10 OCT 2022

Fitch Upgrades Macquarie Group to 'A' and Affirms Macquarie Bank at 'A'; Outlook Stable

Fitch Ratings - Sydney - 10 Oct 2022: Fitch Ratings has upgraded the Long-Term Issuer Default Ratings (IDR) of Macquarie Group Limited (MGL) and subsidiary Macquarie Financial Holdings Pty. Limited (MFHL) to 'A' from 'A-'. Fitch has also affirmed the Long-Term IDRs of Macquarie Bank Limited (MBL) and Macquarie International Finance Limited (MIFL), a subsidiary of MBL, at 'A'. The Outlook on the entities' Long-Term IDRs is Stable.

A full list of rating actions is below.

Key Rating Drivers

Low Double Leverage: MGL is the group's non-operating holding company, and the same factors that apply to MBL underpin its IDRs, Viability Rating (VR) and senior debt rating, although the starting point is the group's consolidated risk profile. Fitch aligns MGL's ratings with the consolidated group assessment to reflect moderate common equity double leverage (group operates to a 110% limit) and sound liquidity management.

Consolidated Group Ratings Upgrade: The consolidated group and MGL's VRs have been upgraded to 'a' from 'a-', after Fitch revised the group operating environment (OE) score to 'aa-' from 'a+'. The OE reassessment has also supported revisions in the business profile, earnings and profitability, and funding and liquidity scores to 'a' from 'a-'.

Robust Risk Control Framework: MBL is the group's main operating subsidiary. The bank's IDRs, VR and senior debt ratings are underpinned by robust risk controls and a high-quality management team, which has driven a strong financial profile over a number of years. Partly offsetting this is MBL's significant level of non-traditional banking operations relative to domestic bank peers, as well as a modest Australian loan-market share and higher reliance on wholesale funding compared with some international peers.

Internationally Diversified Operations: Fitch takes a blended approach when assigning OE scores for MGL and MBL, given the scope of international operations. We revised MGL's score to 'aa-', reflecting the heavy weighting of its assets in jurisdictions where Fitch has a score in the 'aa' range. The same applies for MBL; however, the 'aa-' factor score also reflects the higher exposure to Australia due to mortgage lending. We factor in Australia's high household leverage to reflect households' susceptibility to sharp interest-rate hikes, resulting in a score at the lower end of the 'aa' category.

Business Model Stability Improved: Fitch has revised the consolidated group business profile score to 'a', broadly consistent with the implied score under our Bank Rating Criteria following the revision of the OE score to 'aa-'. We believe the non-banks' business model and earnings stability have improved and are likely to continue improving, supported largely by the Macquarie Asset Management (MAM) business. The business profile score of MBL, which does not encompass MAM, remains at 'a-' and reflects modest loan and deposit market share relative to Australia's major banks.

Some Moderation in Earnings Expected: We believe the earnings and profitability metrics will remain commensurate with the factor scores of 'a' for MBL and MGL over the next two years. Fitch has revised MGL's earnings and profitability score to 'a' from 'a-' following the revision in the OE score to the 'aa' range. This supports a higher implied score as the starting point for Fitch's assessment.

The group's earnings and profitability were resilient through the Covid-19 pandemic, supported by loan and asset growth, combined with strong earnings uplift from market-facing activities, particularly in the commodities and global markets business. We expect earnings to moderate in the financial year ending March 2023 (FY23), but volatile markets could provide further growth. We view MGL's and MBL's earnings as more diverse than more retail-orientated Australian banks but also subject to more volatility in some of its market-facing businesses.

Appropriate Capital Buffers: We expect capital ratios to remain robust and continue to support the 'a' factor score for both MGL and MBL. MBL's common equity Tier 1 (CET1) ratio was 11.5% at FYE22 (FYE21: 12.6%) on strong loan growth but consistent with our expectations. MGL's capital surplus to regulatory requirements was AUD11 billion (or about 47% of the regulatory requirement). MGL does not report a CET1 ratio, so we have placed greater weighting on Fitch's other capitalisation metrics, such as tangible common equity/tangible assets.

