

2014 Pillar 3 Report

**Incorporating the
requirements of APS 330
as at 30 September 2014**



**National
Australia
Bank**

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1. Introduction

National Australia Bank Limited (ABN 12 004 044 937) (NAB) applies the Basel framework as a cornerstone of the NAB Group's risk management framework and capital strategy, and recognises that it is critical for achieving the NAB Group's strategic agenda.

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

This Pillar 3 Report is designed to provide the NAB Group's stakeholders with detailed information about the approach the NAB Group takes to manage risk and to determine capital adequacy, having regard to the operating environment. The report also addresses the requirements of APRA's *Prudential Standard APS 330: Public Disclosure (APS 330)*.

All figures in this report are in Australian dollars (AUD) unless otherwise noted. Disclosures in this Report are based on the APRA Basel III standards that apply from 1 January 2013, except for market risk Risk-Weighted Assets (RWA) that are calculated on a Basel 2.5 basis for each period presented.

Capital Ratio Summary

The NAB Group's Common Equity Tier 1 (CET1) capital ratio of 8.63% at 30 September 2014 is consistent with the NAB Group's objective of maintaining a strong capital position.

Capital ratios (Level 2)	As at	
	30 Sep 14	31 Mar 14
	%	%
Common Equity Tier 1	8.63	8.64
Tier 1	10.81	10.83
Total	12.16	12.17

The NAB Group remains responsive to economic conditions and continues to maintain strong balance sheet settings. These settings enable the NAB Group to operate effectively through difficult market conditions and ensure that it is well positioned for future regulatory change and balance sheet growth.

1.1 The NAB Group's Capital Adequacy Methodologies

The NAB Group operates in Australia, Asia, New Zealand, the United Kingdom and North America. The following table sets out the approach to the Basel Accord, which is applied across the NAB Group as at 30 September 2014.

The NAB Group's Basel Methodologies

Methodology 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	Standardised and IMA
Clydesdale Bank PLC	Standardised	Standardised	IRRBB	n/a
Great Western Bank	Standardised	Standardised	IRRBB	n/a

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 (BNZ) is regulated by the Reserve Bank of New Zealand (RBNZ). Credit risk exposures consolidated in the NAB Group position are calculated under RBNZ requirements.

Clydesdale Bank plc (Clydesdale), NAB's main operating subsidiary in the United Kingdom, is regulated by the Prudential Regulation Authority (PRA). Clydesdale has been accredited to apply the standardised approach to operational and credit risk management in accordance with regulatory requirements. Credit risk exposures and operational risk RWA consolidated in this report are calculated under APRA 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 credit risk and operational risk RWA are subject to APRA Basel standardised methodology.

1.2 APS 330 Disclosure Governance

The NAB Group Disclosure and External Communications 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 NAB Group policies.

The NAB Group's Chief Executive Officer (Group CEO) attests to the reliability of the NAB Group's APS 330 disclosures within the annual declaration provided to APRA under *Prudential Standard APS 310: Audit and Related Matters*.

1.3 Regulatory Reform

Basel Regulatory Reforms

APRA finalised its liquidity standard *Prudential Standard APS 210: Liquidity* during the year which provided certainty in the Group's continued transition towards compliance.

The Group's Basel III liquidity transition strategy is focused on the quality of liquid assets and the stability of the funding that underpins the Liquidity Coverage Ratio (LCR).

The qualitative aspects of this standard came into force on 1 January 2014, while compliance with the LCR is set to commence from 1 January 2015.

The availability of the Reserve Bank of Australia's Committed Liquidity Facility remains central to APRA's liquidity standard.

Other Reform Proposals

The Group also remains focused on other areas of regulatory change. Key reform proposals that may affect its capital and funding include:

- On 5 May 2014, the Group announced that it had received notification from APRA regarding the definition of entities to be included within the composition of a Level 2 Authorised Deposit-Taking Institution (ADI) group. The change is expected to remove over time the capital benefit that NAB gains from the debt on the National Wealth Management Holdings (NWMH) balance sheet. As of 30 September 2014, NWMH has \$1.75 billion of debt outstanding, which is equivalent to 47 basis points of CET1 capital. This is \$225 million lower than at 31 March 2014, in line with the APRA approved transition period, which will allow the capital benefit of the majority of the outstanding debt to be progressively reduced through to December 2017
- APRA's announcement of Level 3 Conglomerate Supervision requirements, which include a Level 3 prudential capital requirement. Final standards were released by APRA in August 2014 and the implementation date has been deferred, pending the release of recommendations from the Australian Federal Government's Financial System Inquiry. APRA has confirmed a minimum 12 month transition period will be provided once an implementation date is established, and has stated that quantitative impact analysis suggests that no potential Level 3 Group would be required to raise additional capital as a result of the implementation of the proposed Level 3 framework
- APRA's consultation earlier this year on revisions to *Prudential Standard APS 120: Securitisation (APS 120)*, which is aimed at moving towards a more flexible and principles based securitisation framework in Australia
- The Basel Committee on Banking Supervision (BCBS) endorsement of the leverage ratio framework and associated disclosure requirements, with migration to Pillar 1 treatment from 1 January 2018. APRA commenced consultation on the implementation of the leverage disclosure requirements, in conjunction with proposed public disclosure for LCR and the Global Systemically Important Banks indicators in September 2014. APRA is proposing compliance with the leverage ratio disclosure requirements from the date of lodgement of the ADI's first financial report, on or after 1 January 2015
- The Australian Federal Government's Financial System Inquiry (Inquiry) which is charged with examining how Australia's financial system could be positioned to support evolving needs and economic growth. Both capital and funding are key considerations of the Inquiry, and recommendations for Government consideration are due to be released in November 2014
- The enhanced prudential requirements for foreign banking organisations under Title I of the *US Dodd-Frank Act*. The final rule is due to take effect in July 2016
- The UK Government's Financial Services (Bank Reform) Act was approved by the UK Parliament in December 2013. The Act is due to come into force on 1 January 2019. Amongst other requirements, it seeks to protect deposit holders and will affect the structure and the amount of capital held by many UK banks. As Clydesdale is a retail bank, the proposed ring-fencing of retail banking (away from investment banking) is expected to be less onerous than for most large UK banks
- The European Union's final rules to implement Basel III were implemented in the UK from 1 January 2014. This implementation affects the Group's UK based businesses, principally Clydesdale. The UK business has noted the changes in capital requirements under the implementation of Basel III and will work with the regulator to ensure it continues to meet capital requirements.

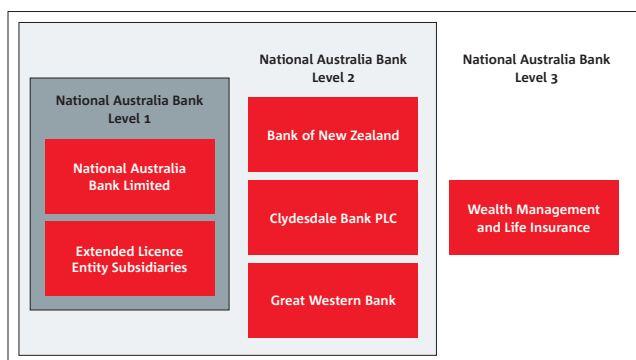
2. Scope of Application

APRA measures the NAB Group's capital adequacy by assessing financial strength at three levels:

- Level 1: comprises NAB and its subsidiary entities approved by APRA as part of the Extended Licensed Entity (ELE)
- Level 2: comprises NAB and the entities it controls, subject to certain exceptions set out below
- Level 3: comprises the conglomerate NAB Group.

This report applies to the Level 2 consolidated group (the Level 2 Group).

NAB Group Consolidation for Regulatory Purposes



The controlled entities in the Level 2 Group include BNZ, Clydesdale, GWB and other financial entities (e.g. finance companies and leasing companies).

Wealth management and life insurance activities are excluded from the calculation of RWA and the related controlled entities are deconsolidated from the Level 2 Group for the purposes of calculating capital adequacy. Capital adequacy deductions are applied to the investments in, and profits of, these activities. NWMH has not been treated as part of the Level 2 Group for the purposes of this report.

In addition, certain securitisation special purpose vehicles (SPVs) to which assets have been transferred in accordance with APRA's requirements as set out in *APS 120* have been deconsolidated from the Level 2 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.

Differences in Consolidation Arising Between the Regulatory and Accounting Approaches

For financial reporting, the NAB Group applies International Financial Reporting Standards (IFRS) and 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 NAB Group for

financial reporting purposes can be found in the Company's 30 September 2014 Annual Financial Report.

Restrictions on the Transfer of Funds and Regulatory Capital within the NAB Group

Limits are placed on the level of capital and funding transfers and on the level of exposure (debt and equity) that the NAB Group may have to a related entity. These limits are subject to the NAB Group Balance Sheet and Liquidity Risk (GBSLR) Policy which requires that contagion risk be managed under regulatory requirements (*Prudential Standard APS 222 Associations with Related Entities*) and the Board's risk appetite for intra-group exposures.

Each banking subsidiary works with the NAB Group to manage capital to target capital ranges approved by their local Boards. Any capital transfer is subject to maintaining adequate subsidiary and parent company capitalisation.

Disclosure 2A: Scope of Application

There were no capital deficiencies in non-consolidated subsidiaries of the NAB Group as at 30 September 2014 or 31 March 2014.

Clydesdale Bank plc

Clydesdale is a wholly owned subsidiary of NAB and operates as a regionally autonomous retail and business bank in the United Kingdom. It applies the provisions laid down in the UK PRA's requirements *BIPRU 2.1 Solo Consolidation Waiver*. This enables some intra-group exposures and investments of Clydesdale in its subsidiaries to be eliminated and the free reserves of such subsidiaries to be aggregated when calculating capital resource requirements of Clydesdale.

Bank of New Zealand

BNZ is a wholly owned subsidiary of NAB and operates as a regionally autonomous, full-service bank in New Zealand. The BNZ Board is responsible for corporate governance and derives its authority from the Constitution of BNZ and applicable New Zealand legislation.

BNZ is subject to the Basel Accord capital adequacy requirements applicable in New Zealand, mandated by the RBNZ. The capital ratios for BNZ presented in this report have been derived under the RBNZ's Capital Adequacy Framework (Internal Models Based Approach). Full Basel disclosures for BNZ are published separately under the Disclosure Statement regime applicable to banks incorporated in New Zealand.

Great Western Bank

GWB credit risk and operational risk RWA are subject to APRA Basel standardised methodology.

On 15 October 2014, the Group sold a minority stake (31.8%) in its US-based business GWB through an initial public offering of shares in the US. The Group plans to sell 100% of the GWB business over time, subject to market conditions.

3. Risk Governance and Management

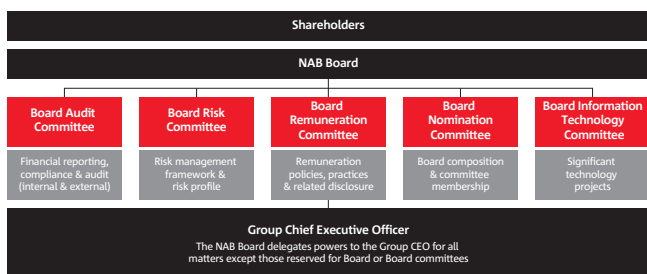
The NAB Group has a transparent and robust corporate governance structure and supporting processes to meet the needs and expectations of the NAB Group's shareholders and broader stakeholders.

The corporate governance structure provides guidance for effective decision-making in all areas of the NAB Group through:

- strategic and operational planning
- risk management and compliance
- financial management and external reporting
- succession planning and culture.

It also plays a key role in supporting the NAB Group's business operations and provides clear guidance on how authority is exercised.

A diagram of the corporate governance structure is shown below.



Board Governance

The NAB Board (the Board) represents NAB's shareholders and is responsible for directing and overseeing the NAB Group's affairs. Its central role is to create and deliver value by effectively governing the NAB Group, while meeting the interests of shareholders and other stakeholders through transparent reporting and active engagement.

The Board determines the most appropriate corporate governance practices for the NAB Group and is supported by a number of committees, including the Audit, Risk, Remuneration, Nomination, and Information Technology committees.

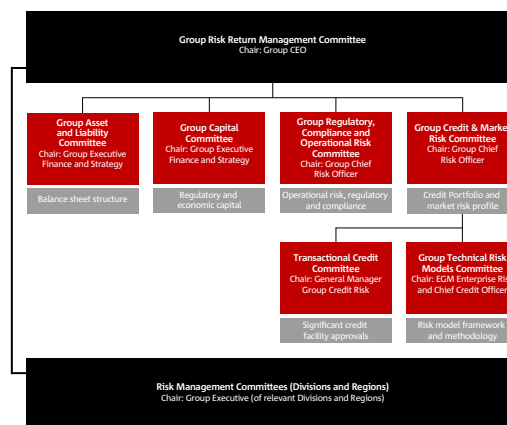
The Principal Board Risk Committee (PBRC) supports the framework for risk management across the NAB Group by:

- overseeing the risk profile and risk management of the NAB Group within the context of the Board determined risk appetite
- making recommendations to the Board concerning the NAB Group's risk appetite and particular risks or risk management practices
- reviewing management's plans for mitigation of material risks faced by the NAB Group
- overseeing the implementation and review of risk management and internal compliance and control systems throughout the NAB Group
- promoting awareness of a risk-based culture and the achievement of a balance between risk and reward for risks accepted.

