Fitch Ratings

Banks
Universal Commercial Banks
Australia

Macquarie Bank Limited

Key Rating Drivers

Outlook Revised to Stable: Fitch Ratings revised the Outlook on Macquarie Bank Limited's (MBL) Long-Term Issuer Default Rating to Stable, from Negative, in May 2021. This was based to lower downside risk to the bank's Viability Rating, as the operating environment was stronger than Fitch had anticipated in May 2020 when it revised the Outlook to Negative. Strong levels of support and stimulus from the authorities in MBL's core markets and diverse business model have also resulted in asset quality and earnings exceeding our expectations.

Risk Management Underpins Ratings: The IDR and Viability Rating are underpinned by MBL's robust risk management framework and high-quality management team, which have maintained a strong financial profile over a number of years. These offset its significantly more complex business model and larger risk appetite relative to Australian retail banks and a higher reliance on wholesale funding compared with international peers.

Rated Above Parent: MBL is rated one notch above its parent, Macquarie Group Limited (MGL; A-/Stable/a-), due to the bank's stronger standalone risk profile and greater regulatory oversight relative to the consolidated group.

Better Loan Performance than Fitch Expected: Asset quality remained satisfactory during the coronavirus pandemic, as evident through a rapid decline in the number of loans on repayment deferrals through to end-March 2021. Some downside risk remains as government support measures are unwound, but we believe there are sufficient buffers to warrant revising the factor outlook to stable.

Earnings to Moderate: MBL's earnings and profitability were resilient through the pandemic, assisted by a strong uplift in earnings from market-facing activities, particularly in the commodities and global markets business. We expect some moderation in earnings in 2022, but for MBL's core metrics to remain consistent with its 'a' factor score and have revised the outlook on the score to stable as a result.

Sound Capital Buffers: Capital buffers continued to improve in the financial year ending March 2021 (FY21), despite weaker operating conditions, and we believe there is a large cushion to absorb any shocks to earnings or asset quality. MBL's common equity Tier 1 (CET1) ratio using the local regulatory framework increased to 12.6% in FY21 (FY20: 12.2%), which the bank estimates is equivalent to 16.2% on a globally harmonised basis.

Strong Liquidity Management: We expect limited funding and liquidity pressure over the next 18 months; MBL's conservative liquidity management offsets its high reliance on wholesale funding relative to international peers. This is reflected in an average liquidity coverage ratio of 174% in 4QFY21 and a net stable funding ratio of 115%.

Rating Sensitivities

Core Metric Deterioration: MBL's Viability Rating and Long-Term IDR may be downgraded if its financial profile weakens significantly. This could be reflected in a combination of the four-year average of Stage 3 loans/gross loans increasing to above 3%, the four-year average of operating profit/risk-weighted assets falling below 1.5% or the CET1 ratio falling below 10% without a credible plan to restore it above this level.

Weakening Risk Appetite: A deterioration or findings of significant deficiencies in MBL's risk-management framework and liquidity management could pressure the ratings, as it could indicate that the starting point for risk appetite, funding and liquidity may be lower than Fitch has factored into its scoring.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Support Rating	3
Support Rating Floor	BB+
Sovereign Risk	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Macquarie Group Limited (June 2021)

Improved Environment Supports Stable Outlook for Large Australian Banks (April 2021)

Global Economic Outlook (March 2021)

