2011 RISK & CAPITAL REPORT

Incorporating the requirements of APS 330

First Quarter Update

31 December 2010

National Australia Bank

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1. Introduction

The Group, as defined in *Section 2. Scope of Application*, applies the Basel II framework as a cornerstone of its risk management framework and capital strategy, and recognises it is critical for achieving the Group's strategic agenda.

This report provides quarterly information on the following:

- Capital Adequacy - Risk-Weighted Assets ("RWA") and Capital Ratios;
- Credit Risk Exposures;
- Credit Risk Provisions, Impaired and Past Due Facilities; and
- Charges for Specific Provisions and Write-offs.

In Australia, the Australian Prudential Regulation Authority ("APRA") has regulatory responsibility for the implementation of Basel II through the release of prudential standards.

This Risk and Capital Report addresses the requirements of APRA's Pillar 3 public disclosure standard, *Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information* ("APS 330") for the quarter ended 31 December 2010.

All figures are in Australian dollars ("AUD") unless otherwise noted.

The Group's Basel II Methodologies

National Australia Bank Limited and its controlled entities operate in multiple regulatory jurisdictions. The following table sets out the methodologies applied across the Group as at 31 December 2010.

Basel II Approach	Credit Risk	Operational Risk	Non-Traded Market Risk	Traded Market Risk
National Australia Bank Limited	Advanced IRB	AMA	IRRBB	Standardised and IMA
Bank of New Zealand	Advanced IRB	AMA	IRRBB	n/a
Clydesdale Bank PLC	Standardised	Standardised	IRRBB	n/a
Great Western Bank	Basel I	n/a	IRRBB [(1)]	n/a

(1) Calculated using an interim measure.

IRB: Internal Ratings Based approach
AMA: Advanced Measurement Approach
IRRBB: Interest Rate Risk in the Banking Book
IMA: Internal Models Approach

Bank of New Zealand credit risk exposures consolidated in the Group position are calculated under Reserve Bank of New Zealand ("RBNZ") requirements.

Great Western Bank ("GWB") is regulated in the United States of America by the South Dakota Division of Banking, the Federal Deposit Insurance Corporation and the Federal Reserve System. GWB uses Basel I methodology for Credit Risk, which is reported under 'Standardised – Other' for the purposes of calculating the consolidated Group position.

Effective 31 December 2010, IRRBB RWA relating to GWB has been calculated and included in the Group's results. IRRBB for GWB is not calculated using the IRRBB internal model. A proxy measurement basis is currently being used to calculate RWA for GWB.

Disclosure Governance

The Group's external disclosure policy defines Board and management accountabilities for APS 330 disclosure, including processes and practices to ensure the integrity and timeliness of prudential disclosures and compliance with Group policies.

The National Australia Bank Group's Chief Executive Officer attests to the reliability of the Group's APS 330 disclosure within the annual declaration provided to APRA under *Prudential Standard APS 310 Audit and Related Matters*.

Disclosure controls and procedures have been designed and implemented to effectively manage prudential reporting risk.

2. Scope of Application

This disclosure applies to the Level 2 consolidated Group, comprising National Australia Bank Limited (“the Company”) and the entities it controls subject to certain exceptions set out below (“the Group”).

The controlled entities in the Level 2 Group include Bank of New Zealand, Clydesdale Bank PLC and Great Western Bank, and certain other financial entities (e.g. finance companies and leasing companies).

Life insurance and funds management entities activities are excluded from the calculation of Basel II RWA and the related controlled entities are deconsolidated from the National Australia Bank Group for the purposes of calculating capital adequacy. Capital adequacy deductions are applied to the investments in, and profits of, these activities.

In addition, certain securitisation special purpose vehicles (“SPVs”) to which assets have been transferred in accordance with APRA’s requirements as set out in *Prudential Standard APS 120: Securitisation* (“APS 120”) have been deconsolidated from the National Australia Bank Group for the purposes of this disclosure. For regulatory purposes credit risk is removed from the sold assets and there is no requirement to hold capital against them, except to the extent the National Australia Bank Group provides facilities to such SPVs.

Differences arising in consolidation between Regulatory and Accounting approaches

For financial reporting, the National Australia Bank Group applies International Financial Reporting Standards (“IFRS”). Under IFRS the National Australia Bank Group consolidates all entities in which it has the power to govern the financial and operating policies so as to obtain benefit from their activities. This includes life insurance, funds management and securitisation SPVs used to house securitised assets. As noted above, these entities receive a different treatment for Level 2 regulatory consolidation purposes.