Sound Liquidity Management: Fitch expects pressure on funding and liquidity to be limited for the group over the next 12 months, due to the liquidity and deposit flows in the system which are still high. The group's strong liquidity management and sound liquidity ratios help to offset some of the risks on its greater reliance on wholesale funding than international peers, and support our factor score of 'a' for MBL and MGL, above the implied 'bbb(cat)'. MBL's average liquidity coverage ratio was 221% in 2Q22, and the net stable funding ratio was 125% at end-March 2022.

GSR: MGL's Government Support Rating (GSR) of 'ns' reflects our view that there is no reasonable assumption of forthcoming support from the Australian authorities. We believe that if support were provided to the group it would most likely be through the regulated bank, MBL.

MBL's GSR of 'bbb-' reflects our view that there is a high probability of support for the banking operations. This rating is higher than those for domestic non-major bank peers and is due to MBL's growing domestic systemic significance, with its increased market shares as Australia's fifth-largest bank by total assets. The bank is also a significant player in domestic financial markets, and the only non-major bank that is subject to the Australian government's bank levy.

Senior Debt Ratings: MGL's senior debt rating is equalised with the consolidated group VR as we expect a large buffer to be available at resolution (the sum of the holding company's senior debt and the group's junior debt buffer exceeding 10% of RWA). Moreover, MGL has highly diversified and reasonably significant subsidiaries. MBL's senior debt ratings are aligned with MBL's IDRs as Australia does not have a sophisticated resolution framework or full depositor protection.

Short-Term Ratings: The 'F1' Short-Term IDRs of MGL and MBL are the lower of the two options available at a VR-driven Long-Term IDR of 'A' because the 'a' funding & liquidity scores of both MGL and MBL are lower than the minimum 'aa-' score to achieve the higher option of 'F1+'.

Rating Sensitivities

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

MGL: MGL's ratings may be downgraded if the common equity double leverage increases to above 120% for a sustained period, although Fitch does not expect this to occur.

MGL's VR and Long-Term IDR are also broadly sensitive to the same factors as those of MBL, as a downgrade in MBL's rating is likely to result in an overall weaker consolidated group rating to which MGL is aligned.

MGL's senior debt rating is sensitive to the consolidated group VR and if we expect the buffer available at resolution (the sum of the holding company's senior debt and the group's junior debt buffer) to not exceed 10% of RWA.

A downgrade of MGL's Short-Term IDR to 'F2' would require the Long-Term IDR to be downgraded by at least two notches to 'BBB+' or by one notch to 'A-' combined with the funding and liquidity score also being lowered to at least 'a-'.

MBL: MBL's VR and Long-Term IDR could be downgraded if a combination of the following were to occur:

- Four-year average stage 3 loans/gross loans increases above 2.0% for a sustained period (FY18-FY22: 1.3%);

- Four-year average operating profit/risk-weighted asset (RWA) ratio declines below 1.5% for a sustained period (FY18-FY22: 2.1%);

- the CET1 ratio falls below 10% without a credible plan to raise it back above this level.

A deterioration or findings of significant deficiencies in MBL's risk-management framework and liquidity management could also put pressure on ratings, as it would most likely result in a lower risk profile score, which may negatively affect our assessment of some of the financial profile factors.

The senior debt ratings are sensitive to the same factors as MBL's IDRs.

A downgrade of MBL's Short-Term IDR would require the Long-Term IDR to be downgraded by at least one notch and the funding and liquidity score to be lowered to at least 'a-'.

GSR: MGL's GSR is already at the lowest level assigned by Fitch.

MBL's GSR could downgraded if there is a negative change in our assumptions around the propensity or ability of Australian authorities to provide timely support. Neither appears probable over the next two years. Negative rating action will not directly affect MBL's IDRs, which are driven by its VR.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

IDRS, VRS and SENIOR DEBT

MGL: MGL's ratings are also broadly sensitive to similar factors as MBL as an upgrade MBL's ratings could result in a higher consolidated group rating to which MGL is aligned.

MGL's Short-Term IDR could be upgraded to 'F1+' if the Long-Term IDR were upgraded to at least 'AA-' or the funding and liquidity score were upgraded to at least 'aa-', currently 'a'.

MBL: An upgrade of the ratings would most likely require an upward revision of the business profile score, possibly driven by further significant improvement in market position, in addition to a combination of the asset quality, earnings and profitability or capitalisation factor scores being revised upward. This would require the four-year average stage 3 loans/gross loans ratio be maintained below 1%, four-year average operating profit/RWA ratio be maintained above 2.5% or the CET1 ratio maintained above 12% for each of the respective factors (or equivalent under the Australian Prudential Regulation Authority's final Basel III framework).

