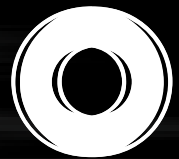


MACQUARIE BANK
2011 ANNUAL REPORT



MACQUARIE
BANK

Directors' Report

for the financial year ended 31 March 2011

In accordance with a resolution of the Voting Directors (the Directors) of Macquarie Bank Limited (MBL, Macquarie Bank, Company), the Directors submit herewith the income statements and the statements of cash flows for the year ended 31 March 2011 and the statements of financial position as at 31 March 2011 of the Company and its subsidiaries (the Consolidated Entity) at the end of, and during, the financial year ended on that date and report as follows:

Directors

At the date of this report, the Directors of Macquarie Bank are:

Independent Voting Directors

H.K. McCann, AM, Chairman¹
M.J. Hawker, AM
P.M. Kirby
C.B. Livingstone, AO
J.R. Niland, AC
H.M. Nugent, AO
P.H. Warne

¹ Appointed as Chairman on 17 March 2011

Executive Voting Directors

W.R. Sheppard, Managing Director and
Chief Executive Officer
N.W. Moore

The Directors listed above each held office as a Director of Macquarie Bank throughout the financial year ended 31 March 2011. Those Directors listed as Independent Directors have been independent throughout the period of their appointment.

Mr D.S. Clarke was the Non-Executive Chairman of Macquarie Bank from the beginning of the financial year until his resignation which was effective on 17 March 2011.

Details of the qualifications, experience and special responsibilities of the Directors and qualifications and experience of the Company Secretaries at the date of this report are set out in Schedule 1 at the end of this report.

Directors' meetings

The number of meetings of the Board of Directors (the Board) and meetings of Committees of the Board, and the number of meetings attended by each of the Directors of Macquarie Bank during the financial year is summarised in the tables below:

Board meetings	Monthly Board meetings 12		Special Board meetings 3	
	Eligible to attend	Attended	Eligible to attend	Attended
D.S. Clarke ¹	11	11	3	2
H.K. McCann	12	11	3	3
W.R. Sheppard	12	12	3	2
N.W. Moore	12	12	3	3
M.J. Hawker	12	12	3	3
P.M. Kirby	12	12	3	3
C.B. Livingstone	12	11	3	3
J.R. Niland	12	12	3	3
H.M. Nugent	12	12	3	3
P.H. Warne	12	12	3	3

¹ Mr Clarke ceased to be a Director on 17 March 2011.

Board committee meetings	Board Audit Committee meetings 7 ²	
	Eligible to attend	Attended
P.M. Kirby	7	7
C.B. Livingstone	7	7
H.K. McCann	7	5
P.H. Warne	7	7

² These are meetings held by the Board Audit Committee (BAC), which is a joint committee of Macquarie Group Limited (Macquarie) and Macquarie Bank. The Macquarie BAC assists the Boards of Voting Directors of Macquarie and Macquarie Bank in fulfilling the responsibility for oversight of the quality and integrity of the accounting and financial reporting practices of Macquarie Group.

Directors' Report

for the financial year ended 31 March 2011

continued

Principal activities

The principal activity of the Consolidated Entity during the financial year ended 31 March 2011 was to act as a full service financial services provider offering a range of commercial banking and retail financial services in Australia and selected financial services offshore. The Bank is a subsidiary of Macquarie Group Limited and is regulated by the Australian Prudential Regulation Authority (APRA) as an authorised deposit-taking institution (ADI). In the opinion of the Voting Directors, there were no significant changes to the principal activities of the Consolidated Entity during the financial year under review not otherwise disclosed in this report.

Result

The financial report for the financial years ended 31 March 2011 and 31 March 2010, and the results herein, have been prepared in accordance with Australian Accounting Standards.

The consolidated profit after income tax attributable to ordinary equity holders for the financial year ended 31 March 2011 was \$A803 million (2010: \$A663 million).

Dividends and distributions

MBL paid dividends and paid or provided distributions during the financial year as set out in the table below:

Security	Payment date	Payment type	\$A	In respect of financial year ended/period	
Ordinary shares	2 July 2010	Final Dividend	450,000,000	31 March 2010	Paid
	15 December 2010	Interim Dividend	184,800,000	31 March 2011	Paid
Macquarie Income Securities ¹	15 April 2010	Periodic	5,888,221	15 January 2010 to 14 April 2010	Paid
	15 July 2010	Periodic	6,292,715	15 April 2010 to 14 July 2010	Paid
	15 October 2010	Periodic	6,654,246	15 July 2010 to 14 October 2010	Paid
	15 January 2011	Periodic	6,563,510	15 October 2010 to 14 January 2011	Paid
	15 April 2011	Periodic	5,588,603	15 January 2011 to 31 March 2011	Provided
Macquarie Income Preferred Securities ²	15 April 2010	Periodic	2,294,615	16 October 2009 to 15 April 2010	Paid
	15 October 2010	Periodic	2,229,073	16 April 2010 to 15 October 2010	Paid
	15 April 2011	Periodic	1,917,399	16 October 2010 to 31 March 2011	Provided

¹ Macquarie Income Securities (MIS) are stapled securities comprising an interest in a note, being an unsecured debt obligation of Macquarie Finance Limited (MFL), issued to a trustee on behalf of the holders of the MIS (MFL note), and a preference share in Macquarie Bank. The MIS are quoted on the Australian Securities Exchange (ASX). The MIS distributions set out above represent payments made, or to be made, by MFL to MIS holders, in respect of the MFL note component of the MIS. The payments are not dividends or distributions paid or provided by Macquarie Bank to its members. The MIS are classified as equity under Australian Accounting Standards – see notes 31 and 32 to the financial report for further information on the MIS and MIS distributions.

² Macquarie Income Preferred Securities (MIPS) are limited partnership interests in Macquarie Capital Funding LP (Partnership), a partnership established in Jersey as a limited partnership, which are traded on the Luxembourg Stock Exchange. In certain circumstances, preference shares issued by Macquarie Bank and held by the general partner of the Partnership may be substituted for the MIPS. The assets of the Partnership include convertible debentures issued by Macquarie Bank (acting through its London Branch) which are listed on the Channel Islands Stock Exchange. The MIPS distributions set out above represent payments made, or to be made, by the Partnership to the MIPS holders. The payments are not dividends or distributions paid or provided by MBL to its members. The MIPS are classified as equity under Australian Accounting Standards – see notes 31 and 32 to the financial report for further information on the MIPS and MIPS distributions.

No other dividends or distributions were declared or paid during the financial year.

State of affairs

There were no other significant changes in the state of the affairs of the Consolidated Entity that occurred during the financial year under review not otherwise disclosed in this report.

Review of operations and financial result

Consolidated net profit after income tax attributable to ordinary equity holders of \$A803 million for the year ended 31 March 2011 increased 21 per cent from \$A663 million in the prior year. Net profit for the second half of the year of \$A509 million increased 73 per cent from \$A294 million in the six months to 30 September 2010. Recently acquired businesses, including Sal. Oppenheim, Macquarie Private Wealth Canada and Delaware Investments, contributed to increases in both operating income and expenses.

Total operating income of \$A4,795 million for the year ended 31 March 2011 increased 31 per cent from \$A3,652 million in the prior year. The main drivers of this increase were:

- a 25 per cent increase in net interest income to \$A1,651 million for the year ended 31 March 2011 from \$A1,325 million in the prior year driven by an increase in Corporate and Asset Finance's corporate lending;
- equity accounting income from investments in associates and joint ventures of \$A45 million for the year ended 31 March 2011, up from \$A7 million in the prior year driven by an improvement in the underlying results of investments; and
- an 991 per cent increase in other operating income to \$A513 million for the year ended 31 March 2011 from \$A47 million in the prior year, primarily due to a reduction in write-downs and impairment charges (net expense of \$A403 million for the prior year decreased 62 per cent to a net expense of \$A155 million for the year ended 31 March 2011).

Total operating expenses of \$A3,690 million for the year ended 31 March 2011 increased 28 per cent from \$A2,890 million in the prior year. The increase was largely driven by:

- a 43 per cent increase in employment expenses to \$A1,553 million for the year ended 31 March 2011 from \$A1,089 million in the prior year, which was due to an increase in average headcount due to the full year impact of acquisitions; and
- a 22 per cent increase in brokerage and commission expenses to \$A669 million from \$A548 million in the prior year mainly due to the full year contribution of Delaware Investments and Macquarie Private Wealth Canada.

Income tax expense for the year ended 31 March 2011 of \$A272 million increased from \$A65 million in the prior year as a result of reduced levels of writedowns and impairment charges. The effective tax rate of 25.3 per cent for the year ended 31 March 2011 increased from 8.9 per cent in the prior year.

Review of financial position

The Consolidated Entity's liquidity risk management framework operated effectively throughout the year ensuring funding requirements were met and sufficient liquidity was maintained.

The Consolidated Entity's capital management policy is to be conservatively capitalised and to maintain diversified funding sources in order to support business initiatives, particularly specialised funds and offshore expansion, whilst maintaining counterparty and client confidence.

Macquarie Bank is subject to minimum capital requirements externally imposed by APRA. Macquarie Bank has received APRA accreditation to adopt Foundation Internal Ratings Based Approach for the calculation of credit risk capital and the Advanced Measurement Approach for operational risk, under the Basel II regulatory capital framework. In addition, Macquarie Bank received APRA accreditation to use an internal model to calculate Interest Rate Risk in the Banking Book.

The Consolidated Entity has met its externally imposed capital requirements throughout the year. The Consolidated Entity is well capitalised, and as at 31 March 2011, it had a Tier 1 capital ratio of 10.7 per cent and a total capital ratio of 12.4 per cent.

Events subsequent to balance date

At the date of this report, the Directors are not aware of any matter or circumstance which has arisen that has significantly affected or may significantly affect the operations of the Consolidated Entity, the results of those operations or the state of affairs of the Consolidated Entity in the financial years subsequent to 31 March 2011 not otherwise disclosed in this report.

Likely developments in operations and expected outcomes

Continuing market uncertainty makes forecasting difficult. The net profit contributions for Fixed Income, Currencies and Commodities and Corporate and Asset Finance for the year ending 31 March 2012 are currently expected to be up on the prior year. The net profit contributions for Macquarie Funds and Banking and Financial Services for the year ending 31 March 2012 are currently expected to be broadly in line with the prior year. Conditions for the Derivatives DeltaOne business of Macquarie Securities, which operates within the Bank, are likely to remain challenging.

The full year 2012 result for each operating group will vary with market conditions. Movements in foreign exchange rates will impact the contribution of each group.

Macquarie Bank's compensation ratio and effective tax rate are expected to be consistent with historical levels. The continued higher cost of funding is likely to reflect market conditions and high liquidity levels.

Consequently, it is currently expected that the result for the Macquarie Bank Limited for the year ending 31 March 2012 will be an improvement on the prior year. However, the final result will be dependent upon market conditions. The full year 2012 result also remains subject to a range of other challenges including increased competition across all markets, the cost of a continued conservative approach to funding and capital, and regulation, including the potential for regulatory change. Over the medium term, Macquarie Bank's businesses are increasingly well positioned to benefit from future growth due to its deep expertise in major markets, growing global market share, strength in diversity, a balance sheet positioned for growth and an effective risk management culture.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011

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Introduction

Through its remuneration strategy, Macquarie aims to generate superior shareholder value over the long term and to reward staff in line with the outcomes they achieve. This broad strategy has been in place since the inception of Macquarie, evolving over time to ensure the system continues to meet its overriding objectives.

Macquarie Bank Limited (Macquarie Bank) is a wholly owned subsidiary of Macquarie Group Limited (Macquarie). Whilst subject to the remuneration framework determined by Macquarie, Macquarie Bank Limited's Board considers remuneration recommendations relating to the senior executives of Macquarie Bank. Throughout this Remuneration Report, for consistency, references are made to Macquarie's remuneration arrangements rather than Macquarie Bank's remuneration arrangements.

Macquarie Group Limited's Board of Directors (the Board) oversees Macquarie's remuneration arrangements, including executive remuneration and the remuneration of Non-Executive Voting Directors. The Board and the Board Remuneration Committee (BRC) annually review the remuneration strategy to encourage the best possible outcomes for Macquarie and its shareholders over the medium to longer term. Following this year's review, the Board's view is that:

While Macquarie's underlying remuneration principles remain unchanged, Macquarie is continuing to enhance its remuneration arrangements to even more strongly align staff and shareholders' interests and to remain in line with or ahead of market practice.

- 1 Macquarie's remuneration framework remains sound and is continuing to deliver against objectives.
- 2 However, some remuneration-related challenges need to be addressed.
- 3 Therefore, Macquarie is enhancing its remuneration arrangements while ensuring its overall remuneration approach remains in place.

These points are discussed in detail in sections one to three of this Remuneration Report.

This Remuneration Report has been prepared in accordance with the *Corporations Act 2001 (Cth)* (the Act). The Report contains disclosures as required by Accounting Standard AASB 124 *Related Party Disclosures* as permitted by Corporations Regulation 2M.3.03.

Financial information is used extensively in this Report. Some long-term trend information is presented, although accounting standards and practices have changed over time. In particular, throughout this Report:

- financial information for Macquarie or Macquarie Bank relating to the years ended 31 March 2006 through to 31 March 2011 has been presented in accordance with Australian Accounting Standards. Compliance with Australian Accounting Standards ensures compliance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Consequently, this financial information has also been prepared in accordance with and complies with IFRS as issued by the IASB
- financial information for Macquarie or Macquarie Bank relating to the year ended 31 March 2005 has been restated to comply with revised Australian Accounting Standards, with the exception of AASB 132 *Financial Instruments: Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement*, which became effective from 1 April 2005
- financial information for Macquarie or Macquarie Bank relating to earlier periods has not been restated and is, therefore, presented in accordance with the Australian Accounting Standards prevailing at the time.

1 Macquarie's remuneration framework remains sound and is continuing to deliver against objectives

1.1 Macquarie's remuneration framework has undergone incremental changes

The Board considers that Macquarie's underlying remuneration framework is robust and has contributed to Macquarie's long-term success in growing earnings. That approach, and its consistency over time, has served shareholders well during recent externally difficult times, as well as over the longer term. The Board considers that this continues to be the appropriate approach.

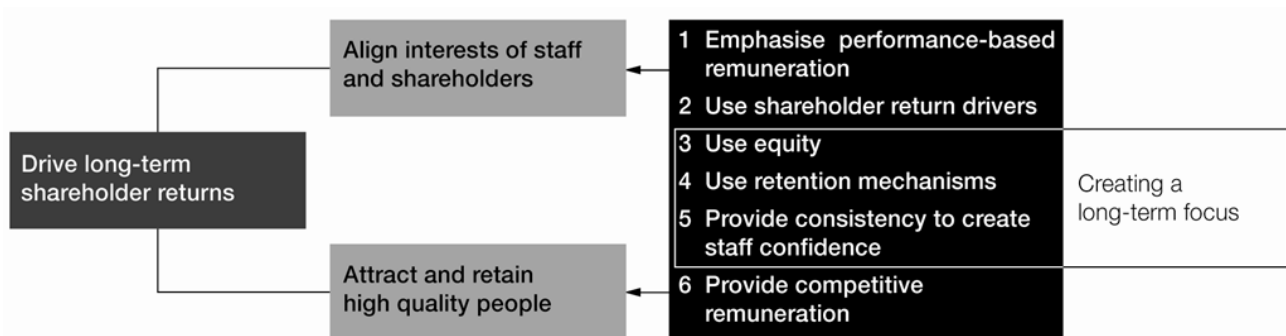
The overarching objective of Macquarie's remuneration framework is to drive superior shareholder returns over the long term while managing risk in a prudent fashion. This is delivered through two key drivers. The first is to attract and retain high quality people by offering a competitive performance-driven remuneration package that encourages both long-term commitment and superior performance. The second key driver is to use remuneration to align the interests of staff and shareholders by motivating staff through its remuneration policies to increase Macquarie's NPAT and sustain a high relative ROE while managing risk.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

The principles that underpin Macquarie's remuneration framework are unchanged:

- emphasising performance-based remuneration with an appropriate balance between short and longer-term incentives having regard to risk (refer section 3.1)
- linking rewards to create sustainable shareholder value through the use of shareholder return drivers, namely profitability and returns in excess of the cost of capital (refer section 3.2)
- using equity to create alignment with shareholder interests (refer section 3.3)
- designing retention mechanisms to encourage a long-term perspective and hence alignment with shareholders (refer section 3.3.1 to 3.3.7)
- using consistent arrangements over time to ensure staff are confident that efforts over multiple years will be rewarded (refer section 3.3)
- ensuring arrangements are competitive on a global basis with Macquarie's international peers (refer discussion in section 2.2 in regards to the competitive environment).

Key elements of the remuneration framework



1.2 Remuneration arrangements continue to play a critical role in delivering results for shareholders

Performance over past five years 2007-2011

		2011	2010	2009	2008	2007
Net profit after tax attributable to ordinary equity holders (NPAT)	\$A millions	803	663	576	15,696 ¹	1,463
Return on average ordinary shareholders' funds (p.a.)	%	9.7	9.9	11.3	23.8 ²	28.1

¹ NPAT from continuing operations for the 12 months to 31 March 2008 was \$A750 million (2007: \$A657 million).

² After adjusting for discontinued operations.

2 However, some remuneration-related challenges need to be addressed

Following on from 2010, there has been a continued focus on executive remuneration both in Australia and across the world. The following table demonstrates the extent of global regulation:

2.1 Continued focus on governance by Governments and regulators

Jurisdiction	Regulator	Details of Review
Global		
Global – Member states	Basel Committee on Banking Supervision	– Basel Committee on Banking Supervision issued the Consultative Document – Pillar 3 disclosure requirements for remuneration in December 2010
Australia		
Australia	Australian Government	<ul style="list-style-type: none"> – In April 2010, Australian Government issued its response to the Final Productivity Commission Report on Executive Remuneration in Australia (released December 2009) – An Exposure Draft and amended Exposure Draft of the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011 were released in December 2010 and February 2011 respectively – Treasury Discussion Paper on Clawback of Director and Executive Remuneration in the Event of a Material Misstatement was issued in December 2010
Australia	APRA	– Implementation of final APRA Prudential Standard APS 510 in April 2010
Australia	Corporations and Markets Advisory Committee (CAMAC)	– CAMAC published an Information Paper on Executive Remuneration – the structure and content of executive remuneration arrangements and reporting on executive remuneration arrangements
EMEA		
European Economic Area	European Parliament	– The European Parliament approved amendments to the Capital Requirements Directive (CRD) in relation to bankers' remuneration (CRD III)
European Economic Area	European Banking Authority (formerly Committee for European Banking Supervisors (CEBS))	– In October 2010, the CEBS published draft guidelines on Remuneration Policies and Practices regarding the remuneration aspects of the CRD III legislative resolution on the implementation of the Basel III agreement on solvency
United Kingdom	Financial Services Authority (FSA)	<ul style="list-style-type: none"> – The FSA published the draft Remuneration Code in August 2010 – In December 2010, the FSA published the Final Remuneration Code (the Code) including prescriptive remuneration and governance principles to implement the CRD III and CEBS guidelines – In April 2011, the FSA published further guidance on the implementation of the Code
Switzerland	Swiss Financial Market Supervisory Authority	– Draft circular setting minimum standards on the design, implementation and disclosure of remuneration systems in financial institutions
France	French Government	– Parts of the CRD III incorporated into French law and the Ministry of Finance Regulations
Germany	German Government and BaFin	– New federal legislation implementing the remuneration provisions in CRD III through the German Remuneration Code
United States		
United States	United States Government	<ul style="list-style-type: none"> – The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Provisions relate to executive compensation and corporate governance – say on executive pay, new compensation committee requirements, clawback, additional compensation disclosures and enhanced corporate governance – The Special Master for Troubled Asset Relief Program (TARP) Executive Compensation announced the conclusion of his review of executive pay, making voluntary proposals recommended for wide adoption – In January 2011, the Securities and Exchange Commission (SEC) adopted final rules implementing Section 951 of the Dodd-Frank Act, relating to shareholder approval and disclosure of executive compensation and 'golden parachute' compensation arrangements
United States	Seven US federal regulatory agencies including the SEC	– Draft rules were proposed to implement s956 of the Dodd-Frank Act (prohibits incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions and are deemed to be excessive, or that may lead to material losses)
Asia		
Hong Kong	Hong Kong Monetary Authority	– Principles-based guidance on remuneration and governance was announced which follows the Financial Stability Board (FSB) Standards closely
Singapore	Monetary Authority of Singapore	– Consultation paper was issued incorporating the FSB principles for sound compensation practices
China	China Banking Regulatory Commission	– Supervisory guidelines on compensation of commercial banks was proposed which is largely compliant with FSB principles
Korea	Financial Supervisory Service	– Compensation and corporate governance guidelines were issued which are broadly in line with FSB principles
Japan	Financial Services Agency	– Indications are that Japan will follow FSB principles

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

2.2 Strong competition for talent

The competition for key individuals in certain businesses is intense and has increased since 2010, and for parts of the Group, turnover is much higher than levels seen in the past. This has been particularly evident outside Australia where some firms are actively building out parts of their businesses, many of which are not constrained by regulator pay guidelines and can therefore offer highly attractive remuneration packages. As a result, many staff and teams have been aggressively headhunted. This is disruptive for teams and detracts from efforts to develop and grow businesses.

The next section of the Remuneration Report discusses how Macquarie has enhanced its remuneration arrangements while ensuring its overall remuneration approach remains in place.

3 Therefore, Macquarie is enhancing its remuneration arrangements while ensuring its overall remuneration approach remains in place

Macquarie has maintained a consistent approach to remuneration, focussed on delivering long-term shareholder returns by ensuring continued alignment of the interests of staff and shareholders.

Building on changes to Macquarie's remuneration arrangements approved by shareholders in December 2009, Macquarie has further enhanced its remuneration arrangements to reflect global regulatory trends and to remain competitive, while at the same time further aligning the interests of staff and shareholders. The changes are as follows:

- For this year, more profit share is being deferred and delivered in Macquarie equity, with less profit share being delivered as cash, including for Executive Directors. A minimum of 40 per cent (50 per cent for Executive Committee members and Designated Executive Directors) up to a maximum of 70 per cent of their annual profit share will be retained, a change from a flat 40 per cent (50 per cent for Executive Committee members and Designated Executive Directors) in FY2010
- 'Malus'¹ is to be introduced for FY2012 in line with regulatory requirements and to incentivise staff to maintain a long-term focus
- Pay mix shift / realignment for select risk and financial control staff has been undertaken to meet regulatory guidance and market practice.

Full details of Macquarie's remuneration arrangements, including the above changes, are set out in the remainder of this section.

¹ Malus is an ex-post risk adjustment to deferred unvested remuneration.

Link between the remuneration principles and the remuneration arrangements

The following table shows how Macquarie's remuneration arrangements relate to its remuneration principles referred to in section 1.1.

Principle	Features of the remuneration system
1 There is an emphasis on performance-based remuneration with an appropriate balance between short and longer-term incentives having regard to risk (Refer discussion in section 3.1)	<ul style="list-style-type: none"> – Profit share allocations are highly variable – Performance-based remuneration can comprise a high proportion of total remuneration in the case of superior performance – Profit share allocations and PSU grants for Executive Committee members provide substantial incentives for superior performance, but low or no participation for less satisfactory performance – The CRO advises the BRC on risk management issues – The CRO and CFO advise the BRC on the risk input into the determination of the profit share pool, such as the cost of equity capital to be used in the profit share pool calculation
2 Rewards are linked to sustainable shareholder value through the use of shareholder return drivers, namely profitability and returns in excess of the cost of capital (Refer discussion in section 3.2)	<ul style="list-style-type: none"> – The overall profit share pool is determined annually by reference to Macquarie's after-tax profit and its earnings over and above the estimated cost of capital – The allocation of the pool to individual businesses, and in turn to individuals, is based primarily, but not exclusively, on relative contribution to profit, taking into account capital usage and other factors including specific risk factors. Performance looks at a range of factors including risk management, governance and compliance, teamwork, people leadership, people development, and upholding Macquarie's <i>Goals and Values</i> – Earnings per share and ROE are used as performance hurdles for Executive Committee PSUs – ROE is used as the performance hurdle for Executive Director options granted under the old remuneration arrangements
3 Equity is used to provide rewards to create alignment with shareholder interests (Refer discussion in section 3.3)	<ul style="list-style-type: none"> – For Executive Directors, retained profit share is invested in a combination of Macquarie shares and notionally in Macquarie-managed fund equity. The investment mix varies depending on an individual's role – For most other staff, retained profit share is invested in Macquarie shares – PSU grants with performance hurdles are granted to Executive Committee members – Grants of Macquarie shares may be made to staff being hired or promoted – Executive Directors are required to acquire and hold a minimum number of shares calculated based on their profit share. This is satisfied through the current equity arrangements – Employee Share Plan is available to encourage broader staff equity participation
4 Retention mechanisms encourage a long-term perspective and hence alignment with shareholders (Refer discussion in section 3.3.1 to 3.3.7)	<ul style="list-style-type: none"> – In 2011, 50-70 per cent (70 per cent for the Macquarie Group Managing Director and Chief Executive Officer) of Executive Committee members annual profit share is retained. When PSUs are taken into consideration, a range of 61 to 76 per cent of performance-based compensation is retained for Executive Committee members (76 per cent for Macquarie Group Managing Director and Chief Executive Officer) – For other Executive Directors, a minimum of 40 per cent of annual profit share is retained (50 per cent for Designated Executive Directors¹) up to a maximum of 70 per cent – Retained profit share for Executive Committee members and Designated Executive Directors is released from years three to seven and from years three to five for other Executive Directors – PSUs for Executive Committee members vest from years two to four if performance hurdles are achieved – For staff below Executive Director, between 25 and 70 per cent of annual profit share is retained dependent on certain thresholds, vests and is released from years two to four
5 Arrangements provide consistency over time to ensure staff have the confidence that efforts over multiple years will be rewarded (Refer discussion in section 3.3)	<ul style="list-style-type: none"> – Macquarie's remuneration approach has been in place since it was founded with incremental changes over time as appropriate
6 Arrangements are competitive on a global basis with international peers (Refer discussion in section 2)	<ul style="list-style-type: none"> – The Board reviews the remuneration arrangements at least annually to ensure that they are equitable and competitive – The compensation ratio is used as a general guide to consider the overall competitiveness of remuneration levels but is not the basis on which the profit share pool is created

¹ Executive Directors who are members of Operations Review Committee and others who have a significant management or risk responsibility in the organisation.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

The primary focus of section 3 is on Executive Director remuneration, in particular, Executive Committee members. However, comments are made in relation to other staff where relevant. Macquarie Bank's Executive Committee has responsibility for the management of Macquarie Bank as delegated by the Macquarie Bank Board, and is made up of a central group comprising the Macquarie Group Managing Director and Chief Executive Officer, the Macquarie Bank Managing Director and Chief Executive Officer, the Chief Risk Officer (CRO), the Chief Financial Officer (CFO) and the heads of Macquarie Bank's major Operating Groups. The current members of the Executive Committee are identified in Appendix 1.

The remainder of this section discusses the remuneration structure and its individual components in greater detail. Specifically, it describes how the remuneration system:

- **emphasises** performance-based remuneration (refer section 3.1)
- **links** the quantum of an individual's annual performance-based remuneration to the individual's contribution to shareholder return drivers (refer section 3.2)
- **delivers** remuneration in a manner which ensures that employees have a direct long-term alignment with shareholder interests which encourages appropriate management of risk (refer section 3.3).

3.1 The remuneration structure continues to emphasise performance-based remuneration

To reflect a structural shift in the market and consistent with regulatory guidance, Executive Committee members received base remuneration increases during the year. For many Executive Committee members, this is the first increase in ten years, and for most, the first increase since joining the Executive Committee. These increases have largely been total compensation neutral through the adjustment downwards of profit share.

In addition, as noted last year, the pay mix for certain risk and finance personnel was reviewed and where appropriate, fixed remuneration was increased to ensure a more appropriate balance between fixed and variable remuneration, which was reflective of regulatory and market guidance.

Despite these increases, the foundation of Macquarie's remuneration structure continues to be an emphasis on performance-based remuneration with an appropriate balance between short and longer-term incentives, as well as aligning remuneration with prudent risk-taking. For front office Executive Directors, fixed remuneration can be relatively low or modest compared with similar roles in non-investment banking organisations. Fixed remuneration generally includes cash salary as well as non-cash benefits, primarily superannuation and nominated benefits, including those provided on a salary sacrifice basis. (Salary sacrifice is calculated on a total cost basis and includes any fringe benefit tax charges related to employee benefits).

The following table summarises FY2011 performance-based remuneration arrangements:

Key Area	Executive Committee (including Managing Director and Chief Executive Officer) and Designated Executive Directors	Other Executive Directors	Staff other than Executive Directors
Amount of profit share retained	50-70 per cent (70 per cent for the Macquarie Group Managing Director and Chief Executive Officer) for Executive Committee members A minimum of 50 per cent up to a maximum of 70 per cent for Designated Executive Directors	A minimum of 40 per cent up to a maximum of 70 per cent	A minimum of 25 per cent up to a maximum of 70 per cent dependent on certain thresholds
How retained profit share is invested	Invested in a combination of Macquarie shares and Macquarie-managed fund equity notionally invested Investment mix will vary depending on an individual's role	Invested in a combination of Macquarie shares and Macquarie-managed fund equity notionally invested Investment mix will vary depending on an individual's role	Invested in Macquarie shares ¹
Vesting and release of retained profit share	All retained amounts vest and are released from three to seven years after the year retained (see also forfeiture below)	All retained amounts vest and are released from three to five years after the year retained (see also forfeiture below)	All retained amounts vest and are released from two to four years after the year retained
Forfeiture of retained profit share while employed²	Board discretion to reduce or eliminate unvested profit share amounts (Malus) in certain circumstances	Board discretion to apply Malus to certain Directors, as identified by the BRC	Board discretion to apply Malus to certain staff, as identified by the BRC
Forfeiture of retained profit share on leaving	Unvested amounts are forfeited except in the case of death, permanent disability, genuine retirement, redundancy and other limited exceptional circumstances Retained profit share is forfeited in stages if a 'disqualifying event' occurs within two years of leaving	Unvested amounts are forfeited except in the case of death, permanent disability, genuine retirement, redundancy and other limited exceptional circumstances Retained profit share is forfeited in stages if a 'disqualifying event' occurs within two years of leaving	Unvested amounts are forfeited except in the case of death, permanent disability, genuine retirement, redundancy and other limited exceptional circumstances
PSUs	Granted to Executive Committee members only, which vest over two to four years	N/A	N/A
Minimum Shareholding Requirement	Required to hold the deemed after-tax equivalent of 10 per cent of all of their profit share allocations over the last 10 years (5 years for Designated Executive Directors) in Macquarie shares (which is satisfied by the above requirements)	Required to hold the deemed after-tax equivalent of 10 per cent of all of their profit share allocations over the last 5 years in Macquarie shares (which is satisfied by the above requirements)	N/A

¹ Invested in a combination of Macquarie shares and Macquarie-managed fund equity for a select group of directors whose primary role relates to the management of the funds business.

² Malus arrangements will take effect from 2012 in respect of profit share awards for the year ended 31 March 2012 and onwards.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

3.2 Remuneration is linked to the drivers of shareholder returns

For most Executive Directors, the largest component of their remuneration is delivered as an annual profit share allocation, based on their performance over the year. Macquarie's approach to measuring performance for the purpose of determining annual profit share is to utilise Macquarie Group financial performance measures which are known to be drivers of long-term shareholder returns. They are NPAT and ROE.

NPAT and ROE were selected as the most appropriate performance measures for the following reasons:

- they are correlated over time with total shareholder returns
- they provide an appropriate incentive because they are elements of performance over which the executives can exercise considerable control. TSR, on the other hand, is influenced by many external factors over which executives have limited control. Moreover, regulators do not support the use of that measure
- both measures can be substantiated using information that is disclosed in audited financial accounts, providing confidence in the integrity of the remuneration system from the perspective of both shareholders and staff.

These two drivers motivate staff to expand existing businesses and establish promising new activities. The use of ROE to measure excess returns – ROE relative to the cost of equity capital – creates a particularly strong incentive for staff to ensure that capital is used efficiently, while having regard to risk. Therefore, the use of these two measures, in combination, results in appropriate outcomes for Macquarie Group's shareholders.

Both measures are also enshrined in the performance hurdles applicable on PSUs for Executive Committee members (refer section 3.3.11.3).

Notwithstanding these factors, other qualitative measures are used in assessing performance.

Overview of profit share arrangements

The profit share arrangements are designed to encourage superior performance by motivating executives to focus on maximising earnings and ROE, while having appropriate regard for risk, thereby driving long-term shareholder returns. A Macquarie-wide profit sharing pool is created at the corporate level which is the basis of creating substantial incentives for superior profitability but low or no participation for less satisfactory performance.

Determination of the profit share pool

The size of the pool is determined annually by reference to Macquarie's after-tax profit and its earnings over and above the estimated cost of capital. A portion of Macquarie's profit earned accrues to the staff profit share pool. Once the cost of equity capital is met, an additional portion of excess profit is accrued to the profit share pool. The methodology used to calculate the profit share pool is reviewed at least annually by the BRC and the Non-Executive Directors of the Macquarie Board (the Board), including:

- the proportion of after-tax profit and the proportion of earnings in excess of Macquarie's cost of equity capital used to calculate the pool
- the cost of equity capital and the tax rate.

As part of this review, the CRO and the CFO advise the BRC on the risk input into the calculation of the profit share pool.

The Non-Executive Directors of the Board have discretions:

- to change the quantum of the pool to reflect internal and external factors if deemed in the interests of Macquarie and shareholders. In doing this, the Board considers shareholders' interests, the employment environment and staff retention requirements. It is critical that Macquarie has the flexibility to remain competitive in the global markets in which it operates while having due regard to shareholder interests over the short and medium term
- to defer the payment of profit share amounts to a subsequent year at a Macquarie business or individual level where it is in the interests of Macquarie and shareholders to do so.

This year, the Non-Executive Directors of the Board have exercised their discretion in relation to changing the quantum of the pool. They have also done so in prior years.

Allocation of the profit share pool

Allocation of the pool to businesses is based on performance, primarily, but not exclusively, reflecting relative contributions to profit (not revenue) while taking into account capital usage. It also takes into account other risk factors such as operational incidents, the risk profiles of the businesses and compliance with regulatory requirements as identified by the CRO to the BRC.

An individual's profit share allocation is based on performance, measured primarily through the performance appraisal policy that requires staff have at least one formal appraisal session with their manager each year.

Performance criteria vary according to an individual's role. Performance is linked where possible to outcomes that contribute directly to NPAT and excess ROE. Capital usage is important as it factors in the level of risk associated with the income derived.

Performance also takes into consideration how business is done. Superior performance looks at a range of indicators that go beyond financial performance and include risk management, governance and compliance, teamwork, people leadership, people development, and upholding Macquarie's *Goals and Values*.

The CRO advises the BRC on risk management issues including the return on economic capital by business, the relationship between profitability and risk (as measured by economic capital usage), losses by divisions and by risk type and the contingent risks associated with large transactions completed during the current financial year.

The performance of staff whose role is not linked to profit contribution is measured according to criteria appropriate to their position. Staff working in support areas may, for example, be rewarded on the basis of their contribution to Macquarie's financial reporting, risk management processes or information systems.

The Board and management seek to ensure that remuneration for risk and financial control personnel, including the CFO and the CRO, is structured so that it does not compromise the independence of these personnel in carrying out their functions and is determined in a way that maintains Macquarie's robust risk management framework. For instance, an evaluation of their performance occurs independently of the business with which they are associated.

Profit share allocations for risk and financial control personnel are reflective of their individual performance, including the quality and integrity of the control functions. The allocations to these staff are not directly linked to the profit of Macquarie or the businesses in which they operate.

The BRC reviews the allocation of the profit share pool to the central Risk Management Group, the central Finance function and Group Legal. It also annually recommends to the Board remuneration for all risk management and finance staff as a total category, in addition to specific recommendations for the CFO, CRO, General Counsel and other Executive Directors with a risk management or financial control role.

For staff with specific fund responsibilities, the performance of the relevant funds is important in determining that individual's profit share allocation. For example, in the case of the Macquarie Funds business, the following factors are relevant:

- in evaluating each executive's contribution to determine their individual profit share allocation, the performance of the fund or funds for which they are responsible, and in particular, the underlying factors influencing fund performance such as management and leadership, the operational performance of the underlying assets, and effective capital management
- in the case of Executive Directors with fund responsibilities (in particular Fund Chief Executive Officers), retained profit share allocated to the Post-2009 DPS Plan is notionally invested in the relevant funds, as discussed in section 3.3.2, giving these individuals a further ongoing incentive to seek to grow the value of the fund.

Arrangements are also in place to ensure that performance-based remuneration is appropriately allocated to the individuals who contributed to particular transactions. Therefore, businesses may further recognise cross-divisional contributions by allocating part of their profit share pool to individuals in other areas of Macquarie who have contributed strongly to their success.

In summary, profit share allocations to each individual generally reflect:

- Macquarie-wide performance – which determines the size of the overall profit share pool
- the performance of their business – which determines the profit share pool allocated to that business
- their individual performance – which determines their own share of the profit share pool for that business.

Profit share allocations to individuals are subject to retention arrangements as discussed in section 3.3.1.

Commentary on allocation to the Managing Director and Chief Executive Officer of Macquarie Bank

In approving the profit share and PSU grants to the Managing Director and Chief Executive Officer of Macquarie Bank, the Non-Executive Directors annually and specifically assess the Managing Director's performance by considering a range of indicators, including risk management, governance and compliance, financial performance measures, strategic initiatives, staff and human resources indicators, reputation management and monitoring, community and social responsibility matters and efforts in respect of diversity.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

3.3 Direct long-term alignment with shareholder interests is emphasised

The remuneration arrangements are also structured to deliver remuneration in a manner which ensures that employees have a direct long-term alignment with shareholder interests through:

- retention arrangements which encourage long-term commitment to Macquarie, and therefore, to shareholders
- the use of equity-based remuneration.

Retained Executive Director profit share is invested in a combination of Macquarie shares, under the Macquarie Group Employee Retained Equity Plan (MEREP) and Macquarie-managed fund equity notionally invested under the DPS Plan (Post-2009 DPS Plan).

A tailored approach is adopted to ensure that retention arrangements and equity-based remuneration are appropriate given the seniority of the individual and their ability to influence results.

Some overarching rules apply to equity-based remuneration:

- the following cannot be hedged:
 - Macquarie shares held to satisfy the minimum shareholding requirement
 - awards under the MEREP
 - Macquarie shares held under the Executive Committee Share Acquisition Plan
 - unvested options
- all shares and options must be dealt with in accordance with Macquarie's *Trading Policy*, which is available on Macquarie's website, including that trading must be conducted within designated trading windows.

All Executive Committee members and Voting Directors are required at least annually to disclose to Macquarie their financing arrangements relating to their Macquarie securities.

More generally, long-term alignment is encouraged through the emphasis on a degree of consistency over time in remuneration arrangements. Whilst the profit share pool is based upon NPAT for the year, these profits may include results from an initiative that has taken many years to come to fruition. Because the remuneration system is outcomes driven, profit share allocations for transactions and business development activities that are 'in progress', are low. Staff must, therefore, have confidence that when a transaction is completed – potentially some years later – the remuneration system will recognise successful outcomes in the way the staff member anticipated at the outset of the transaction. This requires broad consistency over time.

3.3.1 Profit share arrangements – delivery of profit share

A percentage of each employee's annual gross profit share allocation is retained by Macquarie (retained profit share).

The Board has discretion to change the percentage of profit share allocations retained on an annual basis to meet changing market conditions as well as to comply with regulatory and corporate governance guidance, provided that the retention percentage is at least 30 per cent for Executive Directors. This is because:

- regulatory and remuneration trends continue to evolve and change
- Macquarie must have the ability to meet regulatory requirements
- Macquarie must have the flexibility to remain competitive in the global markets in which it operates. The global remuneration environment is a very important consideration when determining remuneration structures.

During the year, the Board has exercised discretion and increased retention rates. In doing this, the Board and the BRC have considered peer organisations' retention rates, the intense competition for certain talented staff, as well as regulatory guidelines. As a result of these revised retention arrangements, less profit share is delivered as cash and more profit share is deferred and delivered in equity, creating an increased alignment with shareholders and ensuring ongoing staff retention.

The percentage is set for Executive Directors according to their role:

Executive Directors

Role	2008	2009	2010	2011
Macquarie Group Managing Director and Chief Executive Officer ¹	30%	55%	55%	70%
Macquarie Bank Managing Director and Chief Executive Officer	30%	50%	50%	50%
Executive Committee Members	30%	50%	50%	50-70%
Designated Executive Directors	20%	50%	50%	50-70%
Other Executive Directors	20%	50%	40%	40-70%

¹ Refers to the percentage retained for Nicholas Moore in 2008 in his role as Group Head of Macquarie Capital.

For staff below Executive Director, the revised retention arrangements reflect increasing retention percentages applying to higher levels of profit share allocations, as follows:

Staff below Executive Director

Profit Share Allocation	Percentage retained – 2011¹
\$A0 – \$A50,000	Nil
\$A50,001 – \$A200,000	25%
\$A200,001 – \$A500,000	35%
Above \$A500,000	40%

¹ For certain staff, the percentage of profit share allocations that is retained is higher, up to a maximum of 70 per cent.

If the calculated retention is less than \$A10,000, no amount will be retained.

The Board also has discretion to change the percentage of profit share allocation retained to meet exceptional circumstances that may arise when a staff member moves between jurisdictions. The Board would consider changing the retention level where local laws impact the application of the transitional arrangements.² These adjustments are to ensure that Executive Directors are in a similar situation and not disadvantaged due to local restrictions, to the extent possible.

3.3.2 Investment of retained profit share

Executive Director retained profit share is invested in a combination of Macquarie shares under the equity plan (MEREP), and Macquarie-managed fund equity notionally invested under the Post-2009 DPS Plan. For most other staff, retained profit share is invested in Macquarie shares under the MEREP. The following table shows the current percentage allocation of retained profit share that is invested in the Post-2009 DPS Plan and the MEREP, depending on the staff member's role:

Role	Post-2009 DPS Plan (notional investment in Macquarie-managed fund equity)	MEREP (Macquarie shares)
Macquarie Group Managing Director and Chief Executive Officer, Macquarie Bank Managing Director and Chief Executive Officer, CFO and CRO, General Counsel	20%	80%
Group Head, Macquarie Funds Group	50%	50%
Other Executive Committee members	10%	90%
Executive Directors with Funds responsibilities	Minimum of 50% to a maximum of 75% depending on role	Minimum of 25% to a maximum of 50% depending on role
Other Executive Directors	10%	90%
Staff other than Executive Directors ³	Nil	100%

³ Invested in a combination of Macquarie shares and Macquarie-managed fund equity for a select group of directors whose primary role relates to the management of the funds business.

Both the MEREP and the DPS Plan are fundamental tools in Macquarie's retention and alignment strategies, encompassing both long-term retention arrangements and equity holding requirements.

The Board or the BRC has discretion to review the percentage allocated to the Post-2009 DPS Plan and the MEREP on an annual basis to reflect an individual Executive Director's responsibilities and to strengthen shareholder alignment for Macquarie and the Macquarie-managed funds.

In limited circumstances, and only with the approval of the BRC, the allocation of retained profit share may be in other than the Post-2009 DPS Plan or the MEREP. An example might include investment in funds or products of a specific business group where there is a view to directly align the interests of employees with those of their clients.

² Under the remuneration arrangements approved by shareholders in December 2009, Executive Directors were given the choice of leaving their pre-2009 retained profit share in the pre-2009 DPS Plan, or move some of these amounts into the new arrangements (Transitioned Amounts).

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

Post-2009 DPS Plan

The Post-2009 DPS Plan comprises exposure to a notional portfolio of Macquarie-managed funds. These retained amounts for Executive Directors are notionally invested over the retention period. This investment is described as 'notional' because Executive Directors do not directly hold securities in relation to this investment. However, the value of the retained amounts will vary as if these amounts were directly invested in actual securities, giving the Executive Directors an effective economic exposure to the performance of the securities.

The notional portfolio is set for each Executive Director according to their role, as determined by the BRC. The BRC makes an annual determination as to how each Executive Director's retained profit share that is invested in Macquarie-managed fund equity (retained DPS in the DPS Plan) for that year should be notionally invested by Macquarie. The Executive Director has no input into that decision or its timing. The following general principles are used in making this decision:

- retained DPS in the DPS Plan for Executive Directors who are involved in the management of a particular fund (e.g. the Chief Executive Officer of a fund), will be 100 per cent notionally invested in that particular fund
- retained DPS in the DPS Plan for Executive Directors who are involved more generally in the management of one of Macquarie's funds businesses, including certain Operating Group Heads, will be notionally invested in a portfolio of funds managed by that particular business
- retained DPS in the DPS Plan for other Executive Committee members will be notionally invested in a general portfolio of Macquarie-managed fund equity
- retained DPS in the DPS Plan for all other Executive Directors will be notionally invested in a general portfolio of Macquarie-managed fund equity.