Executive Governance

Outside the authorities and powers reserved by the Board, the Group CEO is responsible for the management and operations of the NAB Group. Key management decisions below Board level are made by the Group CEO with support from management committees and individual members of management who hold delegated authority.

At an executive level, risk is overseen by the Group CEO through the Group Risk Return Management Committee (GRRMC) and its supporting sub-committees. Additionally, each First Line division has a risk management committee, chaired by the relevant NAB Group Executive, to support it in executing their risk management accountabilities. A diagram of the Group's executive risk committee structure is shown below.



Second Line risk specialists are embedded in the organisation structure (for example, as members of divisional Risk Management Committees and Executive Management Committees) to ensure that a risk and compliance lens is applied to executive decision making.

Risk Management

Risk exists in all aspects of the NAB Group's business and the environment in which it operates. Risk is identified and managed as part of a Group-wide Risk Management Framework that starts with the Board approved strategy, Risk Appetite, Capital, Funding and Operational Plans. Risk Appetite is translated and cascaded to businesses qualitatively (through risk policies, standards and operating procedures) and quantitatively (through our risk limits, settings and decision authorities).

Compliance with the NAB Group's Risk Management Framework is non-negotiable. The NAB Group's operating model differentiates accountabilities using the Three Lines of Defence Model as follows:

- first line: Management (who owns the risks)
- second line: Risk (who establish frameworks and provide insight, oversight and appetite)
- third line: Internal Audit (who provide independent assurance).

Further details of risks associated with the NAB Group are set out in in the NAB 30 September 2014 Annual Financial Report.

4. Capital

4.1 Capital Adequacy

Capital Objectives

The NAB Group assesses capital adequacy to support its overarching capital management objectives:

- a credit rating in the AA range
- meeting regulatory capital requirements
- meeting internal economic capital requirements
- maintaining flexibility to deal with unexpected events
- efficiency in the amount and type of capital
- effective deployment of capital.

Risk Identification and Measurement

The process of assessing capital adequacy begins with the identification of all the material risks of the NAB Group within the Group Risk Inventory (GRI). The GRI includes consistent definitions and the approach to measurement, including for capital adequacy purposes.

The NAB Group measures all material risks and where appropriate, generates a capital adequacy requirement. In managing the business, the NAB Group considers both regulatory and economic capital requirements.

	Regulatory Capital	Economic Capital
Purpose	Regulatory view of the capital required to be held to protect against risks associated with business activities.	Management's view of the capital required to be held to support the specific risk characteristics of the business and its portfolio.
Calculation	Driven by RWA which is calculated under regulatory requirements.	Internal risk-based models.
Risk types	Credit risk, market risk, operational risk and interest rate risk in the banking book.	As per regulatory capital requirements, plus other material risks, including defined-benefit pension risk and business/strategic risk.

Capital Planning

Along with the Risk Appetite Statement, the Capital Management Plan is an integral part of the NAB Group's strategic planning process which considers how the NAB Group will meet its capital requirements over a three-year plan period. The Capital Management Plan covers the NAB Group's:

- capital outlook, including capital forecast
- risks and potential upsides to the forecast
- capital initiatives over the plan period
- dividend outlook and sustainability
- profits test obligations
- other strategic initiatives.

In addition to a base case, the planning process also considers stressed scenarios and sensitivities to ensure the NAB Group maintains capital adequacy in these situations and adjusts plans if these stress tests highlight a need to. Within certain risk categories, the NAB Group performs regular sensitivity and stress tests across material models and businesses to test the veracity of assumptions and to determine the sensitivity of key risk measures (including capital) to management actions and potential changes in the external environment. The NAB

Group then develops plans to mitigate risks in the event of a stressed scenario.

The Board sets capital targets above the internal risk-based assessment of capital. Target ranges are set by reference to factors such as the NAB Group's Risk Appetite Statement, market, regulatory and rating agencies expectations. The NAB Group's current CET1 ratio target is above 7.5% and the NAB Group operates at a buffer to this target. More recently, the NAB Group's CET1 target has been revised to operate between 8.75% and 9.25% from 1 January 2016 to reflect the new Higher Loss Absorbency requirement of 1% announced by APRA in December 2013, which applies to the NAB Group following APRA's confirmation that NAB is a Domestic Systemically Important Bank. The NAB Group will continue to regularly review its operating target levels and aims to retain flexibility in executing capital initiatives. These targets reflect the NAB Group's desire to support balance sheet strength and are consistent with investor risk appetite and global regulatory direction. The NAB Group continues to operate at a comfortable buffer to the Board target.

APRA advises the NAB Group of its Prudential Capital Requirements (PCR) which represent the minimum ratios of regulatory capital to total RWA. The PCRs are not publicly disclosed.

The NAB Group's capital position is monitored on a monthly basis and reported to management and Board committees.

Embedding Capital Requirements in Business Decisions

Capital requirements are taken into consideration in:

- product and facility pricing decisions
- business development, including acquisitions
- strategy and strategic planning
- performance measurement and management, including short and long-term incentive determination
- setting of risk appetite and risk limits, including large exposure limits, industry limits and country limits.

Governance, Reporting and Oversight

A number of risks exist in the management of the NAB Group's capital position which, if not appropriately managed, could lead to the NAB Group not holding sufficient capital and reserves to achieve its strategic aspirations, cover the risks to which it is exposed and protect against unexpected losses.

The annual Internal Capital Adequacy Assessment Process (ICAAP) describes the NAB Group's framework for assessing its capital adequacy. Key features include:

- understanding risks and how capital is used to mitigate these
- capital management
- use of capital in the business
- risk appetite and planning process
- capital adequacy assessment on current and forward looking basis, including the impact of stress and scenario testing.

The NAB Group's ICAAP document, Capital Management Plan, Risk Appetite Statement and Strategic Plan cover the governance, reporting and oversight of the NAB Group's capital adequacy. These documents and plans are reviewed and endorsed by key management committees, including the Group Capital Committee (GCC), the Group Asset and Liability Committee (GALCO) and the GRRMC, and are ultimately approved by the Board.

The ICAAP is also supported by the NAB's GBSLR Policy which defines the framework for the management, monitoring and governance of the NAB Group's capital position. The framework is built around the Board's guiding principles, including preserving the NAB Group's credit rating, maintaining capital adequacy and an efficient capital mix.

Group Treasury is responsible for managing capital risk. The NAB Group and subsidiary Treasuries prepare the Capital Management Plan (incorporating capital targets) and execute the Board-approved strategies outlined in the Capital Management Plan.

GBSLR is responsible for capital oversight and is independent of Treasury. GBSLR maintains a risk framework for effective oversight, supports stress testing of the NAB Group's capital position, supports capital planning and forecasting, and monitors capital activities to ensure compliance with the requirements of the NAB Group's capital framework.

Table 4.1A: Risk-Weighted Assets

The following table provides the Basel Accord RWA for the Level 2 Group.

	As at	
	30 Sep 14	31 Mar 14
	RWA	RWA
	\$m	\$m
Credit risk ⁽¹⁾		
IRB approach		
Corporate (including SME) ⁽²⁾	111,078	106,555
Sovereign	1,608	1,690
Bank	11,341	12,998
Residential mortgage	58,274	60,301
Qualifying revolving retail	3,641	3,649
Retail SME	6,165	6,476
Other retail	3,255	3,467
Total IRB approach	195,362	195,136
Specialised lending (SL)	52,542	52,514
Standardised approach		
Australian and foreign governments	86	68
Bank	107	156
Residential mortgage	18,773	18,790
Corporate	25,451	23,971
Other	3,298	3,172
Total standardised approach	47,715	46,157
Other		
Securitisation	4,210	5,868
Credit value adjustment	10,340	10,221
Central counterparty default fund contribution guarantee	344	220
Other ⁽³⁾	7,861	8,223
Total other	22,755	24,532
Total credit risk	318,374	318,339
Market risk	4,923	5,791
Operational risk	36,534	36,280
Interest rate risk in the banking book	7,821	6,814
Total risk-weighted assets	367,652	367,224

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

⁽²⁾ Corporate (including SME) consists of corporations, partnerships or proprietorships not elsewhere classified and includes non-banking entities held by banks.

⁽³⁾ 'Other' includes non-lending asset exposures and, from September 2013, an RBNZ overlay adjustment required to maintain a minimum risk profile of the NZ Agri portfolio.

Table 4.1B: Capital Ratios

The table below provides the key capital ratios for each significant ADI or overseas bank subsidiary.

Capital ratios ⁽¹⁾	As at	
	30 Sep 14	31 Mar 14
	%	%
Level 2 Common Equity Tier 1 Capital ratio	8.63	8.64
Level 2 Tier 1 Capital ratio	10.81	10.83
Level 2 Total Capital ratio	12.16	12.17
Level 1 National Australia Bank Common Equity Tier 1 Capital ratio	9.90	9.60
Level 1 National Australia Bank Tier 1 Capital ratio	12.27	11.99
Level 1 National Australia Bank Total Capital ratio	13.70	13.40
Significant subsidiaries		
BNZ Common Equity Tier 1 Capital ratio	9.36	9.13
BNZ Tier 1 Capital ratio	10.64	10.58
BNZ Total Capital ratio	12.04	12.13
Clydesdale Common Equity Tier 1 Capital ratio	12.16	13.39
Clydesdale Tier 1 Capital ratio	12.16	13.39
Clydesdale Total Capital ratio	18.77	19.67
GWB Tier 1 Capital ratio	12.30	12.90
GWB Total Capital ratio	13.01	13.64

⁽¹⁾ Level 1 Group represents the extended licence entity. The Level 2 Group represents the consolidation of the NAB Group and all its subsidiary entities, other than non-consolidated subsidiaries as outlined in Section 2 Scope of Application of this report. Capital ratios for offshore banking subsidiaries reflect local regulatory standards.

4.2 Capital Structure

The NAB Group's capital structure comprises various forms of capital. CET1 Capital comprises of paid-up ordinary share capital, retained earnings plus certain other items recognised as capital. The ratio of such capital to risk weighted assets is called the CET1 Ratio. Additional Tier 1 Capital comprises certain securities with required loss absorbing characteristics. Together, these components of capital make up Tier 1 Capital and the ratio of such capital to risk-weighted assets is called the Tier 1 Capital Ratio.

CET1 contains the highest quality and most loss absorbent components of capital, followed by Additional Tier 1 Capital and then followed by Tier 2 Capital. Tier 2 Capital mainly comprises of subordinated instruments, which contributes to the overall capital framework.

Further details of Additional Tier 1 and Tier 2 securities are disclosed in the Capital Instruments section of the NAB Group's website at: <http://capital.nab.com.au/disclaimer-area/capital-instruments.phps>.

Table 4.2A: Regulatory Capital Structure - Summary ⁽¹⁾

The table below provides the structure of Regulatory Capital for the NAB Group. A detailed breakdown is shown in Section 10 of this report.

	As at	
	30 Sep 14	31 Mar 14
	\$m	\$m
Common Equity Tier 1 Capital before regulatory adjustments	44,318	43,767
Total regulatory adjustments to Common Equity Tier 1	12,604	12,031
Common Equity Tier 1 Capital (CET1)	31,714	31,736
Additional Tier 1 Capital before regulatory adjustments	8,044	8,041
Total regulatory adjustments to Additional Tier 1 capital	-	3
Additional Tier 1 Capital (AT1)	8,044	8,038
Tier 1 capital (T1 = CET1 + AT1)	39,758	39,774
Tier 2 Capital before regulatory adjustments	5,046	5,097
Total regulatory adjustments to Tier 2 Capital	83	192
Tier 2 Capital (T2)	4,963	4,905
Total Capital (TC = T1 + T2)	44,721	44,679

⁽¹⁾ Regulatory Capital has been calculated in accordance with APRA definitions in Prudential Standard APS 111 Capital Adequacy: Measurement of Capital. The regulatory approach to calculating capital differs from the accounting approach as defined under IFRS.

5. Credit Risk

5.1 General Disclosure

Credit is any transaction that creates an actual or potential obligation for a counterparty to pay the NAB Group.

Credit risk is the potential that a counterparty or customer may fail to meet its obligations to the NAB Group under agreed terms.

The NAB Group's approach to credit risk management is designed to:

- inform future direction and broader strategic priorities
- achieve effective credit risk management through maintaining exposure to credit risk within acceptable parameters while maximising the NAB Group's risk-adjusted rate of return and ensuring alignment to risk appetite
- be embedded in every aspect of the NAB Group's day-to-day business.

Structure and Organisation

The Board delegates credit decision-making authority to the PBRC and then through the organisation via the Group CEO and Group Chief Risk Officer (CRO), who set the Delegated Commitment Authority (DCA). The DCA is cascaded via the Group Chief Credit Officer to the Transactional Credit Committee (TCC) and the NAB Group's business units.

The GRRMC and its subcommittees oversee the NAB Group's credit risk appetite, principles, policies, models and systems for the management of credit risk across the NAB Group.

Business unit risk management committees are responsible for implementing these disciplines at a business unit level.

Either the PBRC or its delegates set limits on the amount of risk accepted concerning one counterparty or group of counterparties, and geographic and industry segments. These limits are consistent with the NAB Group's risk appetite. Such risks are monitored on a regular basis and are subject to annual or more frequent reviews.