MBL's Short-Term IDR could be upgraded to 'F1+' if the Long-Term IDR were upgraded to at least 'AA-' or the funding and liquidity score were upgraded to at least 'aa-', currently 'a'. This appears unlikely as it would require MBL's loan/customer deposit ratio to fall well below 100% (FYE22: 122%).

GSR: MGL's GSR would only be upgraded if the regulatory focus in Australia was to change from protection of depositors to a broader group focus - this appears improbable.

An upgrade of MBL's GSR would require a significant increase in its systemic importance, reflected in the bank's domestic market position. The GSR may also be upgraded if the Australian authorities provide additional, explicit statements of support for MBL, or otherwise provide greater certainty that support would be provided if needed.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Subordinated Debt: MBL's subordinated Tier 2 debt is rated two notches below its anchor rating - the VR - for loss severity, with non-performance risk adequately captured by the VR. The point of non-viability for these instruments is at the discretion of the regulator. None of the reasons for alternative notching from the anchor rating, as described in the criteria, is present.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Changes in MBL's VR would also be reflected in its Tier 2 debt rating.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

Core and Integral Subsidiaries: MFHL's Long-Term IDR, which is driven by its Shareholder Support Rating (SSR), is equalised with that of its direct parent MGL. Following the rating action on MGL, MFHL's SSR has been upgraded to 'a' from 'a-' and reflects its status as a key and integral part of the group's business, undertaking core non-banking activities. In addition, if MFHL were to default, it would have a huge impact on the reputation of the parent and damage its franchise.

MIFL's Long-Term IDR, which is driven by its SSR, is equalised with that of its direct parent, MBL. MIFL's SSR reflects that it is a key and integral part of the banking group, which increases the propensity of MBL to extend support. If MIFL were to default, it would have a huge impact on the reputation and franchise of MBL and the wider group.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Ratings Linked to Support Provider: Any change in the IDRs of MGL would be also be reflected in the IDRs of MFHL, assuming no change to Fitch's assumption around the ability or propensity of support.

Any change in the IDRs of MBL would be also be reflected in the IDRs of MIFL, assuming no change to Fitch's assumption around the ability or propensity of support.

VR ADJUSTMENTS

The funding and liquidity score of 'a' for MGL have been assigned above the 'bbb' category implied score for following adjustment reason: liquidity coverage (positive).

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

MFHL's IDRs and SSR are linked to the IDRs of MGL.

MIFL's IDRs and SSR are linked to the IDRs of MBL.

ESG Considerations

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

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Macquarie Group Limited	LT IDR	A	Upgrade		A-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	ST IDR	F1	Upgrade		F2
	Viability	a	Upgrade		a-
	Government Support	ns	Affirmed		ns
• senior unsecured	LT	A	Upgrade		A-
• senior unsecured	LT	A	Upgrade		A-
• senior unsecured	ST	F1	Upgrade		F2
Macquarie Financial Holdings Pty Limited	LT IDR	A	Upgrade		A-
	ST IDR	F1	Upgrade		F2
	Shareholder Support	a	Upgrade		a-
Macquarie Bank Limited	LT IDR	A	Affirmed		A
	ST IDR	F1	Affirmed		F1
	Viability	a	Affirmed		a
	Government	bbb-	Affirmed		bbb-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Support				
• senior unsecured	LT	A	Affirmed		A
• senior unsecured	LT	A	Affirmed		A
• subordinated	LT	BBB+	Affirmed		BBB+
• senior unsecured	ST	F1	Affirmed		F1
• senior unsecured	ST	F1	Affirmed		F1
Macquarie International Finance Limited	LT IDR	A	Affirmed		A
	ST IDR	F1	Affirmed		F1
	Shareholder Support	a	Affirmed		a

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		

RATINGS KEY **OUTLOOK** **WATCH**

STABLE ◘

Applicable Criteria

Bank Rating Criteria (pub.07 Sep 2022) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub.31 Jan 2022) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Macquarie Financial Holdings Pty Limited	EU Endorsed, UK Endorsed
Macquarie Group Limited	EU Endorsed, UK Endorsed
Macquarie International Finance Limited	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

Endorsement policy

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