MEREP

Retained profit share invested in Macquarie shares is held under the equity plan, the MEREP. The MEREP has a flexible plan structure that offers different types of equity grants depending on the jurisdiction in which the participating employees are based. In most cases, the equity grants are in the form of units comprising a beneficial interest in a Macquarie share held in a trust for the staff member (Restricted Share Units or RSUs). An RSU comprises a beneficial interest in a Macquarie share held on behalf of a MEREP participant by the Trustee. The participant is entitled to receive dividends on the share and direct the Trustee how to exercise voting rights in the share. The participant also has the right to request the release of the share from the Trust, subject to the vesting and forfeiture provisions of the MEREP. RSUs are the primary form of award under the MEREP. Where legal or tax rules make the grant of RSUs impractical, due to different tax rules for employee equity and different securities laws, equity grants will be in the form of:

- shares held by the staff member subject to restrictions (Restricted Shares). A Restricted Share comprises a Macquarie share transferred from the MEREP Trust and held by a MEREP participant subject to restrictions on disposal, vesting and forfeiture rules. The participant is entitled to receive dividends on those Restricted Shares and to vote those Restricted Shares; or
- the right to receive Macquarie shares in the future (Deferred Share Units or DSUs). A DSU comprises the right to receive on exercise of the DSU either a share held in the Trust or a newly issued share (as determined by Macquarie in its absolute discretion) for no cash payment, subject to the vesting and forfeiture provisions of the MEREP. A MEREP participant holding a DSU has no right or interest in any share until the DSU is exercised. Macquarie may issue shares to the Trustee or procure the Trustee to acquire shares on-market for potential future allocations to holders of DSUs. Generally DSUs provide for cash payments in lieu of dividends paid on Macquarie shares before the DSU is exercised. Further, the number of shares underlying a DSU will be adjusted upon any bonus issue or other capital reconstruction of Macquarie in accordance with the ASX Listing Rules, so that the holder of a DSU does not receive a benefit that holders generally of Macquarie shares do not receive. These provisions are intended to provide the holders of DSUs, as far as possible, with the same benefits and risks as provided to holders of Restricted Shares or RSUs. However, holders of DSUs have no voting rights as to any underlying Macquarie share.

These different types of equity grants enable Macquarie through the MEREP to offer substantially similar economic benefits to staff across multiple jurisdictions.

3.3.3 Income on invested retained profit share

Notional returns on retained profit share invested in the Post-2009 DPS Plan may be paid annually to Executive Directors. These amounts are required to be disclosed as remuneration for Executive KMP. The notional returns are calculated based on total shareholder return. If the notional investment of retained profit share results in a notional loss, this loss will be offset against any future notional income until the loss is completely offset.

Employees with retained profit share invested in the MEREP are entitled to receive either dividends or cash payments or additional equity in lieu of dividends paid on Macquarie shares.

3.3.4 Release of retained profit share – normal vesting

The vesting period is established for each retained profit share allocation by the BRC, according to the prevailing market conditions and having regard to regulatory and remuneration trends at the time of allocation (refer to section 3.3.1 above for further commentary). The BRC established the following release schedule for retained profit share invested in the Post-2009 DPS Plan and the MEREP:

Role	Release schedule
Executive Committee Members (including Managing Director and Chief Executive Officer), Designated Executive Directors	one-fifth in each of years 3–7
Other Executive Directors	one-third in each of years 3–5
Staff other than Executive Directors	one-third in each of years 2–4

For each year's allocation, once the vesting period has been determined it will remain fixed for that allocation. Retained profit share is released immediately after it vests.

3.3.5 Forfeiture of retained profit share whilst employed – malus

From 2012, the Board will have discretion to reduce or eliminate unvested profit share amounts (Malus) where it determines that an Employee's action or inaction has caused Macquarie significant reputational harm, caused a significant unexpected financial loss or caused it to make a material financial restatement.

For the purposes of Malus, 'Employee' includes Executive Committee and Designated Executive Directors or other such Directors as the BRC identifies from time to time as being material risk takers, Code Staff under the FSA Remuneration Code and senior risk and financial control staff, as identified by the BRC.

A significant unexpected financial loss is defined as an impairment charge or provision or other loss as determined by the BRC, over and above the ordinary course of business, directly attributable to the relevant employee, having regard to factors such as Return on Economic Capital or profitability as determined by the BRC.

In considering whether to exercise the discretion to reduce or eliminate an Employee's unvested profit share, the Board will take the following matters, events or circumstances into account:

- the quantum of the actual loss or damage and any impact on Macquarie's financial soundness
- whether there has been a breach of internal risk management requirements and/or regulatory or legal requirements and if so, the extent of the breach
- whether Macquarie's directions, policies, protocols, practices and/or guidelines have been breached
- whether the individual has exhibited recklessness or wilful indifference
- whether any known information at the time of the action or inaction was deliberately withheld, and
- the individual's level of responsibility/accountability for the action or inaction.

Macquarie has always had, and continues to have, the ability to terminate staff for such circumstances, at which time any unvested profit share would have been forfeited in full.

3.3.6 Early vesting and release of retained profit share

As approved by shareholders in December 2009, the Board, the BRC or the Executive Committee under delegation from the BRC has discretion to accelerate the vesting of retained profit share and/or reduce the retention period, including where an Executive Director's employment ends on the grounds of genuine retirement or redundancy (subject to the disqualifying events provisions).

In considering whether discretion should be exercised in a particular case of genuine retirement, factors including, but not limited to, the following matters, events or circumstances may be taken into account:

- whether the Executive Director demonstrates that he/she is genuinely retiring from the industries within which Macquarie operates and competes
- whether the Executive Director is likely to work at any time in the future within the industries within which Macquarie operates and competes
- whether the Executive Director is likely to work full-time in any capacity, including directorships or consultancy
- whether the Executive Director has facilitated an appropriate succession strategy
- the Executive Director's length of service with Macquarie reflecting a sustained contribution and commitment to Macquarie, with an expectation of at least 10 years of service as an Executive Director.

If an Executive Director dies or becomes wholly and permanently unable to work while employed by Macquarie, 100 per cent of their retained profit share will vest and (subject to the disqualifying event provisions) be released to the Executive Director or, in the case of death or incapacity, to the Executive Director's legal personal representative.

In certain other limited exceptional circumstances, discretion may be exercised to accelerate the vesting of retained profit share and reduce the retention period on the grounds of business efficacy. If the discretion is exercised, all relevant factors will be considered on a case by case basis and will include consideration as to whether exercise of the discretion is in the best interests of Macquarie.

In all cases where discretion is exercised, the Board, the BRC or the Macquarie Executive Committee under delegation from the BRC may impose such other conditions as it considers appropriate.

Under the current remuneration arrangements, in the year to 31 March 2011, discretion has been exercised in relation to six executives who transferred employment for the following reasons:

- internalisation of the management of the Fund for which they provided services
- sale of some or part of the business for which they provided services
- transfer of employment to the joint venture for which they provided services.

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3.3.7 Disqualifying events

On leaving Macquarie, an Executive Director will not be entitled to receive any of their unvested Transitioned Amounts or retained profit share from 2009 and future years if the Board, the BRC or the Macquarie Executive Committee under delegation from the BRC determines, in its absolute discretion, that the Executive Director has during the period of employment with Macquarie or (subject to certain time constraints set out below) since leaving:

- (a) committed an act of dishonesty (including but not limited to misappropriation of funds and deliberate concealment of a transaction)
- (b) committed a significant and wilful breach of duty that causes material damage to Macquarie
- (c) joined a competitor of Macquarie Group
- (d) taken staff to a competitor or been instrumental in causing staff to go to a competitor or
- (e) otherwise acted, or failed to act, in a way that damages Macquarie, including but not limited to situations, where the action or inaction leads to a material financial restatement, a significant financial loss or any significant reputational harm to Macquarie or its businesses.

If an Executive Director leaves Macquarie and the discretion to release unvested retained amounts is exercised as described in section 3.3.6 'Early vesting and release of retained profit share', the release will occur over the period from six months to two years after the Executive Director leaves. Different disqualifying event provisions will apply at the six month, one year and two year timeframes as follows:

- **retained profit share from all but the last two years** – released on the expiry of six months following the end of employment (the 'First Period') provided the Executive Committee has determined that none of the disqualifying events (a), (b), (c), (d) and (e) set out above occurred during the First Period
- **retained profit share from the second year prior to the end of employment** – released on the expiry of a further six months following the end of the First Period (the 'Second Period') provided the Executive Committee has determined that no disqualifying event occurred during the First Period and disqualifying events (a), (b), (d) and (e) set out above have not occurred during the Second Period
- **retained profit share from the year prior to the end of employment** – released on the expiry of a further 12 months following the end of the Second Period (the 'Third Period') provided the Executive Committee has determined that no disqualifying event occurred during the First Period, disqualifying events (a), (b), (d) and (e) set out above have not occurred during the Second Period and disqualifying events (a), (b) and (e) set out above have not occurred during the Third Period.

3.3.8 Tax events

The Board or its delegate has discretion to change the terms of the MEREP awards, including the vesting date, to avoid situations of undue hardship or to maintain business efficacy. The Board, the BRC or the Macquarie Executive Committee under delegation from the BRC, may exercise discretion to early release MEREP awards where an employee terminates employment and, as a result, this triggers a tax liability in respect of any unvested equity award. Where this occurs, the employee has not received the underlying shares and may not receive the full number of shares on which they are being taxed for a considerable time due to continued vesting conditions and other restrictions beyond cessation of employment (for example, the two year clawback period described in section 3.3.7).

The number of shares released would be limited to the number with an aggregate value equal to the tax liability (see below). The employee would be required contractually to agree to repay an amount equal to the value of the shares released in the event that the BRC deem a disqualifying event has occurred. Approval for early release of Macquarie shares under these circumstances for Executive Committee members will reside with the BRC.

Where an employee terminates employment, and a tax liability arises in respect of retained MEREP awards, the Macquarie Executive Committee and/or the BRC will determine whether to allow early release after, considering, amongst other things, the possibility of the operation of the forfeiture rules. For example, if there is a high risk of forfeiture, early release would not be made.

If a decision to allow early release is made, sufficient shares will be released to the employee to fund the estimated tax liability. Subject to the *Trading Policy*, the employee is then able to sell these shares and use the cash to fund the tax liability. The remaining MEREP awards will be held within the MEREP until the post-termination retention period ends.

3.3.9 Minimum shareholding requirement for Executive Directors

The retention arrangements also impose on Executive Directors a requirement to hold Macquarie ordinary shares equivalent to the aggregate of five per cent (being the deemed after-tax equivalent of 10 per cent) of their annual gross DPS allocation for the past five years (for the wider Executive Director population) or 10 years (for Executive Committee members). These shares cannot be hedged.

This requirement remains but is satisfied through the equity retention arrangements.

Macquarie does not seek retention beyond this period because it considers that executives who are unable to diversify their personal portfolio may seek to leave, thereby creating an unintended consequence.

3.3.10 Staff share plans encourage broader staff equity participation – Employee share plan

Macquarie has the Macquarie Group Employee Share Plan (ESP) that encourages share ownership by employees. The ESP substantially replicates the terms of the Macquarie Bank Employee Share Plan which was approved by Macquarie Bank Limited's shareholders in 1997. Eligible employees in Australia are offered up to \$A1,000 worth of Macquarie ordinary shares funded from pre-tax available profit share.

Shares issued under the ESP cannot be sold until the earlier of three years after issue or the time when the participant is no longer employed by Macquarie or a subsidiary of Macquarie. In all other respects, shares issued rank equally with all other fully paid ordinary shares then on issue.

The number of shares each participant receives is \$A1,000 divided by the weighted average price at which Macquarie Group Limited's shares are traded on the ASX on the seven days up to and including the date of allotment, rounded down to the nearest whole share.

In 2011, 1,347 eligible Australian employees elected to participate in the ESP (2010: 1,635).

3.3.11 Performance share units (PSUs)

Executive Committee members are the only group of staff eligible to receive PSUs. Since their introduction, PSUs have been structured as DSUs with performance hurdles. Holders have no right to dividend equivalent payments before the PSUs vest. In all other respects, holders of these PSUs will have the same rights as holders of DSUs.

Unlike options, there is no exercise price for PSUs.

3.3.11.1 Determination and allocation of the PSUs

The Macquarie Board approves the number of PSUs to be allocated to each Executive Committee member each year as part of the annual remuneration review process. This determination has regard to Macquarie's overall performance, the extent to which the Executive Committee members have fulfilled their roles, and the long-term value delivered to shareholders. The allocation to individual executives is broadly in the same manner as annual profit share allocations i.e. it is performance based.

3.3.11.2 Vesting Schedule

The PSUs vest in three equal tranches after two, three and four years from the deemed vesting commencement date (typically 1 July in the year of grant), giving an average vesting period of three years. As a general rule, unvested PSUs will lapse on termination. However, the Macquarie Board or the BRC has the authority to accelerate the vesting of PSUs. The Macquarie Board or the BRC may consider exercising this authority where, for example, a staff member dies, is totally and permanently disabled, gives notice of their intention to enter into genuine retirement or a staff member's employment ends on the grounds of redundancy, illness or in other limited exceptional circumstances, such as hardship or where business efficacy justifies exercising the discretion.

3.3.11.3 Performance hurdles for Executive Committee PSUs

PSUs issued under the MEREP are released or become exercisable upon the achievement of certain performance hurdles. There are two performance hurdles and each applies individually to 50 per cent of the total number of PSUs awarded.

The BRC periodically reviews the performance hurdles, including the reference group, and has discretion to change the performance hurdles in line with regulatory and remuneration trends.

Description of performance hurdles:

Hurdle 1: 50 per cent of the PSUs, based solely on the relative average annual ROE over the vesting period compared to a reference group of domestic and international financial institutions. Vesting is on a sliding scale with 50 per cent vesting above the 50th percentile and 100 per cent vesting at the 75th percentile. For example, if ROE achievement is at the 60th percentile, 70 per cent of the award would vest.

The reference group comprises significant Australian financial companies within the ASX100 as well as Macquarie's major international investment banking peers with whom Macquarie competes and frequently compares its performance. The reference group comprises ANZ Group, Commonwealth Bank, National Australia Bank, Westpac, Suncorp, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley and UBS.

Hurdle 2: 50 per cent of the PSUs, based solely on compound annual growth rate (CAGR) in EPS over the vesting period. Awards vest on a sliding scale with 50 per cent vesting at EPS CAGR of 9 per cent and 100 per cent vesting at EPS CAGR of 13 per cent. For example, if EPS CAGR was 11 per cent, 75 per cent of the award would vest.

Under both performance hurdles, the objective is examined once only, effectively at the calendar quarter end immediately before vesting. If the condition is not met when examined, the PSUs due to vest expire.

Rationale for selection of performance hurdles:

- ROE and EPS are considered appropriate measures of performance as they are regarded as the drivers of longer term shareholder returns and are broadly similar to the performance measures Macquarie uses for determining annual profit share
- EPS provides closer alignment with the interests of shareholders as it is a measure with which they are directly concerned. In addition, such a measure is particularly appropriate for the Executive Committee who are at a level within Macquarie where they can affect its achievement without being highly impacted by factors, including market sentiment, over which other executives have reduced control
- ROE and EPS can be substantiated using information that is disclosed in audited financial statements, providing confidence in the integrity of the remuneration system from the perspective of both shareholders and staff

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

- the use of a sliding vesting scale diversifies the risk of not achieving the hurdle for executives, provides rewards proportional to performance for shareholders and replaces the all-or-nothing test which some have argued could, in the current climate, promote excessive risk taking. Sliding vesting scales are also more widely used and supported by governance agencies
 - use of a reference group of significant Australian financial companies and international peers provides an appropriate reference. This also recognises that, following the significant changes in global financial markets, regulated financial institutions will likely face increased regulatory requirements, which other companies will not. The inclusion of international peers recognises the extent of Macquarie's internationalisation. At 31 March 2011, over half of Macquarie's income and over half of Macquarie's staff were offshore. Also, international ownership of Macquarie's shares remains significant with non-Australian ownership averaging approximately 34 per cent over the three years to 31 March 2011
 - the approach is consistent with that advocated by APRA in not using TSR as a measure.
- Performance level required to meet hurdles:
- being two, three or four year average measures aligned with the vesting period, Macquarie's performance hurdles reward sustained strong performance and are relatively well insulated from short-term fluctuations
 - the ROE hurdle has vesting only commencing if the mid-point of peers' performance has been exceeded and 100 per cent vesting is only achieved if the 75th percentile has been reached
 - the use of an absolute EPS hurdle requires Macquarie to deliver increased business results before awards are vested, lessening the chance that awards could vest when results are negative as with the use of a relative measure
 - the chosen EPS CAGR hurdle is considered appropriate having regard to a range of factors including historical average market EPS CAGR figures. The table below shows the five year historical mean and 75th percentile EPS CAGRs for some relevant market sectors.

5 year EPS CAGR (per cent per annum)¹

	S&P/ASX 100 ex Resources	S&P/ASX Banks	S&P/ASX Financials ex Property Trusts	MSCI Financials
Mean	4.7	5.9	3.0	(0.3)
75th percentile	14.0	8.9	8.9	8.5

¹ Data provided by Macquarie Research Equities as at 31 March 2011. MSCI refers to the MSCI All Countries World Index.

Macquarie's EPS CAGR over the same five year period was (6.7) per cent per annum and since listing in 1996 has been 10.8 per cent per annum.

3.3.12 Options, while discontinued, remain outstanding

Options were previously granted to approximately the most senior 20 per cent of staff based on performance and promotion. As previously noted, Macquarie has ceased offering options.

This section explains the options arrangements that were in place for previous option grants, some of which are currently unvested. These arrangements are no longer in place. However, background information is provided to assist in understanding the relevant option disclosures in Appendix 2 and Appendix 3. Final tranches will vest in October 2013.

3.3.12.1 General terms of option arrangements

The Plan and key option terms

Plan	Macquarie Group Employee Share Option Plan (MGESOP)
History	Macquarie has had an employee option plan in place since 1995, with only minor amendments to the Plan rules being made over that time.
Eligible staff	Associate Director, Division Director and Executive Director
Options over	Fully paid unissued ordinary shares in Macquarie Group Limited
Term of options	Five years
Consideration	Nil
Exercise price	Set at the prevailing market price: the exercise price will generally be the weighted average price of shares traded on ASX during one week up to and including the date of grant of the options (adjusted for cum-dividend trading and excluding certain special trades)
Vesting schedule	Options vest in three tranches after two, three and four years. However, vested options can only be exercised by Executive Directors if the relevant performance condition is also satisfied
Hedging	Staff are not permitted to hedge unvested options.

3.3.12.2 Performance hurdles for Executive Committee options

Description of performance hurdles for Executive Committee options

Applicability	Performance conditions are imposed as summarised below on options granted to Executive Committee members
Description of performance hurdle	The performance hurdle requires that Macquarie's three year average ROE exceeds the three year average ROE of companies in the S&P/ASX 100 Index at the 65th percentile. This hurdle operates in addition to both the vesting rules and the embedded share price hurdle
Application of retesting	No retesting for option grants has applied since June 2006. The performance hurdle is tested once only (at time of vesting)
Calculation methodology	In assessing whether Macquarie's performance is above these hurdles, Macquarie obtains data from external sources and, where required, supplements this with data published by the individual companies. The percentile ranking of Macquarie, based on the three year average annual ROE against all companies in the applicable reference index, is determined quarterly.

The majority of unvested options are currently out of the money and are unlikely to vest.

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3.3.13 No special contractual termination payments

The following table summarises key features of the employment contracts for Executive Committee members including the Macquarie Bank Managing Director and Chief Executive Officer:

Length of contract	Permanent open ended
Remuneration review period	1 April to 31 March annually
Directors' profit share participation	All Executive Directors are eligible to be considered for a DPS allocation, referred to in section 3.3.1, which ensures that a large part of their remuneration is 'at risk'. The DPS terms are set out in the Macquarie Group Executive Directors' Remuneration Booklet (also known as the Grey Book). A departing Executive Director's retained DPS will only be released early on a discretionary basis in the case of genuine retirement, redundancy and certain other limited exceptional circumstances and will be subject to forfeiture provisions. Upon retirement from Macquarie, Executive Directors may be entitled to the vested retained DPS held under the Pre-2009 DPS Plan scheme provided that it is determined that no disqualifying events have occurred
Option participation	Executive Directors are no longer eligible for options (five year options over ordinary unissued Macquarie ordinary shares). Subject to discretions able to be exercised by the Board or its delegates, on termination from Macquarie, all Executive Directors continue to remain entitled to retain options which are vested at the termination date
PSU participation	Executive Committee are eligible to receive PSUs which are DSUs with performance hurdles and are a replacement for options grants
Termination of employment	Termination of employment by Macquarie or the Executive Director requires four weeks notice. ¹ Depending on the jurisdiction, Executive Directors may also receive a payment in lieu of any accrued but untaken leave and entitlements. Aside from notice (for which a payment or part payment may be made in lieu of being required to work the notice subject to legislative restrictions on termination benefits), no other solely contractual termination benefits exist

¹ Subject to compliance with local regulatory and legal requirements. In Australia, Executive Directors given notice by Macquarie may receive an additional week's notice if they are over 45 years of age and have more than two years' continuous service at the time of termination.

Subject to variations arising from local employment, transmission of business and other laws in the jurisdictions in which Macquarie operates, these contractual arrangements generally apply to all staff at Executive Director level.

Executive Directors who chose to keep some or all pre-2009 profit share in the Pre-2009 DPS Plan and leave Macquarie are eligible to receive the vested portion (subject to there being no disqualifying events in the period of up to six months following their departure) under the Pre-2009 DPS Plan. Executive Directors who leave Macquarie may also retain any vested but unexercised options (which will lapse if they are not exercised in the six months following departure).

3.4 Strong governance has been exercised

Effective governance is central to Macquarie's remuneration strategy and approach. The Board aims to ensure that Macquarie's remuneration system is sound in the following ways:

- strong Board and Board Remuneration Committee (BRC) oversight
- assessment of risk as part of the profit share allocation process
- independent remuneration review.

These key elements of Macquarie's approach are described below.

3.4.1 Strong Board oversight exists to ensure sound overall remuneration governance

The Macquarie Board of Directors (the Board) has oversight of Macquarie's remuneration arrangements. The Board has a BRC whose objective is to assist the Macquarie Board and the Board of Macquarie Bank Limited (Macquarie Bank or MBL) with Macquarie's remuneration policies and practices.

The BRC currently comprises three Independent Non-Executive Directors:

Helen Nugent	BRC Chairman
John Niland	BRC Member
Peter Warne	BRC Member

The BRC members have the required experience and expertise in both human resources and risk to achieve effective governance of Macquarie's remuneration system. All members of the BRC are also members of the Board Risk Committee, with Mr Warne being the Chairman since 27 August 2009. In addition, all members of the BRC have extensive experience in remuneration, either through their professional background or as members of the remuneration committees of other boards.

The BRC has a regular meeting cycle and held a significant number of additional meetings this year in order to address the various remuneration issues arising from the changing remuneration environment. The BRC met 12 times over the last financial year. Attendance at the meetings is set out in the Directors' Report.

The Board pays serious, sustained attention to the design and the operation of remuneration practices for all of Macquarie, not just for the most senior executives.

The responsibilities of the BRC are set out in a formal charter which is available on Macquarie's website. Board oversight of the approval framework for remuneration recommendations can be summarised as follows:

Executive Remuneration Policy and Framework Recommendations

The Macquarie Board is responsible for approving the remuneration policy on the recommendation of the BRC. This includes the following:

- assessing the effectiveness of the remuneration policy and compliance with legal and regulatory requirements
- material changes to the remuneration policy, including remuneration structure, retention and termination policies for all staff
- material changes to the recruitment policies and procedures for Macquarie's senior management team (Executive Committee and other Operating Group Heads)
- appropriate levels of delegated responsibility from Macquarie's Board to management for remuneration-related policies and practice decisions, and
- the continued application of the profit share methodology and any adjustments.

The BRC has the authority to review and approve the following on behalf of the Macquarie Board:

- changes to remuneration, recruitment, retention and termination policies and procedures not requiring Board approval
- material changes to superannuation/pension arrangements
- the percentage of Executive Directors' retained profit share allocated to Macquarie shares and Macquarie-managed fund equity, and
- the specific notional portfolio allocations of retained profit share amounts for individual Executive Directors.

The BRC also has the authority to monitor the implementation of the executive remuneration policy, including an annual review of compliance with the Executive Director minimum shareholding requirements.

Executive Remuneration Recommendations

The Boards of Macquarie and Macquarie Bank (the Boards), as appropriate, approve the following on the recommendation of the BRC:

- all individual remuneration and profit share recommendations for members of the respective Executive Committees and other Executive Voting Directors (including the Managing Director), Designated Executive Directors and other persons whose activities may, in the BRC's opinion, affect the financial soundness of Macquarie and MBL (Specific Remuneration Recommendations)
- all individual PSU grants to members of the respective Executive Committees, with the proviso that grants to Executive Voting Directors (including the Managing Director) must be approved by shareholders at the Annual General Meeting
- other remuneration recommendations relating to individuals or groups of individuals which are disclosed or are significant because of their sensitivity or precedent implications, or because they are specifically covered by regulatory standards (Significant Remuneration Recommendations), and
- determination of the total PSU pool available for Executive Committee Members.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

The BRC has the authority to review and approve the following on behalf of the Boards:

- all individual remuneration and profit share recommendations for Executive Directors, other than those required to be approved by the Non-Executive Directors of Macquarie and MBL. This review is to include consideration of the performance of the Executive Directors, other than those covered by the Specific Remuneration Recommendations and the Significant Remuneration Recommendations referred to above
- remuneration recommendations made outside of policy relating to individuals or groups of individuals, subject to the Specific Remuneration Recommendations and the Significant Remuneration Recommendations referred to above, and
- all individual Director promotion equity grants to staff other than those designated above.

Non-Executive Director Remuneration

The BRC is responsible for reviewing and making recommendations to the Macquarie Board in relation to:

- the remuneration framework for the Non-Executive Directors of Macquarie and MBL, and
- remuneration recommendations for Non-Executive Director fees.

The Board has adopted internal guidelines on declaring and dealing with conflicts of interest. These are rigidly followed by the BRC.

This remuneration governance framework ensures that remuneration recommendations relating to staff at various levels of seniority must be approved at an appropriate level of authority.

3.4.2 Risk is assessed as part of the profit share allocation process

The Board considers that the effective alignment of remuneration with prudent risk taking to be a fundamental criteria for any successful remuneration system. The Board's approach to risk management is to make risk decisions at multiple levels. The Board has always used both executive judgement and quantitative risk measures to determine the quantum of variable remuneration allocations. The quantitative measures are as follows:

- the profit share pool is determined by reference to both profit (not revenue) and earnings over and above the estimated cost of capital. The CRO and the CFO advise the BRC on the risk input into the calculation of the profit share pool
- ROE is taken into account at a Macquarie-wide level and economic and prudential capital usage at a business group level for profit share pool allocation
- the performance hurdle for existing Executive Director options and Executive Committee PSUs to vest is linked to ROE, not TSR.

The Board acknowledges that quantitative risk measures have limitations and, therefore, overlays these measures with executive judgement. Just as judgement is required in managing Macquarie's risk profile, significant judgement is exercised when risk-adjusting profit share allocations. When assessing the performance of businesses and individuals, management and the BRC look at a range of factors, including risk management, governance and compliance, people leadership and upholding Macquarie's *Goals and Values*. The CRO reports to the BRC on the following:

- return on economic capital, by business
- the relationship between profitability and risk (as measured by economic capital usage)
- losses by divisions and by risk type
- the contingent risks associated with large transactions concluded during the current financial year
- Information on significant losses and compliance breaches by individual.

The BRC uses this information when considering the profit share allocated to individual Operating Groups, and profit share allocations to individuals.

In addition to this, the Non-Executive Directors of the Board have discretion to change the quantum of the profit share pool to reflect internal or external factors if deemed in Macquarie's and shareholders' interests, and/or to defer the payment of profit share amounts to a subsequent year at a Macquarie-wide, business or individual level where it is in the interests of Macquarie and shareholders to do so.

The Board seeks to ensure that remuneration is sensitive to risk outcomes in the following three ways:

Remuneration outcomes must be consistent with risk outcomes

Profit share allocations are truly variable. The profit share component is variable upward and downward in response to good or poor performance. The fact that the profit share pool at a Macquarie-wide level is determined by reference to both profit and earnings over and above the estimated cost of capital means that there is generally no available profit share in the event of a loss at a Macquarie Group level other than via the Board's discretion.

Remuneration payout schedules must be sensitive to the time horizon of risks

Under the current remuneration arrangements, the proportion of an Executive Director's 2011 profit share allocation that is deferred and subject to the time horizon of risk ranges from 40 to 70 per cent, and 50 to 70 per cent for Executive Committee members and Designated Executive Directors (70 per cent for the Macquarie Group Managing Director and Chief Executive Officer). When PSUs are taken into consideration, the effective deferral rate is increased.

A departing Executive Director's unvested retained profit share is only paid out in the case of genuine retirement, redundancy or in certain other limited exceptional circumstances, and is forfeited in stages if a 'disqualifying event' occurs within two years of leaving. For example, the payment of a departing Executive Director's retained profit share will be subject to forfeiture if it is found that the individual has acted in a way that damages Macquarie, including but not limited to action or inaction that leads to a material financial restatement, a significant financial loss or any significant reputational harm to Macquarie or its businesses.

From 2012, the Board will have discretion to reduce or eliminate unvested profit share amounts (Malus) where it determines that an Employee's action or inaction has caused Macquarie significant reputational harm, caused a significant unexpected financial loss or caused it to make a material financial restatement. For the purposes of Malus, 'Employee' includes Executive Committee and Designated Executive Directors, Code Staff under the FSA Remuneration Code, senior risk and financial control staff and any other staff as determined by the BRC. Consistent with previous arrangements there are no 'golden handshake' payments.

The mix of cash, equity and other forms of remuneration should be consistent with risk alignment

Macquarie adopts a tailored approach to ensure that the retention levels and equity-based remuneration is appropriate given the seniority of the individual and their ability to influence results.

3.4.3 An independent remuneration review has been undertaken

The BRC has access to Macquarie senior management and has retained independent consultant, Pay Governance, which was previously part of the business of Towers Watson, for the use of the Board to obtain advice on the appropriateness of remuneration packages and other employment conditions as required.

The BRC, on behalf of the Non-Executive Directors of Macquarie, commissioned an independent review of Executive Director remuneration from a US office of Pay Governance (the Pay Governance Review). The only services that Pay Governance provides to Macquarie are executive compensation consulting to the BRC. This year, the Pay Governance Review considered the overall approach to remuneration, peer organisations' overall approach to remuneration, the extent of alignment with shareholder interests and a comparison of individual remuneration for senior executives where relevant peer information was available. In addition, the BRC independently analysed global remuneration trends and data. The cost of the Pay Governance Review was approximately \$US110,000. Pay Governance has not provided any other kind of advice to Macquarie for the FY2011.

Pay Governance has confirmed that their analyses and observations have been made free from undue influence by Macquarie's Executive KMP.

Arrangements were made to ensure that the Pay Governance Review was free from undue influence by Executive KMP, including that:

- the agreement for services was executed by the Chairman of the BRC under delegated authority on behalf of Macquarie
- the Pay Governance Review was provided by Pay Governance directly to the BRC only
- Pay Governance attended two BRC meetings and presented their findings
- Pay Governance held a meeting with the BRC Chairman, and
- in relation to the Pay Governance Review, no senior executives had separate, direct contact with Pay Governance.

The Board is satisfied that the remuneration review conducted by Pay Governance was made free from undue influence by the Executive KMP for the reasons listed above.

Pay Governance's findings were that:

- Macquarie has used essentially the same remuneration system since Macquarie's founding, which has incrementally evolved in response to the changing market and regulatory environment
- the objectives on which Macquarie's remuneration system are built are similar to those cited by other leading global investment banks, including the need to align the interests of management and shareholders, the importance of attracting and retaining the right talent, and that the remuneration structure does not encourage excessive risks
- Macquarie's remuneration system:
 - has a paramount goal to encourage management to drive shareholder returns over the short and longer term
 - has assisted Macquarie's strong shareholder returns, consistent return on equity results, and steady earnings growth over the past decade
 - has helped ensure that pay and performance are linked tightly
 - has several means to align executive reward and shareholder value creation
 - orients senior staff toward longer-term value creation rather than short-term benefits
- Macquarie's remuneration governance structure is fairly similar to that in place at Macquarie's peer US investment banks
- Macquarie's remuneration components support its remuneration principles and are very much in line with practices at peer global investment banks, including that:
 - fixed remuneration is modest, although not insignificant, relative to total compensation, the bulk of which is delivered through variable means (annual and long-term incentives)
 - the annual profit share is based on profit and return on equity, which are recognised by most peers as necessary to drive share price
 - individual profit share awards to executives are highly differentiated by individual contribution and results

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- a significant portion of profit share is invested in both Macquarie equity and Macquarie-managed fund equity and withheld for several years executives must maintain an equity stake in Macquarie
- equity-based compensation (in the form of Macquarie shares and Macquarie PSUs for Executive Committee) is used as a long-term incentive for executives
- Macquarie imposes a long vesting period on the portion of profit share deferred
- Macquarie's total remuneration as a percentage of revenue and as a percentage of earnings is centred slightly above the median relative to investment banking peers.

An external review of Non-Executive Directors' remuneration was also commissioned in early 2011 from Guerdon Associates (refer section 3.5.2 for details).

3.5 Non-Executive Directors continue to be recognised for their role

Finally, Macquarie's remuneration approach ensures that the Non-Executive Directors are appropriately recognised. The remuneration arrangements applicable to Non-Executive Directors, as outlined in this section, are different from the arrangements applicable to executives, reflecting their different role.

3.5.1 Non-Executive Director remuneration policy

The overall objective of *Macquarie's Non-Executive Director remuneration policy* is to ensure that Non-Executive Directors are remunerated appropriately. This objective is achieved by:

- setting Board and Board Committee fees in line with market rates for relevant Australian financial organisations for the time commitment and responsibilities involved
- delivering these fees in a form that is not contingent on Macquarie's performance
- not providing termination or retirement benefits other than payments relating to their accrued superannuation contributions comprising part of their remuneration.

Thus, Macquarie's Non-Executive Director remuneration arrangements are structured quite differently from the executive remuneration arrangements. Executive Directors are not remunerated for acting as Voting Directors.

All Voting Directors are required to at least annually disclose their financing arrangements relating to their Macquarie securities to Macquarie.

All Non-Executive Directors of Macquarie Group Limited are also Non-Executive Directors of Macquarie Bank Limited. This policy governs the remuneration of Non-Executive Directors of both Macquarie and Macquarie Bank in aggregate.

3.5.2 Board and Committee fees

Non-Executive Directors are remunerated via Board and Committee fees in line with market rates for relevant Australian financial organisations for the time commitment and responsibilities involved. These fees are reviewed annually on the basis of a comparison to market rates. An external review is conducted periodically both as verification of the market comparison and also to provide observations concerning the continuing validity of the methodology.

Such an external review was completed in early 2011 to ensure that the Non-Executive Directors' remuneration was in line with relevant benchmark organisations and consistent with market trends, and to ensure that the methodology and framework employed was appropriate. The review was conducted by independent consultant, Guerdon Associates, which received a fee of approximately \$A67,000.

The Board Remuneration Committee and the Board critically evaluated the analyses and the conclusions reached.

The current per annum base outlined below are consistent with the recommendations of this review.

Macquarie Bank Fees

	Macquarie Bank fees	
	\$A Chairman	\$A Member
Board	240,000	65,000

Macquarie Bank Limited does not have separate committees. Macquarie Group Limited's Audit Committee is a joint Committee with Macquarie Bank and the Remuneration Committee also support both Boards.

Base fees are paid quarterly. Non-Executive Directors may elect to receive their remuneration, in part, in the form of superannuation contributions.

Information on the frequency of Board meetings is included on page 5 of the Directors' Report.

There are no termination payments to Non-Executive Directors on their retirement from office (and there never have been in the case of both Macquarie Group Limited and Macquarie Bank Limited) other than payments relating to their accrued superannuation contributions comprising part of their remuneration.

Macquarie's Non-Executive Directors are remunerated for their services from the maximum aggregate amount (currently \$A4,000,000 per annum) approved by shareholders for that purpose. The current limit of \$A4,000,000 was approved by Macquarie Group Limited shareholders at Macquarie Group's 2010 AGM. Although fees have been split between Macquarie Bank Limited and Macquarie Group Limited, the Board ensures that Non-Executive Director remuneration for Macquarie Group Limited and Macquarie Bank Limited taken together does not exceed this shareholder approved maximum aggregate amount.

3.5.3 Minimum shareholding requirement for Non-Executive Directors

To encourage long-term commitment and to more closely align the interests of the Board with shareholders, the Board has a minimum shareholding requirement for Non-Executive Directors. Non-Executive Directors are required to have a meaningful direct shareholding in Macquarie.

Under the minimum shareholding requirement, Non-Executive Directors are required to acquire and maintain, directly or indirectly, a holding of 4,000 Macquarie ordinary shares, which they may accumulate over three years from the date of appointment. They are required to extend this holding by an additional 2,000 Macquarie ordinary shares over the next two years, such that they then maintain a holding of 6,000 Macquarie ordinary shares. Under Macquarie's *Trading Policy*, Non-Executive Directors are forbidden from hedging shares held to meet this minimum Macquarie shareholding requirement. Actual shareholdings are set out in Appendix 3 on page 38.

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Appendices: Key Management Personnel disclosures

Appendix 1: Key Management Personnel

The following persons were Voting Directors of Macquarie Bank Limited for the period during the financial years ended 31 March 2011 and 31 March 2010, unless otherwise indicated:

Directors:		Changes during 2010 and 2011 (except as noted below)
Executive		
N.W. Moore ¹	Macquarie Group Managing Director and Chief Executive Officer	
L.G. Cox, AO		Resigned 29 July 2009
W.R. Sheppard ¹	MBL Managing Director and Chief Executive Officer	
Non-Executive		
D.S. Clarke, AO		On leave of absence for part of FY2010 up to 30 August 2009. Resigned on 17 March 2011
M.J. Hawker, AM		Appointed to the Board on 22 March 2010
P.M. Kirby		
C.B. Livingstone, AO		
H.K. McCann, AM	Non-Executive Chairman	Acting Chairman in D.S. Clarke's leave of absence. Appointed Chairman on 17 March 2011
J.R. Niland, AC		
H.M. Nugent, AO		
P.H. Warne		Acting Chairman of the Macquarie Group Board Risk Committee in D.S. Clarke's leave of absence and was appointed Chairman of the Macquarie Group Board Risk Committee on 27 August 2009

In addition to the Executive Directors listed above, the following persons also had authority and responsibility for planning, directing and controlling the activities of Macquarie and its controlled entities during the financial years ended 31 March 2011 and 31 March 2010, unless otherwise indicated:

Executives:

S.D. Allen ¹	Group Head, Risk Management Group (appointed 28 September 2009)
A.J. Downe ¹	Group Head, Fixed Income, Currencies and Commodities Group
G.A. Farrell ¹	Group Head, Corporate and Asset Finance Group (appointed 2 July 2010)
R.S. Laidlaw ^{1,2,3}	Group Head, Macquarie Securities Group and Macquarie Capital
P.J. Maher ¹	Group Head, Banking and Financial Services Group
N.R. Minogue	Former Group Head, Risk Management Group (resigned 30 November 2009)
S. Vrcelj ^{1,3}	Head of Global Cash and Equities (appointed 2 July 2010)
G.C. Ward ¹	Chief Financial Officer
S. Wikramanayake ^{1,2}	Group Head, Macquarie Funds Group

¹ Member of the Bank's Executive Committee as at 29 April 2011

² Mr Laidlaw's and Ms Wikramanayake's responsibilities increased during the year. Mr Laidlaw became Group Head of Macquarie Capital, in addition to his existing role as Group Head of Macquarie Securities Group. Ms Wikramanayake's role as Group Head of Macquarie Funds Group broadened during the year following the merger of Macquarie Capital Funds with Macquarie Funds Group

³ Subsequent to 31 March 2011, Mr Laidlaw was appointed Executive Chairman of Macquarie Securities Group and will continue as Group Head of Macquarie Capital. Mr Vrcelj was appointed Group Head of Macquarie Securities.

The remuneration and other related party disclosures included in the Remuneration Report have been prepared in accordance with the requirements of the *Corporations Act 2001 (Cth)* and in compliance with AASB 124 *Related Party Disclosures*.

For the purpose of these disclosures, all the individuals listed above have been determined to be Key Management Personnel, as defined by AASB 124 *Related Party Disclosures*. Macquarie's Non-Executive Directors are specifically required by the *Corporations Act 2001 (Cth)* to be included as Key Management Personnel for the purposes of the disclosures in the Remuneration Report. However, the Non-Executive Directors do not consider themselves as part of 'management'.

Appendix 2: Remuneration disclosures

Executive remuneration

The remuneration arrangements for all of the persons listed above as Executive Directors or Executives are described in section 3 above.

In accordance with the requirements of AASB 124 *Related Party Disclosures*, the remuneration disclosures in the remuneration tables for the years ended 31 March 2011 and 31 March 2010, only include remuneration relating to the portion of the relevant periods that each individual was a Key Management Person.

While MEREP equity awards in respect of the current year's performance will be granted in the following financial year, Macquarie begins recognising an expense (based on an initial estimate) from 1 April of the current financial year in relation to these future grants. The expense is estimated using the Macquarie share price as at 31 March 2011 (and for PSUs, also incorporates a risk free interest rate of 5.71 per cent; expected life of four years; and a dividend yield of 5.2 per cent per annum). In the following financial year, Macquarie will adjust the accumulated expense recognised for the final determination of fair value for each MEREP award when granted, and will use this valuation for recognising the expense over the remaining vesting period.

As explained in section 3.3.2 above, profit share amounts retained under the Post-2009 DPS Plan are notionally invested for Executive Directors, providing them with an economic exposure to the underlying investments, typically Macquarie-managed funds. This ensures that they are exposed to both the upside and downside of the underlying securities.

Executive Directors are each entitled to amounts equivalent to the investment earnings (dividends/distributions and security price appreciation) on the underlying securities. Where these amounts are positive, they may be paid to Executive Directors as additional remuneration and are included in the relevant remuneration disclosures below as part of Long-Term Employee Benefits (refer to the 'Earnings on prior year restricted profit share' column in the tables on pages 34 to 35. When these amounts are negative, they are deducted from 'Long-Term Employee Benefits' remuneration in the same column.

These earnings on restricted profit share amounts reflect the investment performance of the assets in which prior year retained DPS amounts have been invested. Their inclusion in the individual remuneration disclosures below may therefore cause distortions when year-on-year remuneration trends are examined. They do not reflect remuneration review decisions made in relation to the individual's current year performance.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

Executive key management personnel remuneration disclosure

			Short-Term Employee Benefits		
			Salary (including superannuation) \$A	Performance related remuneration ¹ \$A	Total short-term employee benefits \$A
Executive Directors					
N.W. Moore	<i>Macquarie Group Managing Director and Chief Executive Officer</i>	2011	484,885	1,754,197	2,239,082
		2010	297,203	2,681,904	2,979,107
W.R. Sheppard	<i>MBL Managing Director and Chief Executive Officer</i>	2011	571,844	1,206,894	1,778,738
		2010	423,389	926,337	1,349,726
Other Executives					
A.J. Downe	<i>Group Head, Fixed Income, Currencies and Commodities Group</i>	2011	624,576	3,007,541	3,632,117
		2010	420,965	3,565,907	3,986,872
R.S. Laidlaw	<i>Group Head, Macquarie Securities Group and Macquarie Capital</i>	2011	142,979	320,293	463,272
		2010	89,895	738,605	828,500
P.J. Maher	<i>Group Head, Banking and Financial Services Group</i>	2011	640,546	1,659,591	2,300,137
		2010	436,580	1,520,590	1,957,170
G.C. Ward	<i>Chief Financial Officer</i>	2011	447,548	1,231,015	1,678,563
		2010	247,669	1,002,989	1,250,658
S. Wikramanayake	<i>Group Head, Macquarie Funds Group</i>	2011	279,724	1,075,388	1,355,112
		2010	334,781	906,733	1,241,514
Total Remuneration – Comparable Executive Key Management Personnel		2011	3,192,102	10,254,919	13,447,021
		2010	2,250,482	11,343,065	13,593,547
New Executives					
S.D. Allen	<i>Group Head, Risk Management Group⁹</i>	2011	439,980	1,538,769	1,978,749
		2010	111,870	86,500	198,370
G.A. Farrell	<i>Group Head, Corporate and Asset Finance Group¹⁰</i>	2011	530,187	1,636,931	2,167,118
		2010	–	–	–
S. Vrcelj	<i>Head of Global Cash and Equities¹⁰</i>	2011	28,423	34,709	63,132
		2010	–	–	–
Former Executive Directors and Executives					
L.G. Cox	<i>Former Executive Voting Director¹¹</i>	2011	–	–	–
		2010	8,533	–	8,533
N.R. Minogue	<i>Former Group Head, Risk Management Group¹²</i>	2011	–	–	–
		2010	166,023	406,349	572,372
Total Remuneration – Executive Key Management Personnel (including new and former members)		2011	4,190,692	13,465,328	17,656,020
		2010	2,536,908	11,835,914	14,372,822

Long-Term Employee Benefits			Share Based Payments				Percentage of remuneration that consists of options and PSUs	
Restricted profit share ²	Earnings on prior year restricted profit share ³	Total long-term employee benefits	Equity Awards including shares ⁴	PSUs ^{5,6}	Options ^{7,8}	Total share-based payments	Total remuneration	%
\$A	\$A	\$A	\$A	\$A	\$A	\$A	\$A	
818,625	398,365	1,216,990	2,268,700	1,495,437	(1,573,450)	2,190,687	5,646,759	(1.38)
423,893	196,699	620,592	205,522	688,542	981,244	1,875,308	5,475,007	30.50
241,378	116,600	357,978	625,481	479,200	(512,710)	591,971	2,728,687	(1.23)
156,469	69,950	226,419	236,797	169,545	359,302	765,644	2,341,789	22.58
300,754	1,472,465	1,773,219	1,857,117	1,957,275	(1,338,210)	2,476,182	7,881,518	7.85
(428,090)	466,881	38,791	151,572	1,193,709	1,061,308	2,406,589	6,432,252	35.06
74,735	145,128	219,863	370,441	338,912	(146,238)	563,115	1,246,250	15.46
(15,910)	55,355	39,445	104,134	172,084	211,344	487,562	1,355,507	28.29
165,960	61,714	227,674	910,107	792,896	(436,786)	1,266,217	3,794,028	9.39
(55,993)	36,179	(19,814)	239,211	390,654	310,562	940,427	2,877,783	24.37
246,203	99,155	345,358	691,047	670,801	(319,140)	1,042,708	3,066,629	11.47
56,612	30,165	86,777	35,136	369,470	203,053	607,659	1,945,094	29.43
537,694	123,477	661,171	224,843	355,358	(140,710)	439,491	2,455,774	8.74
579,454	297,553	877,007	8,557	273,926	439,817	722,300	2,840,821	25.12
2,385,349	2,416,904	4,802,253	6,947,736	6,089,879	(4,467,244)	8,570,371	26,819,645	
716,435	1,152,782	1,869,217	980,929	3,257,930	3,566,630	7,805,489	23,268,253	
307,754	96,902	404,656	585,154	470,753	165,043	1,220,950	3,604,355	17.64
(26,700)	(6,212)	(32,912)	257,707	53,412	136,729	447,848	613,306	31.00
163,693	496,767	660,460	614,068	303,103	213,097	1,130,268	3,957,846	13.04
-	-	-	-	-	-	-	-	-
8,099	3,095	11,194	37,696	10,721	8,613	57,030	131,356	14.72
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	460	460	-	-	(3,729)	(3,729)	5,264	(70.82)
-	-	-	-	-	-	-	-	-
406,349	75,651	482,000	-	-	(179,141)	(179,141)	875,231	(20.47)
2,864,895	3,013,668	5,878,563	8,184,654	6,874,456	(4,080,491)	10,978,619	34,513,202	
1,096,084	1,222,681	2,318,765	1,238,636	3,311,342	3,520,489	8,070,467	24,762,054	

Note: for accompanying notes, refer to page 36.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

Notes on elements of executive remuneration

- ¹ Performance related remuneration represents the current portion of each individual's profit share allocation in relation to the reporting period. For 2010, these amounts also include an adjustment to reflect the difference between the percentage of 2009 profit share that was reported as current in the 2009 Executive remuneration disclosure and the actual percentage of 2009 profit share that is current, as per the remuneration arrangements approved by shareholders on 17 December 2009.
- ² This is the amount of retained profit share which is deferred to future periods and held as a notional investment in Macquarie managed-fund equity, as described in section 3.3.2. For 2011, this amount also includes an adjustment to reflect reallocations of 2010 retained profit share between the Post-2009 DPS Plan and the MEREP. For 2010, this amount also includes an adjustment to reflect the difference between the percentage of 2009 retained profit share notionally invested in Macquarie-managed fund equity as reported in the 2009 Executive remuneration disclosure and the actual percentage of 2009 retained profit share notionally invested in Macquarie-managed fund equity, as per the remuneration arrangements approved by shareholders on 17 December 2009.
- ³ This is the notional earnings / (loss) on prior year restricted profit share allocations described on page 34 to 35 in this Appendix.
- ⁴ This is the current year amortisation, calculated on the basis as described in note 1(xx) – Share based payments to the 2011 Financial Statements in respect of:
- retained profit share, which is deferred to future periods and invested in Macquarie ordinary shares as described in section 3.3.2.
 - the discount to the fair value per share at grant date for Transitioned Amounts (as defined in section 3.3.1).
- For 2010, this amount also represents the write back of 100 per cent of 2009 profit share which was allocated to invest in fully vested Macquarie ordinary shares under the Executive Committee Share Acquisition Plan.^a This is an adjustment because this was delivered as Macquarie equity under MEREP, which is expensed over the vesting period from 1 April 2009, which is up to seven years for the most senior group
- ⁵ This amount has been calculated on the basis as described in note 1(xx) – Share based payments to the 2011 Financial Statements. PSU grants for each individual have been measured at their grant date based on each grant's fair value, and this amount is recognised evenly over the relevant vesting period for each tranche of PSUs granted. For grants in respect of the 2011 performance year which have not yet been granted, the Macquarie share price as at 31 March 2011 is used to estimate the expense.

