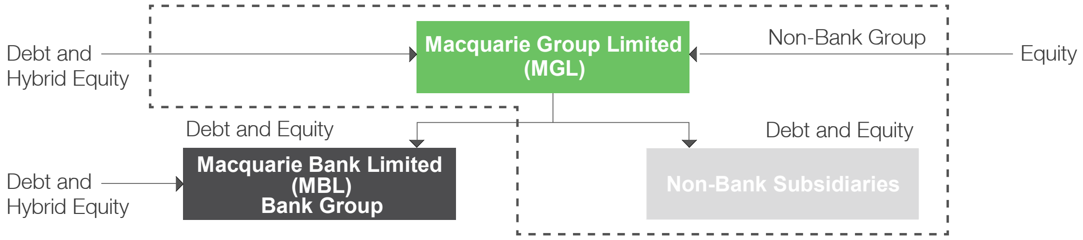
5

5.1 LIQUIDITY RISK GOVERNANCE AND MANAGEMENT FRAMEWORK

Governance and oversight

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

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



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

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

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

Liquidity policy and risk appetite

Macquarie Group maintains two key liquidity policies:

– The MGL liquidity policy: applies to all Macquarie Group entities except the Bank Group.
– The MBL liquidity policy: applies to the Bank Group.

The principles of the MGL and MBL liquidity policies are consistent and together represent a consolidated view of Macquarie Group. In some cases, certain entities within Macquarie Group may also be required to have a standalone liquidity policy. In these cases, the principles applied within the entity specific liquidity policies are consistent with those applied in the broader Macquarie Group-wide policy.

Macquarie Group establishes a liquidity risk appetite for both MGL and MBL, which are defined within each of the respective liquidity policies. Each risk appetite is approved by the respective Board and represents an articulation of the nature and level of liquidity risk that is acceptable in the context of achieving Macquarie Group's strategic objectives.

Macquarie Bank Limited

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

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

5.1 LIQUIDITY RISK GOVERNANCE AND MANAGEMENT FRAMEWORK CONTINUED

Liquidity risk tolerance and principles

Macquarie Group's liquidity risk appetite is supported by a number of risk tolerances and principles applied to managing liquidity risk in both MGL and MBL.

Risk tolerances

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

Liquidity management principles

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

Liquidity contingency plan

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

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

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

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

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

Funding strategy

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

5.2 MANAGEMENT OF LIQUIDITY RISK

Scenario analysis

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

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

The scenarios separately consider the requirements of the Bank Group, the Non-Bank Group and the Consolidated Entity. They are run over a number of timeframes and a range of conservative assumptions are used regarding the level of access to capital markets, deposit outflows, contingent funding requirements and asset sales.

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

Liquid asset holdings

Group Treasury centrally maintains a portfolio of highly liquid unencumbered assets in the Consolidated Entity to ensure adequate liquidity is available in all funding environments, including worst case wholesale and retail market conditions. The minimum level of cash and liquid assets is calculated with reference to internal scenario projections and minimum regulatory requirements.

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

The cash and liquid asset portfolio is held in a range of currencies to ensure Macquarie Group's liquidity requirements are broadly matched by currency. Certain other business units also hold cash and liquid assets as part of their operations. The Bank Group had $A22.8 billion of cash and liquid assets as at 30 September 2017 (31 March 2017: $A20.0 billion).

Funds transfer pricing

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

5.2 MANAGEMENT OF LIQUIDITY RISK CONTINUED

Credit ratings[1] at 30 September 2017 are detailed below.

	Macquarie Bank Limited		
	Short term rating	Long term rating	Outlook
Moody's Investors Service	P-1	A2	Stable
Standard and Poor's[2]	A-1	A	Negative
Fitch Ratings	F-1	A	Stable

1. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by an assigning rating agency and any rating should be evaluated independently of any other information.
2. Standard and Poor's does not place outlook statements on short-term ratings.

Regulatory developments

The Australian Prudential Regulation Authority's (APRA) liquidity standard (APS210) details the local implementation of the Basel III liquidity framework for Australian banks. The current standard incorporates the Liquidity Coverage Ratio (LCR) as well as a range of additional qualitative requirements. APRA have also finalised a revised APS210 which incorporates the Net Stable Funding Ratio (NSFR) rules and will come into effect from 1 January 2018.

As the regulated ADI in the Consolidated Entity, the LCR and associated regulatory requirements apply specifically to Macquarie Bank.

Liquidity coverage ratio

The LCR requires sufficient levels of unencumbered HQLA to be held to meet expected net cash outflows under a combined 'idiosyncratic' and market-wide stress scenario lasting 30 calendar days. In Australia, HQLA includes cash, balances held with the RBA, Commonwealth Government and semi-government securities, as well as any CLF allocation. The LCR determines Macquarie Bank's regulatory minimum required level of liquid assets.