Management

Exposure to credit risk is managed by regularly analysing the ability of counterparties and potential counterparties to meet interest and capital repayment obligations, and by changing lending limits and lending conditions where appropriate.

Group Credit Policy applies globally and encompasses the NAB Group's:

- credit risk appetite and principles
- credit underwriting standards
- approach to ensure compliance with regulatory standards.

Senior management and line management within each business unit have primary responsibility to ensure their respective areas follow the NAB Group's credit policies, processes and standards.

The Credit Risk functions at the NAB Group and business unit levels are charged with implementing a sound risk framework to maintain appropriate asset quality across the NAB Group in line with credit risk appetite, credit risk underwriting standards and policy.

Group Credit Risk plays a key role in managing risk appetite, portfolio measurement, assisting businesses with portfolio management, and measuring compliance with strategic targets and limits. Group Credit Risk also:

- owns and is accountable for the credit risk policies and systems, concentration limits, large counterparty credit approvals and the management of large underperforming loans
- ensures that such policies and systems comply with the various regulatory and prudential requirements
- owns and monitors the performance of Group-wide models and methodology.

A key assurance area across non-retail banking activities is the Asset Quality Assurance function. This function is responsible and accountable for the independent review and reporting of asset quality, lending process standards and credit policy compliance across transaction-managed lending portfolios. The function operates independently from the credit approval process and reports its findings to the respective business units and risk management committees highlighting adverse trends and required remedial action.

Retail lending teams undertake independent reviews and report these results to senior management in the respective business and risk management committees.

Measurement

Later sections of this report detail the credit risk measurement approaches.

Monitoring and Reporting

The NAB Group has a comprehensive process for reporting credit and asset quality.

The NAB Group and business unit CROs receive regular reports covering credit risk parameters, asset concentrations and asset quality for both business and retail credit. These reports incorporate key credit risk measures including economic capital and detailed analysis of concentration risk, TCC approvals and updates on defaulted counterparties. Key reports are provided to the internal committees and the PBRC.

On a monthly basis, the NAB Group and business unit Credit Risk Committees receive a detailed analysis of asset quality measures. Periodically, the business unit and Group Credit Risk functions provide the PBRC and the GRRMC with portfolio and industry reviews, as well as the outcome of portfolio stress testing.

Definitions of Default and Impairment

Default occurs when a loan obligation is 90 days or more past due, or when it is considered unlikely that the credit obligation to the NAB Group will be paid in full without recourse to actions, such as realisation of security. There are no material exceptions to the NAB Group's definition of default.

A facility is classified as impaired when the ultimate ability to collect principal and interest and other amounts (including legal, enforcement and realisation costs) is compromised, and the bank's security is insufficient to cover these amounts, leading to a loss occurring.

Impaired facilities consist of:

- retail loans (excluding unsecured portfolio-managed facilities) which are contractually 90 days or more past due with security insufficient to cover principal and arrears of interest revenue
- unsecured portfolio-managed facilities which are 180 days past due (if not written off)
- non-retail loans that are contractually 90 days or more past due and/or sufficient doubt exists about the ultimate ability to collect principal and interest
- impaired off-balance sheet credit exposures, where current circumstances indicate that losses may be incurred.

Creation of Specific Provisions, Collective Provisions and the General Reserve for Credit Losses

Specific provisions

Specific provisions are raised for assets classified as default loss expected. A specific provision will be raised when the estimated cash flows accruing to an asset, including the estimated realisable value of securities after meeting security realisation costs, are less than the face value of the asset.

The calculation and raising of specific provisions is subject to tight controls with only appropriate Categorised Asset Approval Authority (CAAA) holders capable of establishing these provisions.

Collective provisions

Collective provisions are raised for assets that are not impaired. This process involves grouping financial assets with similar credit risk characteristics and collectively assessing them for incurred loss in accordance with the requirements of IFRS.

For retail assets the calculation relies on the portfolio delinquency profile and historical loss experience while the non-retail calculation relies on the risk characteristics of credit rating models.

In addition, the NAB Group uses its expert judgement to estimate the amount of incurred loss. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact the reliability of the calculations as all assessments are conducted within the requirements of IFRS, which requires that provisions only be raised for loss events that have occurred at or before the reporting date.

The NAB Group's collective provision is disclosed in the NAB 30 September 2014 Annual Financial Report.

Default-no-loss assets are defaulted or otherwise non-performing assets, such as 90+ days past due (90+ DPD) retail and default-no-loss non-retail exposures. Provisions for default-no-loss assets are reported as additional regulatory specific provisions within this report.

General reserve for credit losses

Prudential Standard APS 220 Credit Quality (APS 220) requires a reserve to be held to cover credit losses estimated but not certain to arise in the future over the full life of all individual facilities. The general reserve for credit losses (GRCL) represents an appropriation of retained profits to non-distributable reserves.

The GRCL is calculated as a collective provision for doubtful debts, excluding securitisation and provisions on default-no-loss assets. The difference between the GRCL and accounting collective provisions is covered with an additional top up, created through a deduction from retained earnings to reflect losses expected as a result of future events that are not recognised in the NAB Group's collective provision for accounting purposes.

Write-offs

When an asset is considered uncollectible, it is written off against the related provision. Such assets are written off after all the necessary recovery procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts written off reduce the amount of the expense in the income statement.

Table 5.1A: Credit Risk Exposures Summary

This table provides the amount of gross credit risk exposure subject to the Standardised and Advanced IRB approaches. The Level 2 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 before 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 before the application of on-balance sheet netting and credit risk mitigation. For the Standardised approach, EaD is reported net of any specific provision and before the application of on-balance sheet netting and credit risk mitigation. Exposures exclude non-lending assets, securitisation, Credit Value Adjustment (CVA) and the Central Counterparty (CCP) default fund contribution guarantee.

Definitions of impairment and past due facilities are based on APS 220. This standard also provides guidance for Provisioning, estimated future credit losses and the General Reserve for Credit Losses ⁽¹⁾.

Exposure type	As at 30 Sep 14					6 months ended 30 Sep 14
	Total exposure (EaD) ⁽²⁾	Risk-weighted Assets	Regulatory expected loss	Impaired facilities ⁽³⁾	Specific provisions ⁽⁴⁾	Net write-offs ⁽⁵⁾
	\$m	\$m	\$m	\$m	\$m	\$m
IRB approach						
Corporate (including SME)	234,372	111,078	2,021	1,292	464	307
Sovereign	65,322	1,608	2	-	-	-
Bank	66,908	11,341	19	1	-	1
Residential mortgage	317,400	58,274	879	420	101	63
Qualifying revolving retail	10,882	3,641	170	-	-	81
Retail SME	16,194	6,165	206	113	58	39
Other retail	4,522	3,255	125	4	2	46
Total IRB approach	715,600	195,362	3,422	1,830	625	537
Specialised lending (SL)	62,138	52,542	1,827	1,491	524	177
Standardised approach						
Australian and foreign governments	12,304	86	-	14	-	-
Bank	1,650	107	-	-	-	-
Residential mortgage	44,423	18,773	-	181	58	7
Corporate	67,745	25,451	-	603	243	92
Other	3,870	3,298	-	3	4	24
Total standardised approach	129,992	47,715	-	801	305	123
Total	907,730	295,619	5,249	4,122	1,454	837

⁽¹⁾ The General Reserve for Credit Losses (GRCL) at 30 September 2014 is calculated as follows:

	\$m
Collective provision for doubtful debts	2,636
Less collective provisions reported as additional regulatory specific provisions	(382)
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	2,254
Plus reserve created through a deduction from retained earnings	601
General reserve for credit losses (after-tax basis)	2,855

⁽²⁾ Total credit risk exposure is EaD estimates of potential exposure, according to product type, for a period of one year.

⁽³⁾ Impaired facilities includes \$196 million of restructured loans (March 2014: \$182 million) which includes \$7 million of restructured fair value assets (March 2014: \$81 million).

Impaired facilities includes \$187 million of gross impaired loans at fair value (March 2014: \$390 million).

Australian and foreign governments impaired facilities refer to the portion of loans covered by the loss share agreement with the FDIC.

⁽⁴⁾ 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 \$96 million (March 2014: \$172 million) of specific provisions on gross impaired loans at fair value.

⁽⁵⁾ September 2014 includes net write-offs of fair value loans.

Exposure type	As at 31 Mar 14					6 months ended 31 Mar 14
	Total exposure (EaD)	Risk-weighted Assets	Regulatory expected loss	Impaired facilities	Specific provisions	Net write-offs
	\$m	\$m	\$m	\$m	\$m	\$m
IRB approach						
Corporate (including SME)	225,909	106,555	2,126	1,585	467	198
Sovereign	62,204	1,690	2	-	-	-
Bank	71,436	12,998	21	1	1	-
Residential mortgage	307,538	60,301	870	514	125	53
Qualifying revolving retail	11,167	3,649	224	-	-	106
Retail SME	16,603	6,476	224	141	70	36
Other retail	4,748	3,467	145	7	3	52
Total IRB approach	699,605	195,136	3,612	2,248	666	445
Specialised lending (SL)	62,918	52,514	2,653	2,494	959	198
Standardised approach						
Australian and foreign governments	2,955	68	-	28	-	-
Bank	12,701	156	-	-	-	-
Residential mortgage	42,116	18,790	-	200	41	8
Corporate	49,973	23,971	-	642	287	62
Other	3,728	3,172	-	2	1	39
Total standardised approach	111,473	46,157	-	872	329	109
Total	873,996	293,807	6,265	5,614	1,954	752

(1) The General Reserve for Credit Losses (GRCL) at 31 March 2014 is calculated as follows:

	\$m
Collective provision for doubtful debts	2,912
Less collective provisions reported as additional regulatory specific provisions	(520)
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	2,392
Plus reserve created through a deduction from retained earnings	563
General reserve for credit losses (after-tax basis)	2,955

Credit Exposures by Measurement Approach

Table 5.1B: Total and Average Credit Risk Exposures

This table provides the amount of gross credit risk exposure subject to the Standardised and Advanced IRB approaches. The Level 2 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. 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.

For the IRB approach, 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, securitisation, CVA and the CCP default fund contribution guarantee.

Exposure type	As at 30 Sep 14				6 months ended 30 Sep 14
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Total exposure	Average total exposure
	\$m	\$m	\$m	\$m	\$m
IRB approach					
Corporate (including SME) ⁽¹⁾	124,737	53,093	56,542	234,372	230,141
Sovereign ⁽¹⁾	47,798	627	16,897	65,322	63,763
Bank ⁽¹⁾	25,649	1,709	39,550	66,908	69,172
Residential mortgage	272,065	45,335	-	317,400	312,469
Qualifying revolving retail	5,575	5,307	-	10,882	11,025
Retail SME	12,523	3,671	-	16,194	16,399
Other retail	3,223	1,299	-	4,522	4,635
Total IRB approach	491,570	111,041	112,989	715,600	707,603
Specialised lending (SL)	52,548	8,337	1,253	62,138	62,528
Standardised approach					
Australian and foreign governments ⁽²⁾	12,095	209	-	12,304	7,630
Bank ⁽²⁾	343	40	1,267	1,650	7,176
Residential mortgage	41,178	3,245	-	44,423	43,270
Corporate ⁽¹⁾	23,004	3,097	41,644	67,745	58,859
Other	3,647	223	-	3,870	3,799
Total standardised approach	80,267	6,814	42,911	129,992	120,733
Total	624,385	126,192	157,153	907,730	890,863

⁽¹⁾ Total credit risk exposure, net of eligible financial collateral is \$778,155 million. For materially impacted asset classes, exposure net of collateral is as follows:

	\$m
Corporate (including SME)	189,278
Sovereign	50,404
Bank	38,578
Corporate (Standardised)	28,464

⁽²⁾ Australian and Foreign Governments includes \$10,930 million of Central Bank exposures previously classified within the Standardised Bank asset class. The value of this exposure as at March 2014 was \$10,397 million.

Exposure type	As at 31 Mar 14				6 months ended 31 Mar 14
	On- balance sheet exposure	Non- market related off-balance sheet	Market related off-balance sheet	Total exposure	Average total exposure
	\$m	\$m	\$m	\$m	\$m
IRB approach					
Corporate (including SME) ⁽¹⁾	121,307	49,558	55,044	225,909	218,675
Sovereign ⁽¹⁾	42,352	703	19,149	62,204	53,025
Bank ⁽¹⁾	29,582	1,383	40,471	71,436	65,764
Residential mortgage	264,869	42,669	-	307,538	303,033
Qualifying revolving retail	5,490	5,677	-	11,167	11,131
Retail SME	12,848	3,755	-	16,603	16,740
Other retail	3,357	1,391	-	4,748	4,647
Total IRB approach	479,805	105,136	114,664	699,605	673,015
Specialised lending (SL)	54,399	7,360	1,159	62,918	64,065
Standardised approach					
Australian and foreign governments	2,782	173	-	2,955	3,513
Bank	10,662	13	2,026	12,701	11,579
Residential mortgage	39,011	3,105	-	42,116	40,070
Corporate ⁽¹⁾	21,062	3,193	25,718	49,973	47,950
Other	3,545	183	-	3,728	3,736
Total standardised approach	77,062	6,667	27,744	111,473	106,848
Total	611,266	119,163	143,567	873,996	843,928

⁽¹⁾ Total credit risk exposure, net of eligible financial collateral is \$755,874 million. For materially impacted asset classes, exposure net of collateral is as follows:

	\$m
Corporate (including SME)	179,707
Sovereign	44,518
Bank	42,017
Corporate (Standardised)	27,369

Table 5.1C: Exposures by Geography

This table provides the total gross credit risk exposures, by major geographical areas, derived from the booking office where the exposure was transacted. Exposures exclude non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee.