^a Remuneration arrangements for Executive Committee members were changed in 2008 whereby 10 per cent of pre-tax annual profit share was allocated to invest in fully vested Macquarie ordinary shares for at least three years. In 2009, this was to be increased to 35 per cent pre-tax for the Macquarie Group Managing Director and Chief Executive Officer and 20 per cent pre-tax for other Executive Committee members (including the MBL Managing Director and Chief Executive Officer). As the shares were fully vested, 100 per cent of the allocation was expensed in the year of grant.

⁶ Performance hurdles attached to the PSUs issued to the Executive Committee allow for PSUs to become exercisable upon vesting only when the relevant performance hurdles are met. Performance hurdles for PSUs issued in respect of the 2009 performance year and vesting at 1 July 2011 are not expected to be achieved and therefore the PSUs are not expected to vest. The related expense previously recognised to 31 March 2010 has been reversed in the current financial year and results in a reduction in total 2011 remuneration for the impacted individuals.

⁷ This amount has been calculated on the basis as described in note 1(xx) – Share based payments to the 2011 Financial Statements. Prior option grants for each individual have been measured at their grant dates based on each grant's fair value, and this amount is recognised evenly over the relevant vesting period for each tranche of options granted, regardless of whether the options are in or out of the money. For 2011, the amount is based on options granted in August 2006 (exercise price of \$A61.79), August 2007 (exercise price of \$A71.41) and August 2008 (exercise price of \$A53.91).

If an option lapses in a reporting period, amounts previously recognised as remuneration in relation to the lapsed options are deducted from remuneration in the reporting period. For 2010, in the case of Mr Cox, 9,083 options lapsed during FY 2010 when he resigned from the Board on 29 July 2009, and in the case of Mr Minogue, 87,502 options lapsed during FY2010 when he resigned from executive responsibilities on 30 November 2009. The reversal of the amounts previously recognised in relation to these options exceeded the amounts recognised in relation to their options which vested during the year, resulting in a negative balance in the table above for 2010 for Mr Cox and Mr Minogue.

⁸ Performance hurdles attached to the options issued to the Executive Committee and Executive Voting Directors allow for options to become exercisable upon the relevant performance hurdles being met. Performance hurdles for options issued on or after 30 June 2006 and vesting at 1 July 2010 were not achieved and therefore the options did not vest. The related expense previously recognised for these option grants has been reversed in the current financial year and results in a reduction in total 2011 remuneration for the impacted individuals. Performance hurdles for options issued on or after 30 June 2006 and vesting at 1 July 2011 are not expected to be achieved and therefore the options are not expected to vest. The related expense previously recognised to 31 March 2010 has been reversed in the current financial year and results in a reduction in total 2011 remuneration for the impacted individuals.

Notes on individuals

- ⁹ Mr Allen was appointed to the Executive Committee on 28 September 2009.
- ¹⁰ Mr Farrell and Mr Vrcelj were appointed to the Executive Committee on 2 July 2010.
- ¹¹ Mr Cox resigned from the Board on 29 July 2009.
- ¹² Mr Minogue resigned from the Executive Committee on 30 November 2009.

Non-Executive Director remuneration

The remuneration arrangements for all of the persons listed below as Non-Executive Directors are described in section 3.5.2 above.

		Directors Fees \$A	Other Benefits ¹ \$A	Total Compensation \$A
D.S. Clarke ²	2011	240,000	–	240,000
	2010	167,554	–	167,554
M.J. Hawker ³	2011	65,000	8,571	73,571
	2010	1,747	–	1,747
P.M. Kirby	2011	65,000	–	65,000
	2010	65,000	–	65,000
C.B. Livingstone	2011	65,000	–	65,000
	2010	65,000	–	65,000
H.K. McCann ⁴	2011	72,056	–	72,056
	2010	137,446	–	137,446
J.R. Niland	2011	65,000	–	65,000
	2010	65,000	–	65,000
H.M. Nugent	2011	65,000	–	65,000
	2010	65,000	–	65,000
P.H. Warne	2011	65,000	–	65,000
	2010	65,000	–	65,000
Total Remuneration – Non-Executive Key Management Personnel	2011	702,056	8,571	710,627
	2010	631,747	–	631,747

¹ Other benefits for Non-Executive Directors include an additional annual travel allowance of \$A40,000 for the consolidated entity for Mr Hawker effective 1 July 2010 as a Non-Executive Director based in the United Kingdom..

² Mr Clarke sought and was granted leave for part of FY2010 up to 30 August 2009 and resigned from the Board on 17 March 2011.

³ Mr Hawker was appointed to the Board on 22 March 2010.

⁴ Mr McCann was appointed Acting Chairman in Mr Clarke's absence (for part of FY2010 up to 30 August 2009) and Chairman on 17 March 2011.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

Appendix 3: Loan disclosures

Loans to Key Management Personnel

Details of loans provided by Macquarie to Key Management Personnel and their related parties are disclosed in the following tables:

		Opening balance at 1 April \$A'000	Interest charged \$A'000	Write-down \$A'000	Closing balance at 31 March \$A'000	Number in group 31 March
Total for Key Management Personnel and their related parties	2011	31,691	1,290	–	5,532	n/a
	2010	42,861	3,045	–	31,691	n/a
Total for Key Management Personnel	2011	12,422	693	–	5,532	3
	2010	22,729	863	–	12,422	5

Loans and other financial instrument transactions are made by Macquarie in the ordinary course of business with related parties.

Certain loans are provided under zero cost collar facilities secured over Macquarie Group Limited shares under normal terms and conditions consistent with other customers and employees.

Key Management Personnel including their related parties with loans above \$A100,000 at any time during the financial year:

For the year ended 31 March 2011

Name and position	Balance at 1 April 2010 \$A'000	Interest charged ¹ \$A'000	Write-down \$A'000	Balance at 31 March 2011 ² \$A'000	Highest balance during financial year \$A'000
Executive Directors					
N.M. Moore	5,274	304	–	5,274	5,274
Executives					
R.S. Laidlaw	238	14	–	238	238
Former					
D.S. Clarke ³	26,160	971	–	5,757	26,526

¹ All loans provided by Macquarie to Directors and Executives are made in the ordinary course of business on an arm's-length basis and are entered into under normal terms and conditions consistent with other customers and employees. There have been no write-downs or allowances for doubtful debts.

² Or date resignation if earlier.

³ Mr Clarke resigned from the Board on 17 March 2011. Balance at 31 March 2011 represents the balance at date of resignation.

Key Management Personnel including their related parties with loans above \$A100,000 at any time during the financial year continued:

For the year ended 31 March 2010

Name and position	Balance at 1 April 2009 \$A'000	Interest charged ¹ \$A'000	Write-down \$A'000	Balance at 31 March 2010 ² \$A'000	Highest balance during financial year \$A'000
Executive Directors					
N.M. Moore	5,313	330	–	5,274	5,313
Non-Executive Directors					
D.S. Clarke ³	37,290	2,700	–	26,160	38,975
Executives					
R.S. Laidlaw	238	14	–	238	238

¹ All loans provided by Macquarie to Directors and Executives are made in the ordinary course of business on an arm's-length basis and are entered into under normal terms and conditions consistent with other customers and employees. There have been no write-downs or allowances for doubtful debts.

² Or date of resignation if earlier.

³ Mr Clarke sought and was granted leave for part of FY2010 up to 30 August 2009.

Directors' Report – Remuneration Report for the financial year ended 31 March 2011 continued

Appendix 4: Other disclosures

Other transactions and balances of Key Management Personnel and their related parties

Certain Key Management Personnel and their related parties have acquired Infrastructure Bonds and similar products from subsidiaries within the Bank, which have been financed with limited recourse loans and are subject to forward sale agreements. The loan repayments and proceeds arising from the forward sale agreements are subject to a legal right of set-off and as such are not recognised for financial reporting purposes. The only amounts recognised by the economic entity in respect of these transactions are the annual payments from the relevant Key Management Personnel which are brought to account as fee revenue. These transactions have been undertaken on terms and conditions consistent with other customers and employees.

	Consolidated 2011 \$A'000	Consolidated 2010 \$A'000
Total annual contributions from Key Management Personnel and their related parties in respect of Infrastructure Bonds and similar products	12,181	7,772

The annual contributions in respect of Infrastructure Bonds and similar products relate to the following Key Management Personnel:

Executive Directors

N.W. Moore

W.R. Sheppard

Non-Executive Directors

P.M. Kirby

Executives

S.D. Allen, A.J. Downe, G.A. Farrell (2011 only) R.S. Laidlaw, P.J. Maher, S. Vrcelj (2011 only), G.C. Ward, S. Wikramanayake

Former

L.G. Cox (2010 only), N.R. Minogue (2010 only)

The following Key Management Personnel (including related parties) have entered into zero cost collar transactions with Macquarie and other non related entities in respect of Macquarie ordinary shares. This has the effect of acquiring cash-settled put options against movements in the Macquarie share price below nominated levels and disposing of the benefit of any share price movement above the nominated level.

Name and position	Description	Number of shares 2011 ¹	Number of shares 2010 ²
Executives			
A.J. Downe	Matured August 2010	21,905	–
	Matured July 2010	–	21,905
Former			
D.S. Clarke	Matured June 2010	–	213,517

- Mr Downe entered into a zero cost collar for the period 4 June 2010 to 2 August 2010. There was no loan associated with this collar and the shares were not sold upon maturity on 2 August 2010. Mr Downe subsequently sold these shares in August 2010.
- The collar and the loan reported for Mr Clarke and the collar reported for Mr Downe for the year ending 31 March 2010 were unwound on 31 May 2010 and 1 June 2010 respectively. The shares and the loan (where applicable) were repaid on those dates.

All other transactions with Key Management Personnel (including their personally related parties) were conducted on an arm's-length basis in the ordinary course of business and under normal terms and conditions for customers and employees. These transactions were trivial or domestic in nature and consisted principally of normal personal banking and financial investment services.

This is the end of the Remuneration Report.

Directors' Report

for the financial year ended 31 March 2011

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Voting Directors' equity participation

At 29 April 2011, none of the Voting Directors held any relevant interests, as notified by the Voting Directors to the ASX in accordance with the *Corporations Act 2001 (Cth)*, in shares or share options of Macquarie Bank.

Directors' and officers' indemnification and insurance

Under Macquarie Bank's Constitution, Macquarie Bank indemnifies all past and present Directors and Secretaries of Macquarie Bank (including at this time the Voting Directors named in this report and the Secretaries), and its wholly-owned subsidiaries, against every liability incurred by them in, and all legal costs incurred in defending or resisting (or otherwise in connection with) proceedings in which they become involved because of their respective capacities unless:

- the liability is owed to Macquarie Bank or to a related body corporate;
- the liability did not arise out of conduct in good faith;
- the liability is for a pecuniary penalty order or a compensation order under the *Corporations Act 2001 (Cth)*;
- in the case of legal costs, the costs are incurred in defending or resisting a liability excluded above, criminal proceedings in which the person is found guilty or proceedings brought by the Australian Securities & Investments Commission (ASIC) or a liquidator where grounds for a court order are established (but excluding costs relating to investigations before commencement of proceedings for the court order), or the costs incurred in relation to proceedings for relief to the person under the *Corporations Act 2001 (Cth)* in which the court denies relief;
- Macquarie Bank is forbidden by statute to indemnify the person against the liability or legal costs; or
- an indemnity by Macquarie Bank of the person against the liability or legal costs would, if given, be made void by statute.

Following approval by shareholders at the 1998 Annual General Meeting, Macquarie Bank entered into a Deed of Access, Indemnity and Insurance dated 4 August 1998 (Deed), which protects Voting Directors acting as Voting Directors during their term of office and after their resignation (except where an individual engages in conduct involving a lack of good faith). Under the Deed, Macquarie Bank agrees to:

- indemnify a current or past Voting Director to the full extent of the indemnity given in relation to officers of Macquarie Bank under its Constitution in force from time to time;
- take out and maintain a reimbursement insurance policy and make available to Voting Directors a Directors' and Officers' insurance policy (each policy to be in an amount and on terms and conditions appropriate for a reasonably prudent bank in Macquarie Bank's position) for seven years after the Voting Director ceases to be a Voting Director of Macquarie Bank;
- loan funds to a Voting Director to cover the Voting Director's legal costs in defending a claim, repayable when the outcome of the proceedings is determined (where the outcome results in the Voting Director having an indemnity for such legal costs, the loan will be repayable from the amount paid by Macquarie Bank to the Voting Director under the indemnity); and
- grant access to Voting Directors to all Board papers for at least seven years after the Voting Director ceases to be a Voting Director of Macquarie Bank, and access to other documents if the documents were in Macquarie Bank's possession at the time the Voting Director was a Voting Director and where it is not contrary to Macquarie Bank's interest for the documents to be provided.

In addition, following the approval of shareholders at the 1999 Annual General Meeting, Macquarie Bank made an Indemnity and Insurance Deed Poll on 30 July 1999 (Deed Poll). The benefit of the undertakings made by Macquarie Bank under the Deed Poll have been given to each of the Directors, Secretaries, persons involved in the management and certain other persons, of Macquarie Bank, its wholly-owned subsidiaries and other companies where the person is acting as such at the specific request of Macquarie Bank or a wholly-owned subsidiary of Macquarie Bank. The Deed Poll provides for the same indemnity and insurance arrangements for those persons with the benefit of the Deed Poll as for the Deed of Indemnity, Access and Insurance described above. However, the Deed Poll does not provide for access to documents of Macquarie Bank.

Directors' Report

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Following the approval of shareholders at the 2000 Annual General Meeting, both the Deed and the Deed Poll were amended in a minor way to clarify the operation of the deeds with respect to the provision of loans to indemnified persons for legal costs and the requirement to repay such loans. From November 2005, each Director, each Secretary and other officers having the benefit of the indemnity provisions under Macquarie Bank's Constitution, the Deed and the Deed Poll was asked to agree that those indemnities would not apply to the extent to which an indemnity for any liability or legal costs is forbidden by Australian statute or would, if given, be made void by Australian statute. These limitations on the indemnities were subsequently adopted into the indemnity provisions of Macquarie Bank's Constitution with the approval of shareholders at the 2006 Annual General Meeting with the effect that this limitation now applies directly to the terms of the Deed and the Deed Poll.

Certain Directors or Secretaries have executed the Macquarie Indemnity and Insurance Deed Poll under which Macquarie indemnifies them against every liability incurred by them, including all legal costs incurred in defending or resisting (or otherwise in connection with) proceedings in which they become involved, because of their respective capacities.

This indemnity does not apply to the extent that:

- Macquarie is forbidden by law to indemnify the person against the liability or legal costs; or
- an indemnity by Macquarie of the person against the liability or legal costs, if given would be void by law.

A Directors' and Officers' insurance policy, taken out by Macquarie, is in place that provides cover for each person in favour of whom such insurance is required to be taken out under the Deed and the Deed Poll and for Macquarie Bank in indemnifying such persons pursuant to the Deed and the Deed Poll. Relevant individuals pay the premium attributable to the direct coverage under the policy and Macquarie Bank pays the premium attributable to the Bank reimbursement coverage under the policy. The Directors' and Officers' insurance policy prohibits disclosure of the premium payable under the policy and the nature of the liabilities insured.

Share options

Information on Macquarie's share option scheme, options granted and shares issued as a result of the exercise of options during or since the end of the financial year is contained in note 36 – Employee equity participation, in the financial report.

No unissued shares in Macquarie Bank are under option as at the date of this report.

Directors' relevant interests

The relevant interests of Directors on 29 April 2011 in managed investment schemes made available by related bodies corporate of Macquarie Bank and other disclosable relevant interests are listed in the table below:

Name and position	Direct interests	Indirect interests		
Executive Voting Directors				
W.R. Sheppard	Macquarie ordinary shares	8,519	Macquarie ordinary shares	219,664
	Macquarie Group Employee Retained Equity Plan (MEREP) Restricted Share Units (RSUs)	115,669	MGESOP Options	96,000
	MEREP Performance Share Units (PSUs)	28,827	Macquarie Convertible Preference Securities (CPS)	6,000
	Macquarie Group Employee Share Option Plan (MGESOP) Options	45,000	Macquarie Small Companies Growth Fund units	132,933
	Macquarie Wrap Cash Account (MWCA) units	205,063.84	Macquarie Master Australian Enhanced Equities Fund units	350,378
			No.1 Martin Place Trust units	329,600
			Macquarie Global Infrastructure Fund (GIF) (A) units	98,044
			Macquarie GIF (B) units	2,156
			Charter Hall REIT units	121,801
	N.W. Moore	Macquarie ordinary shares	858,699	Macquarie ordinary shares
MEREP RSUs		571,822	Macquarie GIF (B) units	64,177
MGESOP Options		558,300	Macquarie GIF III (B) units	362,382
MEREP PSUs		146,525		
Macquarie GIF(B) units		483,674		
2006 Macquarie ReFlexion Trusts units		5,000,000		
2004 Macquarie Timber Land Trust units		50		
2006 Macquarie Timber Land Trust units		75		
Macquarie GIF III (B) units		1,637,618		
Independent Voting Directors				
M.J. Hawker	Macquarie ordinary shares	2,000	Macquarie CPS	450
			MWCA units	50,921.66
P.M. Kirby	Macquarie ordinary shares	23,198	MQ Capital-Asia Trust units	175,000
			MQ Special Events Fund units	340,038
C.B. Livingstone	Macquarie ordinary shares	646	Macquarie ordinary shares	11,354
			Charter Hall REIT units	3,762
H.K. McCann	Macquarie ordinary shares	11,922	Macquarie ordinary shares	1,563
			No.1 Martin Place Trust units	103,000
J.R. Niland	Macquarie ordinary shares	2,309	Macquarie ordinary shares	7,813
H.M. Nugent	Macquarie ordinary shares	3,564	Macquarie ordinary shares	9,442
P.H. Warne	Macquarie ordinary shares	2,744	Macquarie ordinary shares	13,077
			Charter Hall REIT units	14,084

Directors' Report

for the financial year ended 31 March 2011

continued

Environmental regulations

Macquarie Bank and its subsidiaries have policies and procedures in place that are designed to ensure that, where operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory, those obligations are identified and appropriately addressed.

The Voting Directors have determined that there has not been any material breach of those obligations during the financial year.

Non-audit services

Details of the amounts paid or payable to the auditor of MBL, PricewaterhouseCoopers (PwC), and its related practices for non-audit services provided during the year is disclosed in note 43 – Audit and other services provided by PricewaterhouseCoopers.

Macquarie Bank's external auditor policy, which is discussed in the Macquarie Corporate Governance Statement contained in the 2011 Macquarie Group Annual Report, states that the external auditor is not to provide non-audit services under which the auditor assumes the role of management, becomes an advocate for Macquarie Bank, or audits its own professional expertise. The policy also provides that significant permissible non-audit assignments awarded to external auditors must be approved in advance by the BAC or the BAC Chairman, as appropriate.

The BAC has reviewed a summary of non-audit services provided during the year by PwC and its related practices, and has confirmed that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Act. This has been formally advised to the Board of Directors. Consequently, the Voting Directors are satisfied that the provision of non-audit services during the year by the auditor and its related practices did not compromise the auditor independence requirements of the Act.

Auditor's independence declaration

A copy of the auditor's independence declaration, as required under section 307C of the Act, is set out in the Directors' Report Schedule 2 following this report.

Rounding of amounts

In accordance with *ASIC Class Order 98/0100* (as In accordance with *ASIC Class Order 98/0100* (as amended)), amounts in the Annual Report have been rounded off to the nearest million dollars unless otherwise indicated.

This report is made in accordance with a resolution of the Voting Directors.



H. Kevin McCann, AM
Independent Director and
Chairman



Richard Sheppard
Managing Director and
Chief Executive Officer

Sydney
29 April 2011

Directors' Report Schedule 1 for the financial year ended 31 March 2011

Directors' experience and special responsibilities

H Kevin McCann, AM, BA LLB (Hons) (Syd), LLM (Harv), FAICD (age 70)

Independent Chairman since 17 March 2011

Independent Voting Director – joined the Board in December 1996

Member – Board Audit Committee

Kevin McCann joined the Board of Macquarie Bank as an Independent Voting Director in December 1996. He has been a member of the Board of Macquarie Group Limited since August 2007. Mr McCann was appointed as Macquarie's Lead Independent Director in October 2007 and as the Chairman of the Macquarie Bank Limited and Macquarie Group Limited Boards on 17 March 2011. Mr McCann is currently Chairman of Origin Energy Limited (since February 2000) and ING Management Limited (since September 2010), a Director of BlueScope Steel Limited (since May 2002) and a member of the Council of the National Library of Australia, the University of Sydney Senate and the Evans and Partners Advisory Board. He is also NSW President and a board member of the Australian Institute of Company Directors.

Mr McCann was a Partner (from 1970 to 2004) and Chairman of Allens Arthur Robinson, a leading firm of Australian lawyers. He practiced as a commercial lawyer specialising in Mergers and Acquisitions, Mineral and Resources Law and Capital Markets Transactions. He was previously Chairman of Triako Resources Limited (April 1999 to 2006) and Healthscope Limited (March 1994 to October 2008).

Mr McCann is a resident of New South Wales.

W Richard Sheppard BEd (Hons) (Sydney) (age 62)

Managing Director and Chief Executive Officer since November 2007

Executive Voting Director – joined the Board in November 2007

Following the restructure of Macquarie Bank in November 2007, Mr Sheppard was appointed Managing Director and Chief Executive Officer of Macquarie Bank Limited and Deputy Managing Director of Macquarie Group Limited. He has been a member of the Group Executive Committee since 1986 and Deputy Managing Director since 1996. He is also currently a member of Macquarie Group Limited's Board Risk Committee, a member of the Government's Financial Sector Advisory Council and a Director of the Australian Financial Markets Association. Mr Sheppard is a member of a number of other boards including the Bradman Foundation and the Sydney Cricket Club.

Richard Sheppard joined Macquarie Bank's predecessor, Hill Samuel Australia in 1975, initially working in Corporate Finance. He was Head of the Bank's Melbourne Office from 1986 until 1988 and became Head of the Corporate Banking Group in 1988. He is a past Chairman of several of the Bank's associates including Hills Motorway Trust (December 2002 to April 2006), Macquarie Airports (December 2002 to April 2006), Macquarie Private Capital Group (Director from August 2004 and Chairman from October 2005 until June 2008), Macquarie CountryWide Management Limited (March 2007 to March 2010) and Macquarie DDR Management Limited (October 2003 to June 2010) and a former Director of Macquarie Office Management Limited (May 2009 to March 2010).

Mr Sheppard is a resident of New South Wales.

Directors' Report Schedule 1

for the financial year ended 31 March 2011

continued

Nicholas W Moore, BCom LLB (UNSW), FCA (age 52)

Executive Voting Director – joined the Board in May 2008

Nicholas Moore joined the Board of Macquarie Bank as an Executive Director in May 2008, and has been an Executive Voting Director of Macquarie Group Limited since February 2008. Currently, Mr Moore is Managing Director and Chief Executive Officer of Macquarie Group Limited. He is also Chairman of the Police and Community Youth Clubs NSW Limited, a Director of the Centre for Independence Studies and Chairman of the University of NSW Business School Advisory Council.

Mr Moore joined Macquarie's Corporate Services Division in 1986. He led a range of transactions, including Hills Motorway, which led the development of Macquarie's infrastructure business. In 1996, Mr Moore was appointed Head of the Project and Structured Finance Division. In 1998 he was appointed Head of the Asset and Infrastructure Group and then Head of the Investment Banking Group (predecessor to Macquarie Capital) on its inception in 2001. In this role, he oversaw significant growth in Macquarie Capital's net income through the global growth of the advisory, fund management, financing and securities businesses. He was previously a Director of Macquarie Infrastructure Group (January 1996 to April 2008), Macquarie Capital Alliance Group (August 2003 to April 2008) and Macquarie Media Group (September 2005 to April 2008).

Mr Moore is a resident of New South Wales.

Michael J Hawker, AM, BSc (Sydney), FAICD, FAIM, SF Fin (age 51)

Independent Voting Director – joined the Board in March 2010

Michael Hawker has been an Independent Voting Director of Macquarie Bank and Macquarie Group Limited since March 2010. Mr Hawker also serves as a Director of Aviva plc, the largest insurance provider in the UK (since January 2010), the Australian Rugby Union, the Sydney University Football Club Foundation and Chairman of the George Institute for Global Health. He is also a member of the board of trustees of the Giant Steps Foundation and a member of the Advisory Board to GEMS, a Hong Kong based private equity firm.

Mr Hawker was Chief Executive Officer and Managing Director of Insurance Australia Group from 2001 to 2008. From 1995 to 2001, he was with Westpac Banking Corporation where his roles included Group Executive of Business and Consumer Banking and General Manager of Financial Markets. Prior to this, he held a number of roles with Citibank, including Deputy Managing Director for Australia and subsequently Executive Director, Head of Derivatives, Europe. He has also been President of the Insurance Council of Australia, Chairman of the Australian Financial Markets Association, board member of the Geneva Association, member of the Financial Sector Advisory Council and is the founder of the Australian Business in the Community Network.

Mr Hawker is a resident of the United Kingdom.

Peter M Kirby, BEc (Rhodes), BEc (Hons) (Natal), MA (Manch), MBA (Wits) (age 63)

Independent Voting Director – joined the Board in June 2003

Member - Board Audit Committee

Peter Kirby joined the Board of Macquarie Bank as an Independent Voting Director in June 2003 and has been a member of the Board of Macquarie Group Limited since August 2007. Mr Kirby is currently Chairman of DuluxGroup Limited (since July 2010) and a Director of the Beacon Foundation.

Mr Kirby was the Managing Director and Chief Executive Officer of CSR Limited from 1998 to March 2003. He was a member of the Board of the Business Council of Australia from 2001 to 2003. Mr Kirby received the Centenary Medal in 2003. Prior to joining CSR, he was with the Imperial Chemical Industries PLC group (ICI) for 25 years in a variety of senior management positions around the world, including Chairman/CEO of ICI Paints, responsible for the group's coatings businesses worldwide, and a member of the Executive Board of ICI PLC, with responsibility for ICI Americas and the western hemisphere. He is a former Chairman and Director of Medibank Private Limited and a former Director of Orica Limited (from July 2003 to July 2010).

Mr Kirby is a resident of Victoria.

Catherine B Livingstone, AO, BA (Hons) (Macquarie), HonDBus (Macquarie), HonDSc (Murdoch), FCA, FTSE, FAICD (age 55)

Independent Voting Director – joined the Board in November 2003

Chairman – Board Audit Committee

Catherine Livingstone joined the Board of Macquarie Bank as an Independent Voting Director in November 2003 and has been a member of the Board of Macquarie Group Limited since August 2007. Ms Livingstone is currently Chairman of Telstra Corporation Limited (Director since November 2000 and Chairman since May 2009), a Director of WorleyParsons Limited (since June 2007) and Future Directions International Pty Ltd and a member of the New South Wales Innovation Council and the Royal Institution of Australia.

Ms Livingstone was the Managing Director of Cochlear Limited from 1994 to 2000. Prior to that she was the Chief Executive, Finance at Nucleus Limited and before that held a variety of finance and accounting roles including having been with chartered accountants, Price Waterhouse, for several years. Ms Livingstone was also previously Chairman of CSIRO and a Director of Goodman Fielder and Rural Press Limited. Ms Livingstone was awarded the Centenary Medal in 2003 for service to Australian Society in Business Leadership and was elected a Fellow of the Australian Academy of Technological Sciences and Engineering in 2002.

Ms Livingstone is a resident of New South Wales.

Directors' Report Schedule 1

for the financial year ended 31 March 2011

continued

John R Niland, AC, BCom MCom HonDSc (UNSW), PhD (Illinois), DUniv (SCU), FAICD (age 70)

Independent Voting Director – joined the Board in February 2003

John Niland joined the Board of Macquarie Bank as an Independent Voting Director in February 2003 and has been a member of the Board of Macquarie Group Limited since August 2007. Dr Niland is a Professor Emeritus of the University of New South Wales (UNSW) and was Vice-Chancellor and President of UNSW from 1992 to 2002. Before that he was the Dean of the Faculty of Commerce and Economics. He is currently Chairman of Campus Living Funds Management Limited and Deputy Chairman of the Board of Trustees of Singapore Management University.

Dr Niland is a former Chief Executive of the State Pollution Control Commission and Executive Chairman of the Environment Protection Authority. He has served on the Australian Universities Council, the Prime Minister's Science, Engineering and Innovation Council, the boards of the Centennial Park and Moore Park Trust, realestate.com.au Limited, St Vincent's Hospital, the Sydney Symphony Orchestra Foundation, the Sydney Olympic bid's Building Commission and the University Grants Committee of Hong Kong. He is a former President of the National Trust of Australia (NSW).

Dr Niland is a resident of New South Wales.

Helen M Nugent, AO, BA (Hons)(Qld), PhD (Qld), MBA (Harv), HonDBus (Qld) (age 62)

Independent Voting Director – joined the Board in June 1999

Helen Nugent joined the Board of Macquarie Bank as an Independent Voting Director in June 1999 and has been a member of the Board of Macquarie Group Limited since August 2007. Dr Nugent is currently Chairman of Funds SA and a Director of Origin Energy Limited (since March 2003) and Freehills. She is also Deputy Chairman of the National Portrait Gallery and Chancellor of Bond University.

Previously, Dr Nugent was involved in the financial services sector as a Director of Strategy at Westpac Banking Corporation (1994 to 1999) and a Non-Executive Director of the State Bank of New South Wales (1993 to 1994) and Mercantile Mutual (1992 to 1994). In addition, she was previously Chairman of Hudson (Australia and New Zealand) and Swiss Re Life and Health (Australia) Limited and a Director of UNITAB, Carter Holt Harvey and Australia Post. She has also been a Partner at McKinsey and Company. She has been actively involved in the arts and education. In the arts, she was formerly Deputy Chairman of the Australia Council, Chairman of the Major Performing Arts Board of the Australia Council, Chairman of the Ministerial Inquiry into the Major Performing Arts and Deputy Chairman of Opera Australia. In education, Dr Nugent was a member of the Bradley Review into Higher Education and a Professor in Management and Director of the MBA Program at the Australian Graduate School of Management.

Dr Nugent is a resident of New South Wales.

Peter H Warne, BA (Macquarie) (age 55)

Independent Voting Director – joined the Board in July 2007

Member – Board Audit Committee

Peter Warne joined the Board of Macquarie Bank as an Independent Voting Director in July 2007 and has been a member of the Board of Macquarie Group Limited since August 2007. Mr Warne is on the boards of other listed entities as Chairman of ALE Property Group (since September 2003) and Deputy Chairman of WHK Group Limited (Director since May 2007). He is also Deputy Chairman of Capital Markets CRC Limited, a Director of Next Financial Limited, Securities Research Centre of Asia Pacific Limited and ASX Limited, and a member of the Advisory Board of the Australian Office of Financial Management.

Mr Warne was Head of Bankers Trust Australia Limited's (BTAL) Financial Markets Group from 1988 to 1999. Prior to this he held a number of roles at BTAL. He is also a former Director of Macquarie Capital Alliance Group (February 2005 to June 2007) and a former Chairman and Director of TEYS Limited (Director from October 2007 and Chairman from July 2008 to June 2009). Mr Warne was a Director and Deputy Chairman of the Sydney Futures Exchange (SFE) from 1995 to 1999 and a Director from 2000 to 2006. When the SFE merged with the Australian Securities Exchange in 2006 he became a Director of ASX Limited.

Mr Warne is a resident of New South Wales.

Bank secretaries' qualifications and experience

Dennis Leong, BSc BE (Hons) (Syd), MCom (UNSW), CPA, FCIS

Company Secretary since 12 October 2006

Dennis Leong is an Executive Director of Macquarie and Head of the Group's Company Secretarial Division, which is responsible for the Group's company secretarial requirements, professional risks and general insurances and employee equity plans. He has had over 17 years company secretarial experience and 12 years experience in corporate finance at Macquarie and Hill Samuel Australia Limited.

Amelia Cho, BCom LLB (UNSW)

Assistant Company Secretary since 29 March 2001

Amelia Cho is an Associate Director of Macquarie. Ms Cho has had 15 years experience in the Company Secretarial Division at Macquarie. She was previously an Associate Lawyer in the Commercial Division of Dunhill Madden Butler (now known as PricewaterhouseCoopers Legal). She holds a current practising certificate with the Law Society of NSW.

Paula Walsh, ACIS

Assistant Company Secretary since 29 May 2008

Paula Walsh is a Division Director of Macquarie. She has over 23 years company secretarial experience, with 24 years service at British Telecommunications plc where, amongst other roles, she was most recently Head of Corporate Governance, Asia Pacific, until joining Macquarie in May 2007.

Nigel Donnelly BEc LLB (Hons) (Macquarie)

Assistant Company Secretary since 30 October 2008

Nigel Donnelly is a Division Director of Macquarie and has over 11 years experience as a solicitor. Nigel joined Macquarie in April 2006, and was previously a Senior Associate at Mallesons Stephen Jaques with a general corporate advisory and corporate governance focus.

Directors' Report Schedule 2 for the financial year ended 31 March 2011



Auditor's independence declaration

As lead auditor for the audit of Macquarie Bank Limited for the year ended 31 March 2011, I declare that to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of the *Corporations Act 2001 (Cth)* in relation to the audit, and
- b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Macquarie Bank Limited and the entities it controlled during the period.

A handwritten signature in black ink, appearing to read 'DH Armstrong'. The signature is stylized with a large, sweeping loop at the end.

DH Armstrong
Partner
PricewaterhouseCoopers

Sydney
29 April 2011

Macquarie Bank Limited

2011 Financial Report

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The Financial Report was authorised for issue by the Directors on 29 April 2011.

The Consolidated Entity has the power to amend and reissue the Financial Report.

Income statements

for the financial year ended 31 March 2011

	Notes	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Interest and similar income		5,141	4,353	3,856	3,166
Interest expense and similar charges		(3,490)	(3,028)	(2,812)	(2,311)
Net interest income	2	1,651	1,325	1,044	855
Fee and commission income	2	1,307	1,036	95	96
Net trading income	2	1,279	1,237	594	582
Share of net profits of associates and joint ventures accounted for using the equity method	2	45	7	-	-
Other operating income and charges	2	513	47	659	1,026
Net operating income		4,795	3,652	2,392	2,559
Employment expenses	2	(1,553)	(1,089)	(853)	(687)
Brokerage and commission expenses	2	(669)	(548)	(615)	(401)
Occupancy expenses	2	(139)	(122)	(84)	(86)
Non-salary technology expenses	2	(98)	(88)	(59)	(58)
Other operating expenses	2	(1,231)	(1,043)	(736)	(824)
Total operating expenses		(3,690)	(2,890)	(2,347)	(2,056)
Operating profit before income tax		1,105	762	45	503
Income tax (expense)/benefit	4	(272)	(65)	(15)	81
Profit after income tax		833	697	30	584
Profit attributable to non-controlling interests:					
Macquarie Income Preferred Securities	5	(4)	(8)	-	-
Other non-controlling interests		-	(5)	-	-
Profit attributable to non-controlling interests		(4)	(13)	-	-
Profit attributable to equity holders of Macquarie Bank Limited		829	684	30	584
Distributions paid or provided on:					
Macquarie Income Securities	5	(26)	(21)	-	-
Convertible debentures	5	-	-	(4)	(15)
Profit attributable to ordinary equity holders of Macquarie Bank Limited		803	663	26	569

The above income statements should be read in conjunction with the accompanying notes.

Statements of comprehensive income for the financial year ended 31 March 2011

	Notes	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Profit after income tax for the financial year		833	697	30	584
Other comprehensive income/(expense):					
Available for sale investments, net of tax	32	115	188	56	173
Cash flow hedges, net of tax	32	21	99	21	-
Share of other comprehensive expense of associates and joint ventures, net of tax	32	-	(29)	-	-
Exchange differences on translation of foreign operations, net of tax		(406)	(167)	23	110
Total other comprehensive (expense)/income for the financial year		(270)	91	100	283
Total comprehensive income for the financial year		563	788	130	867
Total comprehensive income for the financial year is attributable to:					
Ordinary equity holders of Macquarie Bank Limited		537	689	126	852
Macquarie Income Preferred Securities holders		-	73	-	-
Macquarie Income Securities holders		26	21	-	-
Convertible debenture holders		-	-	4	15
Other non-controlling interests		-	5	-	-
Total comprehensive income for the financial year		563	788	130	867

The above statements of comprehensive income should be read in conjunction with the accompanying notes.

Statements of financial position

as at 31 March 2011

	Notes	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Assets					
Due from financial institutions	6	7,579	6,490	6,256	5,120
Cash collateral on securities borrowed and reverse repurchase agreements	7	7,418	6,084	7,370	5,978
Trading portfolio assets	8	14,423	11,324	13,543	11,151
Loan assets held at amortised cost	9	45,382	43,794	17,299	16,162
Other financial assets at fair value through profit or loss	11	10,607	7,125	9,940	6,949
Derivative financial instruments – positive values	40	21,145	21,540	18,551	14,955
Other assets	12	6,839	6,567	3,702	3,103
Investment securities available for sale	13	15,003	16,761	13,948	15,937
Intangible assets	14	866	948	40	16
Life investment contracts and other unitholder investment assets	15	5,062	4,854	–	–
Due from related body corporate entities	34	2,443	2,391	2,230	2,457
Due from subsidiaries	34	–	–	20,134	16,361
Interests in associates and joint ventures accounted for using the equity method	16	856	915	471	342
Property, plant and equipment	17	2,363	893	16	23
Investments in subsidiaries	18	–	–	3,781	3,848
Deferred income tax assets	20	376	373	61	283
Non-current assets and assets of disposal groups classified as held for sale	21	–	51	–	–
Total assets		140,362	130,110	117,342	102,685
Liabilities					
Due to financial institutions	22	1,580	2,167	1,011	1,238
Cash collateral on securities lent and repurchase agreements	23	6,103	7,201	6,099	7,195
Trading portfolio liabilities	24	5,732	4,921	5,621	4,910
Derivative financial instruments – negative values	40	21,455	21,634	18,191	14,866
Deposits		35,106	22,288	34,827	22,043
Debt issued at amortised cost	25	36,943	39,408	17,697	19,170
Other financial liabilities at fair value through profit or loss	26	2,909	2,625	2,122	2,355
Other liabilities	27	7,463	6,727	4,049	3,103
Current tax liabilities		67	76	15	18
Life investment contracts and other unitholder liabilities		5,055	4,864	–	–
Due to related body corporate entities	34	6,471	8,008	6,212	8,044
Due to subsidiaries	34	–	–	10,607	9,596
Provisions	28	80	71	56	53
Deferred income tax liabilities	20	393	273	57	78
Liabilities of disposal groups classified as held for sale	21	–	9	–	–
Total liabilities excluding loan capital		129,357	120,272	106,564	92,669
Loan capital					
Subordinated debt at amortised cost		1,430	905	1,430	905
Subordinated debt at fair value through profit or loss		467	499	467	499
Total loan capital	30	1,897	1,404	1,897	1,404
Total liabilities		131,254	121,676	108,461	94,073
Net assets		9,108	8,434	8,881	8,612

	Notes	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Equity					
Contributed equity					
Ordinary share capital	31	7,278	6,508	7,278	6,508
Equity contribution from ultimate parent entity	31	102	87	75	67
Macquarie Income Securities	31	391	391	391	391
Convertible debentures	31	–	–	107	107
Reserves	32	(436)	(170)	351	251
Retained earnings	32	1,701	1,533	679	1,288
Total capital and reserves attributable to ordinary equity holders of Macquarie Bank Limited					
		9,036	8,349	8,881	8,612
Non-controlling interests					
Macquarie Income Preferred Securities	32	63	67	–	–
Other non-controlling interests	32	9	18	–	–
Total equity		9,108	8,434	8,881	8,612

The above statements of financial position should be read in conjunction with the accompanying notes.

Statements of changes in equity for the financial year ended 31 March 2011

	Notes	Contributed equity \$m	Reserves \$m	Retained earnings \$m	Total \$m	Non- controlling interests \$m	Total equity \$m
Consolidated							
Balance at 1 April 2009		4,951	(201)	1,250	6,000	410	6,410
Total comprehensive income for the financial year		–	26	684	710	78	788
Transactions with equity holders in their capacity as equity holders:							
Contributions of equity, net of transaction costs	31	2,005	–	–	2,005	–	2,005
Contributions from ultimate parent entity in relation to share based payments	31	30	–	–	30	–	30
Dividends and distributions paid or provided	5	–	–	(401)	(401)	–	(401)
Reserves arising from group restructure of combining entities under common control	32	–	5	–	5	–	5
Non-controlling interests:							
Contributions of equity, net of transaction costs	32	–	–	–	–	6	6
Cancellation of Macquarie Income Preferred Securities	32	–	–	–	–	(396)	(396)
Distributions paid or provided		–	–	–	–	(13)	(13)
		2,035	5	(401)	1,639	(403)	1,236
Balance at 31 March 2010		6,986	(170)	1,533	8,349	85	8,434
Total comprehensive (expense)/income for the financial year		–	(266)	829	563	–	563
Transactions with equity holders in their capacity as equity holders:							
Contributions of equity, net of transaction costs	31	770	–	–	770	–	770
Contribution from ultimate parent entity in relation to share based payments	31	15	–	–	15	–	15
Dividends and distributions paid or provided	5	–	–	(661)	(661)	–	(661)
Non-controlling interests:							
Distributions of equity, net of transaction costs	32	–	–	–	–	(9)	(9)
Distributions paid or provided		–	–	–	–	(4)	(4)
		785	–	(661)	124	(13)	111
Balance at 31 March 2011		7,771	(436)	1,701	9,036	72	9,108

	Notes	Contributed equity \$m	Reserves \$m	Retained earnings \$m	Total \$m	Non- controlling interests \$m	Total equity \$m
							Bank
Balance at 1 April 2009		5,822	(32)	1,099	6,889	–	6,889
Total comprehensive income for the financial year		–	283	584	867	–	867
Transactions with equity holders in their capacity as equity holders:							
Contributions of equity, net of transaction costs	31	1,228	–	–	1,228	–	1,228
Contribution from ultimate parent entity in relation to share based payments	31	23	–	–	23	–	23
Dividends and distributions paid or provided	5	–	–	(395)	(395)	–	(395)
		1,251	–	(395)	856	–	856
Balance at 31 March 2010		7,073	251	1,288	8,612	–	8,612
Total comprehensive income for the financial year		–	100	30	130	–	130
Transactions with equity holders in their capacity as equity holders:							
Contributions of equity, net of transaction costs	31	770	–	–	770	–	770
Contribution from ultimate parent entity in relation to share based payments	31	8	–	–	8	–	8
Dividends and distributions paid or provided	5	–	–	(639)	(639)	–	(639)
		778	–	(639)	139	–	139
Balance at 31 March 2011		7,851	351	679	8,881	–	8,881

The above statements of changes in equity should be read in conjunction with the accompanying notes.