Macquarie Bank's 3-month average LCR to 30 September 2017 was 153% (average based on daily observations). For a detailed breakdown of Macquarie Bank's LCR, please refer to Macquarie Group's regulatory disclosures (available on Macquarie Group's website).

Net stable funding ratio

NSFR is a 12-month structural funding metric, requiring that 'available stable funding' be sufficient to cover 'required stable funding', where 'stable' funding has an actual or assumed maturity of greater than twelve months. The NSFR will become a regulatory requirement on 1 January, 2018. Macquarie Bank's NSFR at 30 September 2017 was 109%.

5.3 FUNDED BALANCE SHEET

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

The table below reconciles the reported assets of the Bank Group to the net funded assets as at 30 September 2017.

		AS AT		
	Notes	**Sep 17 $Ab**	Mar 17 $Ab	Sep 16 $Ab
Total assets per the Bank Group's statement of financial position		**171.2**	167.4	176.6
Accounting deductions:				
Self-funded trading assets	1	**(19.8)**	(14.4)	(20.3)
Derivative revaluation accounting gross-ups	2	**(10.4)**	(10.6)	(12.5)
Life investment contracts and other segregated assets	3	**(9.0)**	(9.6)	(9.4)
Outstanding trade settlement balances	4	**(4.3)**	(3.4)	(2.8)
Short term working capital assets	5	**(3.5)**	(4.0)	(4.3)
Intercompany gross ups		**(5.0)**	(7.3)	(6.5)
Non-recourse funded assets:				
Securitised assets and other non-recourse funding	6	**(11.3)**	(13.5)	(13.7)
Net funded assets		**107.9**	104.6	107.1

Explanatory notes concerning net funded assets

1. Self-funded trading assets

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

2. Derivative revaluation accounting gross-ups

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

3. Life investment contracts and other segregated assets

These represent the assets and liabilities that are recognised where the Bank Group provides products such as investment-linked policy contracts or where the Bank Group holds segregated client monies. The policy (contract) liability and client monies will be matched by assets held to the same amount and hence do not require funding.

4. Outstanding trade settlement balances

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

5. Short term working capital assets

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

6. Securitised assets and other non-recourse funding

These represent assets that are funded by third parties with no recourse to the Bank Group including lending assets (mortgages and leasing) sold down into external securitisation entities.

5.4 FUNDING PROFILE

Funded balance sheet

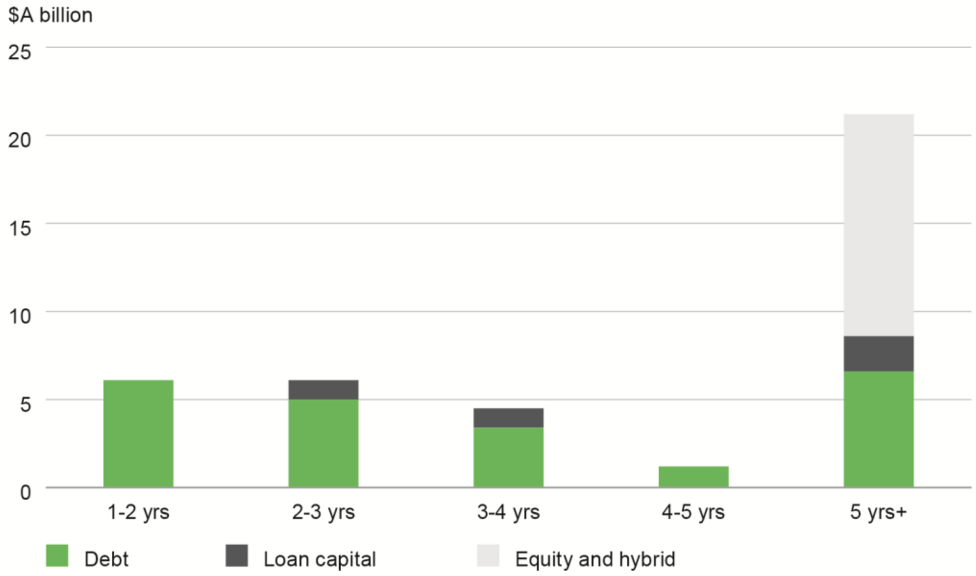
	Notes	AS AT Sep 17 $Ab	Mar 17 $Ab	Sep 16 $Ab
Funding sources				
Wholesale issued paper:	1			
Certificates of deposit		**0.8**	0.9	0.5
Commercial paper		**11.6**	5.7	6.8
Net trade creditors	2	**1.2**	1.6	0.5
Structured notes	3	**2.1**	2.6	3.3
Secured funding	4	**4.0**	4.4	4.6
Bonds	5	**20.9**	21.7	26.1
Other loans	6	**0.4**	0.3	0.4
Syndicated loan facilities	7	**0.7**	2.4	2.5
Customer deposits	8	**49.4**	47.8	46.1
Loan capital	9	**4.2**	4.6	3.8
Equity and hybrid	10	**12.6**	12.6	12.5
Total		**107.9**	104.6	107.1
Funded assets				
Cash and liquid assets	11	**22.8**	20.0	18.7
Self-securitisation	12	**16.7**	16.5	15.4
Net trading assets	13	**17.4**	21.8	23.3
Loan assets including operating lease assets less than one year	14	**13.3**	13.6	14.4
Loan assets including operating lease assets greater than one year	14	**39.0**	36.1	37.1
Debt investment securities	15	**1.4**	1.9	2.0
Non-Bank Group deposit with MBL		**(4.2)**	(6.7)	(5.2)
Co-investment in Macquarie-managed funds and other equity investments	16	**0.8**	0.8	0.8
Property, plant and equipment and intangibles		**0.7**	0.6	0.6
Total		**107.9**	104.6	107.1