Exposure type	As at 30 Sep 14				
	Australia \$m	United Kingdom \$m	New Zealand \$m	Other ⁽¹⁾ \$m	Total exposure \$m
IRB approach					
Corporate (including SME)	151,523	33,288	29,297	20,264	234,372
Sovereign	52,260	1,948	4,400	6,714	65,322
Bank	24,733	25,775	4,141	12,259	66,908
Residential mortgage	287,306	-	30,094	-	317,400
Qualifying revolving retail	10,882	-	-	-	10,882
Retail SME	14,364	-	1,830	-	16,194
Other retail	2,231	-	2,291	-	4,522
Total IRB approach	543,299	61,011	72,053	39,237	715,600
Specialised lending (SL)	50,407	5,213	5,780	738	62,138
Standardised approach					
Australian and foreign governments	-	9,951	-	2,353	12,304
Bank	13	1,633	-	4	1,650
Residential mortgage	2,856	38,255	-	3,312	44,423
Corporate	3,476	29,767	97	34,405	67,745
Other	1,094	2,531	-	245	3,870
Total standardised approach	7,439	82,137	97	40,319	129,992
Total exposure (EaD)	601,145	148,361	77,930	80,294	907,730

⁽¹⁾ 'Other' comprises North America and Asia.

Exposure type	As at 31 Mar 14				
	Australia \$m	United Kingdom \$m	New Zealand \$m	Other \$m	Total exposure \$m
IRB approach					
Corporate (including SME)	145,028	33,223	30,207	17,451	225,909
Sovereign	44,997	2,175	4,917	10,115	62,204
Bank	26,232	32,265	3,281	9,658	71,436
Residential mortgage	276,706	-	30,832	-	307,538
Qualifying revolving retail	11,167	-	-	-	11,167
Retail SME	14,640	-	1,963	-	16,603
Other retail	2,304	-	2,444	-	4,748
Total IRB approach	521,074	67,663	73,644	37,224	699,605
Specialised lending (SL)	48,363	7,743	5,942	870	62,918
Standardised approach					
Australian and foreign governments	-	1,008	-	1,947	2,955
Bank	-	12,298	-	403	12,701
Residential mortgage	2,383	36,500	2	3,231	42,116
Corporate	4,094	23,956	115	21,808	49,973
Other	1,072	2,463	-	193	3,728
Total standardised approach	7,549	76,225	117	27,582	111,473
Total exposure (EaD)	576,986	151,631	79,703	65,676	873,996

Table 5.1D: Exposures by Industry

This table provides the distribution of gross credit risk exposures, excluding non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee, by major industry type. Industry classifications follow ANZSIC Level 1 classifications ⁽¹⁾.

Exposure type	As at 30 Sep 14												Total
	Accommodation, cafes, pubs and restaurants	Agriculture, forestry, fishing and mining	Business services and property services	Commercial property	Construction	Finance and insurance	Manufacturing	Personal	Residential mortgages	Retail and wholesale trade	Transport and storage	Other ⁽²⁾	
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
IRB approach													
Corporate (including SME)	7,875	38,237	12,769	12,029	7,269	69,680	20,026	294		25,469	14,295	26,429	234,372
Sovereign	-	-	60	-	-	25,663	-	-		-	-	39,599	65,322
Bank	-	-	-	-	-	65,833	-	-		-	-	1,075	66,908
Residential mortgage	-	-	-	-	-	-	-	-	317,400	-	-	-	317,400
Qualifying revolving retail	-	-	-	-	-	-	-	10,882	-	-	-	-	10,882
Retail SME	901	3,898	2,011	499	1,771	799	1,033	101	-	2,834	756	1,591	16,194
Other retail	-	-	-	-	-	-	-	4,522	-	-	-	-	4,522
Total IRB approach	8,776	42,135	14,840	12,528	9,040	161,975	21,059	15,799	317,400	28,303	15,051	68,694	715,600
Specialised lending (SL)	11	672	25	54,526	480	265		306		1	1,547	4,305	62,138
Standardised approach													
Australian and foreign governments	-	-	-	21	-	10,407	-	-	-	-	-	1,876	12,304
Bank	-	-	-	-	-	1,650	-	-	-	-	-	-	1,650
Residential mortgage	-	-	-	-	-	-	-	-	44,423	-	-	-	44,423
Corporate	1,733	5,004	2,330	1,660	701	42,667	2,582	17	1,723	3,232	904	5,192	67,745
Other	3	11	19	4	9	1	7	3,593	10	14	3	196	3,870
Total standardised approach	1,736	5,015	2,349	1,685	710	54,725	2,589	3,610	46,156	3,246	907	7,264	129,992
Total exposure (EaD)	10,523	47,822	17,214	68,739	10,230	216,965	23,648	19,715	363,556	31,550	17,505	80,263	907,730

⁽¹⁾ To provide for a meaningful differentiation and quantitative estimates of risk that are consistent, verifiable, relevant and soundly based, exposures are disclosed based on the counterparty to which the NAB Group is exposed to credit risk, including guarantors and derivative counterparties.

⁽²⁾ Immaterial categories are grouped collectively under 'Other'.

As at 31 Mar 14													
	Accommodation cafes, pubs and restaurants	Agriculture, forestry, fishing and mining	Business services and property services	Commercial property	Construction	Finance and insurance	Manufacturing	Personal	Residential mortgages	Retail and wholesale trade	Transport and storage	Other	Total
Exposure type	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
IRB approach													
Corporate (including SME)	7,527	37,772	11,952	11,459	7,241	65,963	19,451	308	-	25,613	13,145	25,478	225,909
Sovereign	-	-	-	-	-	30,186	-	-	-	-	-	32,018	62,204
Bank	-	-	-	-	-	70,260	-	-	-	-	-	1,176	71,436
Residential mortgage	-	-	-	-	-	-	-	-	307,538	-	-	-	307,538
Qualifying revolving retail	-	-	-	-	-	-	-	11,167	-	-	-	-	11,167
Retail SME	952	3,931	2,059	518	1,821	787	1,061	112	-	2,965	774	1,623	16,603
Other retail	-	-	-	-	-	-	-	4,748	-	-	-	-	4,748
Total IRB approach	8,479	41,703	14,011	11,977	9,062	167,196	20,512	16,335	307,538	28,578	13,919	60,295	699,605
Specialised lending (SL)	23	475	23	55,857	667	266	63	36	-	2	1,337	4,169	62,918
Standardised approach													
Australian and foreign governments	-	-	-	20	-	1,424	-	-	-	-	-	1,511	2,955
Bank	-	-	-	-	-	12,701	-	-	-	-	-	-	12,701
Residential mortgage	-	-	-	-	-	-	-	-	42,116	-	-	-	42,116
Corporate	1,742	4,702	2,504	1,400	698	26,441	2,581	24	-	3,161	888	5,832	49,973
Other	3	7	19	3	8	1	6	3,622	-	13	2	44	3,728
Total standardised approach	1,745	4,709	2,523	1,423	706	40,567	2,587	3,646	42,116	3,174	890	7,387	111,473
Total exposure (EaD)	10,247	46,887	16,557	69,257	10,435	208,029	23,162	20,017	349,654	31,754	16,146	71,851	873,996

Table 5.1E: Exposures by Maturity

This table sets out the residual contractual maturity breakdown of gross credit risk exposures, excluding non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee. Overdraft and other similar revolving facilities are allocated to the category that most appropriately captures the maturity characteristics of the product.

Exposure type	As at 30 Sep 14			
	<12 months	1 – 5 years	>5 years	No specified maturity ⁽¹⁾
	\$m	\$m	\$m	\$m
IRB approach				
Corporate (including SME)	102,034	100,473	25,822	6,043
Sovereign	27,513	14,307	23,428	74
Bank	43,031	11,594	12,166	117
Residential mortgage	43,368	7,059	266,414	559
Qualifying revolving retail	1	-	-	10,881
Retail SME	5,489	6,678	3,363	664
Other retail	186	1,217	707	2,412
Total IRB approach	221,622	141,328	331,900	20,750
Specialised lending (SL)	21,877	33,423	5,497	1,341
Standardised approach				
Australian and foreign governments	7,544	377	2,519	1,864
Bank	1,337	252	55	6
Residential mortgage	2,502	3,072	37,389	1,460
Corporate	50,787	8,444	6,887	1,627
Other	1,216	1,518	252	884
Total standardised approach	63,386	13,663	47,102	5,841
Total exposure (EaD)	306,885	188,414	384,499	27,932

⁽¹⁾ No specified maturity includes exposures related to credit cards, on demand facilities and guarantees given by the Level 2 Group with no fixed maturity date.

Exposure type	As at 31 Mar 14			
	<12 months	1 – 5 years	>5 years	No specified maturity
	\$m	\$m	\$m	\$m
IRB approach				
Corporate (including SME)	104,481	92,046	23,334	6,048
Sovereign	31,850	8,462	21,844	48
Bank	48,737	11,309	11,268	122
Residential mortgage	44,407	7,355	255,206	570
Qualifying revolving retail	-	-	-	11,167
Retail SME	5,436	6,950	3,507	710
Other retail	198	1,250	683	2,617
Total IRB approach	235,109	127,372	315,842	21,282
Specialised lending (SL)	23,771	31,865	4,978	2,304
Standardised approach				
Australian and foreign governments	422	107	2,397	29
Bank	10,695	160	155	1,691
Residential mortgage	3,088	4,057	34,877	94
Corporate	33,818	8,847	6,956	352
Other	1,243	1,361	242	882
Total standardised approach	49,266	14,532	44,627	3,048
Total exposure (EaD)	308,146	173,769	365,447	26,634

Credit Provisions and Losses

Table 5.1F: Provisions by Asset Class

The following tables set out information on credit risk provision by Basel Accord asset class, excluding non-lending assets and securitisation exposures. Definitions of impairment and past due facilities are based on APS 220. This standard also provides guidance for Provisioning, estimated future credit losses and the GRCL ⁽¹⁾.

Exposure type	As at 30 Sep 14			6 months ended 30 Sep 14	
	Impaired facilities ⁽²⁾	Past due facilities ≥90 days	Specific provisions ⁽³⁾	Charges for specific provisions	Net write-offs ⁽⁴⁾
	\$m	\$m	\$m	\$m	\$m
IRB approach					
Corporate (including SME)	1,292	272	464	275	307
Sovereign	-	-	-	-	-
Bank	1	-	-	-	1
Residential mortgage	420	1,216	101	31	63
Qualifying revolving retail	-	57	-	89	81
Retail SME	113	110	58	25	39
Other retail	4	42	2	43	46
Total IRB approach	1,830	1,697	625	463	537
Specialised lending (SL)	1,491	288	524	70	177
Standardised approach					
Australian and foreign governments	14	-	-	-	-
Bank	-	-	-	-	-
Residential mortgage	181	210	58	20	7
Corporate	603	117	243	35	92
Other	3	30	4	34	24
Total standardised approach	801	357	305	89	123
Total	4,122	2,342	1,454	622	837

⁽¹⁾ The General Reserve for Credit Losses (GRCL) at 30 September 2014 is calculated as follows:

	\$m
Collective provision for doubtful debts	2,636
Less collective provisions reported as additional regulatory specific provisions	(382)
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	2,254
Plus reserve created through a deduction from retained earnings	601
General reserve for credit losses (after-tax basis)	2,855

⁽²⁾ Impaired facilities includes \$196 million of restructured loans (March 2014: \$182 million) which includes \$7 million of restructured fair value assets (March 2014: \$81 million).

Impaired facilities includes \$187 million of gross impaired fair value assets (March 2014: \$390 million).

Australian and foreign governments impaired facilities refer to the portion of loans covered by the loss share agreement with the FDIC.

⁽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 \$96 million (March 2014: \$172 million) of specific provisions on gross impaired loans at fair value.

⁽⁴⁾ September 2014 includes net write-offs of fair value loans.

Exposure type	As at 31 Mar 14			6 months ended 31 Mar 14	
	Impaired facilities \$m	Past due facilities ≥90 days \$m	Specific provisions \$m	Charges for specific provisions \$m	Net write-offs \$m
IRB approach					
Corporate (including SME)	1,585	371	467	251	198
Sovereign	-	-	-	-	-
Bank	1	-	1	1	-
Residential mortgage	514	1,146	125	38	53
Qualifying revolving retail	-	74	-	118	106
Retail SME	141	102	70	20	36
Other retail	7	48	3	47	52
Total IRB approach	2,248	1,741	666	475	445
Specialised lending (SL)	2,494	376	959	88	198
Standardised approach					
Australian and foreign governments	28	12	-	-	-
Bank	-	-	-	-	-
Residential mortgage	200	230	41	16	8
Corporate	642	143	287	84	62
Other	2	24	1	42	39
Total standardised approach	872	409	329	142	109
Total	5,614	2,526	1,954	705	752

⁽¹⁾ The General Reserve for Credit Losses (GRCL) at 31 March 2014 is calculated as follows:

	\$m
Collective provision for doubtful debts	2,912
Less collective provisions reported as additional regulatory specific provisions	(520)
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	2,392
Plus reserve created through a deduction from retained earnings	563
General reserve for credit losses (after-tax basis)	2,955

Factors Impacting Loss Experience in the Preceding Period

Non-impaired facilities 90+ Days Past Due

90+DPD facilities declined during the September 2014 half year, mainly driven by NAB UK Commercial Real Estate (CRE) Specialised Lending and UK Banking Residential Mortgages.