Statements of cash flows

for the financial year ended 31 March 2011

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
	Notes			
Cash flows from operating activities				
Interest received	5,004	4,637	3,793	3,436
Interest and other costs of finance paid	(3,531)	(3,195)	(2,839)	(2,467)
Dividends and distributions received	220	144	451	543
Fees and other non-interest income received	1,814	1,628	683	799
Fees and commissions paid	(677)	(566)	(619)	(407)
Net (payments for)/receipts from trading portfolio assets and other financial assets/liabilities	(2,899)	3,012	(3,752)	(641)
Payments to suppliers	(1,425)	(1,595)	(885)	(1,176)
Employment expenses paid	(1,318)	(1,081)	(713)	(748)
Income tax paid	(148)	(131)	(83)	(48)
Life investment contract income/(expense)	126	(137)	-	-
Life investment contract premiums received and other unitholder contributions	2,575	2,295	-	-
Life investment contract payments	(2,411)	(3,226)	-	-
Non-current assets and disposal groups classified as held for sale – net payments for operations	-	(41)	-	-
Net loan assets (granted)/repaid	(3,674)	3,738	(5,506)	2,750
Loan facility repaid by ultimate parent entity	512	2,551	512	2,551
Recovery of loans previously written off	12	19	4	6
Net increase/(decrease) in amounts due to other financial institutions, deposits and other borrowings	10,066	(10,064)	11,028	(5,018)
Net cash flows from/(used in) operating activities	33	4,246	(2,012)	(420)
Cash flows from investing activities				
Net payments for financial assets available for sale and at fair value through profit or loss	(3,778)	(8,222)	(1,950)	(10,199)
Payments for interests in associates	(301)	(188)	(147)	(28)
Proceeds from the disposal of associates	94	138	10	17
Payments for the acquisition of subsidiaries and businesses, excluding disposal groups, net of cash acquired	(33)	(255)	(223)	(259)
Proceeds from the disposal of subsidiaries and businesses excluding disposal groups, net of cash deconsolidated	42	79	-	-
Payments for life investment contracts and other unitholder investment assets	(6,374)	(5,722)	-	-
Proceeds from the disposal of life investment contracts and other unitholder investment assets	6,145	6,852	-	-
Payments for property, plant and equipment, leased assets and intangible assets	(1,830)	(152)	(4)	(15)
Net cash flows used in investing activities	(6,035)	(7,470)	(2,314)	(10,484)

	Notes	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Cash flows from financing activities					
Proceeds from the issue of ordinary shares		770	1,805	770	1,805
Payments to non-controlling interests		(8)	(205)	-	-
Proceeds from/(repayment of) subordinated debt		551	(406)	551	(406)
Dividends and distributions paid		(664)	(419)	(640)	(413)
Convertible debentures extinguished		-	-	-	(622)
Net cash flows from financing activities		649	775	681	364
Net (decrease)/increase in cash and cash equivalents					
Cash and cash equivalents at the beginning of the financial year		(1,140)	(8,707)	441	(10,540)
Cash and cash equivalents at the end of the financial year	33	10,025	11,165	8,673	8,232

The above statements of cash flows should be read in conjunction with the accompanying notes.

Notes to the financial statements

for the financial year ended 31 March 2011

Note 1

Summary of significant accounting policies

(i) Basis of preparation

The principal accounting policies adopted in the preparation of this financial report and that of the previous financial year are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

This financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (which includes Australian Interpretations by virtue of AASB 1048 *Interpretation and Application of Standards*), the *Corporations Act 2001 (Cth)* and the *Banking Act 1959*.

Compliance with IFRS as issued by the IASB

Compliance with Australian Accounting Standards ensures that the financial report complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Consequently, this financial report has also been prepared in accordance with and complies with IFRS as issued by the IASB.

Historical cost convention

This financial report has been prepared under the historical cost convention, as modified by the revaluation of investment securities available for sale and certain other assets and liabilities (including derivative instruments) at fair value.

Critical accounting estimates and significant judgements

The preparation of the financial report in conformity with Australian Accounting Standards requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. The notes to the financial statements set out areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the Bank and its subsidiaries (Consolidated Entity) and the consolidated financial report such as:

- fair value of financial assets and liabilities (note 42);
- impairment of loan assets held at amortised cost, investment securities available for sale, interests in associates and joint ventures and held for sale investments (notes 1(xii), 1(xiii), 10 and 41.1);
- acquisitions and disposals of subsidiaries, associates and joint ventures and assets and disposal groups classified as held for sale (notes 1(ii), 1(xii), 16, 21 and 44);
- distinguishing between whether assets or a business is acquired (note 1(iii));
- determination of control of Special Purpose Entities (SPEs) (notes 1(ii), 9 and 25);
- recoverability of deferred tax assets and provision for current and deferred income tax (notes 1(vii), 4 and 20); and
- the impairment of goodwill and other identifiable intangible assets with indefinite useful lives (notes 1(xvi) and 14).

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including reasonable expectations of future events.

Management believes the estimates used in preparing the financial report are reasonable. Actual results in the future may differ from those reported and therefore it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from our assumptions and estimates could require an adjustment to the carrying amounts of the assets and liabilities reported.

New Accounting Standards, amendments to Accounting Standards and Interpretations that are not yet effective

When a new Accounting Standard is first adopted, any change in accounting policy is accounted for in accordance with the specific transitional provisions (if any), otherwise retrospectively.

The Bank's and the Consolidated Entity's assessment of the impact of the key new Accounting Standards, amendments to Accounting Standards and Interpretations is set out below:

AASB 2010-3 Amendments to Australian Accounting Standards arising from the Annual Improvements Project

AASB 2010-3 is effective for annual reporting periods beginning on or after 1 July 2010 and confirms that:

- contingent consideration arising in a business combination that had been accounted for in accordance with AASB 3 (2004) that has not been settled or otherwise resolved at the adoption date of AASB 3 (2008) continues to be accounted for in accordance with AASB 3 (2004);
- the accounting policy choice to measure non-controlling interests (NCI) upon initial recognition either at fair value or at the NCI's proportionate share of the acquiree's identifiable net assets is limited to instruments that give rise to a present ownership interest and currently entitle the holder to a share of net assets in the event of liquidation. The accounting policy choice does not apply to other instruments, such as written options classified as equity instruments or options granted under share-based payment arrangements – these are generally measured at fair value or otherwise in accordance with the relevant Standards;
- AASB 3 (2008) application guidance applies to unreplaced and voluntarily replaced share-based payment awards; and
- consequential amendments to AASB 121, AASB 128 and AASB 131 as a result of the issue of AASB 127 (2008) relating to disposals of all or part of a foreign operation and accounting for a loss of significant influence/joint control is applied prospectively.

The Consolidated Entity will apply the amendments prospectively from 1 April 2011. Initial application is not expected to result in any material impact.

AASB 2010-4 Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project

AASB 2010-4 is effective for annual reporting periods beginning on or after 1 January 2011 and makes amendments to various disclosure requirements relating to AASB 7 *Financial Instruments: Disclosures*, AASB 101 *Presentation of Financial Statements* and AASB 134 *Interim Financial Reporting*. The Consolidated Entity will first apply the Standard in the financial year beginning 1 April 2011. Initial application is not expected to result in any material impact.

AASB 2010-6 Amendments to Australian Accounting Standards – Disclosures on Transfers of Financial Assets

AASB 2010-6 was issued by the AASB in November 2010 and is effective for annual reporting periods beginning on or after 1 July 2011. The Standard adds and amends disclosure requirements about transfers of financial assets, including in respect of the nature of the financial assets involved and the risks associated with them. The Consolidated Entity will first apply the Standard in the financial year beginning 1 April 2012. Systems are yet to be put in place to capture all the necessary information therefore it is not possible to disclose the impact of the amendments on the Consolidated Entity's financial statement disclosures.

AASB 2010-7 Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)

In December 2010, the AASB re-issued AASB 9 *Financial Instruments*, which is effective for annual reporting periods beginning on or after 1 January 2013. Early adoption is permitted if all the requirements are applied at the same time. The revised AASB 9 includes the classification and measurement requirements for financial liabilities, and the recognition and derecognition requirements for financial instruments, in addition to the classification and measurement requirements for financial assets that appeared in the December 2009 version of the Standard. Under the new guidance, a financial asset is to be measured at amortised cost only if it is held within a business model whose objectives is to collect contractual cash flows and the contractual terms of the asset give rise on specified dates to cash flows that are payments solely of principal and interest (on the principal amount outstanding). All other financial assets are to be measured at fair value.

Changes in the fair value of investments in equity securities that are not part of a trading activity may be reported directly in equity, but upon realisation those accumulated changes in value are not recycled to the income statement. Changes in the fair value of all other financial assets carried at fair value are reported in the income statement. The Consolidated Entity is currently assessing the impact of the new Standard, and it is likely that some financial assets:

- carried at fair value through profit or loss (e.g. quoted bonds outside of trading book) will change to be carried at amortised cost;

- carried at amortised cost (e.g. beneficial interests) will change to be carried at fair value through profit or loss; and
- containing embedded derivatives (e.g. capital protected products) will no longer be separated, and the entire product will change to be carried at fair value through profit or loss.

In respect of financial liabilities, the change in fair value (for financial liabilities designated at fair value through profit or loss) due to changes in an entity's own credit risk is to be presented in other comprehensive income, unless such presentation would create an accounting mismatch. If a mismatch is created or enlarged, all changes in fair value (including the effects of changes in the credit risk of the liability) are presented in profit or loss. All other key requirements for classification and measurement of financial liabilities have been carried forward unamended from AASB 139 *Financial Instruments: Recognition and Measurement*. The recognition and derecognition requirements in AASB 139 have also been retained and relocated to the revised AASB 9 unamended. The Consolidated Entity will first apply AASB 9 in the financial year beginning 1 April 2013. The impact of AASB 9 on the Consolidated Entity's financial statements on initial application has not yet been assessed.

(ii) Principles of consolidation

Subsidiaries

The consolidated financial report comprises the financial report of the Consolidated Entity. Subsidiaries are all those entities (including SPEs) over which the Bank has the power to govern (directly or indirectly) decision-making in relation to financial and operating policies, so as to require that entity to conform with the Bank's objectives. The effects of all transactions between entities in the Consolidated Entity are eliminated in full. NCI in the results and equity of subsidiaries, where the Bank owns less than 100 per cent of the issued capital, are shown separately in the consolidated income statement and consolidated statement of financial position, respectively.

Where control of an entity was obtained during the financial year, its results are included in the consolidated income statement from the date on which control commenced. Where control of an entity ceased during the financial year, its results are included for that part of the financial year during which control existed.

The Bank and Consolidated Entity determine the dates of obtaining control (i.e. acquisition date) and losing control (i.e. disposal date) of another entity based on an assessment of all pertinent facts and circumstances that affect the ability to govern the financial and operating policies of that entity. Facts and circumstances that have the most impact include the contractual arrangements agreed with the counterparty, the manner in which those arrangements are expected to operate in practice and whether regulatory approval is required to complete.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 1

Summary of significant accounting policies continued

(ii) Principles of consolidation continued

Subsidiaries continued

The acquisition or disposal date does not necessarily occur when the transaction is closed or finalised under law.

Subsidiaries held by the Bank are carried in its separate financial statements at cost in accordance with AASB 127 *Consolidated and Separate Financial Statements*.

Impairment of subsidiaries

Investments in subsidiaries are reviewed annually for indicators of impairment, or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the investment's carrying amount exceeds its recoverable amount (which is the higher of fair value less costs to sell and value in use). At each balance date, the investments in subsidiaries that have been impaired are reviewed for possible reversal of the impairment.

Securitisations

Securitised positions are held through a number of SPEs. These are generally categorised as Mortgage SPEs and Other SPEs, and include certain managed funds and re-packaging vehicles. As the Consolidated Entity is exposed to the majority of the residual risk associated with these SPEs, their underlying assets, liabilities, revenues and expenses are reported in the Consolidated Entity's statement of financial position and income statement.

When assessing whether the Consolidated Entity controls (and therefore consolidates) an SPE, judgement is required about whether the Consolidated Entity has the risks and rewards as well as the ability to make operational decisions for the SPE. The range of factors that are considered in assessing control include whether:

- the majority of the benefits of an SPE's activities are obtained;
- the majority of the residual ownership risks related to the SPE's assets are obtained;
- the decision-making powers of the SPE vest with the Consolidated Entity; and
- the SPE's activities are being conducted on behalf of the Consolidated Entity and according to its specific business needs.

Interests in associates and joint ventures accounted for using the equity method

Associates and joint ventures are entities, over which the Consolidated Entity has significant influence or joint control, but not control, and are accounted for under the equity method except for those which are classified as held for sale (see note 1(xii)). The equity method of accounting is applied in the consolidated financial report and involves the recognition of the Consolidated Entity's share of its associates' and joint ventures' post-acquisition profits or losses in the income statement, and its share of post-acquisition movements in reserves.

The Bank and Consolidated Entity determine the dates of obtaining or losing significant influence or joint control of another entity based on an assessment of all pertinent facts and circumstances that affect the ability to significantly influence or jointly control the financial and operating policies of that entity. Facts and circumstances that have the most impact include the contractual arrangements agreed with the counterparty, the manner in which those arrangements are expected to operate in practice, and whether regulatory approval is required to complete. The acquisition/disposal date does not necessarily occur when the transaction is closed or finalised under law.

Associates and joint ventures held by the Bank are carried in its separate financial statements at cost in accordance with AASB 127 *Consolidated and Separate Financial Statements*.

(iii) Business combinations

The purchase method of accounting is used to account for all business combinations (excepting business combinations involving entities or businesses under common control) which occurred before 1 April 2010. From 1 April 2010, business combinations are accounted for using the acquisition method. Cost is measured as the aggregate of the fair values (at the date of exchange) of assets given, equity instruments issued or liabilities incurred or assumed at the date of exchange plus, for business combinations occurring before 1 April 2010, any costs directly attributable to the acquisition. Transaction costs arising on the issue of equity instruments are recognised directly in equity, and those arising on borrowings are capitalised and included in interest expense using the effective interest method.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair value on the acquisition date. The Consolidated Entity can elect, on a transaction-by-transaction basis, to measure any NCI either at fair value or at the NCI's proportionate share of the fair value of the identifiable assets and liabilities. The excess of the cost of acquisition over the fair value of the Consolidated Entity's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the Consolidated Entity's share of the fair value of the identifiable net assets of the business acquired, the difference is recognised directly in the consolidated income statement, but only after a reassessment of the identification and measurement of the net assets acquired. For contingent consideration given in business combinations occurring from 1 April 2010, the amount is subsequently remeasured to its fair value with changes recognised in the consolidated income statement.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present values as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

As a result of applying the revised AASB 3 from 1 April 2010, the definition of a business is now modified: a) to require inputs and processes to always exist, but not necessarily include all inputs or processes that the seller used; b) to clarify the meanings of inputs and processes; and c) for the integrated activities and assets to only be capable of being conducted and managed for the purpose. Distinguishing between whether assets or a business is acquired therefore involves more judgement. Some of the factors that the Consolidated Entity uses in identifying a business combination are:

- the nature of the Consolidated Entity's industry and business model, which affects the nature of an input, process or output;
- whether the acquisition included at least a majority of the critical inputs (e.g. tangible or intangible assets, and intellectual property) and a majority of the critical processes (e.g. strategic processes, skilled and experienced workforce);
- the relative ease of replacing the critical processes not acquired by either integrating within the Consolidated Entity's existing processes or subcontracting them to third parties; and
- the presence of goodwill.

The application of revised Standards in the current period has resulted in the recognition of a gain in the income statement as a result of the remeasurement of the Consolidated Entity's retained ownership interest to fair value on the loss of control of an investment in a subsidiary. This retained interest is accounted for as an available for sale investment.

Combinations between entities or businesses under common control

Combinations between entities under common control are business combinations in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination and that control is not transitory. In the consolidated financial statements of the Bank, assets and liabilities of the acquired entities are measured at the carrying amounts recognised previously in the seller's consolidated financial statements at the date of the combination. In the separate financial statements of the Bank, assets and liabilities of the acquired businesses are measured at the carrying amounts recognised previously in the seller's financial statements at the date of the combination. Any difference between the fair value of the consideration given over the carrying amounts recognised is recorded directly in reserves arising from group restructure.

(iv) Segment reporting

Operating segments are identified on the basis of internal reports to senior management about components of the Consolidated Entity that are regularly reviewed by senior management who have been identified as the chief operating decision makers, in order to allocate resources to the segment and to assess its performance.

Information reported to senior management for the purposes of resource allocation and assessment of performance is specifically focused on core products and services offered, comprising eight reportable segments as disclosed in note 3. Information about products and services and geographical segments are based on the financial information used to produce the Consolidated Entity's financial statements.

(v) Foreign currency translation

Functional and presentation currency

Items included in the financial statements of foreign operations are measured using the currency of the primary economic environment in which the foreign operation operates (the functional currency). The Bank and Consolidated Entity's financial statements are presented in Australian dollars (the presentation currency), which is also the Bank's functional currency.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as a result of meeting cash flow hedge or net investment hedge accounting requirements (see note 1(xii)).

Translation differences on non-monetary items (such as equities) held at fair value through profit or loss, are reported as part of the fair value gain or loss in the income statement. Translation differences on non-monetary items (such as equities) classified as available for sale financial assets are included in the available for sale reserve in equity, unless they form part of fair value hedge relationships in which case the translation differences are recognised in the income statement (see note 1(xii)).

Subsidiaries and other entities

The results and financial position of all foreign operations that have a functional currency other than Australian dollars are translated into Australian dollars as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing exchange rate at the date of that statement of financial position;
- income and expenses for each income statement are translated at actual exchange rates at the date of the transactions; and
- all resulting exchange differences are recognised in a separate component of equity – the foreign currency translation reserve.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 1

Summary of significant accounting policies continued

(v) Foreign currency translation continued

Subsidiaries and other entities continued

On consolidation, exchange differences arising from the translation of any net investment in foreign operations, and of borrowings and other foreign currency instruments designated as hedges of such investments, are taken directly to the foreign currency translation reserve. When a foreign operation is disposed of or any borrowings forming part of the net investment are repaid, such exchange differences are recognised in the income statement as part of the gain or loss on disposal.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entities and translated at the closing rate.

(vi) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised for each major revenue stream as follows:

Interest income

Interest income is brought to account using the effective interest method. The effective interest method calculates the amortised cost of a financial instrument and allocates the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or liability. Fees and transaction costs associated with loans are capitalised and included in the effective interest rate and recognised in the income statement over the expected life of the instrument. Interest income on finance leases is brought to account progressively over the life of the lease consistent with the outstanding investment balance.

Fee and commission income

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or liability are capitalised and included in the effective interest rate and recognised in the income statement over the expected life of the instrument.

Other fee and commission income, including fees from funds management, brokerage, account servicing, corporate advisory, underwriting and securitisation arrangements, are recognised as the related services are performed. Where commissions and fees are subject to clawback or meeting certain performance hurdles, they are recognised as income at the point when those conditions can no longer affect the outcome.

Fees charged for performing a significant act in relation to funds managed by the Consolidated Entity are recognised as revenue when that act has been completed.

Net trading income

Net trading income comprises gains and losses related to trading assets and liabilities and includes all realised and unrealised fair value changes, dividends and foreign exchange differences.

Dividends and distributions

Dividends and distributions are recognised as income when the Consolidated Entity becomes entitled to the dividend or distribution. Dividends from subsidiaries, associates and joint ventures are recognised in the income statement when the Bank's right to receive the dividend is established.

(vii) Income tax

The income tax expense for the year is the tax payable on the current period's taxable income based on the national income tax rate for each jurisdiction, adjusted for changes in deferred tax assets and liabilities and unused tax losses.

Deferred tax assets are recognised when temporary differences arise between the tax base of assets and liabilities and their respective carrying amounts which give rise to a future tax benefit, or where a benefit arises due to unused tax losses. In both cases, deferred tax assets are recognised only to the extent that it is probable that future taxable amounts will be available to utilise those temporary differences or tax losses. Deferred tax liabilities are recognised when such temporary differences will give rise to taxable amounts being payable in future periods. Deferred tax assets and liabilities are recognised at the tax rates expected to apply when the assets are recovered or the liabilities are settled.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and liabilities are offset when there is a legally enforceable right to offset and an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously. Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

The Bank and Consolidated Entity exercise judgement in determining whether deferred tax assets, particularly in relation to tax losses, are probable of recovery. Factors considered include the ability to offset tax losses within the group in the relevant jurisdiction, the nature of the tax loss, the length of time that tax losses are eligible for carry forward to offset against future taxable profits and whether future taxable profits are expected to be sufficient to allow recovery of deferred tax assets.

The Consolidated Entity undertakes transactions in the ordinary course of business where the income tax treatment requires the exercise of judgement. The Consolidated Entity estimates its tax liability based on its understanding of the tax law.

Tax consolidation

All eligible Australian resident wholly-owned subsidiaries of the Macquarie Group represent a tax consolidated group, with Macquarie Group Limited (MGL) as the head entity. As a consequence, the Bank and the relevant subsidiaries are not liable to make income tax payments and do not recognise any current tax balances or deferred tax assets arising from unused tax losses in its own financial statements. Under the terms and conditions of a tax funding agreement, MGL charges each subsidiary for all current tax liabilities incurred in respect of their activities and reimburses each subsidiary for any tax assets arising from unused tax losses.

(viii) Cash collateral on securities borrowed/lent and reverse repurchase/repurchase agreements

As part of its trading activities, the Bank and Consolidated Entity borrow and lend securities on a collateralised basis. The securities subject to the borrowing or lending are not derecognised from the statements of financial position of the relevant parties, as the risks and rewards of ownership remain with the initial holder. Where cash is provided as collateral, the cash paid to third parties on securities borrowed is recorded as a receivable, while cash received from third parties on securities lent is recorded as a borrowing.

Reverse repurchase transactions, where the Bank and Consolidated Entity purchase securities under an agreement to resell, and repurchase transactions, where the Bank and Consolidated Entity sell securities under an agreement to repurchase, are also conducted on a collateralised basis. The securities subject to the reverse repurchase and repurchase agreements are not derecognised from the statements of financial position of the relevant parties, as the risks and rewards of ownership remain with the initial holder. Where cash is provided as collateral, the cash paid to third parties on the reverse repurchase agreement is recorded as a receivable, while cash received from third parties on the repurchase agreement is recorded as a borrowing.

The Bank and Consolidated Entity continually review the fair values of the securities on which the above transactions are based and, where appropriate, request or provide additional collateral to support the transactions, in accordance with the underlying agreements.

(ix) Trading portfolio assets and liabilities

Trading portfolio assets (long positions) comprise debt and equity securities, bank bills, treasury notes, bullion and commodities purchased with the intent of being actively traded. Trading portfolio liabilities (short positions) comprise obligations to deliver assets across the same trading categories, which the Bank and Consolidated Entity have short-sold and are actively traded.

Assets and liabilities included in the trading portfolio are carried at fair value (see note 42). Realised gains and losses, and unrealised gains and losses arising from changes in the fair value of the trading portfolio are recognised as net trading income in the income statement in the period in which they arise. Dividend income or expense on the trading portfolio is recognised in the income statement as net trading income.

The Bank and Consolidated Entity use trade date accounting when recording regular way purchases and sales of financial assets. At the date the transaction is entered into (trade date), the Bank and Consolidated Entity recognise the resulting financial asset or liability and any subsequent unrealised profits or losses arising from revaluing that contract to fair value in the income statement. When the Bank and Consolidated Entity become party to a sale contract of a financial asset, the asset is derecognised and a trade receivable is recognised from trade date until settlement date.

(x) Derivative instruments

Derivative instruments entered into by the Bank and Consolidated Entity include futures, forwards and forward rate agreements, swaps and options in the interest rate, foreign exchange, commodity and equity markets. These derivative instruments are principally used for the risk management of existing financial assets and financial liabilities.

All derivatives, including those used for statement of financial position hedging purposes, are recognised on the statement of financial position and are disclosed as an asset where they have a positive fair value at balance date or as a liability where the fair value at balance date is negative.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and subsequently remeasured to their fair value. Fair values are obtained from quoted market prices in active markets including recent market transactions, and valuation techniques including discounted cash flow models and option pricing models, as appropriate. Movements in the carrying amounts of derivatives are recognised in the income statement in net trading income, unless the derivative meets the requirements for hedge accounting.

The best evidence of a derivative's fair value at initial recognition is its transaction price, unless its fair value is evidenced by comparison with other observable current market transactions in the same instrument, or based on a valuation technique for which variables include only data from observable markets. Where such alternative evidence exists, the Bank and Consolidated Entity recognise profits immediately when the derivative is recognised.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 1

Summary of significant accounting policies continued

(xi) Hedge accounting

The Bank and Consolidated Entity designate certain derivatives or financial instruments as hedging instruments in qualifying hedge relationships. On initial designation of the hedge, the Bank and Consolidated Entity document the hedging relationship between hedging instruments and hedged items, as well as its risk management objectives and strategies. The Bank and Consolidated Entity also document its assessment, both at hedge inception and on an ongoing basis, of whether the hedging relationships have been and will continue to be highly effective. Derivatives or financial instruments can be designated in one of the three types of hedge relationships:

Cash flow hedges

For a derivative or financial instrument designated as hedging the variability in cash flows attributable to a particular risk associated with a recognised asset or liability (or a highly probable forecast transaction), the gain or loss on the derivative or financial instrument associated with the effective portion of the hedge is initially recognised in equity in the cash flow hedging reserve and subsequently released to the income statement when the hedged item affects the income statement. The gain or loss relating to the ineffective portion of the hedge is recognised immediately in the income statement.

Fair value hedges

For a derivative or financial instrument designated as hedging the change in fair value of a recognised asset or liability (or an unrecognised firm commitment), the gain or loss on the derivative or financial instrument is recognised in the income statement immediately, together with the loss or gain on the hedged asset or liability that is attributable to the hedged risk.

Net investment hedges

For a derivative or borrowing designated as hedging a net investment in a foreign operation, the gain or loss on revaluing the derivative or borrowing associated with the effective portion of the hedge is recognised in the foreign currency translation reserve and subsequently released to the income statement when the foreign operation is disposed of. The ineffective portion is recognised in the income statement immediately.

The fair values of various financial instruments used for hedging purposes are disclosed in note 40. Movements in the cash flow hedging reserve in equity are shown in note 32.

(xii) Investments and other financial assets

With the exception of trading portfolio assets, derivatives and investments in associates and joint ventures which are classified separately in the statement of financial position, the remaining investments in financial assets are classified into the following categories: loans and receivables (loan assets held at amortised cost,

amounts due from related body corporate entities and amounts due from subsidiaries), other financial assets at fair value through profit or loss, investment securities available for sale and non-current assets and assets of disposal groups classified as held for sale. The classification depends on the purpose for which the financial asset was acquired, which is determined at initial recognition and, except for other assets at fair value through profit or loss, is re-evaluated at each balance date.

Loans and receivables

Loan assets held at amortised cost, amounts due from related body corporate entities and amounts due from subsidiaries are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Other financial assets at fair value through profit or loss

This category includes only those financial assets which have been designated by management as held at fair value through profit or loss on initial recognition. The policy of management is to designate a financial asset as such if: the asset contains embedded derivatives which must otherwise be separated and carried at fair value; it is part of a group of financial assets managed and evaluated on a fair value basis; or doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise. Interest income on debt securities designated as at fair value through profit or loss is recognised in the income statement in interest income using the effective interest method as disclosed in note 1(vi).

Investment securities available for sale

Investment securities available for sale comprise securities that are not actively traded and are intended to be held for an indefinite period. Such securities are available for sale and may be sold should the need arise, including purposes of liquidity, or due to the impacts of changes in interest rates, foreign exchange rates or equity prices.

Investment securities available for sale are initially carried at fair value plus transaction costs. Gains and losses arising from subsequent changes in fair value are recognised directly in the available for sale reserve in equity until the asset is derecognised or impaired, at which time the cumulative gain or loss is recognised in the income statement. Fair values of quoted investments in active markets are based on current bid prices. If the relevant market is not considered active (or the securities are unlisted), fair value is established by using valuation techniques, including recent arm's length transactions, discounted cash flow analysis, and other valuation techniques commonly used by market participants.

Interest income on debt securities available for sale is recognised in the income statement in interest income using the effective interest method as disclosed in note 1(vi).

Non-current assets and disposal groups classified as held for sale

This category includes interests in associates and joint ventures for which their carrying amount will be recovered principally through a sale transaction rather than continuing use, and subsidiaries held exclusively with a view to sale. These assets are classified as held for sale when it is highly probable that the asset will be sold within the 12 months subsequent to being classified as such. Where there is a planned partial disposal of a subsidiary resulting in the loss of control, all of the assets and liabilities of the subsidiary are classified as held for sale.

Non-current assets and disposal groups classified as held for sale are presented separately on the face of the statement of financial position.

Non-current assets and assets of disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. These assets are not depreciated.

An impairment loss is recognised for any initial or subsequent write down of the asset to fair value less costs to sell. A gain is recognised for any subsequent increase in fair value less costs to sell, limited by the cumulative impairment loss previously recognised. A gain or loss not previously recognised by the date of sale is recognised at the date of sale.

(xiii) Impairment**Loan assets held at amortised cost**

Loan assets are subject to regular review and assessment for possible impairment. Provisions for impairment on loan assets are recognised based on an incurred loss model and re-assessed at each balance date. A provision for impairment is recognised when there is objective evidence of impairment, and is calculated based on the present value of expected future cash flows, discounted using the original effective interest rate.

Specific provisions for impairment are recognised where impairment of individual loans are identified. Where individual loans are found not to be impaired, they are placed into pools of assets with similar risk profiles and collectively assessed for losses that have been incurred but are not yet specifically identifiable.

The Bank and Consolidated Entity make judgements as to whether there is any observable data indicating that there is a significant decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of the borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Changes in assumptions used for estimating future cash flows could result in a change in the estimated provisions for impairment on loan assets at the end of the reporting period.

If, in a subsequent period, the amount of impairment losses decrease and the decrease can be related objectively to an event occurring after the impairment losses were recognised, the previously recognised impairment losses are reversed through the income statement to the extent of what the amortised cost would have been had the impairment not been recognised.

Investment securities available for sale

The Consolidated Entity performs an assessment at each balance date to determine whether there is any objective evidence that available for sale financial assets have been impaired. Impairment exists if there is objective evidence of impairment as a result of one or more events (loss event) which have an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

For equity securities classified as available for sale, the main indicators of impairment are: significant changes in the market/economic or legal environment; and a significant or prolonged decline in fair value below cost.

In making this judgement, the Consolidated Entity evaluates among other factors, the normal volatility in share price and the period of time for which fair value has been below cost.

In the case of debt securities classified as available for sale, observable data that relates to loss events are considered, including adverse changes in the payment status of the issuer and national or local economic conditions that correlate with defaults on those assets.

In addition, impairment may be appropriate when there is evidence of deterioration in the financial condition of the investee, industry and sector performance, operational and financing cash flows or changes in technology.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 1

Summary of significant accounting policies continued

(xiii) Impairment continued

Investment securities available for sale continued

When the fair value of an available for sale financial asset is less than its initial carrying amount and there is objective evidence that the asset is impaired, the cumulative loss recognised directly in equity is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement for equity securities classified as available for sale are not subsequently reversed through the income statement. However impairment losses recognised for debt securities classified as available for sale are subsequently reversed through the income statement if the fair value increases and the increase can be objectively related to an event after the impairment loss was recognised in the income statement.

Interests in associates and joint ventures

The Consolidated Entity performs an assessment at each balance date to determine whether there is any objective evidence that its interests in associates and joint ventures are impaired. The entire carrying amount of each investment in associate and joint venture is considered in the assessment. The main indicators of impairment are as for equity securities classified as available for sale, disclosed above.

If there is an indication that an investment in an associate or joint venture may be impaired, then the entire carrying amount of the investment in the associate or joint venture is tested for impairment by comparing the recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Impairment losses recognised in the income statement for investments in associates and joint ventures are subsequently reversed through the income statement if there has been a change in the estimates used to determine the recoverable amount since the impairment loss was recognised.

(xiv) Life insurance business

The life insurance business is comprised of insurance contracts and investment contracts as defined in AASB 4 *Insurance Contracts*. The following are key accounting policies in relation to the life insurance business:

Disclosure

The consolidated financial statements include the assets, liabilities, income and expenses of the life insurance business conducted by a subsidiary of the Bank in accordance with AASB 139 *Financial Instruments: Recognition and Measurement*, and AASB 1038 *Life Insurance Contracts* which apply to investment contracts and assets backing insurance liabilities, respectively. These amounts represent the total life insurance business of the subsidiary, including underlying amounts that relate to both policyholders and shareholders of the life insurance business.

Investment assets

Investment assets are carried at fair value through profit or loss. Fair values of quoted investments in active markets are based on current bid prices. If the relevant market is not considered active (and for unlisted securities), fair value is established by using valuation techniques, including recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Changes in fair values are recognised in the income statement in the financial period in which the changes occur.

Restriction on assets

Investments held in the Life Funds can only be used within the restrictions imposed under the *Life Insurance Act 1995*. The main restrictions are that the assets in a fund can only be used to meet the liabilities and expenses of the fund, acquire investments to further the business of the fund or pay distributions when solvency and capital adequacy requirements allow. Shareholders can only receive a distribution when the capital adequacy requirements of the *Life Insurance Act 1995* are met.

Policy liabilities

Life insurance liabilities are measured as the accumulated benefits to policyholders in accordance with AASB 139 and AASB 1038, which apply to investment contracts and assets backing insurance liabilities, respectively.

(xv) Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any. Property, plant and equipment are reviewed for impairment annually. Historical cost includes expenditure directly attributable to the acquisition of the asset. Property, plant and equipment includes assets under operating lease.

Depreciation on assets is calculated on a straight-line basis to allocate the difference between cost and residual values over their estimated useful lives, at the following rates:

Furniture and fittings	10 to 20 per cent
Leasehold improvements ¹	20 per cent
Communication equipment	33 per cent
Computer equipment	33 to 50 per cent
Infrastructure assets	5 to 20 per cent
Aviation	3 to 4 per cent
Other operating lease assets	2 to 50 per cent

¹ Where remaining lease terms are less than five years, leasehold improvements are depreciated over the remaining lease term.

Useful lives and residual values are reviewed annually and re-assessed in light of commercial and technological developments. If an asset's carrying value is greater than its recoverable amount due to an adjustment to its useful life, residual value or impairment, the carrying amount is written down immediately to its recoverable amount. Adjustments arising from such items and on disposal of property, plant and equipment are recognised in the income statement.

Gains and losses on disposal are determined by comparing proceeds with the asset's carrying amount and are included in the income statement.

(xvi) Goodwill and other identifiable intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Consolidated Entity's share of the net identifiable assets of the acquired entity at the date of acquisition. Goodwill arising from business combinations is included in intangible assets on the face of the statement of financial position. Goodwill arising from acquisitions of associates is included in the carrying amount of investments in associates.

Other identifiable intangible assets

An intangible asset is considered to have an indefinite useful life where it is expected to contribute to the Consolidated Entity's net cash inflows indefinitely.

Licences and trading rights are carried at cost less accumulated impairment losses. These assets are not amortised because they are considered to have an indefinite useful life.

Management rights have a finite useful life and are carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated using the straight-line method to allocate the cost of management rights over the estimated useful life, usually a period not exceeding 20 years.

Customer and servicing contracts acquired with a finite useful life are carried at cost less accumulated amortisation and any impairment losses. Amortisation is calculated based on the timing of projected cash flows of the contracts over their estimated useful lives.

Customer and servicing contracts with indefinite useful life are carried at cost less accumulated impairment losses.

Software

Certain internal and external costs directly incurred in acquiring and developing certain software are capitalised and amortised over their estimated useful life, usually a period of three years. Costs incurred on software maintenance are expensed as incurred.

Impairment

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. For intangible assets that have a finite useful life, an assessment is made at each reporting date for indication of impairment. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Intangible assets (other than goodwill) that suffered an impairment are reviewed for possible reversal of the impairment at each balance date.

(xvii) Financial liabilities

The Consolidated Entity has on issue debt securities and instruments which are initially recognised at fair value net of transaction costs incurred, and subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the income statement over the period of the borrowings using the effective interest method.

Other financial liabilities at fair value through profit or loss

This category includes only those financial liabilities which have been designated by management as held at fair value through profit or loss on initial recognition. The policy of management is to designate a financial liability as such if: the liability contains embedded derivatives which must otherwise be separated and carried at fair value; the liability is part of a group of financial assets and financial liabilities managed and evaluated on a fair value basis; or if by doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise. Interest expense on such items is recognised in the income statement in interest expense, using the effective interest method.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 1

Summary of significant accounting policies continued

(xviii) Provisions

Employee benefits

A liability for employee benefits is recognised by the entity that has the obligation to the employee. Generally, this is consistent with the legal position of the parties to the employment contract.

Liabilities for unpaid salaries, salary related costs and provisions for annual leave are recorded in the statement of financial position at the salary rates which are expected to be paid when the liability is settled. Provisions for long service leave and other long-term benefits are recognised at the present value of expected future payments to be made.

In determining this amount, consideration is given to expected future salary levels and employee service histories. Expected future payments are discounted to their net present value using discount rates on high quality corporate bonds, except where there is no deep market, in which case rates on Commonwealth Government securities are used. Such discount rates have terms that match as closely as possible the expected future cash flows.

Provisions for unpaid employee benefits are derecognised when the benefit is settled, or it is transferred to another entity and the Bank and Consolidated Entity are legally released from the obligation and do not retain a constructive obligation.

Dividends

Provisions for dividends to be paid by the Bank are recognised on the statement of financial position as a liability and a reduction in retained earnings when the dividend has been declared.

(xix) Performance based remuneration

Share based payments

The ultimate parent entity, MGL, operates share-based compensation plans, which include options granted to employees and shares (including those delivered through the Macquarie Group Employee Retained Equity Plan (MEREP)) granted to employees under share acquisition plans. Information relating to these schemes is set out in note 36. The Consolidated Entity recognises an expense for the shares and options granted to its employees by MGL. The shares and options are measured at the grant dates based on their fair value and using the number of equity instruments expected to vest. This amount is recognised as an expense evenly over the respective vesting periods.

Performance hurdles attached to options, and Performance Share Units (PSUs) under MEREP, that are issued to the Executive Officers are not taken into account when determining their fair value at grant date. Instead, these vesting conditions are taken into account by adjusting the number of equity instruments expected to vest.

The fair value of each option granted in prior years was estimated on the date of grant using standard option pricing techniques based on the Black-Scholes theory. The following key assumptions were adopted for grants made in the prior financial year:

- risk free interest rate: 6.77 per cent (weighted average);
- expected life of options: four years;
- volatility of share price: 24 per cent; and
- dividend yield: 3.47 per cent per annum.

In December 2009, MGL established a new equity plan, MEREP. Restricted Share Units (RSUs)/Deferred Share Units (DSUs) and PSUs for Executive Committee members, have been granted in the current year in respect of 2010. The fair value of each of these grants is estimated using MGL's share price on the date of grant, and for each PSU also incorporates a discounted cash flow method using the following key assumptions:

- risk free interest rate: 5.20 per cent (weighted average);
- expected life of options: four years; and
- dividend yield: 3.47 per cent per annum.

While RSUs/DSUs and PSUs for Executive Committee members, in respect of the current year's performance will be granted in the following financial year, the Consolidated Entity and the Bank begins recognising an expense (based on an initial estimate) from 1 April of the current financial year related to these future grants. The expense is estimated using MGL's share price as at 31 March 2011 (and for PSUs, also incorporates a risk free interest rate of 5.71 per cent; an expected life of four years; and a dividend yield of 5.20 per cent per annum) and the number of equity instruments expected to vest. In the following financial year, the Consolidated Entity and the Bank will adjust the accumulated expense recognised for the final determination of fair value for each RSU/DSU and PSU to be granted when granted, and will use this valuation for recognising the expense over the remaining vesting period.

Where options and shares are issued by MGL to employees of the Consolidated Entity and the Bank, and MGL is not subsequently reimbursed by the Consolidated Entity and the Bank, the Consolidated Entity and the Bank recognises the equity provided as a capital contribution from MGL. Where MGL is reimbursed, the Consolidated Entity and the Bank recognises any amount it pays in advance (of the share-based payment to be recognised as an expense over the future vesting period) as a prepaid asset.

Executive Directors' retained profit share that is no longer to be paid in cash is reversed in the current year and recognised in profit, and the RSUs/DSUs granted are accounted for as a share-based payment from the grant date.

The Consolidated Entity and the Bank annually revise the estimates of the number of shares (including those delivered through MEREP) and options that are expected to vest. Where appropriate, the impact of revised estimates are reflected in the income statement over the remaining vesting period, with a corresponding adjustment to the share based payments reserve in equity.

Profit share remuneration

The Consolidated Entity and the Bank recognise liabilities and expenses for profit share remuneration to be paid in cash, based on a formula that takes into consideration the Consolidated Entity's profit after income tax and its earnings over and above the estimated cost of capital.

(xx) Cash and cash equivalents

Cash and cash equivalents comprise:

- cash and balances with central banks and short-term amounts included in due from financial institutions; and
- trading portfolio assets and debt securities with remaining contractual maturity of three months or less.

(xxi) Leases

Where finance leases are granted to third parties, the present value of the lease payments is recognised as a receivable and included in loan assets held at amortised cost. The difference between the gross receivable and the present value of the receivable is recognised as unearned interest income. Lease income is recognised over the term of the lease using the effective interest method, which reflects a constant rate of return.

Leases entered into by the Bank and Consolidated Entity as lessee are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Purchased assets, where the Bank and Consolidated Entity are the lessor under operating leases, are carried at cost and depreciated over their useful lives which vary depending on each class of asset and range from 3 to 50 years. Operating lease income is recognised on a straight-line basis over the period of the lease unless another systematic basis is more appropriate. Assets under operating leases are included in property, plant and equipment.

(xxii) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported on the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the financial asset and settle the financial liability simultaneously.

(xxiii) Loan capital

Loan capital is debt issued by the Consolidated Entity with terms and conditions that qualify for inclusion as capital under APRA Prudential Standards. Loan capital debt issues are initially recorded at fair value plus directly attributable transaction costs and thereafter at either amortised cost using the effective interest method or at fair value through profit or loss (for subordinated debt at fair value through profit or loss).

(xxiv) Contributed equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(xxv) Changes in ownership interests

From 1 April 2010, when acquiring additional interests of a financial asset (such that it becomes an associate, joint venture or subsidiary) or an investment in an associate or joint venture (such that it becomes a subsidiary), previously held interests are revalued to their current fair value and any gain or loss is immediately recognised in profit or loss. In prior years, previously held interests were not revalued for such transactions.

Similarly, from 1 April 2010, when selling ownership interests of a subsidiary (such that control is lost), or an investment in associate or joint venture (such that it becomes a financial asset), retained ownership interests are revalued to their current fair value and any gain or loss is immediately recognised in the income statement. In prior years, retained ownership interests were not revalued for such transactions.

From 1 April 2010, when increasing or decreasing the ownership interests of a subsidiary that remains a subsidiary afterwards, the consideration exchanged is recognised directly in equity. In prior years, transactions with NClS were recognised using the parent-entity approach, which results in a gain recognised in the income statement when securities held by NCl are acquired by the Consolidated Entity at a price less than their carrying amount.

(xxvi) Comparatives

Where necessary, comparative information has been restated to conform with changes in presentation in the current year.

(xxvii) Rounding of amounts

The Bank is of a kind referred to in ASIC Class Order 98/0100 (as amended), which relates to the rounding off of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with that Class Order to the nearest million dollars unless otherwise indicated.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 2				
Profit for the financial year				
Net interest income				
Interest and similar income received/receivable:				
Other entities	5,036	4,198	3,264	2,592
Subsidiaries (note 34)	–	–	476	419
Related body corporate entities (note 34)	105	155	116	155
Interest expense and similar charges paid/payable:				
Other entities	(3,274)	(2,861)	(2,316)	(1,895)
Subsidiaries (note 34)	–	–	(288)	(252)
Related body corporate entities (note 34)	(216)	(167)	(208)	(164)
Net interest income	1,651	1,325	1,044	855
Fee and commission income				
Base fees	598	464	13	16
Performance fees	25	45	–	–
Mergers and acquisitions, advisory and underwriting fees	50	37	26	22
Brokerage and commissions	338	288	56	58
Other fee and commission income	218	154	–	–
Income from life investment contracts and other unitholder investment assets (note 15)	78	48	–	–
Total fee and commission income	1,307	1,036	95	96
Net trading income¹				
Equities	345	555	292	619
Commodities	553	663	238	(33)
Foreign exchange products	191	104	(376)	513
Interest rate products	190	(85)	440	(517)
Net trading income	1,279	1,237	594	582
Share of net profits of associates and joint ventures accounted for using the equity method				
	45	7	–	–

¹ Included in net trading income are fair value gains of \$393 million (2010: \$295 million loss) relating to financial assets and financial liabilities designated as held at fair value through profit or loss. This includes \$9 million loss (2010: \$255 million loss) as a result of changes in own credit spread on issued debt and subordinated debt carried at fair value. Fair value changes relating to derivatives are also reported in net trading income which partially offsets the fair value changes relating to the financial assets and financial liabilities designated at fair value. This also includes fair value changes on derivatives used to hedge the Consolidated Entity's economic interest rate risk where hedge accounting requirements are not met – refer to note 1(xi) – Summary of significant accounting policies.