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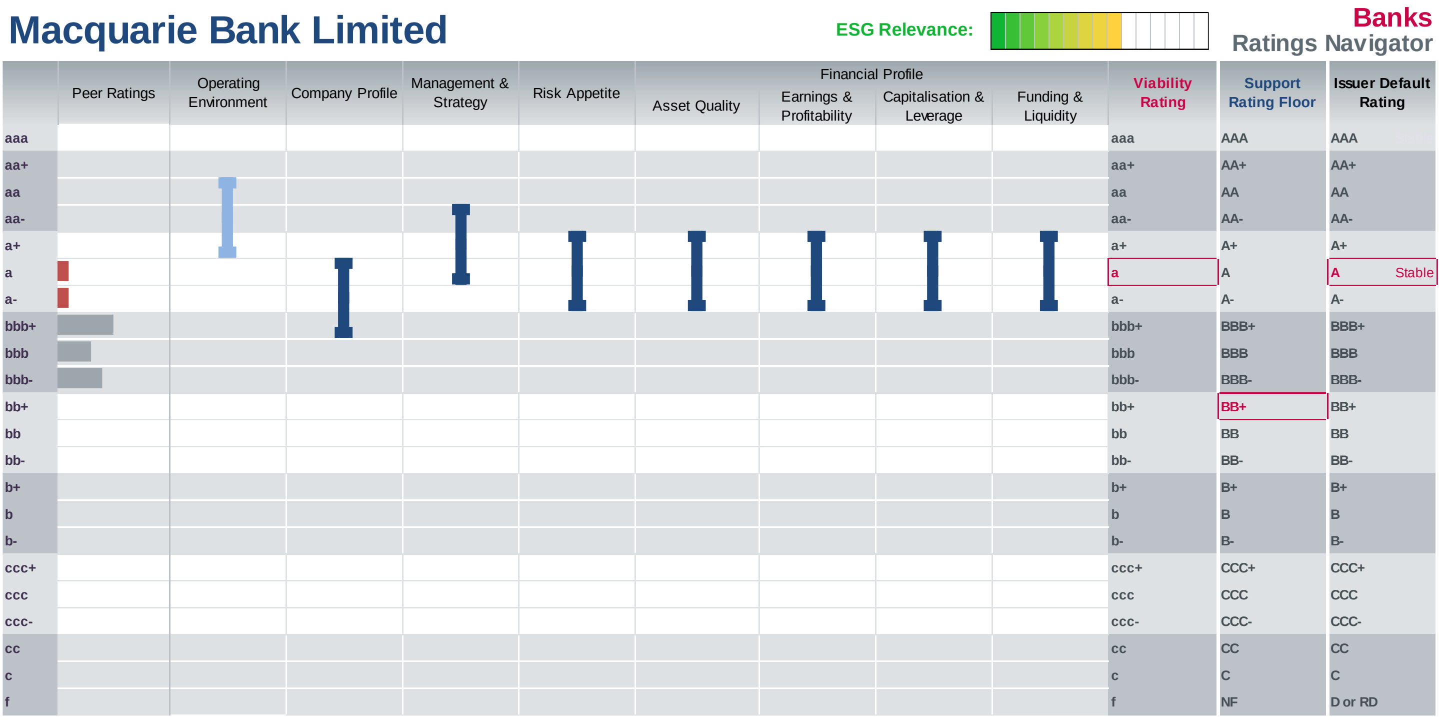
Ratings Navigator



Significant Changes

All Factor Outlooks Stable

We revised the operating environment, asset quality and earnings and profitability factor outlooks to stable, from negative, as part of the review completed on 18 May 2021. Downward pressure on MBL's Viability Rating has reduced as a result of economic conditions and recovery being stronger than we had anticipated. We now expect headroom to be sufficient to maintain the current level over the next two years.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧	Positive	⇩	Negative
⇳	Evolving	▫	Stable

Company Summary

Weighted Average Approach to Operating Environment

Fitch utilises a weighted-average approach in determining MBL's operating environment score to incorporate the large portion of the business that is conducted outside Australia. Greater emphasis is given to Australia to reflect that it is MBL's home jurisdiction and the country's strong regulatory framework. Greater certainty in our economic base case and strong stimulus and support measures have contributed to the revision of MBL's operating environment score to stable, from negative.

Undertakes Group Banking Operations

MBL is the registered bank within Macquarie group. It was Australia's fifth-largest bank by domestic assets at end-February 2021, accounting for 3.5% of total system assets. MBL's key businesses within the wider group include banking and financial services and part of the commodities and global markets segment. MBL's business model adds complexity relative to most retail-oriented Australian banks, but boosts geographic and revenue diversity.

Aligned with Group Strategy

MBL's management quality, corporate governance and strategy are consistent with those of MGL, reflecting the high level of integration throughout the group; see the Macquarie Group Limited report for details.

Strong Risk Management Framework

Credit risk is MBL's largest risk, accounting for around 83% of risk-weighted assets at FYE21. Much of this was generated by the loan portfolio (46% of total assets at FYE21), although MBL also has large securities (13%) and derivatives (9%) exposures, unlike most other local banks.

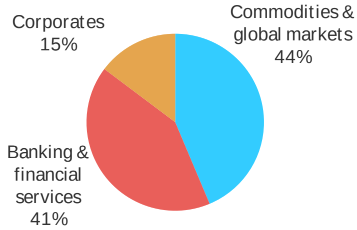
MBL's underwriting standards are aligned with the group and are broadly consistent with those of peers in the areas in which MBL writes loans. Mortgages accounted for 72% of total loans at FYE21 have been a key source of loan growth for the bank. Loan growth, at 13% in FY21, continued to outperform system levels and appeared to be assisted by product and servicing offerings and investment in systems rather than a weakening in underwriting standards. This has been partly evident in the continued reduction in mortgages with loan/value ratios of above 80%.