Partially offsetting this was an increase in 90+DPD facilities in the Australian Banking Advanced IRB Residential Mortgage portfolio.

Impaired facilities

Impaired facilities decreased during the September 2014 half year driven by reductions in all divisions. Specialised Lending portfolio reduced, reflecting the continued run-off, repayment and sale of UK CRE assets and to a lesser extent, reductions in Australia Banking.

The decrease in Corporate (including SME) and Residential Mortgage were driven by lower levels of new gross impaired assets and successful work-out strategies of long standing customers.

Charges for Specific Provisions

The total specific provision charge for the September 2014 half was \$622m, \$83m lower than the March 2014 half. The six month reduction to September 2014 was primarily due to lower specific provision charges across Clydesdale, NAB UK CRE and Specialised Group Assets (SGA) reflecting improving operating conditions resulting in recoveries against previously provided for debt.

The lower specific provision charges were driven by Clydesdale Corporate portfolio and NAB UK CRE Specialised Lending portfolio. The decrease was a result of improved operating conditions within the UK that have led to fewer single large provisions and lower levels of new impairments.

Higher specific provision charges in Australian Banking was mainly within Specialised Lending partially offset by lower specific provision charges in Qualifying Revolving Retail.

Net Write-Offs

Net write-offs increased from \$752 million for the March 2014 half year to \$837 million for the September 2014 half year. The increase was due to higher write-offs across all major divisions in particular for the Australian Banking Advanced IRB Corporate portfolio and Clydesdale Standardised Corporate portfolio.

IFRS 9 impacts

In July 2014 the accounting standard IFRS9 was issued and the Group has the intention of early adopting the Australian equivalent standard AASB 9 from 1 October 2014. Adoption of AASB 9 will have the impact of increasing our Provision for Doubtful Debts for amortised and fair value loans with a corresponding adjustment through retained earnings, resulting in an increase in the collective provision coverage ratio. Additionally the Group will reclassify certain assets including those in the Held to Maturity and Available for Sale categories to Fair Value, again with adjustments taken through retained earnings. Implementation remains contingent upon a number of items including the issue of AASB 9 by the Australian Accounting Standards Board expected shortly.

Table 5.1G (i): Loss Experience

Table 5.1G (i) provides the regulatory expected loss (which are forward-looking loss estimates) compared to the realised actual losses calculated as an exposure weighted average since 30 September 2009.

Actual losses (net write-offs) measured over the short-term will differ to regulatory expected loss estimates as actual losses are a lag indicator of the quality of the assets in prior periods. Other differences between these measures are:

- actual losses do not take into account modelled economic costs such as internal workout costs factored into estimates of loss
- regulatory expected loss is based on the quality of exposures at a point-in-time (PiT) using long run Probability of Default (PDs) and stressed Loss Given Default (LGDs). In most years actual losses would be below the regulatory expected loss estimate
- regulatory expected loss includes expected losses on non-defaulted assets which is a function of long-run PDs and downturn stressed LGDs. For defaulted exposures, regulatory expected loss is based on the NAB Group's best estimate of expected loss.

	As at 30 Sep 14	
	Exposure weighted average actual loss (net write-offs) ⁽¹⁾	Exposure weighted average regulatory expected loss ⁽²⁾
	\$m	\$m
IRB approach		
Corporate (including SME)	727	2,966
Sovereign	-	11
Bank	10	69
Residential mortgage	119	844
Qualifying revolving retail	191	225
Retail SME	81	298
Other retail	95	149
Total IRB approach	1,223	4,562

⁽¹⁾ Calculated as an exposure weighted average of actual losses (net write-offs) experienced through each respective 12 monthly period since 30 September 2009.

⁽²⁾ Calculated as an exposure weighted average of regulatory expected loss covering each respective 12 monthly period since 30 September 2009.

	As at 31 Mar 14	
	Exposure weighted average actual loss (net write-offs) ⁽¹⁾	Exposure weighted average regulatory expected loss ⁽²⁾
	\$m	\$m
IRB approach		
Corporate (including SME)	823	3,188
Sovereign	-	2
Bank	10	67
Residential mortgage	129	870
Qualifying revolving retail	188	234
Retail SME	81	313
Other retail	93	155
Total IRB approach	1,324	4,829

⁽¹⁾ Calculated as an exposure weighted average of actual losses (net write-offs) experienced through each respective 12 monthly period since 31 March 2009.

⁽²⁾ Calculated as an exposure weighted average of regulatory expected loss covering each respective 12 monthly period since 31 March 2009.

Accuracy of Risk Estimates

The following tables have been provided to summarise and compare across asset classes, the estimates of credit risk factors used within the calculation of regulatory capital with actual outcomes. Estimates for Specialised Lending have not been included as these exposures are subject to the Supervisory Slotting Criteria approach, which relies upon the application of supervisory risk weights when calculating regulatory Expected Loss (EL).

A full explanation of the Internal Ratings Process and the application of credit risk models to calculate PD, EaD and LGD is provided within Section 5.3 of this report.

Table 5.1G (ii): Accuracy of Risk Estimates – PD and EaD

This table provides a comparison of internal estimates of long-run PD with actual default rates averaged over a period of five years to 30 September 2014. Averages of actual and estimated PD are calculated from customers not in default at the beginning of the financial year and averaged out over the five year observation period. The EaD ratio compares the estimated downturn EaD at the beginning of the financial year against the actual default amount.

	As at 30 Sep 14		
	Average Estimated PD	Average Actual PD	Ratio of estimated to actual EAD
	%	%	
IRB approach			
Corporate (including SME)	1.81	2.16	1.1
Sovereign ⁽¹⁾	0.40	0.15	1.3
Bank ⁽¹⁾	0.34	0.22	1.1
Residential mortgage ⁽²⁾	0.93	0.89	1.0
Qualifying revolving retail	1.56	1.52	1.1
Retail SME	1.97	2.36	1.1
Other retail	2.23	2.89	1.0

⁽¹⁾ Average actual PDs for Sovereign and Bank exposures are based on a low number of observed defaults.

⁽²⁾ Estimated PDs includes BNZ assets subject to RBNZ calibration overlay.

	As at 31 Mar 14		
	Average Estimated PD ⁽¹⁾	Average Actual PD ⁽¹⁾	Ratio of estimated to actual EAD
	%	%	
IRB approach			
Corporate (including SME)	1.80	2.13	1.1
Sovereign	0.40	0.13	1.1
Bank	0.33	0.30	1.0
Residential mortgage	1.00	0.86	1.0
Qualifying revolving retail	1.67	1.58	1.0
Retail SME	1.96	2.31	1.1
Other retail	2.33	2.93	1.0

⁽¹⁾ These values provide a comparison of internal estimates of long-run PD with actual default rates averaged over a period of four years to 31 March 2014.

Table 5.1G (iii): Accuracy of Risk Estimates – LGD

This table provides comparison of internal estimates of downturn LGD with actual losses which were evidenced during the five years to 30 September 2014. Actual LGD was calculated using net write-offs from defaults during the five year observation period with the most recent defaults excluded to allow sufficient time for the workout of the asset and recognition of any losses. For defaults relating to qualifying revolving retail and other retail, this period is the most recent 12 months and for all other asset classes the period is the most recent two years. Estimates are calculated using the downturn LGD at the beginning of the financial year.

	As at 30 Sep 14	
	Average estimated downturn LGD	Average actual LGD
	%	%
IRB approach		
Corporate (including SME) ⁽¹⁾	36.0	31.1
Sovereign ⁽²⁾	45.0	-
Bank ⁽²⁾	-	-
Residential mortgage ⁽³⁾	20.7	3.7
Qualifying revolving retail	87.1	67.0
Retail SME	37.0	23.0
Other retail	75.2	52.8

⁽¹⁾ Estimated downturn LGD includes BNZ assets subject to RBNZ regulatory floors.

⁽²⁾ Average actual LGDs for Sovereign and Bank exposures are based on a low number of observed defaults.

⁽³⁾ Estimated downturn LGD subject to APRA and RBNZ imposed regulatory floors.

	As at 31 Mar 14	
	Average estimated downturn LGD ⁽¹⁾	Average actual LGD ⁽¹⁾
	%	%
IRB approach		
Corporate (including SME)	35.8	32.1
Sovereign	14.1	-
Bank	-	-
Residential mortgage	20.7	3.9
Qualifying revolving retail	87.2	68.7
Retail SME	37.9	21.7
Other retail	74.5	54.4

⁽¹⁾ These values provide a comparison of internal estimates of downturn LGD with actual losses which were evidenced during the four years to 31 March 2014.

Table 5.1H: Provisions by Industry

This table shows provisioning information by industry. Industry classifications follow ANZSIC Level 1 classifications. Totals do not include amounts relating to non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee.

Industry sector	As at 30 Sep 14			6 months ended 30 Sep 14	
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	Charges for specific provisions	Net write-offs
	\$m	\$m	\$m	\$m	\$m
Accommodation, cafes, pubs and restaurants	324	42	125	38	60
Agriculture, forestry, fishing and mining	431	126	109	117	82
Business services and property services	209	59	85	32	40
Commercial property	1,497	313	453	80	177
Construction	145	51	103	29	33
Finance and insurance	76	12	42	26	15
Manufacturing	181	48	78	6	28
Personal	7	130	7	139	160
Residential mortgages	601	1,426	159	51	70
Retail and wholesale trade	181	61	61	29	90
Transport and storage	37	20	19	1	11
Other	433	54	213	74	71
Total	4,122	2,342	1,454	622	837
Additional regulatory specific provision			382		

Industry sector	As at 31 Mar 14			6 months ended 31 Mar 14	
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	Charges for specific provisions	Net write-offs
	\$m	\$m	\$m	\$m	\$m
Accommodation, cafes, pubs and restaurants	369	49	153	52	38
Agriculture, forestry, fishing and mining	582	116	127	34	90
Business services and property services	263	109	95	46	21
Commercial property	2,410	421	829	116	204
Construction	270	56	109	30	14
Finance and insurance	82	41	34	5	15
Manufacturing	204	47	85	67	57
Personal	34	158	11	207	193
Residential mortgages	714	1,376	166	54	61
Retail and wholesale trade	250	69	120	50	44
Transport and storage	41	33	26	14	13
Other	395	51	199	30	2
Total	5,614	2,526	1,954	705	752
Additional regulatory specific provision			520		

Table 5.1I: Provisions by Geography

	As at 30 Sep 14			
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	General reserve for credit losses
	\$m	\$m	\$m	\$m
Geographic region				
Australia	1,924	1,693	550	1,656
United Kingdom	1,846	449	767	654
New Zealand	249	186	106	252
Other ⁽¹⁾	103	14	31	74
Total	4,122	2,342	1,454	2,636
Regulatory specific provisions			382	(382)
Plus reserve created through retained earnings				601
General reserve for credit losses ⁽²⁾				2,855

⁽¹⁾ 'Other' comprises North America and Asia.

⁽²⁾ The GRCL balance allocated across geographic regions of \$2,636 million includes \$1,760 million of provisions on loans at amortised cost and \$876 million of provisions held on assets at fair value.

	As at 31 Mar 14			
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	General reserve for credit losses
	\$m	\$m	\$m	\$m
Geographic region				
Australia	2,356	1,634	672	1,777
United Kingdom	2,754	640	1,139	793
New Zealand	374	236	124	270
Other	130	16	19	72
Total	5,614	2,526	1,954	2,912
Regulatory specific provisions			520	(520)
Plus reserve created through retained earnings				563
General reserve for credit losses ⁽¹⁾				2,955

⁽¹⁾ The GRCL balance allocated across geographic regions of \$2,912 million includes \$2,059 million of provisions on loans at amortised cost and \$853 million of provisions held on assets at fair value.

Table 5.1J: Movement in Provisions

This table discloses the movements in the balance of provisions over the reporting period for both specific provisions and the general reserve for credit losses. Totals do not include amounts relating to non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee.

	6 months ended 30 Sep 14	6 months ended 31 Mar 14
	\$m	\$m
General reserve for credit losses		
Collective provision balance at start of period	2,059	2,178
Total charge to income statement for impairment loss	335	528
Net transfer to specific provision	(624)	(675)
Recoveries	-	-
Balances written off	-	-
Disposal of controlled entities	(18)	-
Foreign currency translation and other adjustments	8	28
Collective provision on loans at amortised cost	1,760	2,059
Plus provisions held on assets at fair value ⁽¹⁾	876	853
Less additional regulatory specific provisions	(382)	(520)
Plus reserve created through retained earnings	601	563
General reserve for credit losses	2,855	2,955
Specific provisions		
Balance at start of period	1,782	1,840
Net transfer from general reserve for credit losses	624	675
Bad debts recovered	73	112
Bad debts written off	(896)	(864)
Disposal of controlled entities	(221)	-
Foreign currency translation and other adjustments	(4)	19
Specific provisions excluding provisions for assets at fair value	1,358	1,782
Specific provisions held on assets at fair value	96	172
Additional regulatory specific provisions	382	520
Total regulatory specific provisions	1,836	2,474
Total provisions	4,691	5,429

⁽¹⁾ Provisions held on assets at fair value are presented gross of \$12 million regulatory specific provisions for assets held at fair value (March 2014: \$100 million).