A list of material controlled entities included in the consolidated National Australia Bank Group for financial reporting purposes can be found in National Australia Bank Limited’s 30 September 2010 Annual Financial Report.

3. Regulatory Environment

On 16 December 2010, the Basel Committee on Banking Supervision (“BCBS”) released its final capital and liquidity reform package ("Basel III"); a new global regulatory framework developed to:

- Strengthen regulation; financial stability and the banking sector's ability to absorb shocks arising from financial and economic stresses;
- Improve supervision, transparency and disclosure; and
- Improve risk management and governance practices in the banking sector.

Key features of the prudential measures include setting higher and better quality of capital; introducing a new leverage ratio as a backstop to capital and creating two liquidity measures to promote stronger liquidity buffers and resilience to liquidity stresses.

The BCBS also released additional Tier 1 and Tier 2 capital criteria presenting minimum requirements to ensure that all regulatory capital instruments issued by banks are capable of absorbing losses in the event that a bank is unable to support itself in the private market. The additional criteria entitled *“Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability”* was released on 13 January 2011 and will be added to the regulatory framework.

The reforms are to be implemented in Australia in January 2013 by APRA and will be followed by an appropriate transitional period.

The BCBS is also yet to finalise the market risk and securitisation components of the Basel II enhancements. These will be released in early 2011 and are intended to be effective from 1 January 2012. APRA will undertake a process of consultation with the industry on the proposed changes to its regulatory framework during 2011 and 2012.

The Group will continue to actively engage and participate with the industry and the regulator on these initiatives while ensuring it leverages the benefits of these reforms to promote balance sheet strength.

4. Capital

Capital Adequacy [APS 330 Tables 16a – e]

The following table provides the Basel II RWA and capital ratios for the Group.

	As at 31 Dec 10 RWA $m	As at 30 Sep 10 RWA $m
Credit risk [(1)]		
IRB approach		
Corporate (including SME)	120,179	116,128
Sovereign [(2) (3)]	953	1,044
Bank [(3) (4)]	6,813	5,842
Residential mortgage [(4)]	49,917	48,909
Qualifying revolving retail [(4)]	4,120	3,991
Retail SME	9,201	9,174
Other retail	3,762	3,749
Total IRB approach	**194,945**	**188,837**
Specialised lending (SL)	**40,721**	**40,606**
Standardised approach		
Australian and foreign governments [(2) (3)]	40	41
Bank [(3)]	256	270
Residential mortgage	22,247	22,944
Corporate	27,601	29,333
Other	10,164	11,036
Total standardised approach	**60,308**	**63,624**
Other		
Securitisation	10,638	11,103
Equity	1,456	1,342
Other [(5)]	6,672	6,833
Total other	**18,766**	**19,278**
Total credit risk	**314,740**	**312,345**
Market risk	3,281	3,079
Operational risk	22,275	22,234
Interest rate risk in the banking book	9,784	7,000
Total risk-weighted assets	**350,080**	**344,658**

Capital ratios	**%**	**%**
Level 2 Tier 1 capital ratio	8.96%	8.91%
Level 2 total capital ratio	11.15%	11.36%

(1) *RWA which are calculated in accordance with APRA's requirements under Basel II, are required to incorporate a scaling factor of 1.06 to assets that are not subject to specific risk weights.*

(2) *'Sovereign' includes government guaranteed exposures.*

(3) *As at 31 December 2010, the Group held $4.4 billion (September 2010: $5.1 billion) of government guaranteed Financial Institution Debt. This resulted in the application of lower risk weights on these holdings with a reduction in RWA of $1.0 billion (September 2010: $1.2 billion) and an effective increase in Tier 1 capital ratio of 0.03% (September 2010: 0.03%) and Total capital ratio of 0.03% (September 2010: 0.04%). This debt is assessed in accordance with normal credit approval processes. While the Australian Government guarantee shall remain for existing Financial Institution Debt guaranteed under the scheme, the Australian Federal Government revoked this arrangement for new issuance from 31 March 2010.*

(4) *For IRB approach: 'Bank' includes ADIs, overseas banks and non-commercial public sector entities. 'Residential mortgages' includes exposures that are partly or fully secured by residential properties. 'Qualifying revolving retail' exposures are revolving, unsecured and unconditionally cancellable (both contractually and in practice), for individuals and not explicitly for business purposes.*

(5) *'Other' includes non-lending asset exposures that are not covered in the above categories. Non-lending assets are specifically excluded from credit risk exposures shown on pages 4 to 7 of this report*

5. Credit Risk Exposures

Total Gross Credit Risk Exposures [APS 330 Table 17a]

This table provides the amount of gross credit risk exposure subject to the Standardised and Advanced IRB approaches. The Group has no credit risk exposures subject to the Foundation IRB approach. Gross credit risk exposure refers to the potential exposure as a result of a counterparty default prior to the application of credit risk mitigation. It is defined as the outstanding amount on drawn commitments plus a credit conversion factor on undrawn commitments on a given facility. For derivatives, the exposure is defined as the mark-to-market value plus a potential value of future movements.