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 2

Profit for the financial year continued

Other operating income and charges

Net gains on sale of investment securities available for sale	205	42	196	117
Impairment charge on investment securities available for sale	(29)	(101)	(9)	(3)
Net gains on sale of associates (including associates held for sale) and joint ventures	13	9	-	-
Impairment (charge)/write-back on investment in associates and joint ventures	(18)	(69)	4	(21)
Impairment charge on subsidiaries	-	-	(130)	(84)
Gain/(loss) on acquiring, disposing and change in ownership interest in subsidiaries, associates and businesses held for sale	41	138	(156)	141
Gain on remeasurement of retained investments ¹	18	-	-	-
Impairment charge on non-financial assets	(6)	(23)	-	-
Gain on repurchase of subordinated debt	-	55	-	55
Net operating lease income ²	151	72	-	-
Dividends/distributions received/receivable:				
Investment securities available for sale	30	23	29	29
Subsidiaries (note 34)	-	-	407	491
Management fees, group service charges and cost recoveries	(18)	(27)	370	471
Collective allowance for credit losses written back/(provided for) during the financial year (note 9)	18	(1)	21	2
Specific provisions:				
Loan assets provided for during the financial year (note 9)	(89)	(175)	(75)	(161)
Other receivables provided for during the financial year	-	(27)	(1)	(27)
Recovery of loans previously provided for (note 9)	16	32	15	29
Recovery of other receivables previously provided for	11	5	11	-
Loan losses written off	(70)	(63)	(46)	(23)
Recovery of loans previously written off	12	19	4	6
Other income	228	138	19	4
Total other operating income and charges	513	47	659	1,026
Net operating income	4,795	3,652	2,392	2,559

¹ Includes gain on remeasurement of retained ownership interest to fair value on the loss of control of investment in a subsidiary.

² Includes rental income of \$257 million (2010: \$279 million) less depreciation of \$106 million (2010: \$207 million) in relation to operating leases where the Consolidated Entity is lessor.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 2				
Profit for the financial year continued				
Employment expenses				
Salary and salary related costs including commissions, superannuation and performance-related profit share	(1,437)	(1,012)	(795)	(661)
Share based payments	(101)	(66)	(50)	(21)
Provision for annual leave	(12)	(8)	(5)	(3)
Provision for long service leave	(3)	(3)	(3)	(2)
Total employment expenses	(1,553)	(1,089)	(853)	(687)
Brokerage and commission expenses				
Brokerage expenses	(473)	(417)	(303)	(313)
Other fee and commission expenses	(196)	(131)	(312)	(88)
Total brokerage and commission expenses	(669)	(548)	(615)	(401)
Occupancy expenses				
Operating lease rentals	(72)	(68)	(42)	(48)
Depreciation: furniture, fittings and leasehold improvements (note 17)	(19)	(28)	(6)	(18)
Other occupancy expenses	(48)	(26)	(36)	(20)
Total occupancy expenses	(139)	(122)	(84)	(86)
Non-salary technology expenses				
Information services	(57)	(45)	(34)	(32)
Depreciation: computer equipment (note 17)	(2)	(9)	(4)	(6)
Other non-salary technology expenses	(39)	(34)	(21)	(20)
Total non-salary technology expenses	(98)	(88)	(59)	(58)
Other operating expenses				
Professional fees	(141)	(111)	(69)	(83)
Auditor's remuneration (note 43)	(12)	(12)	(6)	(5)
Travel and entertainment expenses	(68)	(55)	(37)	(33)
Advertising and promotional expenses	(50)	(40)	(19)	(24)
Communication expenses	(20)	(16)	(9)	(8)
Amortisation of intangibles (note 14)	(56)	(22)	-	-
Other expenses ¹	(884)	(787)	(596)	(671)
Total other operating expenses	(1,231)	(1,043)	(736)	(824)
Total operating expenses	(3,690)	(2,890)	(2,347)	(2,056)

¹ Other expenses includes recharges from Macquarie Group Services Australia Pty Limited (MGSA) which provides administration and central support functions.

Note 3

Segment reporting

(i) Operating segments

For internal reporting and risk management purposes, the Consolidated Entity is divided into six operating groups, one operating division and a corporate group. These segments have been set up based on the different core products and services offered.

Since 31 March 2010, there have been the following restructures of operating groups and divisions:

- Macquarie Infrastructure and Real Assets (formerly Macquarie Capital Funds) – this division of Macquarie Capital was transferred to Macquarie Funds Group.
- Real Estate Structured Finance – this division of Real Estate Banking Division was transferred to Corporate and Asset Finance.

All restructures are effective from 1 April 2010. Segment information has been prepared in conformity with the Consolidated Entity's segment accounting policy. In accordance with AASB 8 *Operating Segments*, comparative information has been restated to reflect current reportable operating segments.

Macquarie Securities Group activities include institutional and retail derivatives, structured equity finance, arbitrage trading, synthetic products, capital management, collateral management and securities borrowing and lending. It is a full-service institutional cash equities broker in the Asia Pacific region and South Africa, and offers specialised services in other regions. It also provides an equity capital markets service through a joint venture with Macquarie Capital Advisers.

Macquarie Capital comprises Macquarie Group's corporate advisory, equity underwriting and debt structuring and distribution businesses, private equity placements and principal products.

Macquarie Funds Group is Macquarie Group's funds management business. It is a full-service asset manager, offering a diverse range of capabilities and products including investment management, infrastructure and real asset management and fund and equity based structured products.

Fixed Income, Currencies and Commodities provides a variety of trading, research, sales and financing services across the globe with an underlying specialisation in interest rate, commodity or foreign exchange related institutional trading, marketing, lending, clearing or platform provision.

Corporate and Asset Finance is the lending and leasing business of Macquarie Group.

Banking and Financial Services Group is the primary relationship manager for Macquarie Group's retail client base. The group brings together the retail banking and financial services businesses providing a diverse range of wealth management products and services to financial advisers, stockbrokers, mortgage brokers, professional service industries and the end consumer.

Real Estate Banking Division activities include real estate investment, development management and asset management.

Corporate includes Group Treasury, head office and central support functions. Costs within Corporate include unallocated head office costs, employment related costs, earnings on capital, non-trading derivative volatility, income tax expense and certain expenses attributable to NCI. Corporate is not considered an operating group.

Any transfers between segments are determined on an arm's length basis and eliminate on consolidation.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Macquarie Securities Group \$m	Macquarie Capital Group \$m	Macquarie Funds Group \$m
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Note 3

Segment reporting continued

(i) Operating segments continued

The following is an analysis of the Consolidated Entity's revenue and results by reportable segment for the financial year:

Revenues from external customers	307	4	1,050
Inter-segmental (expense)/revenue ¹	(124)	36	(24)
Interest revenue	102	2	170
Interest expense	(38)	(32)	(55)
Depreciation and amortisation	(1)	-	(23)
Share of net profits/(losses) of associates and joint ventures accounted for using the equity method	-	11	16
Reportable segment (loss)/profit	(132)	(1)	249
Reportable segment assets	17,510	247	10,091

Revenues from external customers	489	5	1,135
Inter-segmental (expense)/revenue ¹	(56)	23	(26)
Interest revenue	36	3	148
Interest expense	(22)	-	(40)
Depreciation and amortisation	(1)	-	(17)
Share of net profits/(losses) of associates and joint ventures accounted for using the equity method	-	12	24
Reportable segment profit/(loss)	116	(50)	92
Reportable segment assets	12,687	478	8,098

¹ Internal reporting systems do not enable the separation of inter-segmental revenues and expenses. The net position is disclosed above. The key inter-segmental item is internal interest and funding costs charged to businesses for funding of their business net assets.

Fixed Income, Currencies and Commodities \$m	Corporate and Asset Finance \$m	Banking and Financial Services Group \$m	Real Estate Banking Division \$m	Corporate \$m	Total \$m
Consolidated 2011					
1,845	1,499	2,528	71	1,339	8,643
(225)	(497)	768	(29)	95	-
625	1,441	1,586	16	1,199	5,141
(363)	(186)	(1,658)	-	(1,158)	(3,490)
(20)	(108)	(37)	-	6	(183)
15	9	1	(5)	(2)	45
549	505	278	(40)	(605)	803
42,978	18,284	28,698	458	22,096	140,362
Consolidated 2010					
1,790	1,026	2,242	100	956	7,743
(68)	(273)	119	(38)	319	-
637	1,056	1,494	13	966	4,353
(380)	(184)	(1,128)	(5)	(1,269)	(3,028)
(108)	(108)	(30)	(2)	-	(266)
10	(5)	2	(33)	(3)	7
736	250	268	(149)	(600)	663
42,060	15,331	29,860	642	20,954	130,110

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 3

Segment reporting continued

(ii) Products and services

For the purposes of preparing a segment report based on products and services, the activities of the Consolidated Entity have been divided into four areas:

Asset and Wealth Management: distribution and manufacture of funds management products;

Financial Markets: trading in fixed income, equities, currency, commodities and derivative products;

Capital Markets: corporate and structured finance, advisory, underwriting, facilitation, broking and property development; and

Lending: banking activities, mortgages, and leasing.

	Asset and Wealth Management \$m	Financial Markets \$m	Capital Markets \$m	Lending \$m	Total \$m
Consolidated 2011					
Revenues from external customers	1,877	3,102	67	3,597	8,643
Consolidated 2010					
Revenues from external customers	1,845	3,014	11	2,873	7,743

(iii) Geographical areas

Geographical segments have been determined based on where the transactions have been booked. The operations of the Consolidated Entity are headquartered in Australia.

	Revenues from external customers \$m	Non-current assets ¹ \$m
Consolidated 2011		
Australia	5,692	1,599
Asia Pacific	238	39
Europe, Middle East and Africa	1,069	1,873
Americas	1,644	1,810
Total	8,643	5,321
Consolidated 2010		
Australia	4,898	1,924
Asia Pacific	708	110
Europe, Middle East and Africa	1,036	498
Americas	1,101	1,830
Total	7,743	4,362

¹ Non-current assets consist of intangible assets, interests in associates and joint ventures accounted for using the equity method, property, plant and equipment, property held for sale and development and certain amounts due from related body corporate entities.

(iv) Major customers

The Consolidated Entity does not rely on any major customer.

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 4

Income tax expense

(i) Income tax (expense)/benefit

Current tax (expense)/benefit	(155)	(428)	184	(436)
Deferred tax (expense)/benefit	(117)	363	(199)	517
Total	(272)	(65)	(15)	81

Deferred income tax (expense)/benefit included in income tax benefit/(expense) comprises:

(Decrease)/increase in deferred tax assets	(51)	564	(248)	348
(Increase)/decrease in deferred tax liabilities	(66)	(201)	49	169
Total	(117)	363	(199)	517

(ii) Numerical reconciliation of income tax expense to prima facie tax payable

Prima facie income tax expense on operating profit ¹	(331)	(229)	(13)	(151)
Tax effect of amounts which are (not deductible)/non-assessable in calculating taxable income:				
Rate differential on offshore income	57	200	5	166
Distribution provided on Macquarie Income Preferred Securities and related distributions	1	2	-	7
Share-based payments expense	(8)	(9)	(2)	(6)
Intra-group dividends	-	-	122	147
Impairment charge on controlled entities	-	-	(127)	-
Other items	9	(29)	-	(82)
Total income tax (expense)/benefit	(272)	(65)	(15)	81

(iii) Tax (expense)/benefit relating to items of other comprehensive income

Available for sale reserve	(44)	(51)	(19)	(52)
Cash flow hedges	(10)	(42)	(9)	3
Foreign currency translation reserve	54	(204)	26	(26)
Share of other comprehensive income of associates and joint ventures	-	13	-	-
Total tax expense relating to items of other comprehensive income	-	(284)	(2)	(75)

¹ Prima facie income tax on operating profit is calculated at the rate of 30 per cent (2010: 30 per cent). The Australian tax consolidated group has a tax year ending on 30 September.

Revenue authorities undertake risk reviews and audits as part of their normal activities. The Group has assessed these and other taxation claims, including seeking advice where appropriate, and considers that it holds appropriate provisions.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 5

Dividends paid and distributions paid or provided for

(i) Dividends paid

Ordinary share capital

Interim dividend paid	185	35	185	35
2010 Final dividend paid	450	345	450	345
Total dividends paid (note 32)	635	380	635	380

(ii) Dividends not recognised at the end of the financial year

Since the end of the financial year the Directors have recommended the payment of a dividend. The aggregate amount of the proposed dividend expected to be paid on 4 July 2011 from retained profits at 31 March 2011, but not recognised as a liability at the end of the financial year, is \$297 million (2010: \$450 million).

(iii) Distributions paid or provided for

Macquarie Income Preferred Securities

Distributions paid (net of distributions previously provided)	2	6	-	-
Distributions provided for	2	2	-	-
Total distributions paid or provided for (note 32)	4	8	-	-

The Macquarie Income Preferred Securities (MIPS) represent the NCI of a subsidiary. Accordingly, the distributions paid/provided for in respect of the MIPS are recorded as movements in NCI, as disclosed in note 32 – Reserves, retained earnings and non-controlling interests. The Bank can redirect the payments of distributions under the convertible debentures to be paid to itself. For each debenture 500 Bank preference shares may be substituted at the Bank's discretion at any time, in certain circumstances (to meet capital requirements), or on maturity. Refer to note 32 – Reserves, retained earnings and non-controlling interests, for further details on these instruments.

Macquarie Income Securities

Distributions paid (net of distributions previously provided)	20	16	-	-
Distributions provided for	6	5	-	-
Total distributions paid or provided for (note 32)	26	21	-	-

The Macquarie Income Securities (MIS) are stapled arrangements, which include a perpetual preference share issued by the Bank. No dividends are payable under the preference shares until the Bank exercises its option to receive future payments of interest and principal under the other stapled security. Upon exercise, dividends are payable at the same rate, and subject to similar conditions, as the MIS. Dividends are also subject to Directors' discretion. The distributions paid or provided for in respect of the MIS are recognised directly in equity in accordance with AASB 132 *Financial Instruments: Presentation*. Refer to note 31 – Contributed equity for further details on these instruments.

Convertible Debentures

Distributions paid (net of distributions previously provided)	-	-	2	12
Distributions provided for	-	-	2	3
Total distributions paid or provided for (note 32)	-	-	4	15

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 6

Due from financial institutions

Cash at bank	4,212	2,745	3,199	1,666
Overnight cash at bank ¹	2,900	2,966	2,777	2,776
Other loans to banks	295	697	202	596
Due from clearing houses ²	172	82	78	82
Total due from financial institutions	7,579	6,490	6,256	5,120

¹ Included within this balance is \$6 million (2010: \$126 million) provided as security over payables.

² Included within this balance is \$nil (2010: \$9 million) provided as security over payables.

The majority of the above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity and the Bank.

Note 7

Cash collateral on securities borrowed and reverse repurchase agreements

Governments ¹	43	28	–	28
Financial institutions	7,372	6,036	7,367	5,930
Other	3	20	3	20
Total cash collateral on securities borrowed and reverse repurchase agreements	7,418	6,084	7,370	5,978

¹ Governments include federal, state and local governments and related enterprises.

The Consolidated Entity and the Bank enter into stock borrowing and reverse repurchase transactions with counterparties which require lodgement of non-cash collateral. The fair value of collateral held as at 31 March 2011 is \$7,610 million (2010: \$6,237 million). Under certain transactions, the Consolidated Entity and the Bank are allowed to resell or repledge the collateral held.

The above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity and the Bank.

Note 8

Trading portfolio assets

Equities ¹				
Listed	6,305	4,566	6,169	4,537
Unlisted	71	28	72	6
Corporate bonds	2,915	2,699	2,799	2,678
Commodities	2,002	131	1,701	33
Commonwealth government bonds ¹	1,818	2,455	1,818	2,455
Foreign government bonds ¹	508	305	488	305
Promissory notes	508	1	242	1
Other government securities	197	1,063	196	1,063
Treasury notes	58	73	58	73
Bank bills	40	3	–	–
Certificates of deposit	1	–	–	–
Total trading portfolio assets²	14,423	11,324	13,543	11,151

¹ Included within these balances are assets provided as security over issued notes and payables to other external investors and financial institutions. The value of assets provided as security is \$8 million (2010: \$121 million).

² Included within this balance are trading assets of \$3,721 million (2010: \$4,144 million) pledged as collateral to secure liabilities under repurchase agreements and stock lending agreements.

The above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity and the Bank.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 9				
Loan assets held at amortised cost				
Due from clearing houses	1,789	2,217	642	1,229
Due from governments¹	538	297	450	200
Due from other entities				
Other loans and advances	39,564	38,160	16,561	15,158
Less specific provisions for impairment	(312)	(332)	(253)	(293)
	39,252	37,828	16,308	14,865
Lease receivables	4,017	3,684	72	57
Less specific provisions for impairment	(2)	(5)	-	-
Total due from other entities	43,267	41,507	16,380	14,922
Total loan assets before collective allowance for credit losses	45,594	44,021	17,472	16,351
Less collective allowance for credit losses	(212)	(227)	(173)	(189)
Total loan assets held at amortised cost^{2,3}	45,382	43,794	17,299	16,162

¹ Governments include federal, state and local governments and related enterprises in Australia.

² Included within this balance are loans of \$13,390 million (2010: \$15,998 million) held by consolidated SPEs which are available as security to note holders and debt providers.

³ Included within this balance are loans of \$614 million (2010: \$690 million) provided as security over issued notes and payables to other external investors and financial institutions.

Of the above amounts, \$11,428 million (2010: \$10,989 million) is expected to be recovered within 12 months of the balance date by the Consolidated Entity and \$3,950 million (2010: \$2,981 million) is expected to be recovered by the Bank.

Specific provisions for impairment

Balance at the beginning of the financial year	337	410	293	326
Provided for during the financial year (note 2)	89	175	75	161
Loan assets written off, previously provided for	(79)	(142)	(72)	(106)
Recovery of loans previously provided for (note 2)	(16)	(32)	(15)	(29)
Transfer from/(to) related body corporate entities	-	2	(14)	-
Attributable to foreign currency translation	(17)	(76)	(14)	(59)
Balance at the end of the financial year	314	337	253	293
Specific provisions as a percentage of total gross loan assets	0.68%	0.76%	1.43%	1.76%

Collective allowance for credit losses

Balance at the beginning of the financial year	227	219	189	180
(Written back)/provided for during the financial year (note 2)	(18)	1	(21)	(2)
Loan assets written off, previously provided for	(5)	-	(4)	-
Attributable to acquisitions during the financial year	9	11	9	11
Attributable to foreign currency translation	(1)	(4)	-	-
Balance at the end of the financial year	212	227	173	189

The collective allowance for credit losses is intended to cover losses in the existing overall credit portfolio which are not yet specifically identifiable.

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 10

Impaired financial assets

Impaired debt investment securities available for sale before specific provisions for impairment	117	143	-	-
Less specific provisions for impairment	(86)	(115)	-	-
Debt investment securities available for sale after specific provisions for impairment	31	28	-	-
Impaired loan assets and other financial assets with specific provisions for impairment	723	994	608	898
Less specific provisions for impairment	(359)	(368)	(297)	(322)
Loan assets and other financial assets after specific provisions for impairment	364	626	311	576
Total net impaired assets	395	654	311	576

Note 11

Other financial assets at fair value through profit or loss

Investment securities	8,132	4,479	7,450	4,241
Loan assets	2,475	2,646	2,490	2,708
Total other financial assets at fair value through profit or loss¹	10,607	7,125	9,940	6,949

¹ Included within this balance is \$907 million (2010: \$581 million) provided as security over payables to other financial institutions. Of the above amounts, \$1,436 million (2010: \$901 million) is expected to be recovered within 12 months of the balance date by the Consolidated Entity and \$1,504 million (2010: \$834 million) by the Bank.

Note 12

Other assets

Debtors and prepayments	5,338	4,491	3,047	1,864
Security settlements ¹	889	1,446	654	1,237
Property held for sale and development	506	563	1	1
Other	106	67	-	1
Total other assets²	6,839	6,567	3,702	3,103

¹ Security settlements are receivable within three working days of the relevant trade date.

² Included within this balance is \$20 million (2010: \$14 million) of assets which are provided as security over amounts payable to other financial institutions.

In the year ended 31 March 2010, \$754 million (2009: \$926 million) of assets under operating leases were included in Other assets. These balances are now included in Property, plant and equipment and are disclosed in note 17.

The majority of the above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity and the Bank.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 13				
Investment securities available for sale				
Equity securities				
Listed ¹	511	391	470	289
Unlisted	394	270	111	61
Debt securities ^{2, 3, 4}	14,098	16,100	13,367	15,587
Total investment securities available for sale⁵	15,003	16,761	13,948	15,937

¹ Included within this balance is \$2 million (2010: \$1 million) provided as security over payables to other financial institutions.

² Includes \$2,314 million (2010: \$2,234 million) of Negotiable Certificates of Deposit (NCD) due from financial institutions and \$43 million (2010: \$20 million) of bank bills.

³ Included within this balance is \$238 million (2010: \$299 million) provided as security over payables to other financial institutions.

⁴ Included within this balance are debt securities of \$107 million (2010: \$nil) which are recognised as a result of total return swaps which meet the pass through test of AASB 139 *Financial Instruments: Recognition and Measurement*. The Consolidated Entity does not have legal title to these assets, but has full economic exposure to them.

⁵ Included within this balance is \$136 million (2010: \$182 million) pledged as collateral to secure liabilities under repurchase agreements and stock lending agreements.

Of the above amounts, \$5,721 million (2010: \$5,825 million) is expected to be recovered within 12 months of the balance date by the Consolidated Entity and \$5,424 million (2010: \$5,541 million) is expected to be recovered by the Bank.

Note 14

Intangible assets

Goodwill	332	378	-	-
Customer and servicing contracts	139	168	-	-
Intangible assets with indefinite lives	236	262	-	-
Other identifiable intangible assets	159	140	40	16
Total intangible assets	866	948	40	16

The majority of the above amounts are expected to be recovered after 12 months of the balance date by the Consolidated Entity and the Bank.

Reconciliation of the Consolidated Entity's movement in intangible assets:

	Goodwill \$m	Customer and servicing contracts \$m	Intangible assets with indefinite lives \$m	Other identifiable intangible assets \$m	Total \$m
Balance at the beginning of the financial year	378	168	262	140	948
Acquisitions during the financial year	28	12	-	82	122
Reclassifications during the financial year	(8)	7	-	1	-
Adjustments to purchase consideration ¹	(3)	1	-	(6)	(8)
Disposals during the financial year	(21)	(3)	-	(5)	(29)
Impairment during the financial year	(7)	-	-	(1)	(8)
Amortisation expense for the financial year	-	(27)	-	(29)	(56)
Currency translation difference arising during the financial year	(35)	(19)	(26)	(23)	(103)
Balance at the end of the financial year	332	139	236	159	866

¹ These balances relate to adjustments to purchase considerations and allocations.

In relation to businesses acquired and held for disposal, the individual business is treated as a cash generating unit. Assets associated with strategic business acquisitions are allocated to each of the operating segments (refer to note 3 – Segment reporting) and assessed for impairment on a regional legal entity operating group basis.

Note 14

Intangible assets continued

The recoverable amount of goodwill is determined using the higher of value-in-use and fair value less costs to sell.

Value-in-use calculations are based upon discounting estimated post-tax cashflows at a risk-adjusted interest rate appropriate to the cash generating unit to which the goodwill applies. The determination of both cashflows and discount rates require the exercise of judgement. The calculations use cash flow estimations based on financial budgets and forecasts reviewed by management. These cashflows are discounted at rates that have been determined by reference to historical company and industry experience and publicly available data.

Fair value less cost to sell calculations are determined using an earnings multiple approach applicable to that type of business. These have been determined by reference to historical company and industry experience and publicly available data.

Note 15

Life investment contracts and other unitholder investment assets

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Cash and due from financial institutions	144	103	-	-
Debt securities	514	617	-	-
Units in unit trusts	4,254	3,968	-	-
Equity securities	150	166	-	-
Total life investment contracts and other unitholder investment assets	5,062	4,854	-	-

Investment assets are held to satisfy policy and unitholder liabilities, which are predominately investment linked.

The majority of the above assets are recoverable within 12 months of the balance date.

Income from life investment contracts and other unitholder investment assets

Premium income, investment revenue and management fees	324	667	-	-
Life investment contract claims, reinsurance and changes in policy liabilities	(199)	(585)	-	-
Direct fees	(47)	(34)	-	-
Total income from life investment contracts and other unitholder investment assets (note 2)	78	48	-	-

Solvency requirements for the life investment contracts business have been met at all times during the financial year.

As at 31 March 2011, the life investment contracts business had investment assets in excess of policy holder liabilities of \$10 million (2010: \$13 million).

Note 16

Interests in associates and joint ventures accounted for using the equity method

Loans and investments without provisions for impairment	665	723	220	144
Loans and investments with provisions for impairment	323	394	291	241
Less provision for impairment	(132)	(202)	(40)	(43)
Loans and investments at recoverable amount	191	192	251	198
Total interests in associates and joint ventures accounted for using the equity method	856	915	471	342

The above amounts are expected to be recovered after 12 months of the balance date by the Consolidated Entity and the Bank.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 16

Interests in associates and joint ventures accounted for using the equity method continued

	Consolidated 2011 \$m	Consolidated 2010 \$m
(i) Reconciliation of movement in the Consolidated Entity's interests in associates and joint ventures accounted for using the equity method:		
Balance at the beginning of the financial year	915	1,571
Transfer as part of restructure	(58)	2
Associates acquired/equity invested	187	200
Share of pre-tax profits of associates and joint ventures	64	10
Share of tax expense of associates and joint ventures	(19)	(3)
Dividends received/receivable from associates (note 34)	(165)	(96)
Associates disposed of	(112)	(129)
Impairment of investments in associates	(18)	(65)
Foreign exchange and other adjustments	(38)	(164)
Transferred from/(to) other asset categories	100	(411)
Balance at the end of the financial year	856	915

(ii) Summarised information of interests in material associates and joint ventures accounted for using the equity method is as follows:

Name of entity	Country of incorporation	Reporting date	Ownership interest	
			2011 %	2010 %
Diversified CMBS Investments Inc ^{1, a}	USA	31 March	57	57
Macquarie Goodman Japan Limited ^b	Singapore	31 March	–	50
MGPA Limited ^{2, b}	Bermuda	30 June	56	56

¹ Voting rights for this investment are not proportional to the ownership interest. The Consolidated Entity has joint control because neither the Consolidated Entity nor its joint investor has control in their own right.

² Significant influence arises due to the Consolidated Entity's voting power and board representation.

^a Funds management and investing.

^b Property development/management entity.

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
(iii) Contingent liabilities of associates and joint ventures are as follows:				
Share incurred jointly with other investors	15	9	–	–
For which the Consolidated Entity is severally liable	8	3	–	–

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 16

Interests in associates and joint ventures accounted for using the equity method continued

(iv) Financial information of interests in associates and joint ventures are as follows:

Consolidated Entity's share of:

Assets	1,246	2,036	558	443
Liabilities	763	1,147	276	323
Revenues	211	558	70	112
Profit after tax	41	4	14	1

Note 17

Property, plant and equipment

Furniture, fittings and leasehold improvements

Cost	191	177	32	48
Less accumulated depreciation	(47)	(50)	(18)	(30)
Total furniture, fittings and leasehold improvements	144	127	14	18

Communication equipment

Cost	2	7	1	5
Less accumulated depreciation	(2)	(6)	(1)	(5)
Total communication equipment	-	1	-	-

Computer equipment

Cost	23	63	16	82
Less accumulated depreciation	(16)	(55)	(14)	(77)
Total computer equipment	7	8	2	5

Infrastructure assets

Cost	9	3	-	-
Less accumulated depreciation	-	-	-	-
Total infrastructure assets	9	3	-	-
Total	160	139	16	23

Assets under operating leases

Aviation

Cost	1,823	342	-	-
Less accumulated depreciation	(63)	(27)	-	-
Total aviation	1,760	315	-	-

Other

Cost	553	662	-	-
Less accumulated depreciation	(110)	(223)	-	-
Total other	443	439	-	-

Total assets under operating lease

	2,203	754	-	-
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Total property, plant and equipment

	2,363	893	16	23
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The majority of the above amounts are expected to be recovered after 12 months of the balance date by the Consolidated Entity and the Bank.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 17

Property, plant and equipment continued

Reconciliation of the movement in the Consolidated Entity's property, plant and equipment at their written-down value:

	Furniture, fittings and leasehold improvements	Communication equipment	Computer equipment	Infrastructure assets	Total
	\$m	\$m	\$m	\$m	\$m
Balance at the beginning of the financial year	127	1	8	3	139
Acquisitions	44	-	2	30	76
Disposals	(2)	-	-	-	(2)
Reclassification	(3)	-	-	-	(3)
Foreign exchange movements	(3)	(1)	(1)	(24)	(29)
Depreciation expense (note 2)	(19)	-	(2)	-	(21)
Balance at the end of the financial year	144	-	7	9	160

Included in the balance of property, plant and equipment are assets pledged as security over payables to other financial institutions. The terms preclude these assets from being sold or being used as security for further liabilities without the permission of the financial institution. The carrying value of assets pledged is \$10 million (2010: \$8 million).

Assets under operating lease

	Aviation	Other	Total
	\$m	\$m	\$m
Balance at the beginning of the financial year	315	439	754
Acquisitions	1,687	128	1,815
Disposals	(30)	(18)	(48)
Reclassification ¹	18	15	33
Foreign exchange movements	(187)	(58)	(245)
Depreciation expense	(43)	(63)	(106)
Balance at the end of the financial year	1,760	443	2,203

¹ Assets that cease to be under operating lease are transferred to inventory where expected to be realised through disposal.

Included in the balance of operating leases are assets pledged as security over payables to other financial institutions. The terms preclude these assets from being sold or being used as security for further liabilities without the permission of the financial institution. The carrying value of assets pledged is \$219 million (2010: \$194 million).

In the year ended 31 March 2010, \$754 million (2009: \$1,454 million) of assets under operating lease were disclosed as part of Other assets. During the year ended 31 March 2010, there were \$350 million of acquisitions (2009: \$282 million), \$2 million of disposals (2009: \$34 million), \$483 million loss on combined foreign exchange movements and depreciation (2009: \$33 million) and \$565 million of reclassification to inventory (2009: \$57 million).

The future minimum lease payments expected to be received under non-cancellable operating leases are as follows:

Assets under operating lease

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Not later than one year	293	81	-	-
Later than one year, not later than five years	789	129	-	-
Later than five years	189	16	-	-
Total future minimum lease payments receivable	1,271	226	-	-

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m

Note 18

Investments in subsidiaries

Investments at cost without provisions for impairment	–	–	3,600	3,794
Investments at cost with provisions for impairment	–	–	609	352
Less provisions for impairment	–	–	(428)	(298)
Investments at recoverable amount	–	–	181	54
Total investments in subsidiaries	–	–	3,781	3,848

The above amounts are expected to be recovered after 12 months of the balance date by the Bank.

The material subsidiaries of the Bank, based on contribution to the Consolidated Entity's profit after income tax, the size of the investment made by the Bank or the nature of activities conducted by the subsidiary, are:

- Boston Australia Pty Limited
- Delaware Management Company (United States)
- Macquarie Agricultural Funds Management Limited
- Macquarie Alternative Assets Management Limited
- Macquarie Equities Limited
- Macquarie Financial Limited/Financiere Macquarie Ltee. (Canada)
- Macquarie Financial Products Management Limited
- Macquarie Funding Holdings Inc. (United States)
- Macquarie Funding Inc. (Canada)
- Macquarie Funds Management Holdings Pty Limited
- Macquarie Income Investments Limited
- Macquarie Investment Management Limited
- Macquarie Investment Services Limited
- Macquarie Life Limited
- Macquarie Private Capital Management Limited
- Macquarie Securitisation Limited
- MQ Portfolio Management Limited

Note: All entities are incorporated in Australia unless otherwise stated.

Overseas subsidiaries conduct business predominantly in their place of incorporation unless otherwise stated.

Beneficial interest in all entities is 100 per cent.

All entities have a 31 March reporting date.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 19

Deed of cross guarantee

On 26 March 2009 MBL, Macquarie Americas Holdings Pty Limited, Macquarie Corporate and Asset Finance Limited, Macquarie Leisure Developments Pty Limited, Macquarie Property Investment Management Holdings Limited and Pacific Rim Operations Limited entered into a deed of cross guarantee under which each company guarantees the debts of the others. On 25 February 2010, Macquarie Australia Pty Limited entered into the deed and on 22 March 2010, Boston Australia Pty Limited and MTF Holdings Pty Limited entered the deed. By entering into the deed, the wholly-owned entities have been relieved from the requirement to prepare a financial report and directors' report under Class Order 98/1418 (as amended) issued by the Australian Securities and Investments Commission.

Consolidated income statement and a summary of movements in consolidated retained earnings

The above entities represent a 'Closed Group' (the Closed Group) for the purpose of the Class Order, and as there are no other parties to the Deed of cross guarantee that are controlled by the Bank they also represent the 'Extended Closed Group'.

Consolidated income statement of the Closed Group for the financial year ended 31 March 2011

	2011 \$m	2010 \$m
Interest and similar income	3,962	3,239
Interest expense and similar charges	(2,812)	(2,311)
Net interest income	1,150	928
Fee and commission income	95	69
Net trading income	581	565
Share of net profits of associates and joint ventures accounted for using the equity method	20	13
Other operating income and charges	595	858
Net operating income	2,441	2,433
Employment expenses	(853)	(688)
Brokerage and commission expenses	(616)	(375)
Occupancy expenses	(84)	(85)
Non-salary technology expenses	(59)	(58)
Other operating expenses	(731)	(707)
Total operating expenses	(2,343)	(1,913)
Operating profit before income tax	98	520
Income tax (expense)/benefit	(150)	83
(Loss)/profit attributable to equity holders of the Closed Group	(52)	603
Summary of movements in consolidated retained earnings		
Retained earnings at the beginning of the financial year	1,277	1,090
(Loss)/profit attributable to equity holder of the Closed Group	(52)	603
Dividends paid or provided	(639)	(416)
Retained earnings at the end of the financial year	586	1,277

Note 19

Deed of cross guarantee continued

Consolidated statement of financial position of the Closed Group as at 31 March 2011

	2011 \$m	2010 \$m
Assets		
Due from financial institutions	6,255	5,120
Cash collateral on securities borrowed and reverse repurchase agreements	7,370	5,978
Trading portfolio assets	13,543	11,151
Loan assets held at amortised cost	17,299	16,162
Other financial assets at fair value through profit or loss	9,940	6,965
Derivative financial instruments – positive values	18,551	14,955
Other assets	3,707	3,103
Investment securities available for sale	13,996	16,014
Intangible assets	40	16
Due from related body corporate entities	2,243	2,457
Due from subsidiaries	16,668	13,835
Interest in associates and joint ventures accounted for using the equity method	476	339
Property, plant and equipment	16	23
Investments in subsidiaries	5,224	5,221
Deferred income tax assets	13	214
Total assets	115,341	101,553
Liabilities		
Due to financial institutions	1,359	1,657
Cash collateral on securities lent and repurchase agreements	6,099	7,195
Trading portfolio liabilities	5,621	4,910
Derivative financial instruments – negative values	18,191	14,866
Deposits	34,481	21,623
Debt issued at amortised cost	17,698	19,170
Other financial liabilities at fair value through profit or loss	2,122	2,355
Other liabilities	4,046	3,103
Current tax liabilities	15	18
Due to related body corporate entities	6,212	8,046
Due to subsidiaries	8,749	8,271
Provisions	58	53
Total liabilities excluding loan capital	104,651	91,267
Loan capital		
Subordinated debt at amortised cost	1,430	905
Subordinated debt at fair value through profit or loss	467	499
Total loan capital	1,897	1,404
Total liabilities	106,548	92,671
Net assets	8,793	8,882
Equity		
Contributed equity		
Ordinary share capital	7,353	6,855
Macquarie Income Securities	391	391
Convertible debentures	107	107
Reserves	356	252
Retained earnings	586	1,277
Total equity	8,793	8,882

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 20				
Deferred income tax assets/(liabilities)				
The balance comprises temporary differences attributable to:				
Other assets and liabilities	176	140	(33)	70
Tax losses	152	115	2	46
Fixed assets	19	26	37	28
Investments in subsidiaries, associates and joint ventures	139	176	23	26
Set-off of deferred tax (liabilities)/assets	(110)	(84)	32	113
Total deferred income tax assets	376	373	61	283
Intangible assets	(139)	(145)	-	-
Financial instruments	(217)	(94)	109	165
Other liabilities	(54)	(78)	(54)	(78)
Tax effect of reserves	(93)	(40)	(80)	(52)
Set-off of deferred tax assets/(liabilities)	110	84	(32)	(113)
Total deferred income tax liabilities	(393)	(273)	(57)	(78)
Net deferred income tax (liabilities)/assets	(17)	100	4	205

The majority of the above amounts are expected to be recovered after 12 months of the balance date by the Consolidated Entity and the Bank.

Potential tax assets of approximately \$17 million (2010: \$58 million) attributable to tax losses carried forward by subsidiaries have not been brought to account in the subsidiaries and in the Consolidated Entity as the Directors do not believe the realisation of the tax assets is probable.

The principles of the balance sheet method of tax effect accounting have been adopted whereby the income tax expense for the financial year is the tax payable on the current year's taxable income, adjusted for changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements and unused tax losses. Deductible temporary differences and tax losses give rise to deferred tax assets. Deferred tax assets are not recognised unless the benefit is probable of realisation.

The deferred tax assets have been applied against deferred tax liabilities to the extent that they are expected to be realised in the same period and within the same tax paying entity.

Taxation of Financial Arrangements (TOFA)

The new tax regime for financial arrangements, TOFA, began to apply to the Australian tax consolidated group from 1 October 2010. The regime aims to align the tax and accounting recognition and measurement of financial arrangements and their related flows. Deferred tax balances for financial instruments that existed on adoption at 1 October 2010 will reverse over a four year period.

Note 21

Non-current assets and disposal groups classified as held for sale

Non-current assets and assets of disposal groups classified as held for sale

Other non-current assets	-	4	-	-
Assets of disposal groups classified as held for sale ¹	-	47	-	-
Total non-current assets and assets of disposal groups classified as held for sale	-	51	-	-
Liabilities of disposal groups classified as held for sale	-	9	-	-
Total liabilities of disposal groups classified as held for sale¹	-	9	-	-

¹ The balance at 31 March 2010 represents the assets and liabilities of Advanced Markets Holdings LLC.

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m

Note 22

Due to financial institutions

OECD banks	600	699	412	197
Clearing houses ¹	3	42	3	42
Other	977	1,426	596	999
Total due to financial institutions	1,580	2,167	1,011	1,238

¹ Amounts due to clearing houses are settled on the next business day.

Note 23

Cash collateral on securities lent and repurchase agreements

Central banks	190	2,776	190	2,776
Governments	344	–	344	–
Financial institutions	5,562	4,419	5,562	4,413
Other	7	6	3	6
Total cash collateral on securities lent and repurchase agreements	6,103	7,201	6,099	7,195

Note 24

Trading portfolio liabilities

Listed equity securities	4,424	3,381	4,325	3,381
Other government securities	496	287	496	287
Corporate securities	472	819	460	808
Commonwealth government securities	340	434	340	434
Total trading portfolio liabilities	5,732	4,921	5,621	4,910

Note 25

Debt issued at amortised cost

Debt issued at amortised cost ¹	36,943	39,408	17,697	19,170
Total debt issued at amortised cost	36,943	39,408	17,697	19,170

¹ Included within this balance are amounts payable to SPE note holders of \$11,679 million (2010: \$14,419 million).

The Consolidated Entity has not had any defaults of principal, interest or other breaches with respect to its debt during the years reported.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
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Note 26

Other financial liabilities at fair value through profit or loss

Debt issued at fair value	2	101	2	95
Equity linked notes	2,907	2,524	2,120	2,260
Total other financial liabilities at fair value through profit or loss	2,909	2,625	2,122	2,355

Reconciliation of debt issued at amortised cost and other financial liabilities at fair value through profit or loss by major currency:

(In Australian dollar equivalent):

United States dollars	14,298	14,035	12,284	12,993
Australian dollars	14,257	18,020	4,683	5,314
Canadian dollars	7,242	5,789	46	39
Euro	2,284	1,622	1,142	804
Japanese yen	1,384	1,350	1,384	1,350
Hong Kong dollars	164	386	164	382
Great British pounds	135	547	70	477
Singapore dollars	62	177	42	59
Others	26	107	4	107
Total by currency	39,852	42,033	19,819	21,525

The Bank's and Consolidated Entity's primary sources for domestic and international debt funding are its multi-currency, multi-jurisdictional Debt Instrument Program and domestic NCD issuance. Securities can be issued for terms varying from one day to 30 years.

Note 27

Other liabilities

Creditors	4,901	4,205	2,636	1,664
Due to brokers and customers	1,374	1,768	628	1,000
Accrued charges and sundry provisions	737	472	419	266
Other	451	282	366	173
Total other liabilities	7,463	6,727	4,049	3,103

The majority of the above amounts are expected to be settled within 12 months of the balance date by the Consolidated Entity and the Bank.

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m

Note 28

Provisions

Provision for annual leave	44	35	26	23
Provision for long service leave	28	26	28	26
Provision for other employee entitlements	–	3	–	1
Provision for dividends	8	7	2	3
Total provisions	80	71	56	53

The majority of the above amounts are expected to be settled within 12 months of the balance date by the Consolidated Entity and the Bank.

Note 29

Capital management strategy

The Bank and Consolidated Entity's capital management strategy is to maximise shareholder value through optimising the level and use of capital resources, whilst also providing the flexibility to take advantage of opportunities as they may arise.

The Consolidated Entity's capital management objectives are to:

- continue to support the Consolidated Entity's credit rating;
- ensure sufficient capital resource to support the Consolidated Entity's business and operational requirements;
- maintain sufficient capital to exceed externally imposed capital requirements; and
- safeguard the Consolidated Entity's ability to continue as a going concern.

The Consolidated Entity's capital management strategy uses both internal and external measures of capital. Internally, an economic capital model (ECM) has been developed to quantify the Consolidated Entity's aggregate level of risk. The ECM is used in the cash flow to support business decision making, including deciding the required level of capital, the setting of risk appetite and as a risk adjusted performance measure.

The Consolidated Entity is subject to minimum capital requirements externally imposed by APRA, following the guidelines developed by the Basel Committee on Banking Supervision. The Bank reports to APRA under Basel II capital requirements and has been granted accreditation by APRA to adopt the Basel II Foundation Internal Ratings Based Approach for credit risk and the Advanced Measurement Approach for operational risk.

Regulatory capital requirements are measured for the Bank and certain subsidiaries which meet the definition of extended licensed entities (Level 1 reporting), and for the Banking Group (Level 2 reporting). Level 2 consists of the Bank, its subsidiaries and its immediate parent less certain subsidiaries of the Bank which are deconsolidated for APRA reporting purposes. These include entities conducting insurance, funds management, non-financial operations and special purpose vehicles. APRA requires ADIs to have a minimum ratio of capital to risk weighted assets of 8 per cent at both Level 1 and Level 2, with at least four per cent of this capital in the form of Tier 1 capital. In addition, APRA imposes ADI specific minimum capital ratios which may be higher than these levels. The Macquarie Group internal capital policy set by the Board requires capital floors above this regulatory required level.

The Bank's Tier 1 capital consists of share capital, retained earnings, certain reserves, Macquarie Income Securities and convertible debentures. Deductions from Tier 1 capital are made for intangibles, certain capitalised expenses, deferred tax assets, and equity investments over prescribed limits. In addition, Basel II requires that investments in subsidiaries that are fund management entities, special purpose securitisation vehicles and non-commercial entities are deducted 50 per cent from Tier 1 capital and 50 per cent from Tier 2 capital. The Bank's Tier 2 capital includes term subordinated debt and certain reserves. Deductions from Tier 2 capital include certain reserves and 50 per cent of investments in subsidiaries as noted above.

The Bank and Consolidated Entity have complied with all internal and external capital management requirements throughout the year.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 30

Loan capital

Subordinated debt

Agreements between the Consolidated Entity and the lenders provide that, in the event of liquidation, 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 the Consolidated Entity.

The dates upon which the Consolidated Entity has committed to repay the principal sum to the lenders are as follows:

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Less than 12 months	26	–	26	–
18 September 2015	–	239	–	239
19 September 2016	306	330	306	330
6 December 2016	441	516	441	516
31 May 2017	308	319	308	319
21 September 2020	816	–	816	–
Total subordinated debt	1,897	1,404	1,897	1,404

Reconciliation of subordinated debt by major currency:

(In Australian dollar equivalent)

Euro	1,283	516	1,283	516
Great British pounds	308	331	308	331
Australian dollars	306	318	306	318
United States dollars	–	239	–	239
Total subordinated debt by currency	1,897	1,404	1,897	1,404

The Consolidated Entity has not had any defaults of principal, interest or other breaches with respect to its loan capital during the years reported.

The carrying value of subordinated debt at fair value through profit or loss at 31 March 2011 is \$5 million higher (2010: \$14 million higher) than the contractual amount at maturity as credit risk and current market interest rates are factored into the determination of fair value.

In accordance with APRA guidelines, the Consolidated Entity includes the applicable portion of its loan capital principal as Tier 2 capital.