5.2 Standardised and Supervisory Slotting Portfolios

Standardised Credit Risk Portfolios

The NAB Group uses the standardised methodology in the Basel Capital Framework, as interpreted by APRA, for the calculation of Basel credit RWA for Clydesdale and GWB, and for defined assets that are immaterial in terms of RWA or are not required to be treated as IRB under the Basel Capital Framework. For its local regulatory reporting to the PRA, Clydesdale uses the standardised methodology in the Basel Capital Framework as interpreted by the PRA. Clydesdale and other applicable portfolios will aim to move to more advanced accreditation for Credit Risk at a time agreed with APRA and the supervisors in the respective jurisdictions.

Fitch, Moody's and Standard & Poor's credit ratings are used to determine the risk weights within the APRA standardised approach, as presented in the table below. APRA's external rating grades table is used to map external ratings into an "external rating grade" or Credit Rating Grade that defines the appropriate risk weight as outlined in *Prudential Standard APS 112: Capital Adequacy Standardised Approach to Credit Risk (APS 112)*.

External Rating Grade Classification

External rating grade	S & P	Moody's	Fitch
1	AAA, AA+, AA, AA-	Aaa, Aa1, Aa2, Aa3	AAA, AA+, AA, AA-
2	A+, A, A-	A1, A2, A3	A+, A, A-
3	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
4	BB+, BB, BB-	Ba1, Ba2, Ba3	BB+, BB, BB-
5	B+, B, B-	B1, B2, B3	B+, B, B-
6	CCC+, CCC, CCC-, CC, C, D	Caa1, Caa2, Caa3, Ca, C	CCC+, CCC, CCC-, CC, C, D

Table 5.2A: Standardised Exposures by Risk Weight

The following table shows the credit exposure amount before and after risk mitigation ⁽¹⁾ in each risk category, subject to the standardised approach.

	As at 30 Sep 14		As at 31 Mar 14	
	Credit exposure before risk mitigation ⁽²⁾	Credit exposure after risk mitigation	Credit exposure before risk mitigation	Credit exposure after risk mitigation
	\$m	\$m	\$m	\$m
Standardised approach – risk weights				
0%	11,468	11,829	35,198	13,166
2%	40,009	1,418	767	767
4%	1,944	1,583	2,650	2,650
20%	661	1,498	2,953	1,644
35%	35,137	34,971	31,557	31,372
50%	5,972	4,970	4,731	4,894
75%	1,939	1,938	2,444	2,444
100%	32,362	30,429	30,508	29,460
150%	500	477	665	658
Total standardised approach (EaD)	129,992	89,113	111,473	87,055

⁽¹⁾ The NAB Group recognises the mitigation of credit risk as a result of eligible financial collateral and mitigation providers. Eligible financial collateral refers to cash and cash equivalents as defined in APS 112.

⁽²⁾ From September 2014, credit exposure before risk mitigation is shown in the risk category representing the risk weight of the counterparty before application of the credit risk mitigant. On this basis, as at March 2014, this would have resulted in a shift of \$23,812m of exposure before risk mitigation from the 0% risk weight to the 2% risk weight.

Table 5.2B: Standardised Exposures by Risk Grade

Asset class by rating grade	As at 30 Sep 14		As at 31 Mar 14	
	Credit exposure before risk mitigation \$m	Credit exposure after risk mitigation \$m	Credit exposure before risk mitigation \$m	Credit exposure after risk mitigation \$m
Australian and foreign governments ⁽¹⁾				
Credit rating grade 1	11,923	12,027	2,546	2,772
Credit rating grade 2	14	14	13	13
Unrated	367	7	396	7
Sub-total	12,304	12,048	2,955	2,792
Bank ⁽¹⁾				
Credit rating grade 1	190	196	10,450	10,455
Credit rating grade 2	899	154	7	185
Credit rating grade 3	414	54	12	12
Unrated	147	21	2,232	521
Sub-total	1,650	425	12,701	11,173
Residential mortgage				
Unrated	44,423	44,369	42,116	42,053
Sub-total	44,423	44,369	42,116	42,053
Corporate				
Credit rating grade 1	-	-	1	1
Credit rating grade 2	719	635	672	599
Credit rating grade 3	24	24	24	24
Unrated	67,002	27,804	49,276	26,745
Sub-total	67,745	28,463	49,973	27,369
Other				
Unrated	3,870	3,808	3,728	3,668
Sub-total	3,870	3,808	3,728	3,668
Total standardised approach (EaD)	129,992	89,113	111,473	87,055

⁽¹⁾ Australian and Foreign Governments includes \$10,930 million of Central Bank exposures previously classified within the Standardised Bank asset class. The value of this exposure as at March 2014 was \$10,397 million.

Portfolios Subject to Supervisory Risk Weights in the IRB Approaches

Specialised Lending is represented by the following four sub-asset classes:

- Project Finance Exposures
- Income-Producing Real Estate Exposures
- Object Finance Exposures
- Commodities Finance Exposures.

The NAB Group maps its internal rating grades for Specialised Lending to the five supervisory slotting categories of strong, good, satisfactory, weak and default. The criteria to map these exposures are found in *APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (Attachment F)*.

For Income-Producing Real Estate, the NAB Group maps a combination of internal rating grade and loss given default to the supervisory slotting categories. Each slotting category is associated with a specific risk weight for unexpected loss that broadly corresponds to a range of external credit assessments as detailed below.

Supervisory category	Risk weight	External rating equivalent
Strong	70%	BBB- or better
Good	90%	BB+ or BB
Satisfactory	115%	BB- or B+
Weak	250%	B to C
Default	0%	N/A

Table 5.2C: Supervisory Slotting by Risk Weight

The following table shows the credit exposure, reported after risk mitigation, in each risk bucket for Specialised Lending products subject to supervisory slotting.

	As at	
	30 Sep 14	31 Mar 14
	Exposure after risk mitigation	Exposure after risk mitigation
	\$m	\$m
IRB supervisory slotting – unexpected loss risk weights		
70%	25,932	24,684
90%	24,104	24,285
115%	8,130	7,975
250%	1,211	1,552
Default	2,412	4,026
Total IRB supervisory slotting (EaD)	61,789	62,522

5.3 Internal Ratings Based Portfolios

General Disclosure on the Internal Rating Based System (IRB)

The NAB Group has been accredited by APRA to use its internal credit models and processes in determining RWA for its retail and non-retail credit portfolios across its Australian, New Zealand⁽¹⁾ and Product & Markets operations.

The NAB Group's internal ratings system measures credit risk using: PD, LGD, and EaD. Distinct PD, EaD and LGD models exist for the retail and non-retail credit portfolios, based on asset categories and customer segments.

Non-retail customers are assessed individually using a combination of expert judgement and statistical risk rating tools. For retail customers, operational scorecards are the primary method of risk rating. The following table summarises exposures type and rating approach for each asset class.

Basel Asset Class	Type of exposures	Rating approach
Non-Retail		
Corporate (including SME)	Companies, including investment banks and non-government entities.	Statistical risk model, external credit rating and expert judgement
Sovereign	Sovereign and Australian dollar claims on the Reserve Bank of Australia. Sovereign includes government guaranteed exposures.	Statistical risk model, external credit rating and expert judgement
Bank	ADIs and overseas banks.	Statistical risk model, external credit rating and expert judgement
Specialised lending	Exposures associated with the financing of individual projects where the repayment is highly dependent on the performance of the underlying pool or collateral, rather than the obligor's creditworthiness. Includes project finance, income-producing real estate, object finance and commodities finance.	Statistical risk model, expert judgement, supervisory slotting
Retail		
Residential mortgage	Exposures partly or fully secured by residential properties.	Statistical risk model
Qualifying revolving retail	Consumer credit cards excluding BNZ credit cards (which are classified as Other Retail under RBNZ rules).	Statistical risk model
Retail SME	Small business and agriculture exposures where the total aggregated business related exposures of the obligor and its related entities are less than \$1 million.	Statistical risk model
Other retail	Retail exposures other than Residential Mortgage, Qualifying revolving retail and Retail SME. Includes personal loan products, overdrafts, transaction account exposures and BNZ credit cards.	Statistical risk model

Internal Risk Rating and External Ratings

The structure of the internal risk rating system and its relationship with external ratings is detailed below.

Description	Internal rating	Probability of default (%)
Super senior investment grade	1, 2	0<0.03
Senior investment grade	3, 4, 5	0.03<0.11
Investment grade	6, 7, 8, 9, 10, 11	0.11<0.55
Acceptable	12, 13, 14, 15, 16, 17, 18, 19	0.55<5.01
Weak/doubtful	20, 21, 22, 23	5.01<99.99
Default	98, 99	100

Description	S&P rating	Moody's rating
Super senior investment grade	AAA, AA+, AA, AA-	Aaa, Aa1, Aa2, Aa3
Senior investment grade	A+, A, A-	A1, A2, A3
Investment grade	BBB+, BBB, BBB-	Baa1, Baa2, Baa3
Acceptable	BB+, BB, BB-, B+	Ba1, Ba2, Ba3, B1
Weak/doubtful	B, B-, CCC+, CCC, CCC-	B2, B3, Caa,Ca
Default	D	C

⁽¹⁾ RBNZ IRB discretions are used for the New Zealand (BNZ) portfolio.

Internal Ratings Process Overview

Probability of Default

PD measures the likelihood that a customer will default within a 12 month period. The NAB Group uses two types of PD estimates:

- PiT which estimates the likelihood of default in the next 12 months taking account of the current economic conditions. PiT PDs are used for management of the portfolio
- Through the Cycle (TTC) which estimates the likelihood of default through a full credit cycle. TTC PDs are used for regulatory and economic capital calculation.

The NAB Group has a common masterscale across all counterparties (non-retail and retail) for PD.

Loss Given Default

LGD measures the portion of the exposure owed to the NAB Group that would be lost in the event of the customer defaulting. LGD is calculated by using a set of estimated parameters including Loss Given Realisation (LGR), post-default cure rates and the bank value of collateral.

The NAB Group applies stresses to the model factors to obtain downturn LGD estimates using internal data, external reference data and benchmarks, and by applying expert judgement.

Exposure at Default

EaD is calculated according to the facility type. The NAB Group's EaD models predict the dollar amount that a customer is likely to have outstanding if they were to default within a 12 month period. This amount includes principal, fees and interest owed at the time of default.

The NAB Group applies stresses to the model factors to obtain downturn EaD estimates using internal data, benchmark studies and expert judgement.

Use of PD, LGD and EaD

PD, LGD and EaD estimates are used for various regulatory and internal Credit Risk calculations, such as Regulatory Expected Loss, RWA, economic capital and provisioning.

Credit Rating System Control

In addition to monthly performance reporting, credit models are reviewed at least annually in accordance with the Group's Model Risk Policy. Regular independent reviews are also conducted.

The outcomes of the model validation process, including proposed actions, are presented to the authorised Risk Committees for review and endorsement of any actions for implementation.

Non-Retail Credit - Internal Ratings Process

Non-Retail – PD Models

The NAB Group has a number of PD models that differentiate by industry or segment, counterparty size and incorporate regional variances. The rating model used is dependent on:

- industry, based on ANZSIC classification
- financial information available
- qualitative information
- net sales/total assets and exposure.

The quantitative (financial) factors consist of financial ratios and indicators (e.g. profitability, leverage and debt service coverage). The qualitative (non-financial) factors are based on qualitative data using the expert judgement of the lender and credit officer (e.g. management ability and industry outlook).

While factors predictive of default have broad similarities across segments (e.g. debt service capability and management quality), the modelling process establishes those factors that are most predictive for each segment, along with their relative weightings. External benchmarking is used for certain segments that have insufficient internal data, a small population and/or low defaults. This is the case for externally rated banks and sovereigns, where external rating agencies data is used. The resulting rating is updated at least annually.

Long run adjustments are made to the models to account for performance over an economic cycle.

Non-Retail – EaD Models

EaD is calculated according to the facility type.

$$\text{EaD} = \text{Balance} + \text{Credit Conversion Factor} \times \text{Undrawn Limit}$$

Conversion factors are used for estimating off-balance sheet exposures into an equivalent on-balance sheet amount, based on internal data.

Non-Retail – LGD Models

LGD for the non-retail portfolio is calculated by using a set of estimated parameters including bank value of collateral, Loss Given Realisation and the probability of realisation occurring subsequent to default. LGD is segmented by customer type, customer size and nature of facility.

Loss Given Realisation is the loss sustained, as a proportion of EaD, following the realisation of security held. It is based on the bank values assigned to each asset type along with the NAB Group's experience with unsecured recoveries. As the market value of the collateral is affected by credit cycle changes, the impact of a credit cycle downturn on LGD has been incorporated.