See Section 5.5 for notes 1–16.

5.4 FUNDING PROFILE CONTINUED

Term funding profile

Detail of drawn term funding maturing beyond one year



	AS AT SEP 17					
	1-2yrs $Ab	2-3yrs $Ab	3-4yrs $Ab	4-5yrs $Ab	5yrs+ $Ab	**Total $Ab**
Structured notes[1]	-	0.1	0.1	-	1.6	**1.8**
Secured funding	0.3	0.2	0.9	0.2	1.6	**3.2**
Bonds	5.8	4.7	1.7	1.0	3.4	**16.6**
Syndicated loan facilities	-	-	0.7	-	-	**0.7**
Total debt	**6.1**	**5.0**	**3.4**	**1.2**	**6.6**	**22.3**
Loan capital[2]	-	1.1	1.1	-	2.0	**4.2**
Equity and hybrid	-	-	-	-	12.6	**12.6**
Total funding sources drawn	**6.1**	**6.1**	**4.5**	**1.2**	**21.2**	**39.1**
Undrawn	-	-	-	-	-	**-**
Total funding sources drawn and undrawn	**6.1**	**6.1**	**4.5**	**1.2**	**21.2**	**39.1**

1. Structured notes are profiled using a behavioural maturity profile.
2. Included in this balance are securities with conditional repayment obligations. These securities are disclosed using the earlier repricing dates instead of contractual maturity.

Macquarie Bank has diversity of funding by both source and maturity. The weighted average term to maturity of term funding maturing beyond one year (excluding equity which is a permanent source of funding) was 4.2 years at 30 September 2017.

As at 30 September 2017, customer deposits represented $A49.4 billion, or 46% of the Bank Group's total funding, short term (maturing in less than 12 months) wholesale issued paper represented $A12.4 billion, or 12% of total funding, and other debt funding maturing within 12 months represented $A7.0 billion, or 6% of total funding.

5.4 FUNDING PROFILE CONTINUED

Term funding initiatives

Macquarie Bank has a liability driven approach to balance sheet management, where funding is raised prior to assets being taken on to the balance sheet. Since 1 April 2017, the Bank Group has continued to raise term wholesale funding across various products and currencies.

Details of term funding raised between 1 April 2017 and 30 September 2017:

		Bank Group $Ab
Secured Funding	– Term securitisation and other secured finance	2.2
Issued paper	– Senior and subordinated	1.9
Loan facilities	– MGL and MBL loan facilities	-
Total		**4.1**

The Bank Group has continued to develop its major funding markets and products during the half year ended 30 September 2017.

From 1 April 2017 to 30 September 2017, the Bank Group raised $A4.1 billion of term funding including:

- $A2.2 billion of term secured finance comprising of $A1.2 billion of SMART auto and equipment ABS and $A1.0 billion of PUMA RMBS.
- $A1.9 billion of term wholesale issued paper comprising of $A1.9 billion in private placements.

5.4 FUNDING PROFILE CONTINUED

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

- $US25 billion Regulation S Debt Instrument Program, including Euro Commercial Paper, Euro Certificate of Deposit, Euro-Medium Term Notes, senior and subordinated fixed/floating rate notes, and Transferable Deposits. The Debt Instrument Program had $US8.9 billion debt securities outstanding at 30 September 2017;
- $US10 billion Commercial Paper Program under which $US8.9 billion of debt securities were outstanding at 30 September 2017;
- $US20 billion US Rule 144A/Regulation S Medium Term Note Program under which $US10.1 billion of issuances were outstanding at 30 September 2017;
- $US5 billion Structured Note Program under which $US1.7 billion of funding from structured notes was outstanding at 30 September 2017;
- £0.4 billion Sterling Facility under which £0.4 billion was outstanding at 30 September 2017;
- $A5 billion Covered Bond Programme under which $A0.7 billion of debt securities were outstanding at 30 September 2017; and
- $US1.5 billion AWAS term loan under which $US1.5 billion of secured funding was outstanding at 30 September 2017.