Securities exposure appears to be of better quality than the loan portfolio. Some exposure relates to client-initiated trades, although there is a small proportion of a proprietary nature. Derivatives exposure mostly relates to client hedging activity, with the bank seeking security for exposure to weak counterparties. Exposures are subject to limit policies and stress testing set at the group level.

Market risk appears manageable, accounting for about 6% of risk-weighted assets at FYE21, with much of the risk associated with MBL's securities operations captured in the credit-risk charge. Traded-market risk is MBL's main form of market risk. The bank says trading is primarily undertaken on behalf of clients and, where possible, interest rate risk in the banking book is transferred to the trading portfolio and overseen by the centralised risk management group. Non-traded foreign-currency exposure is hedged, unless specifically approved by the risk management group.

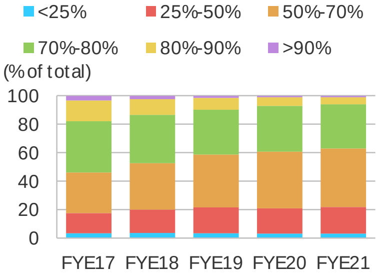
MBL Segment Assets

FYE21



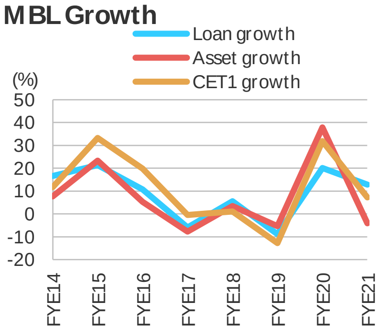
Source: Fitch Ratings, Fitch Solutions, MBL

Australian Mortgage Loan/Value Ratio



Source: Fitch Ratings, Fitch Solutions, MBL

MBL Growth



Source: Fitch Ratings, Fitch Solutions, MGL, MBL

Summary Financials and Key Ratios

	31 Mar 21		31 Mar 20	31 Mar 19	31 Mar 18	31 Mar 17
	Year end	Year end	Year end	Year end	Year end	Year end
	(USDm)	(AUDm)	(AUDm)	(AUDm)	(AUDm)	(AUDm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement						
Net interest and dividend income	1,588	2,089.0	2,040.0	1,978.0	2,024.0	2,180.0
Net fees and commissions	609	801.0	589.0	454.0	271.0	194.0
Other operating income	2,969	3,905.0	3,178.0	2,939.0	3,150.0	2,780.0
Total operating income	5,166	6,795.0	5,807.0	5,371.0	5,445.0	5,154.0
Operating costs	3,172	4,172.0	3,681.0	3,655.0	3,391.0	3,462.0
Pre-impairment operating profit	1,994	2,623.0	2,126.0	1,716.0	2,054.0	1,692.0
Loan and other impairment charges	236	311.0	458.0	233.0	43.0	291.0
Operating profit	1,758	2,312.0	1,668.0	1,483.0	2,011.0	1,401.0
Other non-operating items (net)	-11	-14.0	391.0	952.0	142.0	332.0
Tax	473	622.0	586.0	394.0	570.0	509.0
Net income	1,274	1,676.0	1,473.0	2,041.0	1,583.0	1,224.0
Other comprehensive income	-581	-764.0	525.0	45.0	144.0	-140.0
Fitch comprehensive income	693	912.0	1,998.0	2,086.0	1,727.0	1,084.0
Summary balance sheet						
Assets						
Gross loans	75,844	99,768.0	88,407.0	73,668.0	80,806.0	76,586.0
- Of which impaired	1,013	1,333.0	1,176.0	1,344.0	467.0	875.0
Loan loss allowances	590	776.0	688.0	510.0	367.0	753.0
Net loans	75,254	98,992.0	87,719.0	73,158.0	80,439.0	75,833.0
Interbank	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Derivatives	15,624	20,552.0	44,845.0	14,022.0	12,695.0	12,067.0
Other securities and earning assets	50,335	66,213.0	67,280.0	53,567.0	52,292.0	53,359.0
Total earning assets	141,213	185,757.0	199,844.0	140,747.0	145,426.0	141,259.0
Cash and due from banks	12,137	15,966.0	7,847.0	6,550.0	7,722.0	7,538.0
Other assets	11,498	15,125.0	18,445.0	16,702.0	20,070.0	18,644.0
Total assets	164,848	216,848.0	226,136.0	163,999.0	173,218.0	167,441.0
Liabilities						
Customer deposits	63,963	84,140.0	67,253.0	56,120.0	59,379.0	57,682.0
Interbank and other short-term funding	3,453	4,542.0	2,322.0	4,216.0	11,653.0	14,236.0
Other long-term funding	51,808	68,150.0	75,708.0	56,199.0	56,528.0	53,382.0
Trading liabilities and derivatives	17,948	23,609.0	43,186.0	19,080.0	21,718.0	17,957.0
Total funding	137,171	180,441.0	188,469.0	135,615.0	149,278.0	143,257.0
Other liabilities	15,688	20,637.0	22,067.0	15,652.0	9,431.0	9,859.0
Preference shares and hybrid capital	1,289	1,696.0	1,764.0	1,883.0	1,797.0	2,128.0
Total equity	10,699	14,074.0	13,836.0	10,849.0	12,712.0	12,197.0
Total liabilities and equity	164,848	216,848.0	226,136.0	163,999.0	173,218.0	167,441.0
Exchange rate		USD1 = AUD1.315443	USD1 = AUD1.619433	USD1 = AUD1.411034	USD1 = AUD1.30463	USD1 = AUD1.3082