The NAB Group also uses the following factors for non-retail credit LGD models:

- relevant external benchmarks
- recovery rates
- time value of money
- write-offs.

Where limited internal default data exists, data is supplemented by external benchmarks, market data and expert judgement.

Retail Credit - Internal Ratings Process

Retail Credit – PD Models

Retail PD models are developed using the following:

- application data and scorecards, including external credit bureau data
- customer and account level behavioural data (for example delinquency or limit utilisation) as well as behaviour scorecards that are updated monthly.

Each account is “scored” to assign a PD. This process allows groups of accounts with similar scores to be pooled together and mapped to the PD masterscale.

Appropriate long run adjustments have been made to the models to account for performance over an economic cycle.

Retail Credit – EaD Models

Retail EaD models use a combination of Credit Conversion Factors (CCFs) similar to those used in non-retail, and scaling factors.

CCFs have been developed mainly for revolving credit products, such as credit cards and overdrafts and estimate the amount of unutilised credit a customer may draw in the lead up to default.

Scaling factors have been applied mainly to term lending products, where the customer has less availability of unutilised credit from which to draw in the lead up to default.

Retail Credit – LGD Models

Key account variables, such as months exposure held and balance, are identified and modelled to provide an estimate of the probability that a loan that has defaulted would return to full performance (i.e. cure).

For accounts that do not cure and are written off, internal recovery data is used to assess the ultimate loss (i.e. initial loss less recoveries achieved plus costs of recovery).

Adjustments based on external data and expert judgement are made to the LGD to account for a downturn in the economic cycle, and are applied by varying the cure and recovery rates.

In Australia, the only credit risk mitigation measure applies to the residential mortgage portfolio, where Lenders Mortgage Insurance (LMI) is normally taken for borrowing above 80% Loan to Value Ratio at origination. For loans secured by residential property, APRA has mandated the use of a supervisory floor of 20% for RWA purposes.

Note: LMI does not currently influence the retail LGD metrics used.

Portfolios Subject to IRB Approach

Table 5.3A: Non-Retail Exposure by Risk Grade

This table provides a breakdown of gross non-retail credit exposures by PD risk grade, categorised into bands that broadly correspond to externally recognised risk grades. Moody's risk grades have been included as a reference point. Exposures have been categorised into PD grades as assessed by the Level 2 Group's own internal ratings system and exclude non-lending assets, securitisation, CVA, the CCP default fund contribution guarantee and Specialised Lending.

External credit rating equivalent	As at 30 Sep 14						
	PD risk grade mapping						
	Aa3 and above 0<0.03%	A1, A2, A3 0.03<0.1%	Baa1, Baa2, Baa3 0.1<0.5%	Ba1, Ba2 0.5<2.0%	Ba3, B1 2.0<5.0%	B2 and below 5.0<99.9%	Default 100%
IRB approach	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Total exposure							
Corporate	-	43,018	98,541	66,144	19,634	4,213	2,822
Sovereign	59,126	5,511	655	19	11	-	-
Bank	-	58,290	6,752	1,751	80	34	1
Total exposure (EaD)	59,126	106,819	105,948	67,914	19,725	4,247	2,823
Undrawn commitments							
Corporate	-	11,347	22,287	9,738	2,550	457	138
Sovereign	250	193	157	8	2	-	-
Bank	-	877	129	8	-	-	-
Total undrawn commitments ⁽¹⁾	250	12,417	22,573	9,754	2,552	457	138
IRB approach							
Average EaD (\$m) ⁽²⁾							
Corporate	-	1.27	0.65	0.25	0.17	0.13	0.27
Sovereign	30.82	2.12	1.72	0.08	0.03	-	-
Bank	-	1.96	1.80	4.60	0.95	0.72	0.66
Exposure weighted average LGD (%)							
Corporate	-	34.2 %	33.8 %	29.6 %	32.7 %	35.7 %	44.0 %
Sovereign	4.0 %	21.9 %	42.7 %	44.1 %	44.5 %	-	-
Bank	-	35.7 %	23.8 %	13.5 %	53.2 %	9.8 %	59.6 %
Exposure weighted average risk weight (%)							
Corporate	-	20.0 %	40.5 %	56.8 %	81.6 %	128.0 %	127.2 %
Sovereign	0.9 %	11.4 %	63.8 %	83.6 %	121.3 %	-	-
Bank	-	15.7 %	25.3 %	18.7 %	156.8 %	66.3 %	1.0 %

⁽¹⁾ Total undrawn commitments are included in the calculation of Total Exposures (EaD) shown above.

⁽²⁾ Simple average of exposure by number of arrangements.

As at 31 Mar 14							
External credit rating equivalent	PD risk grade mapping						
	Aa3 and above	A1, A2, A3	Baa1, Baa2, Baa3	Ba1, Ba2	Ba3, B1	B2 and below	Default
IRB approach	0<0.03%	0.03<0.1%	0.1<0.5%	0.5<2.0%	2.0<5.0%	5.0<99.9%	100%
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Total exposure							
Corporate	-	44,536	86,130	67,786	19,605	4,639	3,213
Sovereign	54,792	6,700	687	17	8	-	-
Bank	-	64,322	5,819	1,186	53	21	35
Total exposure (EaD)	54,792	115,558	92,636	68,989	19,666	4,660	3,248
Undrawn commitments							
Corporate	-	9,610	19,970	9,928	2,607	393	182
Sovereign	287	147	244	5	3	-	-
Bank	-	955	13	4	2	-	33
Total undrawn commitments	287	10,712	20,227	9,937	2,612	393	215
IRB approach							
Average EaD (\$m)							
Corporate	-	1.44	0.69	0.36	0.22	0.19	0.41
Sovereign	33.58	2.60	1.72	0.08	0.02	-	-
Bank	-	2.13	2.62	3.71	0.66	0.41	6.94
Exposure weighted average LGD (%)							
Corporate	-	29.1 %	34.7 %	28.9 %	32.5 %	37.1 %	43.5 %
Sovereign	4.2 %	21.7 %	43.6 %	44.9 %	44.2 %	-	-
Bank	-	36.4 %	19.6 %	9.5 %	52.1 %	12.0 %	40.5 %
Exposure weighted average risk weight (%)							
Corporate	-	16.5 %	41.2 %	55.2 %	79.7 %	131.0 %	142.5 %
Sovereign	1.0 %	10.2 %	66.9 %	87.2 %	127.4 %	-	-
Bank	-	17.3 %	25.1 %	12.5 %	156.2 %	81.7 %	466.9 %

Table 5.3B: Retail Exposure by Risk Grade

This table provides a breakdown of gross retail credit exposures by PD risk grade, categorised into bands that broadly correspond to externally recognised risk grades, ranging from Super Senior Investment Grade to Defaulted exposures. Exposures exclude non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee.

IRB approach	As at 30 Sep 14					
	PD risk grade mapping					
	0<0.1%	0.1<0.5%	0.5<2.0%	2.0<5.0%	5.0<99.9%	100%
	\$m	\$m	\$m	\$m	\$m	\$m
Total exposure						
Residential mortgage	98,841	110,216	81,692	15,787	8,720	2,144
Qualifying revolving retail	4,129	2,848	1,916	1,067	894	28
Retail SME	1,582	4,464	6,395	2,438	903	412
Other retail	1,211	896	1,201	723	432	59
Total exposure (EaD)	105,763	118,424	91,204	20,015	10,949	2,643
Undrawn commitments						
Residential mortgage	25,029	13,331	5,820	935	117	103
Qualifying revolving retail	3,144	1,594	429	105	34	1
Retail SME	917	1,153	832	252	66	60
Other retail	748	279	188	66	18	-
Total undrawn commitments ⁽¹⁾	29,838	16,357	7,269	1,358	235	164
IRB approach						
Average EaD (\$m) ⁽²⁾						
Residential mortgage	0.08	0.25	0.20	0.26	0.33	0.21
Qualifying revolving retail	0.01	0.01	0.01	0.01	0.01	0.01
Retail SME	0.02	0.03	0.03	0.02	0.02	0.02
Other retail	0.00	0.01	0.01	0.01	small	0.01
Exposure weighted average LGD (%)						
Residential mortgage	20.0 %	20.0 %	20.6 %	20.0 %	20.0 %	20.5 %
Qualifying revolving retail	83.4 %	84.5 %	86.6 %	87.1 %	87.2 %	88.2 %
Retail SME	24.6 %	25.9 %	29.3 %	30.6 %	33.0 %	38.6 %
Other retail	83.0 %	81.0 %	79.6 %	78.5 %	77.4 %	79.4 %
Exposure weighted average risk weight (%)						
Residential mortgage	3.4 %	10.4 %	27.2 %	55.5 %	95.3 %	196.0 %
Qualifying revolving retail	4.2 %	12.0 %	37.8 %	82.1 %	161.0 %	319.8 %
Retail SME	6.1 %	15.4 %	34.8 %	59.5 %	100.8 %	193.3 %
Other retail	14.7 %	42.8 %	89.1 %	116.1 %	146.0 %	258.8 %

⁽¹⁾ Total undrawn commitments are included in the calculation of Total Exposures (EaD) shown above.

⁽²⁾ Simple average of exposure by number of arrangements.

As at 31 Mar 14

IRB approach	PD risk grade mapping					
	0<0.1% \$m	0.1<0.5% \$m	0.5<2.0% \$m	2.0<5.0% \$m	5.0<99.9% \$m	100% \$m
Total exposure						
Residential mortgage	85,295	105,593	89,447	16,413	8,725	2,065
Qualifying revolving retail	4,243	3,014	2,024	931	880	75
Retail SME	1,707	4,546	6,424	2,509	977	440
Other retail	1,252	907	1,235	782	503	69
Total exposure (EaD)	92,497	114,060	99,130	20,635	11,085	2,649
Undrawn commitments						
Residential mortgage	22,576	13,070	6,459	484	69	11
Qualifying revolving retail	3,190	1,803	477	127	74	6
Retail SME	1,006	1,163	814	253	67	62
Other retail	758	277	222	102	31	1
Total undrawn commitments	27,530	16,313	7,972	966	241	80
IRB approach						
Average EaD (\$m)						
Residential mortgage	0.07	0.28	0.26	0.29	0.35	0.16
Qualifying revolving retail	0.01	0.01	0.01	0.01	0.01	0.01
Retail SME	0.03	0.03	0.03	0.02	0.02	0.02
Other retail	-	0.01	0.01	0.01	-	0.01
Exposure weighted average LGD (%)						
Residential mortgage	20.0 %	19.9 %	20.6 %	20.0 %	20.0 %	20.7 %
Qualifying revolving retail	83.4 %	84.4 %	86.6 %	86.8 %	87.0 %	89.1 %
Retail SME	24.9 %	26.1 %	29.5 %	30.8 %	33.8 %	40.0 %
Other retail	83.2 %	81.2 %	78.5 %	77.7 %	77.9 %	79.1 %
Exposure weighted average risk weight (%)						
Residential mortgage	3.4 %	10.8 %	27.6 %	56.3 %	93.3 %	191.1 %
Qualifying revolving retail	4.1 %	12.1 %	37.6 %	83.5 %	165.8 %	151.0 %
Retail SME	6.1 %	15.5 %	35.1 %	59.3 %	105.6 %	202.6 %
Other retail	14.8 %	42.6 %	87.6 %	115.1 %	147.5 %	249.1 %

5.4 Credit Risk Mitigation

The NAB Group employs a range of techniques to reduce risk in its credit portfolio.

Credit risk mitigation commences with an objective credit evaluation of the counterparty. This includes an assessment of the counterparty's character, industry, business model and capacity to meet its commitments without distress. Other methods to mitigate credit risks include a prudent approach to facility structure, collateral, lending covenants, terms and conditions.

Collateral Management

Collateral provides a secondary source of repayment for funds being advanced, in the event that a counterparty cannot meet its contractual repayment obligations.

Collateral commonly includes:

- fixed and floating charges over business assets
- residential, commercial and rural property
- cash deposits
- fixed income products
- listed shares, bonds or securities
- guarantees, letters of credit and pledges.

To ensure that collateral held is sufficiently liquid, legally valid, enforceable and regularly valued, credit risk policy provides a framework to:

- establish the amount and quality of collateral required to support an exposure
- determine acceptable valuation type and revaluation requirements for each collateral class
- record market value and 'bank value' (a conservative assessment of value in the event the collateral is realised).

Guarantees from financially sound parties are sometimes required to support funds advanced to a counterparty; which can reduce the risk of default on their obligations. Where allowed in credit risk policy, guarantors that are risk rated may enhance the counterparty customer rating.

Credit Hedging

Credit hedging is utilised in the banking book to avoid counterparty concentrations against protection sellers and achieve portfolio diversification.

Credit risk to individual hedge counterparties is mitigated through careful selection of investment grade equivalent counterparties and use of collateral agreements to manage net exposures.

Credit Exposure Netting

Credit Exposure Netting may be adopted to calculate counterparty credit exposures on a net basis. This recognises that the change in value for different products over time is not perfectly correlated; transactions with positive value when netted may offset those with negative value.

Credit Exposure Netting is subject to execution of supporting legal documentation. A credit exposure measurement and reporting system manages the netting pools in accordance with that documentation.

Portfolio Management

Group Credit Risk, together with Business Unit Risk functions, manage the overall risk of the corporate, sovereign and bank credit portfolios. Where credit risks are identified, a variety of techniques are used to mitigate the risk, including credit derivatives and, on occasion, the sale of loan assets (in consultation with the counterparties).