Macquarie Bank accesses the Australian capital markets through the issuance of Negotiable Certificates of Deposit. At 30 September 2017, Macquarie Bank had $A0.8 billion of these securities outstanding.

At 30 September 2017, Macquarie Bank had internally securitised $A16.7 billion of its own mortgages.

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

Deposit strategy

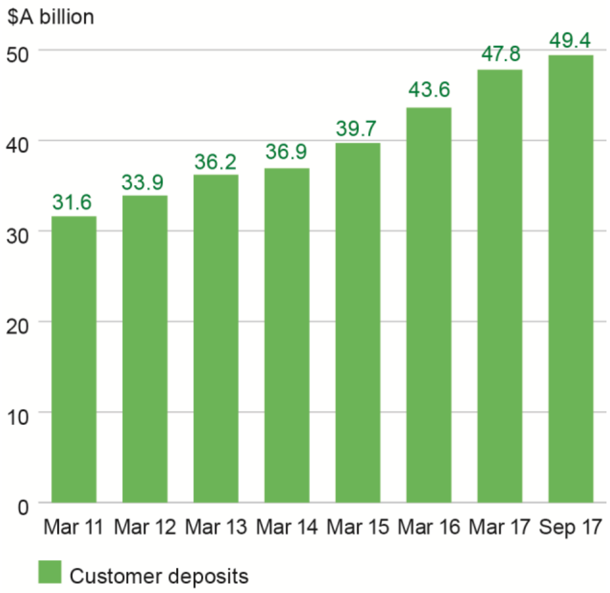
MBL continues to pursue a deposit strategy that is consistent with the core liquidity management tolerance of achieving diversity and stability of funding sources. The strategy is focused on growing the Banking and Financial Services Group deposit base, which represents a stable and reliable source of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

In particular, MBL has focused on the quality and composition of the deposit base, targeting transactional and relationship based deposits such as the Cash Management Account (CMA).

The majority of MBL's deposits continue to be covered by the Financial Claims Scheme. The value cap on the deposits is set at $A250,000 per account holder.

The chart below illustrates the customer deposit growth since 31 March 2011.

Deposit trend



5.5 EXPLANATORY NOTES CONCERNING FUNDING SOURCES AND FUNDED ASSETS

1. Wholesale issued paper

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

2. Net trade creditors

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

3. Structured notes

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

4. Secured funding

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

5. Bonds

Unsecured long term wholesale funding.

6. Other loans

Unsecured loans provided by financial institutions and other counterparties.

7. Syndicated loan facilities

Loan facilities provided by a syndicate of wholesale lenders.

8. Customer deposits

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

9. Loan capital

Long term subordinated debt, Macquarie Additional Capital Securities, Bank Capital Notes and Exchangeable Capital Securities.

10. Equity and hybrid

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

11. Cash and liquid assets

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

12. Self-securitisation

This represents Australian mortgages which have been internally securitised and is a form of collateral on the RBA's list of eligible securities for repurchase agreements.

13. Net trading assets

The net trading asset balance consists of financial markets and equity trading assets including the net derivative position and any margin or collateral balances. It also includes trading assets which are hedging structured notes issued.

14. Loan assets including operating lease assets

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

See section 4.2 for further information.

15. Debt investment securities

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

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

These equity securities include co-investments in Macquarie-managed funds.

CAPITAL

6

6.1 OVERVIEW

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

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

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

Eligible regulatory capital of Macquarie Group consists of ordinary share capital, retained earnings and certain reserves plus eligible hybrid instruments. Eligible hybrid instruments as at 30 September 2017 include the Macquarie Income Securities (MIS), Macquarie Bank Capital Notes (BCN), Macquarie Additional Capital Securities (MACS), Macquarie Group Capital Notes (MCN) and Macquarie Group Capital Notes 2 (MCN2).

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

Pillar 3

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

1. Harmonised Basel III relates to the Basel III guidelines defined by the Basel Committee on Banking Supervision, documented in the following: 'Basel III: a global regulatory framework for more resilient banks and banking systems', published December 2010 (revised June 2011) by the Bank for International Settlements (BIS).
2. APRA Basel III relates to the ADI Prudential Standards released by APRA for the period effective from 1 January 2013.