	Consolidated and Bank		Consolidated and Bank	
	2011	2010	2011	2010
	Number of shares	Number of shares	\$m	\$m

Note 31

Contributed equity

Ordinary share capital

Opening balance of fully paid ordinary shares	444,085,965	337,902,108	6,508	4,503
Issue of shares to Macquarie B.H. Pty Ltd on 1 April 2009 at \$18.33 per share	–	10,920,790	–	200
Issue of shares to Macquarie B.H. Pty Ltd on 28 September 2009 at \$18.06 per share	–	26,301,219	–	475
Issue of shares to Macquarie B.H. Pty Ltd on 31 January 2010 at \$18.96 per share	–	30,854,431	–	585
Issue of shares to Macquarie B.H. Pty Ltd on 29 March 2010 at \$19.55 per share	–	38,107,417	–	745
Issue of shares to Macquarie B.H. Pty Ltd on 29 June 2010 at \$18.70 per share	3,743,316	–	70	–
Issue of shares to Macquarie B.H. Pty Ltd on 30 July 2010 at \$18.87 per share	13,248,543	–	250	–
Issue of shares to Macquarie B.H. Pty Ltd on 29 September 2010 at \$18.78 per share	15,974,441	–	300	–
Issue of shares to Macquarie B.H. Pty Ltd on 29 March 2011 at \$18.71 per share	8,017,104	–	150	–
Closing balance of fully paid ordinary shares	485,069,369	444,085,965	7,278	6,508

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Equity contribution from ultimate parent entity				
Balance at the beginning of the financial year	87	57	67	44
Additional paid up capital	15	30	8	23
Balance at the end of the financial year	102	87	75	67

During the year ended 31 March 2010, the ultimate parent entity, MGL, introduced MEREP, which grants RSUs, DSUs and PSUs to eligible staff of the Consolidated Entity. Under MEREP the staff retained profit share is held in the shares of MGL by the Macquarie Group Employee Retained Equity Plan Trust (MEREP Trust). Where MEREP Awards are issued by MGL to employees of the Consolidated Entity and MGL is not subsequently reimbursed by the Consolidated Entity, the Consolidated Entity recognises the equity provided as a capital contribution from MGL. During the year ended 31 March 2011, compensation expense relating to MEREP which has been treated as paid up capital totalled \$2,532,976 (2010: \$827,641). For further information regarding the terms and conditions of MEREP refer to note 36 – Employee equity participation.

In November 1995, the Bank introduced an Employee Option Plan, as a replacement for the Bank's then closed partly paid share scheme. On 13 November 2007, the date of the restructure of the Macquarie Group, all MBL options were cancelled and replacement options over shares in the new ultimate parent entity, MGL, were issued on the same terms on a one-for-one basis under the Macquarie Group Employee Share Option Plan (MGESOP). Staff eligible to participate are those of Associate Director level and above and consultants to the Consolidated Entity. The options are measured at their grant dates based on their fair value and the number expected to vest. This amount is recognised as an expense evenly over the respective vesting periods. Since 13 November 2007 the equity provided has been treated as an equity contribution from MGL. For the year ended 31 March 2011, compensation expense relating to MGESOP which has been treated as additional paid up capital in the Consolidated Entity totalled \$11,445,656 (2010: \$27,990,616) and in the Bank \$7,300,282 (2010: \$21,429,822). In addition, pursuant to an amendment to the terms of the Macquarie Group Staff Share Acquisition Plan (MGSSAP) and Employee Share Plan (ESP) to allow the issue of new shares as an alternative to acquiring existing shares on-market, compensation expense relating to these plans which has been recognised as additional paid up capital in the Consolidated Entity totalled \$667,121 (2010: \$1,228,751) and in the Bank \$658,369 (2010: \$1,210,953). Details of the MGESOP, MGSSAP and ESP are disclosed in note 36 – Employee equity participation.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m

Note 31

Contributed equity continued

Macquarie Income Securities

4,000,000 Macquarie Income Securities of \$100 each	400	400	400	400
Less transaction costs for original placement	(9)	(9)	(9)	(9)
Total Macquarie Income Securities	391	391	391	391

The Macquarie Income Securities are classified as equity in accordance with AASB 132 *Financial Instruments: Presentation*. Interest is paid quarterly at a floating rate of Bank Bill Swap Rate (BBSW) plus 1.7 per cent p.a. Payment of interest to holders is subject to certain conditions, including the profitability of the Bank. They are a perpetual instrument with no conversion rights. They were listed for trading on the Australian Securities Exchange on 19 October 1999 and became redeemable (in whole or in part) at the Bank's discretion on 19 November 2004.

Convertible debentures

850 convertible debentures of £50,000 each	–	–	107	107
Total convertible debentures	–	–	107	107

As part of the issue of the Macquarie Income Preferred Securities (detailed in note 32 – Reserves, retained earnings and non-controlling interests), the London branch of the Bank issued 7,000 reset subordinated convertible debentures, each with a face value of £50,000, to Macquarie Capital Funding LP, a subsidiary of the Bank. The convertible debentures, which eliminate on consolidation, currently pay a 6.177 per cent (2010: 6.177 per cent) semi-annual cumulative fixed rate distribution. The debentures mature on 15 April 2050, but may be redeemed, at the Bank's discretion, on 15 April 2020 or on any reset date thereafter. If redemption is not elected, then on 15 April 2020 and on each fifth anniversary thereafter, the debenture coupon will be reset to 2.35 per cent (2010: 2.35 per cent) per annum above the then prevailing five year benchmark sterling gilt rate. Following the redemption of 6,150 convertible debentures on 29 September 2009, 850 convertible debentures remain on issue.

The distribution policies for these instruments are included in note 5 – Dividends paid and distributions paid or provided for.

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 32				
Reserves, retained earnings and non-controlling interests				
Reserves				
Foreign currency translation reserve				
Balance at the beginning of the financial year	(241)	(9)	(57)	(167)
Currency translation differences arising during the financial year, net of hedge	(402)	(232)	23	110
Balance at the end of the financial year	(643)	(241)	(34)	(57)
Available for sale reserve				
Balance at the beginning of the financial year	192	4	210	37
Revaluation movement for the financial year, net of tax	174	192	116	177
Transfer to income statement for impairment	(6)	1	(6)	1
Transfer to profit on realisation	(53)	(5)	(54)	(5)
Balance at the end of the financial year	307	192	266	210
Share based payments reserve				
Balance at the beginning of the financial year	186	186	186	186
Balance at the end of the financial year	186	186	186	186
Cash flow hedging reserve				
Balance at the beginning of the financial year	(47)	(146)	(27)	(27)
Revaluation movement for the financial year, net of tax	21	99	21	–
Balance at the end of the financial year	(26)	(47)	(6)	(27)
Share of reserves of interests in associates and joint ventures accounted for using the equity method				
Balance at the beginning of the financial year	1	30	–	–
Share of reserves during the financial year	–	(29)	–	–
Balance at the end of the financial year	1	1	–	–
Reserves arising from group restructure of combining entities under common control				
Balance at the beginning of the financial year	(261)	(266)	(61)	(61)
Arising from acquisition of subsidiaries from the Non-Banking Group (note 44)	–	5	–	–
Balance at the end of the financial year	(261)	(261)	(61)	(61)
Total reserves at the end of the financial year	(436)	(170)	351	251
Retained earnings				
Balance at the beginning of the financial year	1,533	1,250	1,288	1,099
Profit attributable to ordinary equity holders of Macquarie Bank Limited	829	684	30	584
Distributions paid or provided on Macquarie Income Securities (note 5)	(26)	(21)	–	–
Distributions paid or provided on convertible debentures (note 5)	–	–	(4)	(15)
Dividends paid on ordinary share capital (note 5)	(635)	(380)	(635)	(380)
Balance at the end of the financial year	1,701	1,533	679	1,288

Notes to the financial statements

for the financial year ended 31 March 2011

continued

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 32				
Reserves, retained earnings and non-controlling interests continued				
Non-controlling interests				
Macquarie Income Preferred Securities¹				
Proceeds on issue of Macquarie Income Preferred Securities	107	107	-	-
Less issue costs	(1)	(1)	-	-
	106	106	-	-
Current year profit	4	8	-	-
Distribution provided on Macquarie Income Preferred Securities (note 5)	(4)	(8)	-	-
Foreign currency translation reserve	(43)	(39)	-	-
Total Macquarie Income Preferred Securities	63	67	-	-
Other non-controlling interests				
Ordinary share capital	13	9	-	-
Retained earnings	(4)	9	-	-
Total other non-controlling interests	9	18	-	-
Total non-controlling interests	72	85	-	-

¹ On 22 September 2004, Macquarie Capital Funding LP, a subsidiary of the Bank, issued £350 million of Macquarie Income Preferred Securities (the Securities). The Securities - guaranteed non-cumulative step-up perpetual preferred securities - currently pay a 6.177 per cent (2010: 6.177 per cent) per annum semi-annual non-cumulative fixed rate distribution. They are perpetual securities and have no fixed maturity but may be redeemed on 15 April 2020, at the Bank's discretion. If redemption is not elected on this date, the distribution rate will be reset to 2.35 per cent (2010: 2.35 per cent) per annum above the then five-year benchmark sterling gilt rate. The Securities may be redeemed on each fifth anniversary thereafter at the Bank's discretion. The first coupon was paid on 15 April 2005. The instruments are reflected in the Consolidated Entity's financial statements as a NCI, with distribution entitlements being included with the NCI share of profit after tax. Following the cancellation of £307.5 million MIPS in September 2009, £42.5 million MIPS remain on issue.

Note 33

Notes to the statements of cash flows

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Reconciliation of cash and cash equivalents				
Cash and cash equivalents at the end of the financial year as shown in the statements of cash flows are reconciled to related items in the statements of financial position as follows:				
Due from financial institutions ¹	7,548	6,459	6,254	5,023
Trading portfolio assets and debt securities ²	2,477	4,706	2,419	3,209
Cash and cash equivalents at the end of the financial year	10,025	11,165	8,673	8,232

¹ Includes cash at bank, overnight cash at bank, other loans to financial institutions and amounts due from clearing houses as per note 1(xx) - Summary of significant accounting policies.

² Includes certificates of deposit, bank bills, treasury notes and other short-term debt securities as per note 1(xx) - Summary of significant accounting policies.

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m

Note 33

Notes to the statements of cash flows continued

Reconciliation of profit after income tax to net cash flows from/(used in) operating activities

Profit after income tax	833	697	30	584
Adjustments to profit:				
Depreciation and amortisation	183	266	10	24
Dividends received/receivable from associates	165	96	–	–
Fair value changes on financial assets and liabilities at fair value through profit or loss and realised investment securities available for sale	(106)	192	(90)	177
(Gain)/loss on acquiring, disposing and change in ownership interest in subsidiaries and businesses held for sale	(41)	(138)	156	(141)
Gain on repurchase of subordinated debt	–	(55)	–	(55)
Impairment charge on financial and non-financial assets	167	422	210	288
Interest on available for sale financial assets	(137)	244	(59)	250
Loss on disposal of property, plant and equipment	–	5	–	–
Net gains on sale of investment securities available for sale and associates and joint ventures	(236)	(51)	(196)	(117)
Share based payment expense (note 31)	15	30	8	23
Share of net profits of associates and joint ventures accounted for using the equity method	(45)	(7)	–	–
Changes in assets and liabilities:				
Change in dividends receivable	25	25	15	23
Change in fees and non-interest income receivable	102	226	199	227
Change in fees and commissions payable	10	9	(4)	(6)
Change in tax balances	124	(66)	(68)	(129)
Change in provisions for employee entitlements	10	5	4	–
Change in loan assets	(3,674)	3,738	(5,506)	2,750
Change in loan receivable from ultimate parent entity	512	2,551	512	2,551
Change in debtors, prepayments, accrued charges and creditors	91	(14)	127	(3)
Change in net trading portfolio assets and liabilities and net derivative financial instruments	(3,987)	1,122	(4,270)	(1,710)
Change in net interest payable, amounts due to other financial institutions, deposits and other borrowings	10,026	(10,192)	10,996	(5,156)
Change in life investment contract receivables	209	(1,117)	–	–
Net cash flows from/(used in) operating activities	4,246	(2,012)	2,074	(420)

Non-cash investing activity

Acquisition of subsidiaries by means of equity issue	–	200	–	200
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During the year ended 31 March 2010, the Bank acquired certain subsidiaries of the Non-Banking Group (see note 44 – Acquisitions and disposals of subsidiaries and businesses) with the issue of new shares. This increased the Bank's cost of investment in subsidiaries without any corresponding outflow of cash and cash equivalents.

Notes to the financial statements

for the financial year ended 31 March 2011

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Note 34

Related party information

Ultimate and immediate parent entities

The Bank's ultimate parent entity is MGL. The Bank's immediate parent entity is Macquarie B.H. Pty Ltd. Both MGL and Macquarie B.H. Pty Ltd are incorporated in Australia. MGL produces financial statements that are available for public use.

Transactions between the Consolidated Entity and the ultimate and immediate parent entities principally arise from the provision and repayment of loans and the provision of management and administration services.

In the financial year ended 31 March 2008, the Bank provided a \$10.1 billion intra-group loan to MGL of which \$737 million (2010: \$1,249 million) remained outstanding at the balance date. This facility has been repaid on 27 April 2011.

MGL as the ultimate parent entity of the Macquarie Group is the head entity of the Australian tax consolidated group. The terms and conditions of the tax funding agreement are set out in note 1 (vii) – Summary of significant accounting policies. During the year ended 31 March 2011, current tax liabilities of the Consolidated Entity and the Bank attributed to MGL as the head entity of the tax consolidated group amounted to \$249 million (2010: \$494 million) and \$79 million (2010: \$442 million), respectively.

Balances outstanding with MGL are included in Due from related body corporate entities and Due to related body corporate entities, as appropriate, in the statement of financial position. The following balances with the ultimate parent entity were outstanding as at financial year end:

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m
Amounts receivable ¹	791	1,071	758	1,325

¹ As described in note 1(xix) – Summary of significant accounting policies, the amounts receivable by the Bank includes \$44 million (2010: \$18 million) for amounts paid in advance for MEREP offered to their employees and yet to be recognised as a share based payment expense.

Subsidiaries

Transactions between the Bank and its subsidiaries principally arise from the provision of banking and other financial services, the granting of loans and acceptance of funds on deposit, derivative transactions, the provision of management and administration services and the provision of guarantees.

All transactions with subsidiaries are in accordance with regulatory requirements, the majority of which are on commercial terms. All transactions undertaken during the financial year with subsidiaries are eliminated in the consolidated financial statements. Amounts due from and due to subsidiaries are presented separately in the statement of financial position of the Bank except when offsetting reflects the substance of the transaction or event.

Balances arising from lending and borrowing activities between the Bank and subsidiaries are typically repayable on demand, but may be extended on a term basis and where appropriate may be either subordinated or collateralised.

The Bank has entered into derivative transactions with its subsidiaries to hedge their operations. The fair value of derivative financial instruments relating to transactions between the Bank and its subsidiaries at 31 March 2011 are \$825 million (2010: \$136 million) positive value and \$1,389 million (2010: \$597 million) negative value.

A list of material subsidiaries is set out in note 18 – Investments in subsidiaries.

Note 34

Related party information continued

Subsidiaries continued

The following income/(expense) resulted from transactions with subsidiaries during the financial year:

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Interest income received/receivable (note 2)	–	–	476	419
Interest expense paid/payable (note 2)	–	–	(288)	(252)
Fee and commission income	–	–	336	100
Other operating expense	–	–	(4)	(4)
Dividends and distributions received/receivable (note 2)	–	–	407	491
Management fees, group service charges and cost recoveries	–	–	388	482
Brokerage and commission expense	–	–	(252)	–

The following balances with subsidiaries were outstanding as at the financial year end:

Amounts receivable	–	–	20,134	16,361
Amounts payable	–	–	(10,607)	(9,596)

Other related body corporate entities

Transactions between the Consolidated Entity and other related body corporate entities under common control principally arise from the provision of banking and other financial services, the granting of loans and acceptance of funds on deposit, the provision of management and administration services, facilities and accommodation and the provision of guarantees.

Balances arising from lending and borrowing activities between the Consolidated Entity and other related body corporate entities are typically repayable on demand, but may be extended on a term basis and where appropriate may be either subordinated or collateralised.

The following income/(expense) resulted from transactions with subsidiaries during the financial year:

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Interest income received/receivable (note 2)	105	155	116	155
Interest expense paid/payable (note 2)	(216)	(167)	(208)	(164)
Management fees, group service charges and cost recoveries	(19)	(27)	(18)	(17)
Fee and commission expense	(455)	(310)	(479)	(326)
Other operating expenses	(28)	(49)	(28)	(55)
Other income	51	–	–	–

The following balances with other related body corporate entities were outstanding as at financial year end:

Amounts receivable	1,652	1,320	1,472	1,132
Amounts payable	(6,471)	(8,008)	(6,212)	(8,044)

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 34

Related party information continued

Associates and joint ventures

Transactions between the Consolidated Entity and its associates and joint ventures principally arise from the provision of corporate advisory services, the granting of loans, derivative transactions and the provision of management services. All transactions undertaken with associates and joint ventures are eliminated where they are unrealised, to the extent of ownership interests held by the Consolidated Entity, in the consolidated income statement.

During the financial year, the following amounts of income or expense resulted from transactions with associates and joint ventures:

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Interest income received/receivable	3	6	–	10
Fee and commission income/(expense) ¹	13	76	(18)	(21)
Other income	2	2	3	2
Gains on sale of securities ²	13	8	–	–
Dividends and distributions ³ (note 16)	165	96	3	1

¹ Fee and commission income includes all fees charged to associates.

² Gains on sale of securities are shown after elimination of unrealised profits/losses calculated by reference to the Consolidated Entity's ownership interest in the associate.

³ Dividends and distributions are shown as gross amounts. Under the equity method, these amounts are not taken up as profit but are recorded as a reduction of the carrying amount of the investment.

The following balances with associates and joint ventures were outstanding as at financial year end (these exclude amounts which in substance form part of the Consolidated Entity's net investment in associates, disclosed in note 16 – Interests in associates and joint ventures accounted for using the equity method):

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Amounts receivable	110	189	69	214
Amounts payable	(3)	(2)	(3)	(26)

Balances arising from lending and borrowing activities between the Consolidated Entity and its associates and joint ventures are typically repayable on demand, but may be extended on a term basis and where appropriate may be either subordinated or collateralised.

Note 35

Key Management Personnel disclosure

Key Management Personnel

The following persons were Voting Directors of the Bank during the financial years ended 31 March 2011 and 31 March 2010, unless indicated:

Executive Directors

N.W. Moore ¹	
W.R. Sheppard ¹	Managing Director and Chief Executive Officer
L.G. Cox, AO	(resigned 29 July 2009)

Non-Executive Directors

D.S. Clarke, AO	Non-Executive Chairman (resigned 17 March 2011)
M.J. Hawker, AM	(appointed 22 March 2010)
P.M. Kirby	
C.B. Livingstone, AO	
H.K. McCann, AM	Non-Executive Chairman (appointed as Chairman on 17 March 2011)
J.R. Niland, AC	
H.M. Nugent, AO	
P.H. Warne	

In addition to the Executive Directors listed above, the following persons also had authority and responsibility for planning, directing and controlling the activities of the Consolidated Entity during the past two financial years ended 31 March 2011 and 31 March 2010, unless otherwise indicated.

Executives

S.D. Allen ¹	Group Head, Risk Management Group (appointed 28 September 2009)
A.J. Downe ¹	Group Head, Fixed Income, Currencies and Commodities Group
G.A. Farrell ¹	Group Head, Corporate and Asset Finance Group (appointed 2 July 2010)
R.S. Laidlaw ¹	Group Head, Macquarie Securities Group and Macquarie Capital
P.J. Maher ¹	Group Head, Banking and Financial Services Group
N.R. Minogue	Former Group Head, Risk Management Group (resigned 30 November 2009)
S. Vrcelj ¹	Head of Global Cash and Equities (appointed 2 July 2010)
G.C. Ward ¹	Chief Financial Officer
S. Wikramanayake ¹	Group Head, Macquarie Funds Group

¹ Members of the Bank's Executive Committee as at 29 April 2011.

It is important to note that the Bank's Non-Executive Directors are specifically required to be categorised as Key Management Personnel for the purposes of the disclosures in the Remuneration Report. However, the Non-Executive Directors do not consider that they are part of 'management'.

The remuneration arrangements for all of the persons listed above are described in Appendix 2 of the Remuneration Report, contained in the Directors' Report pages 8 to 40.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 35

Key Management Personnel disclosure continued

Key Management Personnel remuneration

The following table details the aggregate remuneration for Key Management Personnel:

	Short-term Employee Benefits			Total short-term Employee Benefits	Long-term Employee Benefits ¹	Share Based Payments	Total remuneration
	Salary and fees (including superannuation)	Performance related remuneration	Other benefits		Restricted profit share	Shares/ PSUs/ Options	
	\$	\$	\$	\$	\$	\$	\$
Executive Remuneration							
2011	4,190,692	13,465,328	–	17,656,020	5,878,563	10,978,619	34,513,202
2010	2,536,908	11,835,914	–	14,372,822	2,318,765	8,070,467	24,762,054
Non-Executive Remuneration							
2011	702,056	–	8,571	710,627	–	–	710,627
2010	631,747	–	–	631,747	–	–	631,747

¹ Includes earnings or losses on restricted profit share.

Loans to Key Management Personnel and their related parties

Details of loans provided by the Consolidated Entity to Key Management Personnel and their related parties are disclosed in the following tables:

		Opening balance at 1 April \$'000	Interest charged \$'000	Write-downs \$'000	Closing balance at 31 March \$'000
Total for Key Management Personnel and their related parties	2011	31,691	1,290	–	5,532
	2010	42,861	3,045	–	31,691
Total for Key Management Personnel¹	2011	12,422	693	–	5,532
	2010	22,729	863	–	12,422

¹ Number of persons included in the aggregate at 31 March 2011: 3 (2010: 5).

Loans and other financial instrument transactions are made by the Consolidated Entity in the ordinary course of business with related parties.

Certain loans are provided under zero cost collars and secured over MGL shares under normal terms and conditions consistent with other customers and employees.

Note 35

Key Management Personnel disclosure continued

For the financial year ended 31 March 2011

Key Management Personnel including their related parties with loans above \$100,000 at any time during the financial year are as follows:

Name and position	Balance at 1 April 2010 ¹ \$'000	Interest charged ² \$'000	Write-downs \$'000	Balance at 31 March 2011 ³ \$'000	Highest balance during financial year \$'000
Executive Directors					
N.W. Moore	5,274	304	–	5,274	5,274
Executives					
R.S. Laidlaw	238	14	–	238	238
Former					
D.S. Clarke ⁴	26,160	971	–	5,757	26,526

¹ Or date of appointment if later.

² All loans provided by the Consolidated Entity to Directors and Executives are made in the ordinary course of business on an arm's length basis and are entered into under normal terms and conditions consistent with other customers and employees. There have been no write-downs or allowances for doubtful debts.

³ Or date of resignation if earlier.

⁴ Mr Clarke resigned from the Board on 17 March 2011. Balance at 31 March 2011 represents the balance at date of resignation.

For the financial year ended 31 March 2010

Name and position	Balance at 1 April 2009 ¹ \$'000	Interest charged ² \$'000	Write-downs \$'000	Balance at 31 March 2010 ³ \$'000	Highest balance during financial year \$'000
Executive Directors					
N.W. Moore	5,313	330	–	5,274	5,313
Non-Executive Directors					
D.S. Clarke ⁴	37,290	2,700	–	26,160	38,975
Executives					
R.S. Laidlaw	238	14	–	238	238

¹ Or date of appointment if later.

² All loans provided by the Consolidated Entity to Directors and Executives are made in the ordinary course of business on an arm's length basis and are entered into under normal terms and conditions consistent with other customers and employees. There have been no write-downs or allowances for doubtful debts.

³ Or date of resignation if earlier.

⁴ Mr Clarke sought and was granted leave from 27 November 2008 to 30 August 2009.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 35

Key Management Personnel disclosure continued

Other transactions and balances of Key Management Personnel and their related parties:

The following Key Management Personnel have acquired Infrastructure Bonds and similar products from subsidiaries within the Bank which have been financed with limited recourse loans and are subject to forward sale agreements. The loan repayments and proceeds arising from the forward sale agreements are subject to legal right of set-off and as such are not recognised for financial reporting purposes. The only amounts recognised by the Consolidated Entity in respect of these transactions are the annual payments from the relevant Key Management Personnel which are brought to account as fee revenue. These transactions have been undertaken on terms and conditions consistent with other customers and employees.

	Consolidated 2011 \$m	Consolidated 2010 \$m
Total annual contributions from Key Management Personnel and their related parties in respect of Infrastructure Bonds and similar products	12,181	7,772

The annual contributions in respect of Infrastructure Bonds and similar products relate to the following Key Management Personnel:

Executive Directors

N.W. Moore, W.R. Sheppard

Non-Executive Directors

P.M. Kirby

Executives

S.D. Allen, A.J. Downe, G.A. Farrell (2011 only), R.S. Laidlaw, P.J. Maher, S. Vrceelj (2011 only), G.C. Ward, S. Wikramanayake

Former Directors

L.G. Cox (2010 only), N.R. Minogue (2010 only)

The following Key Management Personnel (including related parties) have entered a zero cost collar transaction with the Bank and other non-related entities in respect of fully paid ordinary MGL shares. This has the effect of acquiring cash-settled put options against movements in the MGL share price below nominated levels and disposing of the benefit of any share price movement above the nominated level.

Transactions with the Consolidated Entity

Name and position	Description	Number of shares 2011 ¹	Number of shares 2010 ²
Executives			
A.J. Downe	Matured August 2010	21,905	–
	Matured July 2010	–	21,905
Former			
D.S. Clarke	Matured June 2010	–	213,517

¹ Mr Downe entered into a zero cost collar for the period 4 June 2010 to 2 August 2010. There was no loan associated with this collar and the shares were not sold upon maturity on 2 August 2010. Mr Downe subsequently sold these shares in August 2010.

² The collar and the loan reported for Mr Clarke and the collar reported for Mr Downe for the year ended 31 March 2010 were unwound on 31 May 2010 and 1 June 2010 respectively. The shares and the loan (where applicable) were repaid on those dates.

All other transactions with Key Management Personnel (including their personally related parties) were conducted on an arm's length basis in the ordinary course of business and under normal terms and conditions for customers and employees. These transactions were trivial or domestic in nature and consisted principally of normal personal banking and financial investment services.

Note 36

Employee equity participation

Option Plan

MGL has suspended new offers under the Macquarie Group Employee Option Plan (MGESOP) under remuneration arrangements which were the subject of shareholder approvals obtained at a General Meeting of MGL in December 2009. The last grant of Options under the MGESOP was on 8 December 2009. Currently MGL does not expect to issue any further Options under the MGESOP.

Previously, the staff eligible to participate in the MGESOP were those of Associate Director level and above and consultants to the Consolidated Entity. At 31 March 2011, there were 891 (2010: 949) participants of the MGESOP.

Options now on issue are all five year options over fully paid unissued ordinary shares in MGL and were granted to individuals or the individual's controlled company or an entity approved under the MGESOP to hold options. The options are issued for no consideration and are granted at prevailing market prices.

The following is a summary of options which have been granted pursuant to the MGESOP:

	Number of options 2011	Weighted average exercise price 2011 \$	Number of options 2010	Weighted average exercise price 2010 \$
Outstanding at the beginning of the financial year	12,206,770	60.88	13,887,171	59.01
Granted during the financial year	–	–	176,000	35.50
Forfeited during the financial year	(563,371)	56.54	(689,361)	58.92
Exercised during the financial year	(16,410)	31.21	(1,056,432)	33.80
Transfers from related body corporate entities	669,767	62.68	593,840	59.85
Lapsed during the financial year	(2,729,011)	62.69	(704,448)	59.39
Outstanding at the end of the financial year	9,567,745	60.79	12,206,770	60.88
Exercisable at the end of the financial year	5,966,558	63.36	4,812,226	64.80

For options exercised during the financial year the weighted average share price at the date of exercise was \$38.94 (2010: \$41.34).

The range of exercise prices for options outstanding at the end of the financial year was \$17.10 to \$94.48 (2010: \$17.10 to \$94.48).

Notes to the financial statements

for the financial year ended 31 March 2011

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Note 36

Employee equity participation continued

Option Plan continued

The weighted average remaining contractual life for the share options outstanding as at 31 March 2011 is 1.50 years (2010: 2.22 years). The weighted average remaining contractual life when analysed by exercise price range is:

Exercise price range (\$)	Number of options 2011	Remaining life (years) 2011	Number of options 2010	Remaining life (years) 2010
10 – 20	18,000	2.94	18,000	3.94
20 – 30	87,699	2.85	110,500	3.91
30 – 40	160,194	2.80	171,332	3.57
40 – 50	94,870	2.63	99,668	3.12
50 – 60	3,907,432	2.31	4,435,286	3.35
60 – 70	2,662,895	0.37	4,650,726	0.96
70 – 80	2,368,174	1.28	2,465,906	2.31
80 – 90	188,880	1.04	174,417	2.18
90 – 100	79,601	1.21	80,935	2.25
	9,567,745	1.50	12,206,770	2.22

There were no options issued in the financial year. The weighted average fair value of options granted during the previous financial year was \$10.80.

The market value of shares issued during the year as a result of the exercise of these options was \$1 million (2010: \$44 million).

The market value of shares which would be issued from the exercise of the outstanding options at 31 March 2011 was \$350 million (2010: \$577 million). No unissued shares, other than those referred to above, are under option under the MGESOP as at the date of this report.

The options were measured at their grant dates based on their fair value and the number expected to vest. This amount is recognised as an expense evenly over the respective vesting periods and the equity provided is treated as a capital contribution.

Options granted vest as to one third of each tranche after the second, third and fourth anniversaries of the date of allocation of the options. Subject to the MGESOP rules and MGL's personal dealing policy, options can be exercised after the vesting period during an options exercise period up to expiry. In individual cases, such as where an employee leaves with the Bank's agreement towards the end of a vesting period, the Bank's Executive Committee has the power to waive the remainder of any vesting period and allow exercise of some or all of the relevant options.

For options granted to the members of MBL's Executive Committee, Executive Voting Directors and other Executive Directors where the invitation to apply for the options was sent to the Executive on or after 30 June 2006, in respect of each tranche of vested options, options will only be exercisable if MGL's average annual return on ordinary equity for the three previous financial years is above the 65th (Executive Committee and Executive Voting Directors) and 50th (other Executive Directors) percentiles, of the corresponding figures for all companies in the then S&P/ASX 100 Index, with the conditions to be examined only upon vesting.

The MGESOP rules provide that the total number of options which can be on issue at any one time is limited such that the number of shares resulting from exercise of all unexercised options does not exceed 20 per cent of the number of MGL's then issued ordinary shares plus the number of shares which MGL would have to issue if all rights to require MGL to issue shares, which MGL has then granted (including options) were then enforced or exercised to the greatest extent permitted. The Board has applied a second limitation on the number of options, being effectively the same calculation as in the MGESOP rules except that any exercised options granted less than five years ago, where the Executive is still with the Bank, will be treated as still being unexercised.

Fully paid ordinary shares issued on the exercise of options rank pari passu with all other fully paid ordinary shares then on issue.

Note 36

Employee equity participation continued

Option Plan continued

On 25 May 2000, the Board approved amendments to the Macquarie Bank Employee Share Option Plan rules referred to as the Deferred Exercise Share Option Plan (DESOP). Shares resulting from the exercise of options since then have been placed under the DESOP, unless option holders request otherwise. Unless the Bank is aware of circumstances which, in the reasonable opinion of the Bank, indicate that the relevant Executive may have acted fraudulently, dishonestly or in a manner which is in breach of his/her obligations to the Bank or any associated entity, then such a request will be granted. These amendments were rolled forward into the current MGESOP approved by the MGL Board.

Shares acquired under DESOP cannot be sold, transferred or disposed of for a period of six months from the date that the shares are transferred into a participating employee's name and are also subject to forfeiture by an employee in a number of circumstances including theft, fraud, dishonesty, or defalcation in relation to affairs of the Bank or a related entity or if they carry out or fail to carry out an act which brings the Bank or an associated entity into disrepute.

Shares held in the DESOP will be withdrawn on the earlier of:

- an employee's resignation from the Bank or a related Bank;
- upon request from the employee (after the expiration of the non-disposal period); and
- 10 years from the date that the options were originally granted.

Options carry no dividend or voting rights but have standard adjustment clauses for bonus and rights issues and reconstructions.

For the year ended 31 March 2011, compensation expense relating to exchangeable shares, retention securities and option plans totalled \$23 million (2010: \$31 million).

Macquarie Group Employee Retained Equity Plan

In December 2009, MGL shareholders approved the implementation of the Macquarie Group Employee Retained Equity Plan (MEREP) in conjunction with remuneration arrangements. These revised arrangements included a decrease in the portion of staff profit share paid in cash and an increase in the portion delivered as equity, an increase in the proportion of deferred remuneration, and cessation of new option grants under the Macquarie Group Employee Share Option Plan.

Participation in the MEREP is currently provided to the following staff (Eligible Employees):

- Executive Directors with retained Director Profit Share (DPS) from 2009 onwards, a proportion of which was allocated in the form of MEREP Awards (Retained DPS Awards). See the Remuneration Report for more information on the allocation of DPS to Executive Directors;
- Executive Directors with pre-2009 retained DPS which they have elected to transition into the MEREP under the new remuneration arrangements (Transition Awards);
- staff other than Executive Directors with retained profit share, which from 2009 is to be delivered in the form of MEREP Awards under the new remuneration arrangements (Retained Profit Share Awards);
- staff who are promoted to Associate Director, Division Director or Executive Director, who receive a fixed allocation of MEREP awards (Promotion Awards);
- new Macquarie Group staff who commence at Associate Director, Division Director or Executive Director level. Option grants to these staff have now been replaced with a fixed number of MEREP awards depending on level (New Hire Awards); and
- in limited circumstances, Macquarie staff who may receive an equity grant instead of a remuneration or consideration payment in cash. Current examples include individuals who become employees of the Bank on the acquisition of their employer by a Macquarie Group entity or who receive an additional award at the time of joining the Bank (also referred to below as New Hire Awards).

For Retained Profit Share Awards representing 2010 retention, the conversion price was the volume weighted average price from 10 May 2010 up to and including the date of allocation which was taken to be 30 June 2010. That price was calculated to be \$43.48 (2010: \$36.36).

The number of Awards granted was calculated by adjusting the employee's relevant retained profit share amount, or retained DPS, for any applicable on-costs, dividing this amount by the applicable price outlined above, and rounding down to the nearest whole number. The grant of Awards to Eligible Employees working in Australia is subject to payroll tax, calculated based on the market value of shares on the Acquisition Date.

For most New Hire and Promotion Awards, a standard number of Awards was offered, depending on the level at which the employee was hired at or promoted to. In limited cases, there are variations to these fixed amounts for specific individuals.

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continued

Note 36

Employee equity participation continued

Macquarie Group Employee Retained Equity Plan continued

Award Types under the MEREP

Restricted Share Units (RSUs)

A RSU is a beneficial interest in a Macquarie share held on behalf of a MEREP participant by the plan trustee (Trustee). The participant is entitled to receive dividends on the share and direct the Trustee how to exercise voting rights in the share. The participant also has the right to request the release of the share from the Trust, subject to the vesting and forfeiture provisions of the MEREP.

Deferred Share Units (DSUs)

A DSU represents the right to receive on exercise of the DSU either a share held in the Trust or a newly issued share (as determined by MGL in its absolute discretion) for no cash payment, subject to the vesting and forfeiture provisions of the MEREP. A MEREP participant holding a DSU has no right or interest in any share until the DSU is exercised. MGL may issue shares to the Trustee or procure the Trustee to acquire shares on-market for potential future allocations to holders of DSUs. Generally DSUs will provide for cash payments in lieu of dividends paid on MGL shares before the DSU is exercised. Further, the number of shares underlying a DSU will be adjusted upon any bonus issue or other capital reconstruction of MGL in accordance with the ASX Listing Rules, so that the holder of a DSU does not receive a benefit that holders generally of MGL shares do not receive. These provisions are intended to provide the holders of DSUs, as far as possible, with the same benefits and risks as are provided to holders of RSUs. However, holders of DSUs will have no voting rights as to any underlying MGL shares. DSUs will only be offered in jurisdictions where legal or tax rules make the grant of RSUs impractical, or where PSUs are structured as DSUs (see PSUs below).

Performance Share Units (PSUs)

PSUs are structured as DSUs or RSUs with performance hurdles that must be met before the underlying share or cash equivalent (as the case may be) will be delivered. Where PSUs are structured as DSUs, holders have no right to dividend equivalent payments before the PSUs vest. In all other respects, holders of these PSUs will have the same rights as holders of DSUs. For 2010, the PSUs granted to the Executive Committee, including the CEO, are structured as DSUs with performance hurdles. The rights under any future PSUs structured as RSUs will generally be the same as the rights under RSUs, except for the PSU performance hurdles which will not apply to RSUs.

Note 36

Employee equity participation continued

Macquarie Group Employee Retained Equity Plan continued

The following is a summary of Awards which have been granted pursuant to the MEREP:

	Number of RSU Awards 2011	Number of RSU Awards 2010
RSUs on issue at the beginning of the financial year	2,603,211	–
Granted during the financial year	2,150,710	2,548,361
Forfeited during the financial year	(87,197)	(10,400)
Vested RSUs withdrawn from the MEREP during the financial year	(303,826)	–
Transfers from related body corporate entities	559,621	65,250
RSUs on issue at the end of the financial year	4,922,519	2,603,211
RSUs vested and not withdrawn from the MEREP at the end of the financial year	119,661	–

The weighted average fair value of the RSU Awards granted during the financial year was \$42.27 (2010: \$46.35).

	Number of DSU Awards 2011	Number of DSU Awards 2010
DSUs on issue at the beginning of the financial year	447,269	–
Granted during the financial year	173,509	442,080
Forfeited during the financial year	(8,988)	–
Exercised during the financial year	(11,163)	–
Transfers from related body corporate entities	(54,852)	5,189
DSUs on issue at the end of the financial year	545,775	447,269
DSUs exercisable at the end of the financial year	51,362	–

The weighted average fair value of the DSU Awards granted during the financial year was \$44.18 (2010: \$46.35).

	Number of PSU Awards 2011	Number of PSU Awards 2010
PSUs on issue at the beginning of the financial year	28,400	–
Granted during the financial year	86,650	28,400
Transfers to related parties	(36,427)	–
PSUs on issue at the end of the financial year	78,623	28,400
PSUs exercisable at the end of the financial year	–	–

The weighted average fair value of the PSU Awards granted during the financial year was \$34.63 (2010: \$43.85).

The awards are measured at their grant dates based on their fair value and for each PSU the number expected to vest. This amount is recognised as an expense evenly over the respective vesting periods and the equity provided is treated as a capital contribution. For the year ended 31 March 2011, compensation expense relating to the MEREP totalled \$78 million (2010: \$35 million).

Notes to the financial statements

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Note 36

Employee equity participation continued

Vesting of Retained DPS Awards

The Vesting Periods that apply to Retained DPS Awards representing 2009 and 2010 retention are set out below for all Executive Directors:

First staff trading day after ¹	2010 retention		First staff trading day after ¹	2009 retention	
	Portion of Awards released for Designated Executive Directors	Portion of Awards released for Non-Designated Executive Directors		Portion of Awards released for Designated Executive Directors	Portion of Awards released for Non-Designated Executive Directors
1 July 2013	1/5 th	1/3 rd	1 July 2012	1/5 th	1/5 th
1 July 2014	1/5 th	1/3 rd	1 July 2013	1/5 th	1/5 th
1 July 2015	1/5 th	1/3 rd	1 July 2014	1/5 th	1/5 th
1 July 2016	1/5 th	–	1 July 2015	1/5 th	1/5 th
1 July 2017	1/5 th	–	1 July 2016	1/5 th	1/5 th

¹ Vesting will occur on the first day of a staff trading window following 1 July of the specified year. If an Executive Director has been on leave without pay (excluding leave to which the Executive Director may be eligible under local laws) for 12 months or more, the vesting period may be extended accordingly.

Vesting of transition awards

The Vesting Periods that apply to Transition Awards are set out below:

First staff trading day after ²	Portion of Awards released for	
	Executive Committee	Other Executive Directors
1 July 2010	1/7 th	1/5 th
1 July 2011	1/7 th	1/5 th
1 July 2012	1/7 th	1/5 th
1 July 2013	1/7 th	1/5 th
1 July 2014	1/7 th	1/5 th
1 July 2015	1/7 th	–
1 July 2016	1/7 th	–

² Vesting will occur on the first day of a staff trading window following 1 July of the specified year. If an Executive Director has been on leave without pay (excluding leave to which the Executive Director may be eligible under local laws) for 12 months or more, the vesting period may be extended accordingly.

Vesting of 2009 and 2010 Retained Profit Share and 2009 and 2010 Promotion Awards

The Vesting Periods that apply to 2009 and 2010 Retained Profit Share and 2009 and 2010 Promotion Awards are set out below for all Eligible Employees:

2010 Awards		2009 Awards	
First staff trading day after ³	Portion of Awards vested	First staff trading day after ³	Portion of Awards vested
1 July 2012	1/3 rd	1 July 2011	1/3 rd
1 July 2013	1/3 rd	1 July 2012	1/3 rd
1 July 2014	1/3 rd	1 July 2013	1/3 rd

³ Vesting will occur on the first day of a staff trading window following 1 July of the specified year.

In limited cases, the application form for 2009 and 2010 Retained Profit Share Awards and 2009 and 2010 Promotion Awards may set out a different Vesting Period, in which case that period will be the Vesting Period for the Award.

Note 36

Employee equity participation continued

Vesting of New Hire Awards

New Hire Awards to Eligible Employees will then vest in three equal tranches on the first day of the first staff trading period following the second, third and fourth anniversary of the vesting start date.

Vesting of Performance Share Units

PSUs will only be released or become exercisable upon the achievement of certain performance hurdles. Currently, only members of the MGL and MBL Executive Committee are eligible to receive PSUs. For the PSUs allocated to Executive Committee Members in respect of the 2009 and 2010 remuneration years, two performance hurdles have been determined and each will apply individually to 50 per cent of the total number of PSUs awarded. These hurdles are set out below.

The BRC will periodically review the performance hurdles, including the reference group, and has the discretion to change the performance hurdles in line with regulatory and remuneration trends. Any change will be disclosed in the Consolidated Entity's Annual Report.

Performance Hurdle 1

50 per cent of the PSUs, based solely on the relative average annual return on ordinary equity (ROE) over the vesting period compared to a reference group of domestic and international financial institutions.

Vesting is on a sliding scale with 50 per cent vesting above the 50th percentile and 100 per cent vesting at the 75th percentile. For example, if ROE achievement is at the 60th percentile, 70 per cent of the Award would vest. The reference group comprises significant Australian financial companies within the ASX100 as well as Macquarie's major international investment banking peers with whom Macquarie competes and frequently compares its performance. The reference group comprises ANZ Group, Commonwealth Bank, National Australia Bank, Westpac, Suncorp, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley and UBS.

Performance Hurdle 2

50 per cent of the PSUs, based solely on the compound average annual growth rate (CAGR) in earnings per share (EPS) over the vesting period.

Awards will vest on a sliding scale with 50 per cent vesting at EPS CAGR of 9.0 per cent and 100 per cent vesting at EPS CAGR of 13.0 per cent. For example, if EPS CAGR were 11 per cent, 75 per cent of the Award would vest.

Under both performance hurdles, the objective is to be examined once only, effectively at the calendar quarter end immediately before vesting. If the condition is not met when examined, the PSUs due to vest expire.

Employee Share Plan

Following shareholder approval at the 1997 Annual General Meeting, the Bank introduced the Macquarie Bank Employee Share Plan whereby each financial year, Eligible Employees are offered up to \$1,000 worth of fully paid ordinary MBL shares for no cash payment. MGL has since introduced the Macquarie Group Employee Share Plan (ESP) on the same terms.

Shares issued under the ESP cannot be sold until the earlier of three years after issue or the time when the participant is no longer employed by the Bank or a subsidiary of the Bank. In all other respects, shares issued rank equally with all other fully paid ordinary shares then on issue.

The latest offer under the ESP was made during December 2010. A total of 1,347 (2010: 1,635) staff participated in this offer. On 25 January 2011, the participants were each issued with 24 (2010: 19) fully paid ordinary shares based on the offer amount of \$1,000 and the then calculated average market share price of \$40.52 (2010: \$52.04), a total of 32,328 (2010: 31,065) shares were issued. The shares were issued for no cash consideration.

Staff Share Acquisition Plan

Following shareholder approval at the 1999 Annual General Meeting, MBL introduced the Macquarie Bank Staff Share Acquisition Plan (MBSSAP) whereby each financial year, Australian based Eligible Employees were given the opportunity to nominate an amount of their pre-tax available profit share or future commission to purchase fully paid ordinary MBL shares on-market. MGL subsequently introduced the Macquarie Group Staff Share Acquisition Plan (MGSSAP) on the same terms. In early 2010, MGL suspended new offers under the MGSSAP following Australian taxation changes implemented in late 2009 which would have significantly limited the future participation in the plan. MGL does not expect it will make any future allocations under MGSSAP.

The total number of shares purchased under the MGSSAP was limited in any financial year to 3 per cent of the MGL's shares as at the beginning of that financial year.

The shares allocated under the MGSSAP were either newly issued shares or shares acquired on-market by the MGSSAP Plan Company, at the direction of MGL.

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Note 36

Employee equity participation continued

Staff Share Acquisition Plan continued

Shares acquired under the MGSSAP cannot be sold, transferred or disposed of for a period of six months from the date that the shares are transferred into a participating employee's name except in special circumstances if the employee resigns. The shares held in the MGSSAP are also subject to forfeiture by an employee in a number of circumstances including theft, fraud, dishonesty, or defalcation in relation to the affairs of the Bank or a related company or if they carry out an act or fail to do an act which brings the Bank or a related company into disrepute.