For the IRB approach, Exposure at Default ("EaD") is reported gross of specific provisions and partial write-offs and prior to the application of on-balance sheet netting and credit risk mitigation. For the Standardised approach, EaD is reported net of any specific provision and prior to the application of on-balance sheet netting and credit risk mitigation. Exposures exclude non-lending assets, equities and securitisation.

	As at 31 Dec 10			
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Total exposures
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	111,826	44,770	20,513	**177,109**
Sovereign	17,586	666	8,144	**26,396**
Bank	25,190	997	41,262	**67,449**
Residential mortgage	200,531	33,327	-	**233,858**
Qualifying revolving retail	5,401	5,104	-	**10,505**
Retail SME	15,967	4,110	-	**20,077**
Other retail	3,459	1,202	-	**4,661**
Total IRB approach	**379,960**	**90,176**	**69,919**	**540,055**
Specialised lending (SL)	**39,257**	**5,907**	**707**	**45,871**
Standardised approach				
Australian and foreign governments	3,323	166	-	**3,489**
Bank	5,466	3	1,502	**6,971**
Residential mortgage	36,386	2,286	-	**38,672**
Corporate	22,704	4,576	811	**28,091**
Other	9,798	1,098	-	**10,896**
Total standardised approach	**77,677**	**8,129**	**2,313**	**88,119**
Total exposure (EaD)	**496,894**	**104,212**	**72,939**	**674,045**

	As at 30 Sep 10			
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	110,822	41,698	15,666	**168,186**
Sovereign	14,900	733	9,654	**25,287**
Bank	20,815	1,210	42,984	**65,009**
Residential mortgage	193,780	32,727	-	**226,507**
Qualifying revolving retail	5,125	5,152	-	**10,277**
Retail SME	16,267	3,914	-	**20,181**
Other retail	3,422	1,207	-	**4,629**
Total IRB approach	**365,131**	**86,641**	**68,304**	**520,076**
Specialised lending (SL)	**40,361**	**6,027**	**1,045**	**47,433**
Standardised approach				
Australian and foreign governments	3,684	180	-	**3,864**
Bank	6,030	3	1,580	**7,613**
Residential mortgage	37,769	2,386	-	**40,155**
Corporate	23,950	4,806	1,044	**29,800**
Other	10,608	1,170	-	**11,778**
Total standardised approach	**82,041**	**8,545**	**2,624**	**93,210**
Total exposure (EaD)	**487,533**	**101,213**	**71,973**	**660,719**

Average Credit Risk Exposures [APS 330 Table 17a]

The average credit risk exposure is the sum of the gross credit risk exposure at the beginning of the reporting period plus the gross credit risk exposure at the end of the reporting period divided by two.

	3 months ended 31 Dec 10			
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Average total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	111,324	43,234	18,089	**172,647**
Sovereign	16,243	699	8,899	**25,841**
Bank	23,003	1,103	42,123	**66,229**
Residential mortgage	197,156	33,027	-	**230,183**
Qualifying revolving retail	5,263	5,128	-	**10,391**
Retail SME	16,117	4,012	-	**20,129**
Other retail	3,440	1,205	-	**4,645**
Total IRB approach	**372,546**	**88,408**	**69,111**	**530,065**
Specialised lending (SL)	**39,809**	**5,967**	**876**	**46,652**
Standardised approach				
Australian and foreign governments	3,503	173	-	**3,676**
Bank	5,748	3	1,541	**7,292**
Residential mortgage	37,078	2,336	-	**39,414**
Corporate	23,327	4,691	928	**28,946**
Other	10,203	1,134	-	**11,337**
Total standardised approach	**79,859**	**8,337**	**2,469**	**90,665**
Total exposure (EaD)	**492,214**	**102,712**	**72,456**	**667,382**