6.2 BANK GROUP CAPITAL

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

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

Common Equity Tier 1 capital

The Bank Group's Common Equity Tier 1 capital under Basel III consists of ordinary share capital, retained earnings and certain reserves.

Tier 1 capital

Tier 1 capital consists of Common Equity Tier 1 capital and Additional Tier 1 capital (hybrids). Additional Tier 1 capital as at 30 September 2017 consists of MIS, BCN and MACS. MBL periodically pays dividends to MGL and is recapitalised by MGL as required to support projected business growth.

MIS are a perpetual instrument with no conversion rights. MIS were listed for trading on the Australian Stock Exchange (now known as the Australian Securities Exchange) in 1999. MIS distributions are paid quarterly at a floating rate of BBSW plus 1.7% per annum and payment is subject to certain conditions including profitability of the Bank. MIS are eligible for transitional arrangements under Basel III rules.

BCN were issued by MBL in October 2014 and are quoted on the Australian Securities Exchange. The BCN pay discretionary, semi-annual floating rate cash distributions equal to six month BBSW plus 3.30% per annum margin, adjusted for franking credits. These instruments are non-cumulative and unsecured and may be redeemed at face value on 24 March 2020, 24 September 2020 and 24 March 2021 (subject to certain conditions being satisfied) or earlier in specified circumstances. The BCN can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 24 March 2023; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL or MBL); or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support). APRA has confirmed that BCN are eligible for inclusion as Additional Tier 1 capital.

MACS were issued by MBL, acting through its London Branch in March 2017. MACS are subordinated, unsecured notes that pay discretionary, non-cumulative, semi-annual fixed rate cash distributions. Subject to certain conditions the MACS may be redeemed on 8 March 2027, or every 5th anniversary thereafter. MACS can be exchanged for a variable number of fully paid MGL ordinary shares on an acquisition event (where a person acquires control of MBL or MGL), where MBL's common equity Tier 1 capital ratio falls below 5.125%, or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support). APRA has confirmed that MACS are eligible for inclusion as Additional Tier 1 capital.

6.2 BANK GROUP CAPITAL CONTINUED

Bank Group Basel III Tier 1 Capital

	AS AT SEP 17		AS AT MAR 17		*MOVEMENT*	
	Harmonised Basel III $Am	**APRA Basel III $Am**	Harmonised Basel III $Am	APRA Basel III $Am	*Harmonised Basel III %*	*APRA Basel III %*
Common Equity Tier 1 capital						
Paid-up ordinary share capital	**9,523**	**9,523**	9,520	9,520	*<1*	*<1*
Retained earnings	**2,348**	**2,348**	2,354	2,354	*(<1)*	*(<1)*
Reserves	**355**	**355**	411	411	*(14)*	*(14)*
Gross Common Equity Tier 1 capital	**12,226**	**12,226**	12,285	12,285	*(<1)*	*(<1)*
Regulatory adjustments to Common Equity Tier 1 capital:						
Goodwill	**39**	**39**	37	37	*5*	*5*
Deferred tax assets	**54**	**167**	57	157	*(5)*	*6*
Net other fair value adjustments	**(86)**	**(86)**	(104)	(104)	*(17)*	*(17)*
Intangible component of investments in subsidiaries and other entities	**51**	**51**	51	51	–	–
Loan and lease origination fees and commissions paid to mortgage originators and brokers	**–**	**384**	–	349	–	*10*
Shortfall in provisions for credit losses	**339**	**364**	316	338	*7*	*8*
Equity exposures	**–**	**1,137**	–	1,179	–	*(4)*
Other Common Equity Tier 1 capital deductions	**152**	**271**	103	254	*48*	*7*
Total Common Equity Tier 1 capital deductions	**549**	**2,327**	460	2,261	*19*	*3*
Net Common Equity Tier 1 capital	**11,677**	**9,899**	11,825	10,024	*(1)*	*(1)*
Additional Tier 1 Capital						
Additional Tier 1 capital instruments	**1,619**	**1,619**	1,970	1,970	*(18)*	*(18)*
Gross Additional Tier 1 capital	**1,619**	**1,619**	1,970	1,970	*(18)*	*(18)*
Deduction from Additional Tier 1 capital	**–**	**–**	–	–	–	–
Net Additional Tier 1 capital	**1,619**	**1,619**	1,970	1,970	*(18)*	*(18)*
Total Net Tier 1 capital	**13,296**	**11,518**	13,795	11,994	*(4)*	*(4)*

6.2 BANK GROUP CAPITAL CONTINUED

Bank Group Basel III Risk-Weighted Assets (RWA)