Source: Fitch Ratings, Fitch Solutions

Summary Financials and Key Ratios

	31 Mar 21	31 Mar 20	31 Mar 19	31 Mar 18	31 Mar 17
Ratios (annualised as appropriate)					
Profitability					
Operating profit/risk-weighted assets	2.5	1.7	1.9	2.2	1.6
Net interest income/average earning assets	1.1	1.2	1.3	1.4	1.5
Non-interest expense/gross revenue	61.8	63.9	69.2	62.8	68.4
Net income/average equity	12.0	12.1	16.9	12.8	10.0
Asset quality					
Impaired loans ratio	1.3	1.3	1.8	0.6	1.1
Growth in gross loans	12.9	20.0	-8.8	5.5	-6.0
Loan loss allowances/impaired loans	58.2	58.5	38.0	78.6	86.1
Loan impairment charges/average gross loans	0.2	0.4	0.2	0.0	0.3
Capitalisation					
Common equity Tier 1 ratio	12.6	12.2	11.4	11.0	11.1
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.	11.1
Fitch Core Capital ratio	n.a.	n.a.	12.5	12.3	12.0
Tangible common equity/tangible assets	6.1	5.9	6.3	7.2	7.2
Basel leverage ratio	5.5	5.7	5.3	6.0	6.4
Net impaired loans/common equity Tier 1	4.7	4.2	9.4	1.0	1.2
Net impaired loans/Fitch Core Capital	n.a.	n.a.	8.6	0.9	1.1
Funding and liquidity					
Loans/customer deposits	118.6	131.5	131.3	136.1	132.8
Liquidity coverage ratio	n.a.	173.0	154.0	162.0	168.0
Customer deposits/funding	51.1	44.1	44.9	42.6	43.0
Net stable funding ratio	n.a.	118.0	112.9	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions

Key Financial Metrics – Latest Developments

Modest Weakening in Asset Quality Expected

MBL's asset quality tends to be stronger than that of the group, reflecting the lower risk profile of many of the bank's operations. This contributes to the 'a' factor score that is one notch higher than that of the consolidated group. MBL's asset quality has performed better than we expected throughout the pandemic, but we still forecast some weakening in asset quality metrics as support measures are unwound in 2021. However, the core metric should remain at levels commensurate with an 'a' factor score, which has contributed to the revision of the asset quality outlook to stable, from negative.

Loans made up around 45% of total assets at FYE21, most of which were residential mortgages. MBL has less exposure to large corporates relative to the group, as much of its exposure originating within the non-banking operations. This has historically resulted in MBL having a stronger and less volatile Stage 3/gross loans ratio relative to the group. Non-loan financial-asset quality is stronger than the loan portfolio and we expect this to remain the case.

Earnings Maintained Throughout Pandemic

A stronger economic recovery than we expected, combined with the bank's diverse business model, resulted in FY21 profit exceeding our forecasts. We believe earnings will moderate in FY22, as we do not anticipate a repeat of conditions and events that drove strong trading income in the last financial year. MBL's business model has greater diversity than more retail-orientated domestic peers, but this could also result in higher volatility through the cycle considering the former's significant market facing businesses.

Capitalisation Broadly Stable

MBL's capitalisation improved throughout the pandemic and we expect its CET1 ratio to remain consistent with an 'a' factor score. We believe capitalisation will continue to be supported by appropriate profit retention and access to group capital, if required.