Shares held in the MGSSAP will be withdrawn on the earlier of:

- an employee's resignation from the Bank or a related entity
- upon request by the employee (after the expiration of the non-disposal period), and
- ten years from the date that the Shares are registered in an employee's name.

In all other respects, the shares rank equally with all other fully paid ordinary shares then on issue.

Previously, the Eligible Employees were Australian based permanent full-time or part-time employees or fixed term contract employees of the Bank or a related company who either received available profit share in the relevant year of at least \$1,000 in total or allocated at least \$1,000 in available commission towards the MGSSAP.

The Macquarie Bank Executive Director Share Acquisition Plan (MBEDSAP) was a sub-plan of the MBSSAP which was created in 2003 and was open to eligible Executive Directors. The disposal and forfeiture restrictions in the MBEDSAP differ to those in the MBSSAP. MGL subsequently introduced a Macquarie Group Executive Director Share Acquisition Plan (MGEDSAP) on the same terms but no offers have been made under the plan.

In April 2008, a further sub-plan of the MGSSAP was created, the Macquarie Group Executive Committee Acquisition Plan, whereby members of the Bank's Executive Committee were required to contribute certain proportions of their annual profit share to acquire MGL shares, which must be held for at least three years. Further information on this is provided in the Remuneration Report. The first offers under this sub-plan were made in May 2008. The Bank does not intend making any further allocations under this sub-plan, as Executive Committee members now receive the equity component of their retained profit share under the Macquarie Group Employee Retained Equity Plan (see above).

No offers under the MGSSAP (including the Macquarie Group Executive Committee Acquisition Plan) were made during the year ended 31 March 2011. During the year ended 31 March 2010 a total of 106 staff participated in the MGSSAP.

In July 2009, 27,391 MGL shares were issued based on the issue price of \$33.49. In December 2009, 1,194 MGL shares were issued based on the issue price of \$47.99.

Non-Executive Director Share Acquisition Plan

Following shareholder approval at the 1999 Annual General Meeting, the Bank also introduced the Macquarie Bank Non-Executive Director Share Acquisition Plan whereby each financial year certain Australian based Non-Executive Directors (NEDs) of the Macquarie Group of companies were given the opportunity to contribute some or all of their future pre-tax remuneration from the Macquarie Group to acquire Macquarie Bank Limited shares. MGL has since introduced a Macquarie Group Non-Executive Director Share Acquisition Plan (NEDSAP) on the same terms. The Australian taxation changes referred to above in respect of the MGSSAP also apply to the NEDSAP. Accordingly, MGL has currently suspended new offers under the NEDSAP and does not expect to make any future allocations under the plan.

Previously, NEDs could elect to participate in the NEDSAP by nominating a minimum of \$1,000 of their NED remuneration per buying period to go towards the NEDSAP. Participating NEDs could also subsequently apply to reduce their previously nominated contribution provided that the relevant buying period has not commenced.

The shares were acquired at prevailing market prices. Brokerage fees were applied to the NEDs' account.

Shares acquired under the NEDSAP cannot be sold, transferred or disposed of for a period of six months from the date that the shares were transferred into a NED's name except in special circumstances if the NED resigns. The shares held in the NEDSAP are also subject to forfeiture by a NED in a number of circumstances including theft, fraud, dishonesty, or defalcation in relation to the affairs of the Bank or a related company or if they carry out an act or fail to do an act which brings the Bank or a related company into disrepute.

Shares held in the NEDSAP will be withdrawn on the earlier of:

- the participant ceasing to be a NED of MGL
- upon request by the NED (after the expiration of the non-disposal period), and
- 10 years from the date that the shares are registered in a NED's name.

In all other respects, shares rank equally with all other fully paid ordinary shares then on issue.

Shares resulting from participation in the NEDSAP may count towards meeting the minimum shareholding requirements of NEDs.

No offers under the NEDSAP were made during the year ended 31 March 2011. The last offer was made during May 2009 and one NED participated in the NEDSAP. In June 2009, 3,639 MGL shares were acquired on-market.

Consolidated	Consolidated	Bank	Bank
2011	2010	2011	2010
\$m	\$m	\$m	\$m

Note 37

Contingent liabilities and commitments

The following contingent liabilities and commitments exclude derivatives.

Contingent liabilities exist in respect of:

Guarantees	446	755	711	938
Indemnities	13	7	73	72
Letters of credit	149	170	251	773
Performance related contingents	89	95	89	95
Total contingent liabilities¹	697	1,027	1,124	1,878

Commitments exist in respect of:

Undrawn credit facilities	5,317	3,818	4,629	2,810
Forward asset purchases	200	172	120	108
Total commitments²	5,517	3,990	4,749	2,918
Total contingent liabilities and commitments	6,214	5,017	5,873	4,796

¹ Contingent liabilities exist in respect of actual and potential claims and proceedings that arise in the conduct of the Consolidated Entity's business. A provision is recognised where some loss is probable and can be reliably estimated. The Consolidated Entity is currently not engaged in any litigation or claim which is likely to have a material adverse effect on the Consolidated Entity's business, financial condition or performance.

² Total commitments also represent contingent assets. Such commitments to provide credit may convert to loans and other assets in the ordinary course of business.

Notes to the financial statements

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	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Note 38				
Capital and other expenditure commitments				
Capital and other expenditure commitments expected to be incurred:				
Not later than one year	14	15	9	8
Later than one year and not later than five years	7	25	6	25
Later than five years	49	–	49	–
Total capital and other expenditure commitments	70	40	64	33

Note 39

Lease commitments

Non-cancellable operating leases expiring:

Not later than one year	40	49	–	–
Later than one year and not later than five years	122	130	–	–
Later than five years	59	33	–	–
Total operating lease commitments	221	212	–	–

Operating leases relate to commercial buildings. The future lease commitments disclosed are net of any rental incentives received.

Note 40

Derivative financial instruments

Objectives of holding and issuing derivative financial instruments

The Consolidated Entity is an active price maker in derivatives on interest rates, foreign exchange, commodities and equities. Its objective is to earn profits from the price making spread and from managing the residual exposures on hedged positions. Proprietary position taking is a part of the Consolidated Entity's trading activities. Risks on derivatives are managed together with all other trading positions in the same market. All trading positions, including derivatives, are marked to fair value daily.

The Consolidated Entity also uses derivatives to hedge banking operations and for asset and liability management. Certain derivative transactions may qualify as cash flow, fair value or net investment in foreign operations hedges, if they meet the appropriate strict hedge criteria outlined in note 1(xi) – Summary of significant accounting policies:

Cash flow hedges: The Consolidated Entity is exposed to volatility in future interest cash flows arising from the consolidated mortgage securitisation vehicles and other structured products which are subject to variable interest rates. The aggregate principal balances and interest cash flows across these portfolios form the basis for identifying the non-trading interest rate risk of the Consolidated Entity, which is hedged with interest rate swaps and cross-currency swaps.

In addition to this, the interest rate swaps used to hedge the MIPS securities have been designated as cash flow hedges of an intercompany loan by the Bank in its separate financial statements. Changes in the fair value of these interest swaps are deferred in equity and subsequently released to earnings as the interest on the intercompany loan is accrued.

At 31 March 2011, the fair value of outstanding derivatives held by the Bank and designated as cash flow hedges was \$5 million positive value (2010: \$8 million negative value).

During the year the Consolidated Entity recognised \$nil (2010: \$2 million losses) in the income statement due to hedge ineffectiveness on cash flow hedges. At 31 March 2011, the fair value of outstanding derivatives held by the Consolidated Entity and designated as cash flow hedges was \$162 million negative value (2010: \$86 million negative value).

Fair value hedges: The Consolidated Entity's fair value hedges consist of:

- interest rate swaps used to hedge against changes in the fair value of fixed rate issued debt as a result of movements in benchmark interest rates; and
- foreign exchange forward contracts used to hedge against changes in the fair value of foreign denominated equity instruments as a result of movements in market foreign exchange rates.

As at 31 March 2011, the fair value of outstanding derivatives held by the Consolidated Entity and designated as fair value hedges was \$479 million positive value (2010: \$11 million negative value).

During the year fair value gains on the hedging instruments of \$468 million have been recognised (2010: \$111 million), offset by \$456 million (2010: \$107 million) of losses on the hedged item.

Net investment in foreign operations hedges: The Consolidated Entity has applied net investment hedging for foreign exchange risk arising from its non-core foreign operations.

At 31 March 2011, the fair value of outstanding derivatives held by the Consolidated Entity and designated as net investment in foreign operations hedges was \$46 million positive value (2010: \$18 million negative value). During the year the Consolidated Entity recognised \$6 million (2010: \$nil) losses in the income statement due to hedge ineffectiveness on net investment hedges.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 40

Derivative financial instruments continued

Objectives of holding and issuing derivative financial instruments continued

The types of contracts which the Consolidated Entity trades and uses for hedging purposes are detailed below:

Futures: Futures contracts provide the holder with the obligation to buy a specified financial instrument or commodity at a fixed price and fixed date in the future. Contracts may be closed early via cash settlement. Futures contracts are exchange traded.

Forwards and forward rate agreements: Forward contracts, which resemble futures contracts, are an agreement between two parties that a financial instrument or commodity will be traded at a fixed price and fixed date in the future. A forward rate agreement provides for two parties to exchange interest rate differentials based on an underlying principal amount at a fixed date in the future.

Swaps: Swap transactions provide for two parties to swap a series of cash flows in relation to an underlying principal amount, usually to exchange a fixed interest rate for a floating interest rate. Cross-currency swaps provide a tool for two parties to manage risk arising from movements in exchange rates.

Options: Option contracts provide the holder the right to buy or sell financial instruments or commodities at a fixed price over an agreed period or on a fixed date. The contract does not oblige the holder to buy or sell, however the writer must perform if the holder exercises the rights pertaining to the option.

Note 40

Derivative financial instruments continued

The following table provides details of the Consolidated Entity's outstanding derivatives used for trading and in some cases for hedging purposes as at 31 March.

	Consolidated 2011				Consolidated 2010			
	Notional amount \$m	Asset revaluations \$m	Liability revaluations \$m	Net fair value \$m	Notional amount \$m	Asset revaluations \$m	Liability revaluations \$m	Net fair value \$m
Interest rate contracts								
Exchange traded	16,892	322	417	(95)	13,135	46	50	(4)
Forwards	2	-	-	-	2,060	52	69	(17)
Swaps	196,720	2,720	2,168	552	157,358	3,065	3,224	(159)
Options	17,071	36	304	(268)	1,939	5	4	1
Total interest rate contracts	230,685	3,078	2,889	189	174,492	3,168	3,347	(179)
Foreign exchange contracts								
Forwards	59,700	570	744	(174)	16,552	258	391	(133)
Swaps	62,547	1,038	1,096	(58)	59,283	742	884	(142)
Options	2,122	691	902	(211)	656	314	342	(28)
Total foreign exchange contracts	124,369	2,299	2,742	(443)	76,491	1,314	1,617	(303)
Equity contracts								
Exchange traded	56,350	919	1,252	(333)	12,779	176	181	(5)
Swaps	7,271	288	292	(4)	3,036	128	228	(100)
Options	56,019	1,402	1,471	(69)	35,749	986	810	176
Other	-	-	-	-	675	-	4	(4)
Total equity contracts	119,640	2,609	3,015	(406)	52,239	1,290	1,223	67
Commodity contracts								
Exchange traded	114,373	1,831	1,848	(17)	36,045	4,142	4,446	(304)
Forwards	83,782	6,342	5,975	367	60,804	5,173	4,851	322
Swaps	22,661	2,491	2,494	(3)	40,764	4,141	3,826	315
Options	16,653	2,495	2,492	3	86,167	2,312	2,324	(12)
Total commodity contracts	237,469	13,159	12,809	350	223,780	15,768	15,447	321
Total derivatives contracts outstanding	712,163	21,145	21,455	(310)	527,002	21,540	21,634	(94)

Notes to the financial statements

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Note 40

Derivative financial instruments continued

The following table provides details of the Bank's outstanding derivatives used for trading and in some cases for hedging purposes as at 31 March.

	Notional amount \$m	Asset revaluations \$m	Liability revaluations \$m	Bank 2011	Notional amount \$m	Asset revaluations \$m	Liability revaluations \$m	Bank 2010
				Net fair value \$m				Net fair value \$m
Interest rate contracts								
Exchange traded	16,892	322	417	(95)	12,816	46	50	(4)
Forwards	2	-	-	-	2,060	52	69	(17)
Swaps	190,281	2,670	2,097	573	146,788	3,014	2,863	151
Options	6,973	31	22	9	1,939	5	4	1
Total interest rate contracts	214,148	3,023	2,536	487	163,603	3,117	2,986	131
Foreign exchange contracts								
Forwards	59,692	570	741	(171)	16,151	254	391	(137)
Swaps	62,547	1,037	957	80	59,283	783	883	(100)
Options	2,122	691	902	(211)	656	314	342	(28)
Total foreign exchange contracts	124,361	2,298	2,600	(302)	76,090	1,351	1,616	(265)
Equity contracts								
Exchange traded	56,065	919	1,235	(316)	12,779	176	181	(5)
Swaps	7,029	288	39	249	3,036	128	228	(100)
Options	55,868	1,402	1,457	(55)	34,721	1,217	810	407
Other	-	-	-	-	675	-	4	(4)
Total equity contracts	118,962	2,609	2,731	(122)	51,211	1,521	1,223	298
Commodity contracts								
Exchange traded	63,386	1,765	1,593	172	34,773	2,190	2,300	(110)
Forwards	77,530	5,852	5,601	251	53,630	3,739	3,796	(57)
Swaps	9,511	970	966	4	20,197	767	693	74
Options	14,747	2,034	2,164	(130)	86,090	2,270	2,252	18
Total commodity contracts	165,174	10,621	10,324	297	194,690	8,966	9,041	(75)
Total derivatives contracts outstanding	622,645	18,551	18,191	360	485,594	14,955	14,866	89

Note 41

Financial risk management

Risk Management Group

Risk is an integral part of the Consolidated Entity's businesses. The main risks faced by the Consolidated Entity are market risk, equity risk, credit risk, liquidity risk, operational risk, legal risk and compliance risk. Responsibility for management of these risks lies with the individual businesses giving rise to them. It is the responsibility of the Risk Management Group (RMG) to ensure appropriate assessment and management of these risks.

RMG is independent of all other areas of the Consolidated Entity. The Head of RMG, as Macquarie's Chief Risk Officer, is a member of the Executive Committee of MGL and MBL and reports directly to the Managing Director and Chief Executive Officer with a secondary reporting line to the Board Risk Committee. RMG authority is required for all material risk acceptance decisions. RMG identifies, quantifies and assesses all material risks and sets prudential limits. Where appropriate, these limits are approved by the Executive Committee and the Board.

Note 41.1

Credit risk

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

The responsibility for approval of credit exposures is delegated to specific individuals by the Board of MBL. While Operating Groups are assigned modest levels of Credit discretions, all credit exposures above these levels are independently assessed by RMG. Credit risk analysis is focused on ensuring that risks have been fully identified and that the downside risk is properly understood so that a balanced assessment can be made of the worst outcome against the expected rewards. After this analysis is undertaken, limits are set for an acceptable level of potential exposure. All limits and ratings are reviewed at least once a year, or more frequently if necessary, to ensure that the most current information available on counterparties is taken into account.

Credit exposures for loans are evaluated as the full face value whereas exposures for derivatives are a function of potential market movements. When trading gives rise to settlement risk, this exposure is assessed as the full face value of the settlement amount. Credit exposures which fluctuate through the duration of the transaction are monitored daily. These include exposures such as swaps, forward contracts and options, which are assessed using sophisticated valuation techniques.

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

All customers' counterparty limits and exposures are allocated an MGL rating on a 1 – 13 scale which broadly corresponds with Standard & Poor's and Moody's Investor Services credit ratings. Each MGL rating is assigned a Probability of Default estimate. Credit limits and exposures are also allocated a Loss Given Default ratio reflecting the estimated economic loss in the event of default occurring.

All loan assets are subject to recurring review and assessment for possible impairment. Where there is a deteriorating credit risk profile, the exposures are monitored on a monthly basis through the CreditWatch report and FICC CreditWatch report. The business remains responsible for the management of the counterparty and of the risk position, but RMG oversight is increased to ensure that positions are managed for optimal outcomes. When counterparties default, RMG and the business work together to resolve the issues and to manage the facilities through the impairment and provisioning process.

The Consolidated Entity's policies to control credit risk include avoidance of unacceptable concentrations of risk either to any economic sector or to an individual counterparty. Policies are in place to regulate large exposures to single counterparties or groups of counterparties.

The Consolidated Entity has a country risk framework which covers the assessment of country risk and the approval of country risk limits. Where appropriate the country risk is covered by political risk insurance.

The balances disclosed in the credit risk tables below exclude financial assets that are subject to risks other than credit risk, such as equity investments, interests in associates and joint ventures or bank notes and coins.

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continued

Note 41.1

Credit risk continued

Maximum exposure to credit risk

The tables below detail the concentration of credit exposure of the Consolidated Entity's assets to significant geographical locations and counterparty types. The amounts shown represent the maximum credit risk of the Consolidated Entity's assets.

	Due from financial institutions \$m	Cash collateral on securities borrowed and reverse repurchase agreements ¹ \$m	Trading portfolio assets ² \$m	Loan assets held at amortised cost \$m	Other financial assets at fair value through profit or loss \$m
Australia					
Governments	–	302	1,566	524	2,555
Financial institutions	2,795	1,195	334	841	924
Other	–	5	70	24,230	2,432
Total Australia	2,795	1,502	1,970	25,595	5,911
Asia Pacific					
Governments	–	3	614	2	–
Financial institutions	470	44	399	163	30
Other	–	1	69	304	–
Total Asia Pacific	470	48	1,082	469	30
Europe, Middle East and Africa					
Governments	–	217	174	–	40
Financial institutions	2,031	3,562	139	776	1,577
Other	–	293	43	3,159	36
Total Europe, Middle East and Africa	2,031	4,072	356	3,935	1,653
Americas					
Governments	–	916	329	28	250
Financial institutions	2,283	703	669	2,075	298
Other	–	177	1,639	13,280	81
Total Americas	2,283	1,796	2,637	15,383	629
Total	7,579	7,418	6,045	45,382	8,223
Total gross credit risk					

¹ Classified based on the exposure to the underlying security borrowed.

² Included in Australia – Governments are holdings of \$2,852 million (2010: \$4,496 million) issued by Australian Banks which are subject to the Australian Government Guarantee.

The following provides detail around the active management of credit risk by the Consolidated Entity:

The Consolidated Entity enters into master netting agreements with certain counterparties to manage the credit risk where it has trading derivatives in Macquarie Securities Group and Fixed Income, Currencies and Commodities. Stock borrowing and reverse repurchase arrangements entered into by the Consolidated Entity with external counterparties normally require collateral in excess of 100 per cent (which is consistent with industry practice). Mortgage insurance contracts are entered into in order to manage the credit risk around the mortgage portfolios. Other risk mitigation measures include blocked deposits, bank guarantees and letters of credit.

Derivative financial instruments – positive values \$m	Other assets \$m	Debt investment securities available for sale ² \$m	Due from related body corporate entities \$m	Life investment contracts and other unit holder investment assets \$m	Credit commitments and contingent liabilities \$m	Total \$m
Consolidated 2011						
238	231	2,301	–	–	–	7,717
767	–	6,165	–	565	166	13,752
957	1,722	165	955	93	1,709	32,338
1,962	1,953	8,631	955	658	1,875	53,807
8	4	9	–	–	–	640
236	–	559	–	–	29	1,930
300	10	–	163	–	123	970
544	14	568	163	–	152	3,540
2	438	142	–	–	–	1,013
8,360	–	2,868	–	–	235	19,548
2,496	1,774	472	194	–	1,021	9,488
10,858	2,212	3,482	194	–	1,256	30,049
64	71	44	–	–	–	1,702
5,379	–	871	–	–	137	12,415
2,338	1,673	502	1,131	–	2,794	23,615
7,781	1,744	1,417	1,131	–	2,931	37,732
21,145	5,923	14,098	2,443	658	6,214	125,128
						125,128

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 41.1

Credit risk continued

Maximum exposure to credit risk continued

	Due from financial institutions \$m	Cash collateral on securities borrowed and reverse repurchase agreements ¹ \$m	Trading portfolio Assets ² \$m	Loan assets held at amortised cost \$m	Other financial assets at fair value through profit or loss \$m
Australia					
Governments	–	668	3,540	278	1,478
Financial institutions	1,850	349	247	1,322	687
Other	–	–	133	25,427	2,682
Total Australia	1,850	1,017	3,920	27,027	4,847
Asia Pacific					
Governments	–	2	245	3	–
Financial institutions	547	309	32	97	50
Other	–	5	–	325	1
Total Asia Pacific	547	316	277	425	51
Europe, Middle East and Africa					
Governments	–	46	–	–	–
Financial institutions	2,126	3,651	35	886	686
Other	–	228	55	2,882	–
Total Europe, Middle East and Africa	2,126	3,925	90	3,768	686
Americas					
Governments	–	436	167	21	–
Financial institutions	1,967	225	235	1,910	284
Other	–	165	1,910	10,643	67
Total Americas	1,967	826	2,312	12,574	351
Total	6,490	6,084	6,599	43,794	5,935
Total gross credit risk					

¹ Classified based on the exposure to the underlying security borrowed.

² Included in Australia – Governments, are holdings of \$4,496 million (2009: \$1,458 million) issued by Australian banks which are subject to the Australian Government Guarantee.

The following provides detail around the active management of credit risk by the Consolidated Entity:

The Consolidated Entity enters into master netting agreements with certain counterparties to manage the credit risk where it has trading derivatives in Macquarie Securities Group and Fixed Income, Currencies and Commodities. Stock borrowing and reverse repurchase arrangements entered into by the Consolidated Entity with external counterparties normally require collateral in excess of 100 per cent (which is consistent with industry practice). Mortgage insurance contracts are entered into in order to manage the credit risk around the mortgage portfolios. Other risk mitigation measures include blocked deposits, bank guarantees and letters of credit.

Derivative financial instruments – positive values \$m	Other assets \$m	Debt investment securities available for sale ² \$m	Due from related body corporate entities \$m	Life investment contracts and other unit holder investment assets \$m	Credit commitments and contingent liabilities \$m	Total \$m
Consolidated 2010						
548	126	3,716	–	–	–	10,354
371	–	7,159	–	685	99	12,769
479	2,131	394	1,282	35	1,278	33,841
1,398	2,257	11,269	1,282	720	1,377	56,964
4	6	–	–	–	–	260
244	–	41	–	–	91	1,411
105	27	–	223	–	114	800
353	33	41	223	–	205	2,471
85	391	86	–	–	–	608
7,869	–	2,611	–	–	248	18,112
3,373	917	499	97	–	1,156	9,207
11,327	1,308	3,196	97	–	1,404	27,927
88	183	159	–	–	11	1,065
6,329	7	718	–	–	156	11,831
2,045	1,683	717	789	–	1,864	19,883
8,462	1,873	1,594	789	–	2,031	32,779
21,540	5,471	16,100	2,391	720	5,017	120,141
						120,141

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continued

Note 41.1

Credit risk continued

Maximum exposure to credit risk continued

The tables below detail the concentration of credit exposures of the Bank's assets to significant geographical locations and counterparty types. The amounts shown represent the maximum credit risk of the Bank's assets.

	Due from financial institutions \$m	Cash collateral on securities borrowed and reverse repurchase agreements ¹ \$m	Trading portfolio Assets ² \$m	Loan assets held at amortised cost \$m	Other financial assets at fair value through profit or loss \$m
Australia					
Governments	-	302	1,566	450	2,555
Financial institutions	2,501	1,194	334	807	785
Other	-	6	70	8,840	2,511
Total Australia	2,501	1,502	1,970	10,097	5,851
Asia Pacific					
Governments	-	3	380	-	-
Financial institutions	395	44	272	134	30
Other	-	1	26	174	-
Total Asia Pacific	395	48	678	308	30
Europe, Middle East and Africa					
Governments	-	217	174	-	40
Financial institutions	1,775	3,562	139	647	1,548
Other	-	293	43	3,080	-
Total Europe, Middle East and Africa	1,775	4,072	356	3,727	1,588
Americas					
Governments	-	873	315	-	250
Financial institutions	1,585	700	650	1,073	275
Other	-	175	1,632	2,094	73
Total Americas	1,585	1,748	2,597	3,167	598
Total	6,256	7,370	5,601	17,299	8,067
Total gross credit risk					

¹ Classified based on the exposure to the underlying security borrowed.

² Included in Australia – Governments are holdings of \$2,852 million (2010: \$4,496 million) issued by Australian Banks which are subject to the Australian Government Guarantee.

The following provides detail around the active management of credit risk by the Bank:

The Bank enters into master netting agreements with certain counterparties to manage the credit risk where it has trading derivatives in Macquarie Securities Group and Fixed Income, Currencies and Commodities. Stock borrowing and reverse repurchase arrangements entered into by the Bank with external counterparties normally require collateral in excess of 100 per cent (which is consistent with industry practice). Mortgage insurance contracts are entered into in order to manage the credit risk around the mortgage portfolios. Other risk mitigation measures include blocked deposits, bank guarantees and letters of credit.

Derivative financial instruments – positive values \$m	Other assets \$m	Debt investment securities available for sale ² \$m	Due from related body corporate entities \$m	Due from subsidiaries \$m	Credit commitments and contingent liabilities \$m	Total \$m
						Bank 2011
239	169	2,301	-	-	-	7,582
728	-	5,923	-	-	166	12,438
945	1,940	138	895	14,148	1,695	31,188
1,912	2,109	8,362	895	14,148	1,861	51,208
8	1	9	-	-	-	401
236	-	559	-	-	29	1,699
295	-	-	158	593	138	1,385
539	1	568	158	593	167	3,485
2	3	142	-	-	-	578
7,935	-	2,827	-	-	235	18,668
2,464	1,545	434	209	2,694	1,090	11,852
10,401	1,548	3,403	209	2,694	1,325	31,098
-	18	44	-	-	-	1,500
4,810	-	883	-	-	135	10,111
889	-	107	968	2,699	2,385	11,022
5,699	18	1,034	968	2,699	2,520	22,633
18,551	3,676	13,367	2,230	20,134	5,873	108,424
						108,424

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 41.1

Credit risk continued

Maximum exposure to credit risk continued

	Due from financial institutions \$m	Cash collateral on securities borrowed and reverse repurchase agreements ¹ \$m	Trading portfolio Assets ² \$m	Loan assets held at amortised cost \$m	Other financial assets at fair value through profit or loss \$m
Australia					
Governments	–	668	3,540	199	1,478
Financial institutions	1,336	349	247	1,286	687
Other	–	–	132	8,397	2,743
Total Australia	1,336	1,017	3,919	9,882	4,908
Asia Pacific					
Governments	–	2	245	–	–
Financial institutions	429	309	31	91	50
Other	–	5	–	249	1
Total Asia Pacific	429	316	276	340	51
Europe, Middle East and Africa					
Governments	–	46	–	–	–
Financial institutions	1,915	3,651	35	687	686
Other	–	228	55	2,624	–
Total Europe, Middle East and Africa	1,915	3,925	90	3,311	686
Americas					
Governments	–	436	153	–	–
Financial institutions	1,440	119	229	762	252
Other	–	165	1,908	1,867	53
Total Americas	1,440	720	2,290	2,629	305
Total	5,120	5,978	6,575	16,162	5,950
Total gross credit risk					

¹ Classified based on the exposure to the underlying security borrowed.

² Included in Australia – Governments, are holdings of \$4,496 million (2009: \$1,458 million) issued by Australian Banks which are subject to the Australian Government Guarantee.

The following provides detail around the active management of credit risk by the Bank:

The Bank enters into master netting agreements with certain counterparties to manage the credit risk where it has trading derivatives in Macquarie Securities Group and Fixed Income, Currencies and Commodities. Stock borrowing and reverse repurchase arrangements entered into by the Bank with external counterparties normally require collateral in excess of 100 per cent (which is consistent with industry practice). Mortgage insurance contracts are entered into in order to manage the credit risk around the mortgage portfolios. Other risk mitigation measures include blocked deposits, bank guarantees and letters of credit.

Derivative financial instruments – positive values \$m	Other assets \$m	Debt investment securities available for sale ² \$m	Due from related body corporate entities \$m	Due from subsidiaries \$m	Credit commitment s and contingent liabilities \$m	Total \$m
						Bank 2010
548	77	3,715	–	–	–	10,225
462	–	6,895	–	–	99	11,361
706	2,229	368	1,448	11,338	1,352	28,713
1,716	2,306	10,978	1,448	11,338	1,451	50,299
4	–	–	–	–	–	251
244	–	41	–	–	91	1,286
105	2	–	219	631	103	1,315
353	2	41	219	631	194	2,852
6	9	86	–	–	–	147
5,456	–	2,611	–	–	244	15,285
3,221	702	453	104	2,214	1,182	10,783
8,683	711	3,150	104	2,214	1,426	26,215
3	9	159	–	–	11	771
3,772	7	718	–	–	156	7,455
428	–	541	686	2,178	1,558	9,384
4,203	16	1,418	686	2,178	1,725	17,610
14,955	3,035	15,587	2,457	16,361	4,796	96,976
						96,976

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 41.1

Credit risk continued

Credit quality of financial assets

The tables below show the credit quality by class of financial asset (based upon ultimate risk counterparty) for credit exposures, based on the Consolidated Entity's credit rating system.

Credit Quality – Consolidated 2011

	Neither past due nor impaired				Past due or individually impaired \$m	Total \$m
	Investment Grade \$m	Below Investment Grade \$m	Default \$m	Unrated \$m		
Due from financial institutions	7,297	282	–	–	–	7,579
Cash collateral on securities borrowed and reverse repurchase agreements						7,418
Governments	795	643	–	–	–	1,438
Financial institutions	4,173	1,331	–	–	–	5,504
Other	365	111	–	–	–	476
Trading portfolio assets						6,045
Governments	2,291	392	–	–	–	2,683
Financial institutions	1,060	463	18	–	–	1,541
Other	224	1,531	66	–	–	1,821
Loan assets held at amortised cost						45,382
Governments	546	8	–	–	–	554
Financial institutions	2,718	1,111	4	–	22	3,855
Other	25,592	13,405	192	–	1,784	40,973
Other financial assets at fair value through profit or loss						8,223
Governments	2,845	–	–	–	–	2,845
Financial institutions	2,801	28	–	–	–	2,829
Other	675	1,849	–	–	25	2,549
Derivative financial instruments – positive values						21,145
Governments	293	19	–	–	–	312
Financial institutions	14,081	661	–	–	–	14,742
Other	2,903	3,188	–	–	–	6,091
Other assets						5,923
Governments	743	–	–	–	1	744
Other	3,753	1,121	–	254	51	5,179
Debt investment securities available for sale						14,098
Governments	2,496	–	–	–	–	2,496
Financial institutions	10,430	33	–	–	–	10,463
Other	325	783	–	–	31	1,139
Due from related body corporate entities						2,443
Other	803	–	–	1,640	–	2,443
Life investment contracts and other unitholder investment assets						658
Financial institutions	565	–	–	–	–	565
Other	93	–	–	–	–	93
Total						118,914

Included in the past due category are balances in which an amount was overdue by one day or more.

Note 41.1

Credit risk continued

Credit quality of financial assets continued

Credit Quality – Consolidated 2010

	Neither past due nor impaired				Past due or individually impaired \$m	Total \$m
	Investment Grade \$m	Below Investment Grade \$m	Default \$m	Unrated \$m		
Due from financial institutions	6,482	8	–	–	–	6,490
Cash collateral on securities borrowed and reverse repurchase agreements						6,084
Governments	924	228	–	–	–	1,152
Financial institutions	4,507	27	–	–	–	4,534
Other	316	72	10	–	–	398
Trading portfolio assets						6,599
Governments	3,894	58	–	–	–	3,952
Financial institutions	454	64	31	–	–	549
Other	218	1,824	56	–	–	2,098
Loan assets held at amortised cost						43,794
Governments	250	2	–	–	50	302
Financial institutions	3,717	470	–	–	28	4,215
Other	25,253	11,718	161	–	2,145	39,277
Other financial assets at fair value through profit or loss						5,935
Governments	1,478	–	–	–	–	1,478
Financial institutions	1,707	–	–	–	–	1,707
Other	822	1,889	–	–	39	2,750
Derivative financial instruments – positive values						21,540
Governments	697	28	–	–	–	725
Financial institutions	14,165	648	–	–	–	14,813
Other	4,423	1,525	27	–	27	6,002
Other assets						5,471
Governments	706	–	–	–	–	706
Financial institutions	–	–	–	–	7	7
Other	3,047	1,512	–	162	37	4,758
Debt investment securities available for sale						16,100
Governments	3,961	–	–	–	–	3,961
Financial institutions	10,483	46	–	–	–	10,529
Other	739	843	–	–	28	1,610
Due from related body corporate entities						2,391
Other	1,074	–	–	1,317	–	2,391
Life investment contracts and other unitholder investment assets						720
Financial institutions	685	–	–	–	–	685
Other	35	–	–	–	–	35
Total						115,124

Included in the past due category are balances in which an amount was overdue by one day or more.

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for the financial year ended 31 March 2011

continued

Note 41.1

Credit risk continued

Credit quality of financial assets continued

The tables below show the credit quality by class of financial asset (based upon ultimate risk counterparty) for credit exposures, based on the Bank's credit rating system.

Credit Quality – Bank 2011

	Neither past due nor impaired				Past due or individually impaired \$m	Total \$m
	Investment Grade \$m	Below Investment Grade \$m	Default \$m	Unrated \$m		
Due from financial institutions	6,233	23	–	–	–	6,256
Cash collateral on securities borrowed and reverse repurchase agreements						7,370
Governments	751	644	–	–	–	1,395
Financial institutions	4,170	1,330	–	–	–	5,500
Other	364	111	–	–	–	475
Trading portfolio assets						5,601
Governments	2,258	177	–	–	–	2,435
Financial institutions	929	448	18	–	–	1,395
Other	203	1,502	66	–	–	1,771
Loan assets held at amortised cost						17,299
Governments	450	–	–	–	–	450
Financial institutions	1,663	969	7	–	22	2,661
Other	6,347	7,123	189	–	529	14,188
Other financial assets at fair value through profit or loss						8,067
Governments	2,845	–	–	–	–	2,845
Financial institutions	2,638	–	–	–	–	2,638
Other	751	1,808	–	–	25	2,584
Derivative financial instruments – positive values						18,551
Governments	248	1	–	–	–	249
Financial institutions	13,049	660	–	–	–	13,709
Other	2,233	2,360	–	–	–	4,593
Other assets						3,676
Governments	191	–	–	–	–	191
Other	2,677	684	3	112	9	3,485
Debt investment securities available for sale						13,367
Governments	2,496	–	–	–	–	2,496
Financial institutions	10,144	48	–	–	–	10,192
Other	221	458	–	–	–	679
Due from related body corporate entities						2,230
Other	758	–	–	1,472	–	2,230
Due from subsidiaries						20,134
Other	–	–	–	20,134	–	20,134
Total						102,551

Included in the past due category are balances in which an amount was overdue by one day or more.

Note 41.1

Credit risk continued

Credit quality of financial assets continued

Credit Quality – Bank 2010

	Neither past due nor impaired				Past due or individually impaired \$m	Total \$m
	Investment Grade \$m	Below Investment Grade \$m	Default \$m	Unrated \$m		
Due from financial institutions	5,117	3	–	–	–	5,120
Cash collateral on securities borrowed and reverse repurchase agreements						5,978
Governments	924	228	–	–	–	1,152
Financial institutions	4,402	26	–	–	–	4,428
Other	316	72	10	–	–	398
Trading portfolio assets						6,575
Governments	3,880	58	–	–	–	3,938
Financial institutions	449	62	31	–	–	542
Other	217	1,822	56	–	–	2,095
Loan assets held at amortised cost						16,162
Governments	199	–	–	–	–	199
Financial institutions	2,415	386	–	–	25	2,826
Other	6,277	5,809	87	–	964	13,137
Other financial assets at fair value through profit or loss						5,950
Governments	1,478	–	–	–	–	1,478
Financial institutions	1,675	–	–	–	–	1,675
Other	882	1,876	–	–	39	2,797
Derivative financial instruments – positive values						14,955
Governments	561	–	–	–	–	561
Financial institutions	9,605	329	–	–	–	9,934
Other	2,969	1,437	27	–	27	4,460
Other assets						3,035
Governments	95	–	–	–	–	95
Financial institutions	–	–	–	–	7	7
Other	1,899	989	–	29	16	2,933
Debt investment securities available for sale						15,587
Governments	3,960	–	–	–	–	3,960
Financial institutions	10,219	46	–	–	–	10,265
Other	556	806	–	–	–	1,362
Due from related body corporate entities						2,457
Other	1,325	–	–	1,132	–	2,457
Due from subsidiaries						16,361
Other	–	–	–	16,361	–	16,361
Total						92,180

Included in the past due category are balances in which an amount was overdue by one day or more.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 41.1

Credit risk continued

Financial assets whose terms have been renegotiated

The table below includes the carrying value, as at the balance date, of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

	Consolidated 2011 \$m	Consolidated 2010 \$m	Bank 2011 \$m	Bank 2010 \$m
Loan assets held at amortised cost				
Other	56	84	56	84

Ageing analysis of assets past due but not impaired and impaired assets

Class of financial asset	Past due but not impaired					Impaired \$m	Total \$m	Fair value of collateral held \$m
	Less than 30 days \$m	31 to 60 days \$m	61 to 90 days \$m	More than 90 days \$m				
Loan assets held at amortised cost						Consolidated 2011		
Financial institutions	-	-	-	-	22	22	-	
Other	924	219	102	233	306	1,784	2,295	
Other financial assets at fair value through profit or loss								
Other	-	-	-	-	25	25	20	
Other assets								
Government	1	-	-	-	-	1	-	
Other	6	32	1	1	11	51	2	
Debt investment securities available for sale								
Other	-	-	-	-	31	31	-	
Total	931	251	103	234	395	1,914	2,317	

A facility is considered to be past due when a contractual payment falls overdue by one or more days. When a facility is classified as past due, the entire facility balance less provision is disclosed in the past due analysis.

The factors taken into consideration by the Consolidated Entity when determining whether an asset is impaired are set out in note 1(xiii) – Summary of significant accounting policies.

Of the collateral held against past due and impaired balances for loan assets held at amortised cost, \$1,265 million (2010: \$1,100 million) relates to collateral held against past due balances on residential mortgage facilities that are covered by mortgage insurance. A mortgage insurance claim will only be made in an instance where there is an outstanding balance on the mortgage facility after the receipt of proceeds on the disposal of the property held as security. The remaining collateral is made up of assets held as collateral against other loan and receivable balances.

The collateral held against past due and impaired balances for other assets represents equity securities held as security against failed trade settlements.

Note 41.1

Credit risk continued

Ageing analysis of assets past due but not impaired and impaired assets continued

Repossessed collateral

In the event of customer default on facilities, the Consolidated Entity may take possession of real estate or other assets held as security. During the year the Consolidated Entity took possession of fixed assets and property assets with a carrying value of \$413 million (2010: \$466 million).

Class of financial asset	Past due but not impaired					Total	Fair value of collateral held
	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Impaired		
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
						Consolidated 2010	
Loan assets held at amortised cost							
Government	17	33	–	–	–	50	40
Financial institutions	–	3	–	–	25	28	3
Other	1,003	218	89	317	518	2,145	2,547
Other financial assets at fair value through profit or loss							
Other	–	3	2	–	34	39	–
Derivative financial instruments – positive value							
Other	–	–	–	–	27	27	–
Other assets							
Financial institutions	–	–	–	–	7	7	–
Other	3	1	–	18	15	37	3
Debt investment securities available for sale							
Other	–	–	–	–	28	28	27
Total	1,023	258	91	335	654	2,361	2,620

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 41.1

Credit risk continued

Ageing analysis of assets past due but not impaired and impaired assets continued

Class of financial asset	Past due but not impaired					Total \$m	Fair value of collateral held \$m
	Less than 30 days \$m	31 to 60 days \$m	61 to 90 days \$m	More than 90 days \$m	Impaired \$m		
Loan assets held at amortised cost							Bank 2011
Financial institutions	-	-	-	-	22	22	-
Other	177	46	9	42	255	529	804
Other financial assets at fair value through profit or loss							
Other	-	-	-	-	25	25	20
Other assets							
Other	-	-	-	-	9	9	2
Total	177	46	9	42	311	585	826

Note 41.1

Credit risk continued

Ageing analysis of assets past due but not impaired and impaired assets continued

Class of financial asset	Past due but not impaired					Total \$m	Fair value of collateral held \$m
	Less than 30 days \$m	31 to 60 days \$m	61 to 90 days \$m	More than 90 days \$m	Impaired \$m		
Loan assets held at amortised cost							Bank 2010
Financial institutions	–	–	–	–	25	25	–
Other	301	46	8	141	468	964	1,142
Other financial assets at fair value through profit or loss							
Other	–	3	2	–	34	39	–
Derivatives financial instrument – positive value							
Other	–	–	–	–	27	27	–
Other assets							
Financial institutions	–	–	–	–	7	7	–
Other	–	–	–	1	15	16	–
Total	301	49	10	142	576	1,078	1,142

Note 41.2

Liquidity risk

Liquidity management

The Consolidated Entity's liquidity risk management framework ensures 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, the MBL Board and RMG. The Consolidated Entity's liquidity policies are approved by the Board after endorsement by the Asset and Liability Committee. The Asset and Liability Committee includes the Chief Executive Officer, the Chief Financial Officer, Chief Risk Officer, Treasurer and Operating Group Heads.

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

Liquidity policy

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

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

Notes to the financial statements

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continued

Note 41.2

Liquidity risk continued

Scenario analysis

Scenario analysis is central to the liquidity risk management framework. Group Treasury models a number of liquidity scenarios covering both market-wide crises and firm-specific crises. The objective of this modelling is to ensure the Consolidated Entity's ability to meet all repayment obligations under each scenario and determine the capacity for asset growth. The modelling includes 12 month liquidity scenarios significantly more severe than the conditions that have been experienced since August 2007.

Scenarios are run over a number of timeframes and a range of conservative assumptions are used with regard to access to capital markets, deposit outflows, contingent funding requirements and asset sales.

Liquid asset holdings

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

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

Liquidity contingency plan

Group Treasury maintains a liquidity contingency plan. The liquidity contingency plan applies to the entire Consolidated Entity and defines roles and responsibilities and actions to be taken in a liquidity event. This includes identification of key information requirements and appropriate communication plans with both internal and external parties.

Specifically, the plan details factors that may constitute a crisis, the officer responsible for enacting the contingency management, a committee of senior executives who would be responsible for managing a crisis, the information required to effectively manage a crisis, a public relations strategy, a high level check list of actions to be taken, and contact lists to facilitate prompt communication with all key internal and external stakeholders. The liquidity contingency plan is subject to regular review (at least annually) by both Group Treasury and RMG and is submitted to the Board for approval.

Funding transfer pricing

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

Contractual undiscounted cash flows

The following tables summarise the maturity profile of the Consolidated Entity's financial liabilities as at 31 March based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were given immediately. However, the Consolidated Entity expects that many customers will not request repayment on the earliest date the Consolidated Entity could be required to pay and the table does not reflect the expected cash flows indicated by the Consolidated Entity's deposit retention history.

Derivatives (other than those designated in a hedging relationship) and trading portfolio liabilities are included in the 'less than 3 months' column at their fair value. Liquidity risk on these items is not managed on the basis of contractual maturity, since they are not held for settlement according to such maturity and will frequently be settled in the short term at fair value. Derivatives designated in a hedging relationship are included according to their contractual maturity.

Note 41.2

Liquidity risk continued

Contractual undiscounted cash flows continued

	On demand \$m	Less than 3 months \$m	3 to 12 months \$m	1 to 5 years \$m	Over 5 years \$m	Total \$m
Consolidated 2011						
Due to financial institutions	412	88	190	705	588	1,983
Cash collateral on securities lent and repurchase agreements	2,715	3,388	–	–	–	6,103
Trading portfolio liabilities	–	5,732	–	–	–	5,732
Derivative financial instruments (trading)	–	20,906	–	–	–	20,906
Derivative financial instruments (hedging relationship)						
Contractual amounts payable	–	4,401	1,480	3,133	579	9,593
Contractual amounts receivable	–	(4,429)	(1,665)	(3,511)	(818)	(10,423)
Deposits	26,618	5,445	2,780	315	–	35,158
Debt issued at amortised cost ¹	–	6,101	6,384	24,157	2,943	39,585
Other liabilities ²	–	6,381	–	–	–	6,381
Other financial liabilities at fair value through profit or loss	44	1,003	850	958	84	2,939
Life investment contracts and other unitholder liabilities	–	5,055	–	–	–	5,055
Due to related body corporate entities	4,749	693	984	5	63	6,494
Subordinated debt	–	1	782	320	1,154	2,257
Total undiscounted cash flows	34,538	54,765	11,785	26,082	4,593	131,763
Contingent liabilities	–	697	–	–	–	697
Commitments	–	5,459	58	–	–	5,517
Total undiscounted contingent liabilities and commitments³	–	6,156	58	–	–	6,214
Consolidated 2010						
Due to financial institutions	327	97	293	450	1,059	2,226
Cash collateral on securities lent and repurchase agreements	509	6,648	45	–	–	7,202
Trading portfolio liabilities	–	4,921	–	–	–	4,921
Derivative financial instruments (trading)	–	21,068	–	–	–	21,068
Derivative financial instruments (hedging relationship)						
Contractual amounts payable	–	1,586	1,793	2,550	17	5,946
Contractual amounts receivable	–	(1,531)	(1,660)	(2,436)	(12)	(5,639)
Deposits	14,685	5,216	2,334	90	–	22,325
Debt issued at amortised cost ¹	2	6,465	5,306	29,317	2,805	43,895
Other liabilities ²	–	5,973	–	–	–	5,973
Other financial liabilities at fair value through profit or loss	8	1,134	860	510	137	2,649
Life investment contracts and other unitholder liabilities	–	4,864	–	–	–	4,864
Due to related body corporate entities	5,933	878	558	705	–	8,074
Subordinated debt	–	8	35	198	1,487	1,728
Total undiscounted cash flows	21,464	57,327	9,564	31,384	5,493	125,232
Contingent liabilities	–	1,027	–	–	–	1,027
Commitments	–	3,885	105	–	–	3,990
Total undiscounted contingent liabilities and commitments³	–	4,912	105	–	–	5,017

¹ Included in this balance are amounts payable to SPE note holders. The contractual maturity of the notes is dependent on the repayment of the underlying loans. This has been reflected in the maturity analysis.