	AS AT SEP 17		AS AT MAR 17		MOVEMENT	
	Harmonised Basel III $Am	**APRA Basel III $Am**	Harmonised Basel III $Am	APRA Basel III $Am	*Harmonised Basel III %*	*APRA Basel III %*
Credit risk						
Subject to IRB approach:						
Corporate	**26,736**	**26,736**	27,473	27,473	*(3)*	*(3)*
SME Corporate	**2,962**	**2,962**	2,830	2,830	*5*	*5*
Sovereign	**226**	**226**	227	227	*(<1)*	*(<1)*
Bank	**1,315**	**1,315**	1,175	1,175	*12*	*12*
Residential mortgage	**5,228**	**11,597**	4,886	10,545	*7*	*10*
Other retail	**4,093**	**4,093**	3,642	3,642	*12*	*12*
Retail SME	**3,040**	**3,056**	2,885	2,961	*5*	*3*
Total RWA subject to IRB approach	**43,600**	**49,985**	43,118	48,853	*1*	*2*
Specialised lending exposures subject to slotting criteria	**4,939**	**4,939**	6,277	6,277	*(21)*	*(21)*
Subject to Standardised approach:						
Corporate	**938**	**938**	794	794	*18*	*18*
Residential mortgage	**1,635**	**1,635**	1,634	1,634	*<1*	*<1*
Other Retail	**4,847**	**4,847**	5,755	5,755	*(16)*	*(16)*
Total RWA subject to Standardised approach	**7,420**	**7,420**	8,183	8,183	*(9)*	*(9)*
Credit risk RWA for securitisation exposures	**529**	**529**	573	441	*(8)*	*20*
Credit Valuation Adjustment RWA	**3,014**	**3,014**	2,457	2,457	*23*	*23*
Exposures to Central Counterparties RWA	**1,059**	**1,423**	706	1,232	*50*	*16*
RWA for Other Assets	**9,674**	**8,976**	9,156	8,554	*6*	*5*
Total Credit risk RWA	**70,235**	**76,286**	70,470	75,997	*(<1)*	*<1*
Equity risk exposures RWA	**4,057**	**–**	4,224	–	*(4)*	–
Market risk RWA	**3,314**	**3,314**	3,958	3,958	*(16)*	*(16)*
Operational risk RWA	**10,025**	**10,025**	9,979	9,979	*<1*	*<1*
Interest rate risk in banking book RWA	**–**	**–**	–	82	–	*(100)*
Total Bank Group RWA	**87,631**	**89,625**	88,631	90,016	*(1)*	*(<1)*
Capital ratios						
Bank Group Common Equity Tier 1 capital ratio (%)	**13.3**	**11.0**	13.3	11.1		
Bank Group Tier 1 capital ratio (%)	**15.2**	**12.9**	15.6	13.3		

GLOSSARY

7.1 Glossary

7

7.1 GLOSSARY

1H17	The half-year ended 30 September 2016.
1H18	The half-year ended 30 September 2017.
AASB	Australian Accounting Standards Board.
ABS	Asset Backed Securities.
ADI	Authorised Deposit-taking Institution.
Additional Tier 1 Capital	A capital measure defined by APRA comprising high quality components of capital that satisfy the following essential characteristics: provide a permanent and unrestricted commitment of funds; are freely available to absorb losses; rank behind the claims of depositors and other more senior creditors in the event of winding up of the issuer; and provide for fully discretionary capital distributions.
Additional Tier 1 deductions	An amount deducted in determining Additional Tier 1 Capital, as defined in Prudential Standard APS 111 Capital Adequacy: Measurement of Capital.
ALCO	The Asset and Liability Committee.
AMA	Advanced Measurement Approach (for determining operational risk).
APRA	Australian Prudential Regulation Authority.
Associates	Associates are entities over which Macquarie Bank has significant influence, but not control. Investments in associates may be further classified as Held for Sale ('HFS') associates. HFS associates are those that have a high probability of being sold within 12 months to external parties. Associates that are not held for sale are carried at cost and equity-accounted. Macquarie Bank's share of the investment's post-acquisition profits and losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised within equity.
AVS	Available for sale. AVS assets are investments where Macquarie Bank does not have significant influence or control and are intended to be held for an indefinite period. AVS investments are initially carried at fair value plus transaction costs and revalued in subsequent periods to recognise changes in the assets' fair value with these revaluations included in the AVS reserve in equity. If and when the AVS asset is derecognised or impaired, the cumulative gain or loss will be recognised in the income statement.
Bank Group	MBL and its subsidiaries.
Banking Group	The Banking Group comprises BFS, CAF, and some activities of CGM and MAM.
Basel III IRB Formula	A formula to calculate RWA, as defined in Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk.
BCN	On 8 October 2014, MBL issued 4.3 million Macquarie Bank Capital Notes (BCN) at face value of $A100 each. BCN are subordinated, unsecured notes that pay discretionary, non-cumulative, semi-annual floating rate cash distributions and may be redeemed at face value on 24 March 2020, 24 September 2020 or 24 March 2021 (subject to certain conditions being satisfied) or earlier in specified circumstances. BCN can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 24 March 2023; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL or MBL); where MBL's common equity Tier 1 capital ratio falls below 5.125%, or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
BBSW	Bank Bill Swap Rate.
BFS	Banking and Financial Services.
BFS deposits	BFS deposits are those placed with Banking and Financial Services and include products such as the Cash Management Account, Term Deposits and Relationship Banking deposits. Counterparties primarily consist of individuals, self-managed super funds and small-medium enterprises.
BIS	Bank for International Settlements.
CAF	Corporate and Asset Finance.
CCB	Capital Conservation Buffer.