MBL's regulatory capital adequacy is calculated using the foundation internal ratings-based approach for credit risk and the advanced measurement approach for operational risk under Basel III. MBL's CET1 ratio rose to 12.6% in FY21, which the bank estimates is equivalent to 16.2% under the globally harmonised full Basel III framework. The difference between the Australian regulatory and harmonised ratios is driven by the country's conservative mortgage risk-weights and capital deductions; these relate to deductions for equity investments, loan and lease origination fees and commissions and deferred tax assets.

MBL's Basel III leverage ratio, as calculated by the Australian Prudential Regulation Authority, was 5.5% at FYE21 (FYE20: 5.7%), and remains well in excess of the 3.5% minimum proposed by the regulator. Capital in MBL is ringfenced from the broader group – dividends can only be paid out of current-year earnings unless approved by the regulator.

Sound Liquidity Management

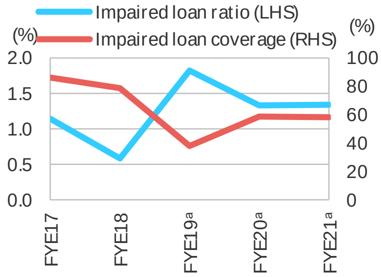
MBL's funding profile skewed more towards customer deposits through 2020 as a result of high deposit inflows, partly driven by strong system support from authorities. The loan/customer deposit ratio improved to 119% in FY21 (FY20: 131%), but we think MBL is still highly reliant on wholesale funding sources when compared with international bank peers. This risk is offset by MBL's strong liquidity and wholesale funding management, combined with access to central bank funding facilities, if required.

Wholesale funding accounted for 49% of total funding in FY21, with the rest comprising customer deposits. The bank's wholesale funding remains diversified by maturity, currency and investor. Foreign currency risk is managed through foreign-currency borrowings, which are either hedged into the currency of the funded asset or aligned to foreign-currency assets.

MBL's liquidity policies are set so the bank is able to meet its obligations over a 12-month period in the event of funding market disruption or a downturn in its business. This has historically meant that the bank holds higher levels of liquid assets relative to domestic peers and we expect this to remain the case. MBL's Basel III liquidity coverage ratio averaged 174% in 4Q21 and it reported a Basel III net stable funding ratio of 115% at FYE21, both well in excess of regulatory minimums.

Asset Quality

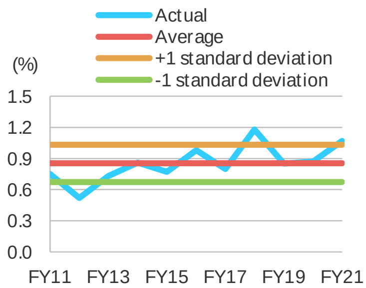
MBL



[a] Stage 3 loans, impaired loans previously
Source: Fitch Ratings, Fitch Solutions, MBL

MBL Earnings Volatility

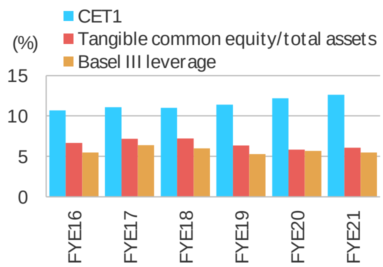
Operating profit/average total assets



Source: Fitch Ratings, Fitch Solutions, MBL

MBL's Capitalisation

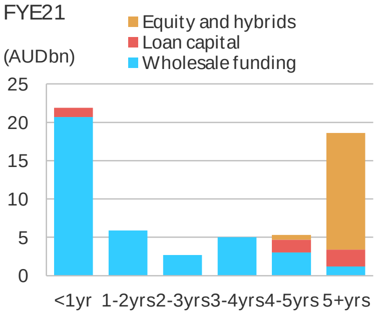
As per Australian Prudentual Regulation Authority rules



Source: Fitch Ratings, Fitch Solutions, MBL

MBL Wholesale Maturity

FYE21



Source: Fitch Ratings, Fitch Solutions, MBL

Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			A+ to A-
Actual country D-SIB SRF			A
Support Rating Floor:			**BB+**
Support Factors	**Positive**	**Neutral**	**Negative**
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank			✓
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

MBL's Support Rating and Support Rating Floor reflect a moderate probability of support, given the bank's position as the fifth-largest Australian bank by total assets, that it is the only non-major bank that is subject to the government's bank levy and that it is a key player in the domestic financial market.

Environmental, Social and Governance Considerations

FitchRatings **Macquarie Bank Limited** Banks Ratings Navigator

Credit-Relevant ESG Derivation

Macquarie Bank Limited has 5 ESG potential rating drivers

- Macquarie Bank Limited has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.