² Excludes items that are not financial instruments and non-contractual accruals and provisions.

³ Cash flows on contingent liabilities and commitments are dependent on the occurrence of various future events and conditions, and may or may not result in an outflow of resources. These are reported in the 'less than 3 months' column unless contractual terms specify a longer dated cash flow.

Notes to the financial statements

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continued

Note 41.2

Liquidity risk continued

Contractual undiscounted cash flows continued

	On demand \$m	Less than 3 months \$m	3 to 12 months \$m	1 to 5 years \$m	Over 5 years \$m	Total \$m
Bank 2011						
Due to financial institutions	392	41	37	461	440	1,371
Cash collateral on securities lent and repurchase agreements	2,712	3,387	–	–	–	6,099
Trading portfolio liabilities	–	5,621	–	–	–	5,621
Derivative financial instruments (trading)	–	18,094	–	–	–	18,094
Derivative financial instruments (hedging relationship)						
Contractual amounts payable	–	2,111	597	1,599	553	4,860
Contractual amounts receivable	–	(2,241)	(847)	(2,115)	(791)	(5,994)
Deposits	26,340	5,441	2,780	315	–	34,876
Debt issued at amortised cost ¹	–	5,133	3,677	9,007	5	17,822
Other liabilities ²	–	3,382	–	–	–	3,382
Other financial liabilities at fair value through profit or loss	23	799	482	774	68	2,146
Due to related body corporate entities	4,466	693	984	29	63	6,235
Due to subsidiaries	9,406	261	322	358	364	10,711
Subordinated debt	–	1	782	320	1,154	2,257
Total undiscounted cash flows	43,339	42,723	8,814	10,748	1,856	107,480
Contingent liabilities	–	1,124	–	–	–	1,124
Commitments	–	4,691	58	–	–	4,749
Total undiscounted contingent liabilities and commitments³	–	5,815	58	–	–	5,873
Bank 2010						
Due to financial institutions	278	14	–	2	948	1,242
Cash collateral on securities lent and repurchase agreements	502	6,648	45	–	–	7,195
Trading portfolio liabilities	–	4,910	–	–	–	4,910
Derivative financial instruments (trading)	–	14,752	–	–	–	14,752
Derivative financial instruments (hedging relationship)						
Contractual amounts payable	–	463	373	837	17	1,690
Contractual amounts receivable	–	(459)	(444)	(1,029)	(12)	(1,944)
Deposits	14,436	5,216	2,334	90	–	22,076
Debt issued at amortised cost ¹	–	4,880	1,699	14,169	65	20,813
Other liabilities ²	–	2,664	–	–	–	2,664
Other financial liabilities at fair value through profit or loss	8	899	846	489	137	2,379
Due to related body corporate entities	5,979	777	652	705	–	8,113
Due to subsidiaries	8,759	336	137	9	388	9,629
Subordinated debt	–	8	35	198	1,487	1,728
Total undiscounted cash flows	29,962	41,108	5,677	15,470	3,030	95,247
Contingent liabilities	–	1,878	–	–	–	1,878
Commitments	–	2,813	105	–	–	2,918
Total undiscounted contingent liabilities and commitments³	–	4,691	105	–	–	4,796

¹ Included in this balance are amounts payable to SPE note holders. The contractual maturity of the notes is dependent on the repayment of the underlying loans. This has been reflected in the maturity analysis.

² Excludes items that are not financial instruments and non-contractual accruals and provisions.

³ Cash flows on contingent liabilities and commitments are dependent on the occurrence of various future events and conditions, and may or may not result in an outflow of resources. These are reported in the 'less than 3 months' column unless contractual terms specify a longer dated cash flow.

Note 41.3

Market risk

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

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

and to the correlation of market prices and rates within and across markets.

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

RMG monitors positions within the Consolidated Entity according to a limit structure which sets limits for all exposures in all markets. Limits are for both individual trading desks and divisions as well as in aggregate. Trigger limits for the Consolidated Entity as a whole ensure that if several trading book limits are being used simultaneously, the aggregate level of risk is in line with the global risk appetite articulated in the economic capital model.

RMG sets three complementary limit structures:

- **Contingent Loss Limits:** worst case scenarios that shock prices and volatilities by more than has occurred historically. Multiple scenarios are set for each market to capture the non-linearity and complexity of exposures arising from derivatives. A wide range of assumptions about the correlations between markets is applied;
- **Position Limits:** volume, maturity and open position limits are set on a large number of market instruments and securities in order to constrain concentration risk and to avoid the accumulation of risky, illiquid positions; and
- **Value-at-Risk (VaR) Limits:** statistical measure based on a 10-day holding period and a 99 per cent confidence level, as stipulated by the APRA capital adequacy standard. The model is validated daily by back testing a one-day VaR against hypothetical and actual daily trading profit or loss.

Value-at-Risk (VaR) figures

The tables below show the average, maximum and minimum VaR over the year for the major markets in which the Consolidated Entity and Bank operate. The VaR shown in the tables are based on a one-day holding period. The aggregated VaR is on a correlated basis.

	2011 Average \$m	2011 Maximum \$m	2011 Minimum \$m	2010 Average \$m	2010 Maximum \$m	2010 Minimum \$m
						Consolidated
Equities	9.03	16.80	3.85	6.27	12.46	2.20
Interest rates	5.54	11.46	3.08	4.16	6.47	2.88
Foreign exchange and bullion	3.54	10.68	1.10	1.96	4.15	0.55
Commodities	11.64	16.34	7.63	10.95	16.98	5.37
Aggregate	15.67	22.29	10.90	13.06	21.62	5.62

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 41.3

Market risk continued

	2011 Average \$m	2011 Maximum \$m	2011 Minimum \$m	2010 Average \$m	2010 Maximum \$m	2010 Minimum \$m
						Bank
Equities	5.89	10.15	3.53	6.44	12.47	2.31
Interest rates	4.99	10.49	2.94	4.14	6.45	2.66
Foreign exchange and bullion	7.64	15.83	1.94	2.13	8.61	0.86
Commodities	3.09	5.60	1.48	2.26	4.21	0.50
Aggregate	10.07	16.28	6.69	8.23	13.81	4.04

Value-at-Risk

The VaR model uses a Monte Carlo simulation to generate normally distributed price and volatility paths, based on three years of historical data. VaR focuses on unexceptional price moves so that it does not account for losses that could occur beyond the 99 per cent level of confidence. These factors can limit the effectiveness of VaR in predicting future price moves when changes to future risk factors deviate from the movements expected by the above assumptions. For capital adequacy purposes, debt-specific risk is measured using APRA's standard method, whilst all other exposures are captured by the VaR model. This combined approach has been approved by APRA and is subject to periodic review.

Interest rate risk

The Consolidated Entity also has exposure to non-traded interest rate risk generated by banking products such as loans and deposits. Banking businesses have small limits to accumulate small levels of interest rate risk. Wherever possible, these interest rate risks are transferred into the trading books of FICC and Group Treasury and managed within traded market risk limits and are included within the VaR figures presented above. Some residual interest rate risks remain in the banking book. These residual risks have independent limits that are monitored by RMG.

Certain interest rate derivative transactions are undertaken to economically hedge interest rate risk associated with the MIPS. As the MIPS are classified as equity for accounting purposes and the hedge accounting requirements cannot be met, the volatility arising from recognising these derivatives at fair value is reflected in the income statement. Interest rate sensitivity on these derivatives is not reflected in the VaR numbers above. Indicatively, a 50 basis point increase or decrease in interest rates would result in a decrease or increase in operating profit before income tax of \$3 million (2010: \$3 million) respectively.

Other than the volatility on the derivatives described above, there are no material non-traded interest rate risks within the Consolidated Entity.

Foreign currency risk

The Consolidated Entity is exposed to foreign currency risk arising from transactions entered into in its normal course of business and as a result of its investments in foreign operations. Movements in foreign currency exchange rates will result in gains or losses in the income statement due to the revaluation of certain balances or in movements in the foreign currency translation reserve due to the revaluation of foreign operations.

In order to manage this risk, the Consolidated Entity has a policy that non-trading foreign currency exposures are appropriately hedged unless specifically approved by RMG, and trading foreign currency exposures remain within trading limits set by RMG.

Forward foreign exchange contracts, or borrowings in the same currency as the exposure, are designated as hedges under Australian Accounting Standards and offset movements on the net assets within foreign operations and are transferred to the foreign currency translation reserve.

Note 41.3

Market risk continued

Foreign currency risk continued

Responsibility for monitoring and managing foreign currency exposures arising from transactions rests with individual businesses which will enter into internal transactions as necessary to transfer the underlying foreign exchange risk to our trading businesses. Any residual foreign exchange risk residing in non-trading divisions is included in the internal model capital calculation by RMG, with the exception of specific investments in core foreign operations as discussed below.

The hedging policy of the group is designed to reduce the sensitivity of the group's regulatory capital position to foreign currency movements. This is achieved by leaving specific investments in core foreign operations exposed to foreign currency translation movements. The resultant change in the Australian dollar value of the foreign investment is captured in the foreign currency translation reserve, a component of regulatory capital. This offsets the corresponding movement in the capital requirements of these investments.

As a result of the Consolidated Entity's foreign exchange policy, the Consolidated Entity is partially exposed to currency risk in relation to the translation of its net investment in foreign operations to Australian dollars.

The table below indicates the sensitivity to movements in the Australian dollar rate against various foreign currencies at 31 March. The Consolidated Entity is active in various currencies globally – those with the most impact on the sensitivity analysis below are USD, GBP, HKD and CAD.

	2011			2010		
	Movement in exchange rates	Sensitivity of equity after tax		Movement in exchange rates	Sensitivity of equity after tax	
	%	Consolidated \$m	Bank \$m	%	Consolidated \$m	Bank \$m
Australian dollar	+10	(276.6)	(235.2)	+10	(113.1)	(28.0)
Australian dollar	-10	338.0	287.5	-10	138.2	34.2

Notes to the financial statements

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Note 41.3

Market risk continued

Equity price risk

The tables below indicate the equity markets to which the Consolidated Entity and the Bank had significant exposure at 31 March on its non-trading investment portfolio excluding interests in associates and joint ventures. The effect on equity (as a result of a change in the fair value of equity instruments held as available for sale at 31 March) and the income statement due to a reasonably possible change in equity prices, with all other variables held constant, is as follows:

Geographic region	2011			2010		
	Movement in equity price %	Sensitivity of profit before tax and profit share \$m	Sensitivity of equity after tax \$m	Movement in equity price %	Sensitivity of profit before tax and profit share \$m	Sensitivity of equity after tax \$m
Consolidated						
Listed						
Australia	+10	3.3	23.6	+10	2.6	21.0
Asia Pacific	+10	-	-	+10	-	0.3
Europe, Middle East and Africa	+10	1.5	4.1	+10	0.2	1.9
Americas	+10	4.0	8.0	+10	3.9	4.0
Unlisted	+10	0.2	28.2	+10	0.1	21.5
Listed						
Australia	-10	(3.3)	(23.6)	-10	(2.2)	(21.0)
Asia Pacific	-10	-	-	-10	-	(0.3)
Europe, Middle East and Africa	-10	(1.5)	(4.1)	-10	-	(1.9)
Americas	-10	(3.5)	(8.0)	-10	(3.9)	(4.0)
Unlisted	-10	(0.2)	(28.2)	-10	(0.1)	(21.5)
Bank						
Listed						
Australia	+10	3.3	22.0	+10	2.6	14.7
Asia Pacific	+10	-	-	+10	-	0.3
Europe, Middle East and Africa	+10	1.5	3.9	+10	0.2	1.8
Americas	+10	4.0	6.9	+10	3.9	3.4
Unlisted	+10	0.2	7.8	+10	0.1	4.3
Listed						
Australia	-10	(3.3)	(22.0)	-10	(2.2)	(14.7)
Asia Pacific	-10	-	-	-10	-	(0.3)
Europe, Middle East and Africa	-10	(1.5)	(3.9)	-10	-	(1.8)
Americas	-10	(3.5)	(6.9)	-10	(3.9)	(3.4)
Unlisted	-10	(0.2)	(7.8)	-10	(0.1)	(4.3)

Note 42

Fair values of financial assets and liabilities

Fair value reflects the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted prices or rates are used to determine fair value where an active market exists. If the market for a financial instrument is not active, fair values are estimated using present value or other valuation techniques, using inputs based on market conditions prevailing on the measurement date.

The values derived from applying these techniques are affected by the choice of valuation model used and the underlying assumptions made regarding inputs such as timing and amounts of future cash flows, discount rates, credit risk, volatility and correlation.

Financial instruments measured at fair value are categorised in their entirety, in accordance with the levels of the fair value hierarchy as outlined below:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The appropriate level for an instrument is determined on the basis of the lowest level input that is significant to the fair value measurement.

The following methods and significant assumptions have been applied in determining the fair values of financial instruments:

- trading portfolio assets and liabilities, financial assets and liabilities at fair value through profit or loss, derivative financial instruments and other transactions undertaken for trading purposes are measured at fair value by reference to quoted market prices when available (e.g. listed securities). If quoted market prices are not available, then fair values are estimated on the basis of pricing models or other recognised valuation techniques;
- investment securities classified as available for sale are measured at fair value by reference to quoted market prices when available (e.g. listed securities). If quoted market prices are not available, then fair values are estimated on the basis of pricing models or other recognised valuation techniques. Unrealised gains and losses, excluding impairment write-downs, are recorded in the available for sale reserve in equity until the asset is sold, collected or otherwise disposed of;
- fair values of fixed rate loans and issued debt classified as at fair value through profit or loss is estimated by reference to current market rates offered on similar loans;
- for financial instruments carried at fair value the determination of fair value includes credit risk (i.e. the premium over the basic interest rate). Counterparty credit risk inherent in these instruments is factored into their valuations via credit valuation adjustments (CVA). This amount represents the estimated market value of protection required to hedge credit risk from counterparties, taking into account expected future exposures, collateral, and netting arrangements. CVA is determined when the market price (or parameter) is not indicative of the credit quality of the specific counterparty. Where financial instruments are valued using an internal model that utilises observable market parameters, market practice is to quote parameters equivalent to an interbank credit rating (that is, all counterparties are assumed to have the same credit quality). Consequently, a CVA calculation is necessary to reflect the credit quality of each derivative counterparty to arrive at fair value; and
- the Consolidated Entity's own credit risk is factored into the valuation of liabilities measured at fair value via debit valuation adjustments (DVA). This is because credit risk affects what the transaction price of the liability would have been in an arm's length exchange motivated by normal business considerations (e.g. it affects the value at which liabilities could be repurchased or settled, the observed market price of quoted debt securities and the contract interest rate offered when debt is initially raised). Consequently, changes in the credit quality of the Consolidated Entity are reflected in valuations where the credit risk would be considered by market participants and excludes fully collateralised transactions and other instruments for which it is established market practice not to include an entity-specific adjustment for own credit. The methodology to determine the adjustment is consistent with CVA and incorporates the Consolidated Entity's credit spread, for the term of the liability measured, as observed through the credit default swap market. This amount represents the estimated difference in the market value of identical obligations.

Notes to the financial statements

for the financial year ended 31 March 2011

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Note 42

Fair values of financial assets and liabilities continued

Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated periodically to test that outputs reflect prices from observable current market transactions in the same instrument or other available observable market data. To the extent possible, models use only observable market data (e.g. for over-the-counter derivatives), however management is required to make assumptions for certain inputs that are not supported by prices from observable current market transactions in the same instrument, such as volatility and correlation.

The following methods and significant assumptions have been applied in determining the fair values of financial instruments which are carried at amortised cost:

- the fair values of liquid assets and other instruments maturing within three months are approximate to their carrying amounts. This assumption is applied to liquid assets and the short-term elements of all other financial assets and financial liabilities;
- the fair value of demand deposits with no fixed maturity is approximately their carrying amount as they are short term in nature or are payable on demand;
- the fair values of variable rate financial instruments, including loan assets and liabilities carried at amortised cost, cash collateral on securities borrowed/cash collateral on securities lent and reverse repurchase/repurchase agreements, are approximate to their carrying amounts. The fair value of loan assets repayable without penalty is approximated by their carrying value;
- the fair value of fixed rate loans and debt carried at amortised cost is estimated by reference to current market rates offered on similar loans and the credit worthiness of the borrower;
- the fair value of debt issued and subordinated debt is based on market prices where available. Where market prices are not available the fair value is based on discounted cash flows using rates appropriate to the term and issue and incorporates changes in the Consolidated Entity's own credit spread;
- substantially all of the Consolidated Entity's commitments to extend credit are at variable rates. As such, there is no significant exposure to fair value fluctuations resulting from interest rate movements relating to these commitments; and
- the fair values of balances due from/to subsidiaries (in the Bank's separate financial statements) and balances due from/to related body corporate entities (in the Bank's and consolidated financial statements) are approximated by their carrying amount as the balances are generally receivable/payable on demand.

Note 42

Fair values of financial assets and liabilities continued

The tables below summarise the carrying value and fair value of financial assets and liabilities held at amortised cost of the Consolidated Entity and the Bank at 31 March 2011:

	2011 Carrying value \$m	2011 Fair value \$m	2010 Carrying value \$m	2010 Fair value \$m
				Consolidated
Assets				
Due from financial institutions	7,579	7,579	6,490	6,490
Loan assets held at amortised cost	45,382	45,402	43,794	44,012
Due from related body corporate entities	2,443	2,481	2,391	2,459
Total assets	55,404	55,462	52,675	52,961
				Bank
Assets				
Due from financial institutions	6,256	6,256	5,120	5,120
Loan assets held at amortised cost	17,299	17,159	16,162	16,147
Due from related body corporate entities	2,230	2,268	2,457	2,525
Due from subsidiaries	20,134	20,134	16,361	16,361
Total assets	45,919	45,817	40,100	40,153
				Consolidated
Liabilities				
Due to financial institutions	1,580	1,643	2,167	2,200
Deposits	35,106	35,154	22,288	22,295
Debt issued at amortised cost	36,943	37,334	39,408	39,375
Due to related body corporate entities	6,471	6,471	8,008	8,008
Subordinated debt at amortised cost	1,430	1,434	905	899
Total liabilities	81,530	82,036	72,776	72,777
				Bank
Liabilities				
Due to financial institutions	1,011	1,074	1,238	1,238
Deposits	34,827	34,876	22,043	22,051
Debt issued at amortised cost	17,697	17,928	19,170	19,429
Due to related body corporate entities	6,212	6,212	8,044	8,044
Due to subsidiaries	10,607	10,607	9,596	9,596
Subordinated debt at amortised cost	1,430	1,434	905	899
Total liabilities	71,784	72,131	60,996	61,257

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair value of financial assets and liabilities continued

The following tables summarise the levels of the fair value hierarchy for financial instruments measured at fair value:

	Level 1 \$m	Level 2 \$m	Level 3 \$m	Total \$m
Consolidated 2011				
Assets				
Trading portfolio assets	9,849	4,085	489	14,423
Other financial assets at fair value through profit or loss	5,470	4,877	260	10,607
Derivative financial instruments – positive values	3,455	17,451	239	21,145
Investment securities available for sale	12,932	1,701	370	15,003
Life investment contracts and other unitholder investment assets	1,201	3,861	–	5,062
Total assets	32,907	31,975	1,358	66,240
Liabilities				
Trading portfolio liabilities	4,390	1,342	–	5,732
Derivative financial instruments – negative values	3,758	17,531	166	21,455
Other financial liabilities at fair value through profit or loss	46	2,711	152	2,909
Life investment contracts and other unitholder liabilities	1,201	3,854	–	5,055
Subordinated debt at fair value through profit or loss	–	467	–	467
Total liabilities	9,395	25,905	318	35,618
Consolidated 2010				
Assets				
Trading portfolio assets	8,505	2,395	424	11,324
Other financial assets at fair value through profit or loss	3,265	3,573	287	7,125
Derivative financial instruments – positive values	3,260	18,004	276	21,540
Investment securities available for sale	15,182	1,168	411	16,761
Life investment contracts and other unitholder investment assets	941	3,913	–	4,854
Total assets	31,153	29,053	1,398	61,604
Liabilities				
Trading portfolio liabilities	3,839	1,079	3	4,921
Derivative financial instruments – negative values	3,857	17,361	416	21,634
Other financial liabilities at fair value through profit or loss	85	2,483	57	2,625
Life investment contracts and other unitholder liabilities	944	3,920	–	4,864
Subordinated debt at fair value through profit or loss	–	499	–	499
Total liabilities	8,725	25,342	476	34,543

Note 42

Fair value of financial assets and liabilities continued

	Level 1 \$m	Level 2 \$m	Level 3 \$m	Total \$m
				Bank 2011
Assets				
Trading portfolio assets	9,637	3,469	437	13,543
Other financial assets at fair value through profit or loss	5,490	4,236	214	9,940
Derivative financial instruments – positive values	3,415	14,974	162	18,551
Investment securities available for sale	12,748	1,013	187	13,948
Total assets	31,290	23,692	1,000	55,982
Liabilities				
Trading portfolio liabilities	4,279	1,342	–	5,621
Derivative financial instruments – negative values	3,673	14,433	85	18,191
Other financial liabilities at fair value through profit or loss	45	1,932	145	2,122
Subordinated debt at fair value through profit or loss	–	467	–	467
Total liabilities	7,997	18,174	230	26,401
				Bank 2010
Assets				
Trading portfolio assets	8,470	2,257	424	11,151
Other financial assets at fair value through profit or loss	3,213	3,459	277	6,949
Derivative financial instruments – positive values	3,467	11,308	180	14,955
Investment securities available for sale	15,080	645	212	15,937
Total assets	30,230	17,669	1,093	48,992
Liabilities				
Trading portfolio liabilities	3,829	1,078	3	4,910
Derivative financial instruments – negative values	3,827	10,787	252	14,866
Other financial liabilities at fair value through profit or loss	85	2,213	57	2,355
Subordinated debt at fair value through profit or loss	–	499	–	499
Total liabilities	7,741	14,577	312	22,630

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair value of financial assets and liabilities continued

Reconciliation of balances in Level 3 of the fair value hierarchy

The following tables reconcile the balances in Level 3 of the fair value hierarchy for the Consolidated Entity and for the Bank for the financial year ended 31 March 2011:

	Trading portfolio assets \$m	Other financial assets at fair value through profit or loss \$m
Balance at the beginning of the financial year	424	287
Purchases	306	86
Sales	(273)	(31)
Issues	–	7
Settlements	–	(123)
Net transfers into/out of Level 3	(68)	61
Fair value gains/(losses) recognised in the income statement ¹	100	(27)
Fair value gains recognised in other comprehensive income ¹	–	–
Balance at the end of the financial year	489	260
Fair value gains/(losses) for the financial year included in the income statement for assets and liabilities held at the end of the financial year ¹	88	–

¹ The Consolidated Entity employs various economic hedging techniques in order to manage risks, including risks in Level 3 positions. Such techniques may include the purchase or sale of financial instruments that are classified in Levels 1 and/or 2. The realised and unrealised gains and losses for assets and liabilities in Level 3 presented in the table above do not reflect the related realised or unrealised gains and losses arising on economic hedging instruments classified in Levels 1 and/or 2.

² The derivative financial instruments in the table above are represented on a net basis. On a gross basis, derivative financial instruments – positive values are \$239 million (2010: \$276 million) and derivative financial instruments – negative values are \$166 million (2010: \$416 million).

Investment securities available for sale \$m	Trading portfolio liabilities \$m	Other financial liabilities at fair value through profit or loss \$m	Derivative financial instruments (net replacement values) ² \$m	Total \$m
Consolidated 2011				
411	(3)	(57)	(140)	922
87	-	(12)	30	497
(74)	-	46	(98)	(430)
-	-	(15)	(43)	(51)
(11)	-	5	29	(100)
(26)	2	(119)	129	(21)
(21)	1	-	166	219
4	-	-	-	4
370	-	(152)	73	1,040
-	-	-	(6)	82

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair value of financial assets and liabilities continued

Reconciliation of balances in Level 3 of the fair value hierarchy

The following tables reconcile the balances in Level 3 of the fair value hierarchy for the Consolidated Entity and for the Bank for the financial year ended 31 March 2010:

	Trading portfolio assets \$m	Other financial assets at fair value through profit or loss \$m
Balance at the beginning of the financial year	755	100
Purchases	503	145
Sales	(752)	(13)
Issues	–	–
Settlements	–	–
Net transfers into/out of Level 3	(83)	42
Fair value gains/(losses) recognised in the income statement ¹	1	13
Fair value losses recognised in other comprehensive income ¹	–	–
Balance at the end of the financial year	424	287
Fair value gains/(losses) for the financial year included in the income statement for assets and liabilities held at the end of the financial year ¹	19	14

¹ The Consolidated Entity employs various economic hedging techniques in order to manage risks, including risks in Level 3 positions. Such techniques may include the purchase or sale of financial instruments that are classified in Levels 1 and/or 2. The realised and unrealised gains and losses for assets and liabilities in Level 3 presented in the table above do not reflect the related realised or unrealised gains and losses arising on economic hedging instruments classified in Levels 1 and/or 2.

² The derivative financial instruments in the table above are represented on a net basis. On a gross basis, derivative financial instruments – positive values are \$276 million and derivative financial instruments – negative values are \$416 million.

Investment securities available for sale \$m	Trading portfolio liabilities \$m	Other financial liabilities at fair value through profit or loss \$m	Derivative financial instruments (net replacement values) ² \$m	Total \$m
Consolidated 2010				
571	–	–	(88)	1,338
196	(25)	(54)	(43)	722
(73)	27	–	15	(796)
–	–	–	(6)	(6)
(11)	–	–	31	20
(138)	–	–	19	(160)
(75)	(5)	(3)	(68)	(137)
(59)	–	–	–	(59)
411	(3)	(57)	(140)	922
(15)	(2)	(3)	(87)	(74)

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair value of financial assets and liabilities continued

Reconciliation of balances in Level 3 of the fair value hierarchy continued

	Trading portfolio assets \$m	Other financial assets at fair value through profit or loss \$m
Balance at the beginning of the financial year	424	277
Purchases	254	83
Sales	(272)	(29)
Issues	–	7
Settlements	–	(123)
Net transfers into/out of Level 3	(67)	25
Fair value gains/(losses) recognised in the income statement ¹	98	(26)
Fair value gains recognised in other comprehensive income ¹	–	–
Balance at the end of the financial year	437	214
Fair value gains/(losses) for the financial year included in the income statement for assets and liabilities held at the end of the financial year ¹	88	–

¹ The Consolidated Entity employs various economic hedging techniques in order to manage risks, including risks in Level 3 positions. Such techniques may include the purchase or sale of financial instruments that are classified in Levels 1 and/or 2. The realised and unrealised gains and losses for assets and liabilities in Level 3 presented in the table above do not reflect the related realised or unrealised gains and losses arising on economic hedging instruments classified in Levels 1 and/or 2.

² The derivative financial instruments in the table above are represented on a net basis. On a gross basis, derivative financial instruments – positive values are \$162 million (2010: \$180 million) and derivative financial instruments – negative values are \$85 million (2010: \$252 million).

Investment securities available for sale \$m	Trading portfolio liabilities \$m	Other financial liabilities at fair value through profit or loss \$m	Derivative financial instruments (net replacement values) ² \$m	Total \$m
Bank 2011				
212	(3)	(57)	(72)	781
54	-	(12)	32	411
(63)	-	46	(99)	(417)
-	-	(7)	(42)	(42)
-	-	5	29	(89)
(21)	2	(120)	64	(117)
(1)	1	-	165	237
6	-	-	-	6
187	-	(145)	77	770
3	-	-	(3)	88

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair value of financial assets and liabilities continued

Reconciliation of balances in Level 3 of the fair value hierarchy continued

	Trading portfolio assets \$m	Other financial assets at fair value through profit or loss \$m
Balance at the beginning of the financial year	711	91
Purchases	505	142
Sales	(707)	(13)
Issues	–	–
Settlements	–	–
Net transfers into/out of Level 3	(83)	42
Fair value (losses)/gains recognised in the income statement ¹	(2)	15
Fair value gains recognised in other comprehensive income ¹	–	–
Balance at the end of the financial year	424	277
Fair value gains/(losses) for the financial year included in the income statement for assets and liabilities held at the end of the financial year ¹	16	13

¹ The Consolidated Entity employs various economic hedging techniques in order to manage risks, including risks in Level 3 positions. Such techniques may include the purchase or sale of financial instruments that are classified in Levels 1 and/or 2. The realised and unrealised gains and losses for assets and liabilities in Level 3 presented in the table above do not reflect the related realised or unrealised gains and losses arising on economic hedging instruments classified in Levels 1 and/or 2.

² The derivative financial instruments in the table above are represented on a net basis. On a gross basis, derivative financial instruments – positive values are \$180 million and derivative financial instruments – negative values are \$252 million.

Investment securities available for sale \$m	Trading portfolio liabilities \$m	Other financial liabilities at fair value through profit or loss \$m	Derivative financial instruments (net replacement values) ² \$m	Total \$m
				Bank 2010
114	–	–	(94)	822
183	(25)	(54)	(42)	709
(73)	27	–	15	(751)
–	–	–	(6)	(6)
–	–	–	42	42
(7)	–	–	19	(29)
(14)	(5)	(3)	(6)	(15)
9	–	–	–	9
212	(3)	(57)	(72)	781
(14)	(2)	(3)	(123)	(113)

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair value of financial assets and liabilities continued

Significant transfers between levels of the fair value hierarchy

During the financial year the Consolidated Entity and the Bank did not have significant transfers between Level 1 and Level 2.

Transfers into Level 3 were due to the lack of observable valuation inputs for certain securities and investments.

Transfers out of Level 3 were principally due to valuation inputs becoming observable during the year.

Unrecognised gains

For financial assets and financial liabilities measured at fair value through profit or loss, when the transaction price in a non-active market is different to the fair market value from other observable current market conditions in the same instrument or based on valuation techniques whose variables include other data from observable markets, the Consolidated Entity and the Bank recognises the difference between the transaction price and the fair value in the income statement. In cases where use is made of data which is not observable, profit or loss is only recognised in the income statement when the inputs become observable, or over the life of the instrument.

The table below summarises the deferral and recognition of profit or loss where a valuation technique has been applied for which not all inputs are observable in the market:

	Consolidated	Consolidated	Bank	Bank
	2011	2010	2011	2010
	\$m	\$m	\$m	\$m
Balance at the beginning of the financial year	34	55	18	47
Deferral on new transactions	14	19	14	9
Amounts recognised in the income statement during the year	(23)	(40)	(14)	(38)
Balance at the end of the financial year	25	34	18	18

Note 42

Fair value of financial assets and liabilities continued

Sensitivity analysis of valuations using unobservable inputs

The table below shows the sensitivity in changing assumptions to reasonably possible alternative assumptions, for those financial instruments for which fair values are determined in whole or in part using valuation techniques such as discounted cashflows, which are based on assumptions that have been determined by reference to historical company and industry experience.

	Favourable changes		Unfavourable changes	
	Profit and loss \$m	Equity \$m	Profit and loss \$m	Equity \$m
Product type				Consolidated 2011
Equity and equity linked products	21	–	(27)	–
Asset backed products	16	13	(15)	(4)
Commodity products	17	–	(16)	–
Credit products	3	–	(3)	–
Interest rate products	1	–	(1)	–
Total	58	13	(62)	(4)
Product type				Consolidated 2010
Equity and equity linked products	32	2	(32)	(2)
Asset backed products	30	–	(28)	–
Commodity products	24	–	(24)	–
Credit products	3	–	(3)	–
FX products	2	–	(2)	–
Interest rate products	1	–	(1)	–
Total	92	2	(90)	(2)

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 42

Fair values of financial assets and liabilities continued

	Favourable changes	Unfavourable changes
	Profit and loss \$m	Profit and loss \$m
		Bank 2011
Product type		
Equity and equity linked products	14	(20)
Commodity products	1	(1)
Credit products	3	(3)
Interest rate products	1	(1)
Total	19	(25)
		Bank 2010
Product type		
Equity and equity linked products	31	(31)
Commodity products	10	(10)
Credit products	3	(3)
FX products	2	(2)
Interest rate products	1	(1)
Total	47	(47)

Note 43

Audit and other services provided by PricewaterhouseCoopers

During the financial year, the auditor of the Consolidated Entity and the Bank, PricewaterhouseCoopers (PwC), and its related practices earned the following remuneration:

	Consolidated 2011 \$'000	Consolidated 2010 \$'000	Bank 2011 \$'000	Bank 2010 \$'000
PwC – Australian Firm				
Audit and review of financial reports of the Bank or any subsidiary of the Bank	5,764	5,556	4,491	3,465
Other audit-related work	550	566	415	454
Other assurance services	1,102	655	486	655
Total audit and other assurance services	7,416	6,777	5,392	4,574
Other advisory services	32	566	32	495
Taxation	353	333	108	270
Total remuneration paid to PwC – Australian Firm	7,801	7,676	5,532	5,339
Related practices of PwC – Australian Firm (including PwC – Overseas Firms)				
Audit and review of financial reports of the Bank or any subsidiary of the Bank	3,753	2,832	–	–
Other audit-related work	42	85	–	10
Other assurance services	170	171	–	–
Total audit and other assurance services	3,965	3,088	–	10
Other advisory services	–	266	–	–
Taxation	531	520	6	–
Total remuneration paid to related practices of PwC – Australian Firm	4,496	3,874	6	10
Total remuneration paid to PwC (note 2)	12,297	11,550	5,538	5,349

Use of PwC's services for engagements other than audit and assurance is restricted in accordance with the Consolidated Entity's and the Bank's Auditor Independence policy. These assignments are principally tax compliance and agreed upon assurance procedures in relation to acquisitions.

Certain fees for advisory services are in relation to Initial Public Offerings and due diligence services for new funds. These fees may be recovered by the Consolidated Entity upon the successful establishment of the funds.

It is the Consolidated Entity's and the Bank's policy to seek competitive tenders for all major advisory projects.

Notes to the financial statements

for the financial year ended 31 March 2011

continued

Note 44

Acquisitions and disposals of subsidiaries and businesses

Significant entities or businesses acquired or consolidated due to acquisition of control:

There were no significant entities or businesses acquired or consolidated during the financial year.

Other entities acquired or businesses acquired or consolidated due to acquisition of control during this financial year are as follows:

CMC Railroad Inc., Innovest Kapitalanlage AG, Latitude FX Limited, Outplan Pty Ltd and Rismark Limited.

Aggregate details of the above entities or businesses acquired or consolidated due to acquisition of control are as follows:

	2011 \$m	2010 \$m
Fair value of net assets acquired¹		
Cash, other financial assets and other assets	28	1,286
Goodwill and other intangible assets	56	567
Property, plant and equipment	102	9
Assets of disposal groups classified as held for sale	5	48
Payables, provisions, borrowings and other liabilities	(142)	(986)
Liabilities of disposal groups classified as held for sale	(4)	(43)
Non-controlling interests	(4)	(2)
Total fair value of net assets acquired	41	879
Consideration		
Cash consideration ²	38	620
Equity issued	-	200
Extinguishment of loan asset	-	56
Fair value of previously held interest	1	-
Total consideration	39	876
Net cash outflow		
Cash consideration ²	(38)	(620)
Less:		
cash and cash equivalents acquired	5	365
Net cash outflow	(33)	(255)

¹ In relation to the acquisition of certain subsidiaries of the Non-Banking Group during the year ended 31 March 2011, assets and liabilities acquired are recognised at carrying amounts. In accordance with the Consolidated Entity's accounting policy, the difference between the fair value of the consideration given over the carrying amounts recognised is recorded directly in reserves. For the year ended 31 March 2011, \$nil (2010: \$5 million) was recognised in Reserves arising from group restructure of combining entities under common control.

² Prior year comparatives include costs directly attributable to the acquisitions.

The operating results of the acquisitions have not had a material impact on the results of the Consolidated Entity.

There are no significant differences between the fair value of net assets acquired and their carrying amounts, other than goodwill and other intangible assets, as noted above. The goodwill acquired during the current financial year has arisen due to the value of the entities or businesses acquired over their individual asset values, the employees acquired as part of the business and synergies the Consolidated Entity expects to realise from the acquisitions.

The 31 March 2010 comparatives relate principally to certain subsidiaries of the Non-Banking Group, Blackmont Capital and Delaware Investments, being the significant entities or businesses acquired or consolidated due to acquisition of control.

Note 44

Acquisitions and disposals of subsidiaries and businesses continued

Significant entities or businesses disposed of or deconsolidated due to loss of control:

There were no significant entities or businesses disposed of or deconsolidated due to loss of control during the financial year.

Other entities or businesses disposed of or deconsolidated during the financial year are as follows:

Advanced Markets Holdings LLC, Everest Absolute Return II Limited, Latitude FX Limited, LexMac Energy Oil & Gas and OzForex Pty Limited, UCITS – Emerging Markets Fund, Veracity Asset Transformation Limited and certain subsidiaries of the Banking Group.

Aggregate details of the above entities or businesses disposed of or deconsolidated are as follows:

	2011 \$m	2010 \$m
Carrying value of assets and liabilities disposed of or deconsolidated		
Cash, other financial assets and other assets	186	154
Goodwill and other intangible assets	24	7
Property, plant and equipment	1	–
Assets of disposal groups classified as held for sale	45	15
Payables, provisions, borrowings and other liabilities	(61)	(89)
Liabilities of disposals groups classified as held for sale	(40)	–
Non-controlling interests	(8)	–
Total carrying value of assets and liabilities disposed of or deconsolidated	147	87
Consideration		
Cash consideration	107	81
Consideration received in equity	86	6
Deferred consideration	–	14
Total consideration	193	101
Net cash flow		
Cash consideration	107	81
Less:		
Cash and cash equivalents disposed of or deconsolidated	(65)	(2)
Net cash inflow	42	79

There were no significant entities or businesses disposed of or deconsolidated due to loss control during the financial year ended 31 March 2011.

Note 45

Events after the Reporting Period

There were no material events subsequent to 31 March 2011 that have not been reflected in the financial statements.

Macquarie Bank Limited

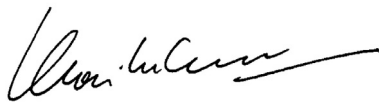
Directors' declaration

In the Directors' opinion:

- a) the financial statements and notes set out on pages 51 to 165 are in accordance with the *Corporations Act 2001 (Cth)*, including:
 - (i) complying with Australian Accounting Standards, the *Corporations Regulations 2001 (Cth)*, and other mandatory professional reporting requirements; and
 - (ii) giving a true and fair view of the Bank and Consolidated Entity's financial position as at 31 March 2011 and of their performance, as represented by the results of their operations and its cash flows, for the financial year ended on that date; and
- b) there are reasonable grounds to believe that MBL will be able to pay its debts as and when they become due and payable; and
- c) the financial statements also comply with International Financial Reporting Standards as issued by International Accounting Standards Board; and
- d) the audited remuneration disclosures set out on pages 8 to 40 of the Directors' Report comply with Australian Accounting Standards AASB 124 *Related Party Disclosures* and the *Corporations Regulations 2001 (Cth)*; and
- e) at the date of this declaration, there are reasonable grounds to believe that the members of the Extended Closed Group identified in note 19 will be able to meet any obligations or liabilities to which they are, or may become, subject by virtue of the deed of cross guarantee described in note 19.

The Directors have been given the declarations by the Chief Executive Officer and Chief Financial Officer required by section 295A of the *Corporations Act 2001 (Cth)*.

This declaration is made in accordance with a resolution of the Directors.



Kevin McCann, AM
Independent Director and
Chairman



Richard Sheppard
Managing Director and
Chief Executive Officer

Sydney
29 April 2011

Independent audit report

To the members of Macquarie Bank Limited



Report on the financial report

We have audited the accompanying financial report of Macquarie Bank Limited (the Bank), which comprises the statement of financial position as at 31 March 2011, and the income statement, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for both Macquarie Bank Limited and the Macquarie Bank Group (the Consolidated Entity). The Consolidated Entity comprises the Bank and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the Bank are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001 (Cth)* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001 (Cth)*.

Auditor's opinion

In our opinion:

- a) the financial report of Macquarie Bank Limited is in accordance with the *Corporations Act 2001 (Cth)*, including:
 - (i) giving a true and fair view of the Bank's and Consolidated Entity's financial position as at 31 March 2011 and of their performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001 (Cth)*; and
- b) the financial report and notes also comply with International Financial Reporting Standards as disclosed in note 1.

Independent audit report

To the members of Macquarie Bank Limited

continued



Report on the Remuneration Report

We have audited the Remuneration Report included in pages 8 to 40 of the directors' report for the year ended 31 March 2011. The directors of the Bank are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001 (Cth)*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's opinion

In our opinion, the Remuneration Report of Macquarie Bank Limited for the year ended 31 March 2011, complies with section 300A of the *Corporations Act 2001 (Cth)*.

A handwritten signature in black ink, appearing to read 'DH Armstrong'.

PricewaterhouseCoopers

A handwritten signature in black ink, appearing to read 'DH Armstrong'.

DH Armstrong

Partner

Sydney

29 April 2011

Glossary

AASB	Australian Accounting Standards Board
the Act	<i>Corporations Act 2001 (Cth)</i>
ADI	authorised deposit-taking institution
AGM	Annual General Meeting
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities & Investments Commission
ASX	Australian Securities Exchange or ASX Limited ABN 98 008 624 691 and the market operated by ASX Limited
BAC	Board Audit Committee
the Bank	Macquarie Bank Limited
Banking Group	the Banking Group comprises Banking and Financial Services Group (BFS), Corporate and Asset Finance Group (CAF), Fixed Income, Currencies and Commodities (FICC), Macquarie Funds Group (MFG) and the trading activities of the Macquarie Securities Group (MSG). There is also one division within the Banking Group; Real Estate Banking Division (REB)
the Board	the Board of Voting Directors of Macquarie Bank Limited
BRC	Board Remuneration Committee
BBSW	Australian Financial Association's bank-bill rate, published daily on AAP Reuters page. The Australian equivalent of LIBOR, SIBOR etc.
CAGR	compound annual growth rate
CEO	Chief Executive Officer
CFO	Chief Financial Officer
the Company	Macquarie Bank Limited
the Consolidated Entity	Macquarie Bank Limited and its subsidiaries
CRO	Chief Risk Officer
CVA	credit valuation adjustments
DESOP	Deferred Exercise Share Option Plan
Directors	the Voting Directors of Macquarie Bank Limited (unless the context indicates otherwise)
DPS	Directors' Profit Share
DSU	Deferred Share Unit issued under the MEREP
ECM	Economic Capital Model
EMEA	Europe, Middle East and Africa
EPS	earnings per share
Equity Plan	Macquarie Group Employee Retained Equity Plan
ERL	Equity Risk Limit
ESP	Macquarie Group Employee Share Plan
Executive Key Management Personnel – (Executive KMP)	members of the Executive Committee of Macquarie Bank Limited
FIRB	Foundation Internal Ratings Board Based Approach
FSF	Financial Stability Forum
FX, Forex	Foreign Exchange

IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
Key Management Personnel (KMP)	all Voting Directors and members of the Executive Committee of Macquarie Bank Limited
Macquarie, MGL, Macquarie Group or Group	Macquarie Group Limited and its subsidiaries
Macquarie Bank, MBL	Macquarie Bank Limited ABN 46 008 583 542
Macquarie Board	the Board of Voting Directors of Macquarie Bank Limited
CPS	Macquarie Convertible Preference Securities
Macquarie ordinary shares	Macquarie Group Limited fully paid ordinary shares
Malus	the discretion of the Board (from 2012) to reduce or eliminate unvested profit share amounts where it determines that an employee's action or inaction has caused Macquarie significant reputational harm, caused a significant or unexpected financial loss or caused Macquarie to make a material financial restatement
MBEDSAP	Macquarie Bank Executive Director Share Acquisition Plan
MCR	minimum capital ratio
MEL	Macro-Economic-Linkages
MEREP	Macquarie Group Employee Retained Equity Plan
MFL	Macquarie Finance Limited
MGEDSAP	Macquarie Group Executive Director Share Acquisition Plan
MGESOP	Macquarie Group Employee Share Option Plan
MGSA	Macquarie Group Services Australia Pty Limited
MGSSAP	Macquarie Group Staff Share Acquisition Plan
MIPS	Macquarie Income Preferred Securities
MIS	Macquarie Income Securities
Non-Banking Group	the Non-Banking Group comprises Macquarie Capital and some business activities of MSG, MFG and FICC that use certain offshore regulated entities of the Non-Banking Group
NCD	negotiable certificates of deposit
NCI	non-controlling interests
NED	Non-Executive Director
NEDSAP	Non-Executive Director Share Acquisition Plan
NOHC	non-operating holding company
NPAT	net profit after tax
OECD	Organisation for Economic Co-operation and Development
ORMF	Operational Risk Management Framework
PSU	Performance Share Unit issued under the MEREP

Glossary

PWC	PricewaterhouseCoopers
RMG	Risk Management Group
ROE	return on equity
RPS	retained profit share
RSU	Restricted Share Unit issued under the MEREP
RWA	risk-weighted assets
S&P	Standard & Poor's
SPE	Special Purpose Entity
TSR	total shareholder returns
VaR	Value-at-Risk
Voting Directors	the Voting Directors of Macquarie Bank Limited

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