7.1 GLOSSARY CONTINUED

Central service groups	The central service groups consist of the Corporate Operations Group, Financial Management Group, Risk Management Group, Legal and Governance and Central Executive.
CGM	Commodities and Global Markets.
CLF	Committed Liquidity Facility.
CMA	Cash Management Account.
Collective allowance for credit losses	The provision relating to losses inherent in a portfolio of loan assets or debt investment securities available for sale that have not yet been specifically identified.
Common Equity Tier 1 Capital	A capital measure defined by APRA, comprising the highest quality components of capital that fully satisfy all the following essential characteristics: provide a permanent and unrestricted commitment of funds; are freely available to absorb losses; do not impose any unavoidable servicing charge against earnings; and rank behind the claims of depositors and other creditors in the event of winding up. Common equity tier 1 capital comprises Paid Up Capital, Retained Earnings, and certain reserves.
Common Equity Tier 1 Capital Ratio	Common Equity Tier 1 Capital net of Common Equity Tier 1 deductions expressed as a percentage of RWA.
Common Equity Tier 1 deductions	An amount deducted in determining Common Equity Tier 1 Capital, as defined in Prudential Standard APS 111 Capital Adequacy: Measurement of Capital.
Compensation ratio	The ratio of Compensation Expense to Net Operating Income.
Directors' Profit Share (DPS)	The DPS plan comprises exposure to a notional portfolio of Macquarie-managed funds. Retained amounts for Executive Directors are notionally invested over the retention period. This investment is described as 'notional' because Executive Directors do not directly hold securities in relation to this investment. However, the value of the retained amounts will vary as if these amounts were due directly invested in actual securities, giving the Executive Directors an effective economic exposure to the performance of the securities. If the notional investment results in a notional loss, this loss will be offset against any future notional income until the loss is completely offset.
Earnings on capital and certain corporate income items	Net operating income includes the income generated by Macquarie Bank's Operating Groups, income from the investment of Macquarie Bank's capital, and certain items of operating income not attributed to Macquarie Bank's Operating Groups. Earnings on capital and certain corporate income items is net operating income less the net operating income generated by Macquarie Bank's Operating Groups.
Earnings per share	A performance measure that measures earnings attributable to each ordinary share, defined in AASB 133 'Earnings Per Share'.
ECAM	Economic Capital Adequacy Model.
ECS	On 26 March 2012, MBL, acting through its London Branch, issued $US250 million of Exchangeable Capital Securities (ECS). ECS were subordinated, unsecured notes that paid discretionary, non-cumulative, semi-annual floating rate cash distributions. ECS were bought back on 20 June 2017.
Effective tax rate	The income tax expense as a percentage of the profit before income tax, both adjusted for amounts attributable to non-controlling interests. The effective tax rate differs from the Australian company tax rate due to permanent differences arising from the income tax treatment of certain income and expenses as well as tax rate differentials on some of the income earned offshore.
Expense/Income ratio	Total operating expenses expressed as a percentage of net operating income.
Financial Report	Macquarie Bank Limited Interim Financial Report.
FIRB	Foundation Internal Ratings Based Approach (for determining credit risk).
Headcount	Headcount represents Macquarie Bank's active permanent and variable workforce, and includes Macquarie Banks employees (permanent and casual) and its contingent workers (contractors, agency workers and secondees). Macquarie Bank's non-executive directors are not included.
HQLA	High-quality liquid assets.