	6 months ended 30 Sep 2010			
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Average total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	117,576	41,554	14,754	**173,884**
Sovereign	13,934	732	9,074	**23,740**
Bank	20,823	1,384	44,782	**66,989**
Residential mortgage	187,826	32,245	-	**220,071**
Qualifying revolving retail	5,141	5,057	-	**10,198**
Retail SME	15,021	3,544	-	**18,565**
Other retail	3,458	1,235	-	**4,693**
Total IRB approach	**363,779**	**85,751**	**68,610**	**518,140**
Specialised lending (SL)	**35,386**	**5,205**	**868**	**41,459**
Standardised approach				
Australian and foreign governments	3,136	179	-	**3,315**
Bank	5,967	168	3,271	**9,406**
Residential mortgage	37,173	2,329	-	**39,502**
Corporate	24,659	4,472	866	**29,997**
Other	9,101	746	-	**9,847**
Total standardised approach	**80,036**	**7,894**	**4,137**	**92,067**
Total exposure (EaD)	**479,201**	**98,850**	**73,615**	**651,666**

6. Credit Provisions and Losses

Credit Risk Provisions [APS 330 Table 17b – c]

The following tables set out credit risk provision information by Basel II asset class, excluding non-lending assets, equities and securitisation. Definitions of impairment and past due facilities are based on APRA Prudential Standard APS 220: Credit Quality and related guidance notes. The determination of specific provisions is in accordance with APRA Guidance Note AGN 220.2: Impairment, Provisioning and the General Reserve for Credit Losses. Impaired facilities are disclosed in accordance with APRA's definition of impaired facilities under Guidance Note AGN 220.1: Impaired Asset Definitions paragraph 7.

	As at 31 Dec 10			3 months ended 31 Dec 10	
	Impaired facilities (1)	Past due facilities ≥90 days (2)	Specific provisions (3)	Charges for specific provisions	Net Write-offs
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	2,586	397	714	114	85
Sovereign	-	-	-	-	-
Bank	37	-	37	-	-
Residential mortgage	574	920	137	27	23
Qualifying revolving retail	-	58	-	48	48
Retail SME	164	136	88	13	16
Other retail	14	38	5	16	14
Total IRB approach	**3,375**	**1,549**	**981**	**218**	**186**
Specialised lending (SL)	**1,229**	**166**	**321**	**45**	**89**
Standardised approach					
Australian and foreign governments	-	-	-	-	-
Bank	-	-	-	-	-
Residential mortgage	88	176	13	1	1
Corporate	1,226	211	152	92	80
Other (4)	67	283	16	44	46
Total standardised approach	**1,381**	**670**	**181**	**137**	**127**
Total	**5,985**	**2,385**	**1,483**	**400**	**402**
Additional regulatory specific provisions (3)			506		
General reserve for credit losses (5)			2,859		

(1) *Impaired facilities includes $223 million of restructured loans (September 2010: $239 million). These loans represent facilities which have been classified as restructured for reasons relating to the financial difficulty of the counterparty.*

Impaired facilities includes $273 million of gross impaired fair value assets (September 2010: $284 million).

In the United States there is US$132 million (September 2010: US$133 million) of "Other Real Estate Owned" assets where the Group assumed ownership or foreclosed in the settlement of debt. Of this amount, US$111 million (September 2010: US$111 million) is covered by the Federal Deposit Insurance Corporation ("FDIC") Loss Sharing Agreement, where the FDIC will absorb 80% of losses arising in recovery of these assets. The real estate assets are included in other assets on the Group's balance sheet and are not included as impaired facilities.

(2) *Past due facilities ≥ 90 days includes $9 million of fair value assets (September 2010: $5 million).*

(3) *Specific provisions for prudential purposes include all provisions for impairment assessed on an individual basis in accordance with IFRS excluding securitisation. All collective provisions on defaulted or otherwise non-performing assets, regardless of expected loss, such as those for 90+ days past due retail and in default with no loss non-retail exposures, have been reported as additional regulatory specific provisions and shown in this report as a separate item.*

Specific provisions includes $98 million (September 2010: $115 million) of gross impaired fair value assets.

(4) *Great Western Bank, as a result of the acquisition of certain assets of TierOne Bank in June 2010, had past due facilities ≥ 90 days of $236 million as at December 2010 (September 2010: $228 million). There is an agreement with the FDIC where the FDIC absorbs 80% of credit losses arising on the majority of the loan portfolio and related assets acquired from TierOne Bank. This agreement excludes approximately US$127 million in agricultural loans and US$44 million in consumer loans, as at June 2010, from the total lending portfolio.*

(5) *The General Reserve for Credit Losses ("GRCL") at 31 December 2010 is calculated as follows:*

	$m
Collective provision for doubtful debts	*3,551*
Less collective provisions for securitisation and management overlay for conduit assets and derivatives	*(160)*
Less collective provisions reported as additional regulatory specific provisions	*(506)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (pre-tax basis)	*2,885*
Less tax effect	*(718)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (after-tax basis)	*2,167*
Plus reserve created through a deduction from retained earnings	*692*
General reserve for credit losses (after-tax basis)	*2,859*

Exposure type	As at 30 Sep 10 Impaired facilities $m	Past due facilities ≥90 days $m	Specific provisions $m	6 months ended 30 Sep 10 Charges for specific provisions $m	Write-offs $m
IRB approach					
Corporate (including SME)	2,487	299	702	336	439
Sovereign	-	-	-	-	-
Bank	37	-	37	-	5
Residential mortgage	599	988	132	56	64
Qualifying revolving retail	-	60	-	94	103
Retail SME	165	132	89	43	54
Other retail	10	39	5	58	54
Total IRB approach	**3,298**	**1,518**	**965**	**587**	**719**
Specialised lending (SL)	**1,334**	**150**	**367**	**262**	**193**
Standardised approach					
Australian and foreign governments	-	-	-	-	-
Bank	-	-	-	-	-
Residential mortgage	76	191	13	6	2
Corporate	1,240	227	154	250	269
Other	71	280	21	52	39
Total standardised approach	**1,387**	**698**	**188**	**308**	**310**
Total	**6,019**	**2,366**	**1,520**	**1,157**	**1,222**

Additional regulatory specific provisions	471
General reserve for credit losses (1)	2,826

(1) *The General Reserve for Credit Losses ("GRCL") at 30 September 2010 is calculated as follows:*

	$m
Collective provision for doubtful debts	*3,570*
Less collective provisions for securitisation and management overlay for conduit assets and derivatives	*(170)*
Less collective provisions reported as additional regulatory specific provisions	*(471)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (pre-tax basis)	*2,929*
Less tax effect	*(801)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (after-tax basis)	*2,128*
Plus reserve created through a deduction from retained earnings	*698*
General reserve for credit losses (after-tax basis)	*2,826*

7. Glossary

Term	Description
ADI	Authorised Deposit-taking Institution ("ADI") as defined by APRA, and authorised by APRA to take deposits from customers.
Advanced IRB approach	The Advanced Internal Ratings Based ("IRB") approach refers to the processes employed by the Group to estimate credit risk. This is achieved through the use of internally developed models to assess potential credit losses using the outputs from the PD, LGD and EaD models.
APRA	The Australian Prudential Regulation Authority ("APRA") is the prudential regulator of the Australian financial services industry. APRA has defined its Basel II requirements in a series of ADI Prudential Standards ("APS").
Company	National Australia Bank Limited ABN 12 004 044 937.
EaD	Exposure at Default ("EaD") is an estimate of the total committed credit exposure expected to be drawn at the time of default for a customer or facility that the Group would incur in the event of a default. It is used in the calculation of RWA.
Foundation IRB	Foundation Internal Ratings Based ("FIRB") approach refers to an alternative approach to Advanced IRB for non-retail credit risk defined under Basel II where a Group develops its own PD models and seeks approval from its regulator to use these in the calculation of regulatory capital, and the regulator provides a supervisory estimate for LGD and EaD.
Group	The Level 2 Group, being the Company and the entities it controls subject to certain exceptions set out in *Section 2 Scope of Application*.
IRRBB	Interest Rate Risk in the Banking Book ("IRRBB") quantifies the inherent risk arising from the Group's banking operations as a result of movements in interest rates. This also includes the impact of differing maturities between assets and liabilities. Quantification of the resulting risk is used in determining capital adequacy.
LGD	Loss Given Default ("LGD") is an estimate of the expected severity of loss for a credit exposure following a default event. Regulatory LGDs reflect a stressed economic condition at the time of default. It is used in the calculation of RWA.
PD	Probability of Default ("PD") is an estimate of the likelihood of a customer defaulting or not repaying their borrowings and other obligations to the Group within the next 12 months.
SME	Small and medium-sized entities.
Standardised approach	Standardised refers to an alternative approach to the assessment of risk (notably credit and operational) whereby the institution uses external rating agencies to assist in assessing credit risk and/or the application of specific values provided by regulators to determine RWA.

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