7.1 GLOSSARY CONTINUED

International income	Operating income is classified as 'international' with reference to the geographic location from which the operating income is reported from a Management perspective. This may not be the same geographic location where the operating income is recognised for reporting purposes. For example, operating income generated by work performed for clients based overseas but recognised in Australia for reporting purposes could be classified as 'international' income. Income earned in the Corporate segment is excluded from the analysis of international income.
LGD	Loss given default is defined as the economic loss which arises upon default of the obligator.
Macquarie Bank, the Consolidated Entity	Macquarie Bank Limited and its subsidiaries.
Macquarie Group	MGL and its subsidiaries.
Macquarie Income Securities (MIS)	Macquarie Income Securities (MIS) are perpetual, subordinated instruments that have no conversion rights to ordinary shares. Discretionary distributions are paid quarterly. They are treated as equity in the statement of financial position. There are four million $A100 face value MIS on issue.
MACS	On 8 March 2017, MBL, acting through its London Branch, issued $US750 million of Macquarie Additional Capital Securities (MACS). MACS are subordinated, unsecured notes that pay discretionary, non-cumulative, semi-annual fixed rate cash distributions. Subject to certain conditions the MACS may be redeemed on 8 March 2027, or every 5 anniversary thereafter. MACS can be exchanged for a variable number of fully paid MGL ordinary shares on an acquisition event (where a person acquires control of MBL or MGL), where MBL's common equity Tier 1 capital ratio falls below 5.125%, or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MAM	Macquarie Asset Management.
MBL, the Company	Macquarie Bank Limited ABN 46 008 583 542.
MCN	On 7 June 2013, MGL issued six million Macquarie Group Capital Notes (MCN) at a face value of $A100 each. MCN are subordinated, non-cumulative, unsecured notes that that pay discretionary, non-cumulative, semi-annual floating rate cash distributions and may be redeemed at face value on 7 June 2018, 7 December 2018 or 7 June 2019 (subject to certain conditions being satisfied) or earlier in specified circumstances. MCN can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 7 June 2021; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL); or where APRA determines MGL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MCN2	On 18 December 2015, MGL issued 5.3 million Macquarie Group Capital Notes 2 (MCN2) at a face value of $A100 each. MCN2 are subordinated, non-cumulative, unsecured notes that that pay discretionary, non-cumulative, semi-annual floating rate cash distributions and may be redeemed at face value on 17 March 2021, 17 September 2021 or 17 March 2022 (subject to certain conditions being satisfied) or earlier in specified circumstances. MCN2 can be converted into a variable number of MGL ordinary shares (subject to certain conditions being satisfied) on these redemption dates; mandatorily exchanged on 18 March 2024; exchanged earlier upon an acquisition event (with the acquirer gaining control of MGL); or where APRA determines MGL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).
MEREP	Macquarie Group Employee Retained Equity Plan.
MFHPL	Macquarie Financial Holdings Pty Limited.
MGL	Macquarie Group Limited ABN 94 122 169 279.
MIM	Macquarie Investment Management.
MSIS	Macquarie Specialised Investment Solutions.
Net loan losses	The impact on the income statement of loan amounts provided for or written off during the period, net of the recovery of any such amounts which were previously written-off or provided for in the income statement.
Net tangible assets per ordinary share	(Total equity less Macquarie Income Securities less non-controlling interest less the Future Income Tax Benefit plus the Deferred Tax Liability less Intangible assets) divided by the number of ordinary shares on issue at the end of the period.

7.1 GLOSSARY CONTINUED

Net Trading Income	Income that comprises gains and losses related to trading assets and liabilities and includes all realised and unrealised fair value changes and foreign exchange differences.
Non-Bank Group	MGL, MFHPL and its subsidiaries.
Non-Banking Group	The Non-Banking Group comprises Macquarie Capital and some business activities of MAM and CGM that use certain offshore regulated entities of the Non-Banking Group.
Non-GAAP metrics	Non-GAAP metrics include financial measures, ratios and other information that are either not required or defined under Australian Accounting Standards.
Operating Groups	The Operating Groups consist of MAM, CAF, BFS and CGM.
RBA	Reserve Bank of Australia.
Risk-weighted assets (RWA)	A risk-based measure of an entity's exposures, which is used in assessing its overall capital adequacy.
RMBS	Residential Mortgage-Backed Securities.
SPEs	Special purpose entities.
Subordinated debt	Debt issued by Macquarie Bank for which agreements between Macquarie Bank and the lenders provide, in the event of liquidation, that the entitlement of such lenders to repayment of the principal sum and interest thereon is and shall at all times be and remain subordinated to the rights of all other present and future creditors of Macquarie Bank. Subordinated debt is classified as liabilities in the Macquarie Bank financial statements and may be included in Tier 2 Capital.
Tier 1 Capital	Tier 1 capital comprises of (i) Common Equity Tier 1 Capital; and (ii) Additional Tier 1 Capital.
Tier 1 Capital Deductions	Tier 1 capital deductions comprises of (i) Common Equity Tier 1 Capital deductions; and (ii) Additional Tier 1 Capital deductions.
Tier 1 Capital Ratio	Tier 1 Capital net of Tier 1 Capital Deductions expressed as a percentage of RWA.
UK	The United Kingdom.
US	The United States of America.