Internal reporting systems are utilised to record all:

- approved derivative, money market, credit line and/or credit trading facility limits
- credit exposure arising from securities sales and purchases, money market lines, commodities, trade, derivative and foreign exchange transactions
- country risk exposures for country economic capital limit purposes.

Limits may be established at a facility, product group or individual product level, based on the level of financial sophistication exhibited by the counterparty. A specialist administration unit operating independently from relationship managers, dealers and credit approvers record and maintain the limits.

Table 5.4A: Mitigation by Eligible Collateral

This table discloses the total credit exposures subject to the standardised and supervisory slotting criteria approaches which are covered by eligible financial collateral. Exposures exclude non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee.

	As at 30 Sep 14	
	Total of which is exposure covered by eligible financial collateral	
	\$m	\$m
Specialised lending (SL)	62,138	349
Standardised approach		
Australian and foreign governments	12,304	256
Bank	1,650	1,226
Residential mortgage	44,423	57
Corporate	67,745	39,697
Other	3,870	730
Total standardised approach	129,992	41,966

⁽¹⁾ Eligible financial collateral, when used to reduce levels of exposure, refers to cash and cash equivalents as defined in APS 112. Exposures covered by eligible financial collateral are measured after the application of regulatory haircuts.

	As at 31 Mar 14	
	Total of which is exposure covered by eligible financial collateral	
	\$m	\$m
Specialised lending (SL)	62,918	396
Standardised approach		
Australian and foreign governments	2,955	163
Bank	12,701	1,528
Residential mortgage	42,116	63
Corporate	49,973	22,604
Other	3,728	60
Total standardised approach	111,473	24,418

Table 5.4B: Mitigation by Guarantees and Credit Derivatives

This table discloses the total credit exposures which are covered by the guarantees and credit derivatives relating to each portfolio. Exposures exclude non-lending assets, securitisation, CVA and the CCP default fund contribution guarantee.

	As at 30 Sep 14		
	Total exposure	of which is covered by guarantees	of which is covered by credit derivatives
	\$m	\$m	\$m
IRB approach			
Corporate (including SME)	234,372	21,336	-
Sovereign	65,322	118	-
Bank	66,908	123	315
Residential mortgage	317,400	-	-
Qualifying revolving retail	10,882	-	-
Retail SME	16,194	-	-
Other retail	4,522	-	-
Total IRB approach	715,600	21,577	315
Specialised lending (SL)	62,138	-	-
Standardised approach			
Australian and foreign governments	12,304	361	-
Bank	1,650	126	-
Residential mortgage	44,423	-	-
Corporate	67,745	-	-
Other	3,870	-	-
Total standardised approach	129,992	487	-

	As at 31 Mar 14		
	Total exposure	of which is covered by guarantees	of which is covered by credit derivatives
	\$m	\$m	\$m
IRB approach			
Corporate (including SME)	225,909	19,816	-
Sovereign	62,204	1	-
Bank	71,436	238	308
Residential mortgage	307,538	-	-
Qualifying revolving retail	11,167	-	-
Retail SME	16,603	-	-
Other retail	4,748	-	-
Total IRB approach	699,605	20,055	308
Specialised lending (SL)	62,918	-	-
Standardised approach			
Australian and foreign governments	2,955	389	-
Bank	12,701	183	-
Residential mortgage	42,116	-	-
Corporate	49,973	2	-
Other	3,728	-	-
Total standardised approach	111,473	574	-

5.5 Counterparty Credit Risk

This section describes the NAB Group's approach to managing credit risk concerning market-related instruments. Counterparty Credit Risk (CCR) is the risk that a counterparty to a transaction may default before the final settlement of the transaction's cash flows. An economic loss would occur if a transaction with a defaulting counterparty has a positive economic value to the NAB Group.

Credit Limits

Credit limits for derivatives are approved and assigned by an appropriately authorised DCA based on the same principles (i.e. amount, tenor, probability of default, loss given default and product type), and internal credit policies used for approving bank loans.

Credit exposures for each transaction are measured as the current mark-to-market value and the Potential Credit Exposure (PCE) which is an estimate of the future replacement cost.

Credit risk economic capital is then allocated to individual counterparty exposures based on their relative risk contribution to Unexpected Loss (UL).

Limit excesses, whether they are active or passive, are subject to formal approval by a DCA.

Collateral

Counterparty credit exposures may be collateralised by an approved list of eligible collateral via market standard master agreements (ISDA and credit support annex). Eligible collateral may be subject to haircuts depending on asset type. Counterparties may also be subject to posting additional collateral before transacting.

Bank systems are in place to support daily marking-to-market of net exposures and margin requirements, marking-to-market of collateral value and reconciliation of collateral receipt and holdings against collateral due.

Wrong Way Risk

Wrong way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty. Credit exposures and potential losses may increase under these circumstances as a result of market conditions. The NAB Group manages these risks through the effective implementation of a number of risk policies, including, but not limited to: single large exposure policy; credit concentration risk policies; aggregation policy; collateralisation policy; and various product restrictions.

Downgrade Impact

As at 30 September 2014, with respect to counterparty derivatives, the NAB Group would need to post an estimated amount of \$264 million of collateral in the event of a one notch downgrade to the NAB Group's credit rating, and \$359 million in the event of a two notch downgrade.

For transactions that would be affected by a downgrade clause, planning for, and the impact of, the event for the NAB Group is managed by Group Treasury.

6. Securitisation

Introduction

Securitisation is a structure where the cash flow from a pool of assets is used to service obligations to at least two different tranches or classes of creditors (typically holders of debt securities), with each class or tranche reflecting a different degree of credit risk (i.e. one class of creditors is entitled to receive payments from the pool before another class of creditors). An exception to this is a warehouse SPV which is a securitisation even if it does not have at least two different tranches of creditors or securities. The Level 2 Group engages in securitisation activities for two primary purposes:

- securitisation activities for business purposes, including arranging and managing securitisations for third parties (clients). These activities are undertaken primarily through securitisation SPVs that provide funding for single or multiple transactions
- securitisation of its own assets for funding, liquidity (including contingent liquidity) purposes, primarily for risk and capital management reasons.

The Level 2 Group has discontinued all securities arbitrage activities (i.e. the funding of purchased assets) and remaining exposures are managed separately in SGA.

The Level 2 Group's securitisation exposures are generally categorised according to the requirements of *APS 330*. Key definitions are provided below.

SPV

- SPV is an entity set up solely for the purpose of securitisation, usually a trust or a company
- the Level 2 Group does not sponsor any SPVs used to securitise third party exposures which are currently issuing securities.

Origination

- originating ADI: the Level 2 Group is an "Originating ADI" if it originally sold the asset to the SPV (directly or indirectly), manages the SPV or provides a non-derivative facility to an Asset Backed Commercial Paper (ABCP) Program
- non-originating ADI facilities: any facility provided by the Level 2 Group in which the Level 2 Group is not an Originating ADI
- originated assets: these refer to assets that were originally written by the Level 2 Group and transferred to the SPV, or in the case of indirect origination, written directly by the SPV at the direction of the Level 2 Group
- traditional securitisations: securitisations in which the pool of assets is assigned to an SPV, usually by a sale

- synthetic securitisations: securitisations in which the risk of the pool of assets is transferred to an SPV through a derivative, usually a credit default swap.

The Level 2 Group's assessment and management of securitisation risk is governed by *APS 120*.

Affiliated Entities

The Level 2 Group manages and advises MLC Limited which may invest in securitisation exposures that the Level 2 Group has securitised. These investments are made as part of MLC Limited's investment process and are made on an arm's length basis. These investments do not form a material percentage of the total funds invested by MLC Limited.

6.1 Third Party Securitisation

The Level 2 Group may undertake any of the following roles in its third party securitisation activities:

Role	Definition
Arranger	Structurer of securitisation transactions.
Liquidity Facility provider	Provider of liquidity facilities to an SPV for the primary purpose of funding any timing mismatches between receipts of funds on underlying exposures and payments on securities issued by the SPV.
Buyer of protection over assets⁽¹⁾	Entering into derivative transactions that provide credit protection over assets on the Level 2 Group's balance sheet.
Dealer	Buyer and seller in the primary and secondary markets of securities.
Derivative provider	Counterparty to swaps and other derivative transactions, including interest rate and currency derivatives provided to securitisation SPVs and credit derivative transactions.
First loss provider⁽¹⁾	Principally for securitisation of the Level 2 Group's own assets, the provider of credit enhancement that bears the first losses (if any) incurred by the securitised pool of assets.
Investor	Purchaser of securitisation debt securities for either trading or banking book purposes.
Letter of credit provider⁽¹⁾	Provider of credit enhancement to securitisation transactions.
Manager	Operator of securitisation SPVs, including managing assets and liabilities and providing accounting and administrative services.
Redraw Facility provider	Provider of liquidity to cover redraws of underlying loans for residential mortgage-backed securitisation transactions.
Securitisation funding facility provider	Lender to securitisation SPVs where the term of the funding extends beyond one year and may match the expected redemption date of the underlying security held by the SPV.
Sponsor⁽¹⁾	The entity that establishes the securitisation SPVs including ABCP conduits and often provides other services.
Standby liquidity provider⁽¹⁾	Provider of liquidity facilities to an SPV to cover the inability of the SPV to roll over ABCP.
Warehouse facility provider	Provider of lending (warehouse) facilities to an SPV for the financing of exposures in a pool.

⁽¹⁾ Immaterial level of involvement.

Structure and Organisation

The Board approves risk appetite limits and periodically monitors and reviews the third party asset securitisation framework, management and reporting with guidance from the Product & Markets Risk Management Committee (Product & Markets RMC), the GRRMC and the PBRC.

The Third Party Asset Securitisation Policy sets out how securitisation activity is governed and managed within the Level 2 Group.

The Product & Markets Risk function is responsible for ensuring that securitisation activity is conducted within the approved limits and maintaining ongoing reporting and compliance.

Management

The Level 2 Group's securitisation business has been segregated into an ongoing core client-based business managed as part of the Product & Markets portfolio and exposures managed by the Level 2 Group's SGA portfolio. SGA exposures comprise 'non-franchise' activities (largely Northern Hemisphere originated exposures) and are set for an orderly run-off by the Level 2 Group.

Third party securitisation activities follow the Level 2 Group's credit decision-making and oversight process. The Product & Markets Credit Risk function is responsible for independent credit decisions for securitisation transactions.

Expert knowledge specialists within the securitisation business work with customers, trustees and rating agencies to structure each transaction according to the requirements of Level 2 Group policies, APS 120 and the rating agencies. Approvals must be in accordance with the delegated commitment authority schedule.

Initial structuring and assessment includes an analysis of matters such as portfolio composition and quality, the

level and type of credit enhancement, due diligence on the quality of the servicer of the assets, and specific structural enhancements such as trigger events.

Measurement

Securitisation exposures and RWAs are measured in accordance with regulatory requirements outlined in APS 120. Key metrics include any external rating (if available), internal risk grading, the seniority of the exposure and the composition of the pool of securitised assets. The Level 2 Group views securitisation exposures for facilities provided to securitisation transactions as 'hold to maturity' exposures.

Depending on the asset class, the Level 2 Group uses either the ratings-based approach (RBA), the internal assessment approach (IAA) or other APS 120 methodologies, as approved by APRA, to calculate RWA for the portfolio.

The IAA methodology is applied to the following asset classes:

- residential mortgages
- equipment receivables
- auto loan receivables.

The IAA methodology has been developed by specialists within the Level 2 Group's securitisation function as part of the Third Party Asset Securitisation policy and was approved as set out under the heading 'Structure and Organisation' above.

The IAA methodology incorporates many of the elements of the external credit assessment institutions (ECAIs) used by the Level 2 Group including stress factors that are at least as conservative as the publicly available ECAI stress factors. The ECAIs used by the Level 2 Group are predominantly Standard & Poor's for rating securitisations for which the Level 2 Group is an originating ADI and Moody's and Fitch for some term transactions.

In addition to providing the basis for assessing the regulatory capital under *APS 120* for the relevant asset classes, the IAA is used in the Level 2 Group's internal risk management process.

The IAA approval also includes an additional risk weighting approach for unrated securitisation facilities to "non-IAA" asset classes that applies the higher (most conservative) risk weight of: (i) *APS 120* or *APS 112 standardised risk weights*, or (ii) *APS 120 IAA risk weights* based on the Level 2 Group's internal assessments. The outcome is that for a majority of the non-IAA asset classes the standardised risk weights apply.

The IAA model for each asset class is based on an asset class specific IAA methodology. The models used are locked-down to ensure a consistency of approach and minimise the risk of manual over-rides occurring. The methodology and model (where applicable) for each asset class are considered on a semi-annual basis to ensure they reflect the NAB Group's desired risk appetite and allow for changes in market conditions. Certain asset classes have a specific actuarial tool developed that allows for systematic assessment of credit risk across different pools of financial receivables. These tools have been provided to third party auditors for verification.

IAA model outputs are used in the credit decision making process for a given exposure according to the NAB Group's DCA matrix. Under the Group's Risk Management Accountability Model, the business has primary responsibility to manage risks originating in the business. This includes ensuring that the methodologies and models used remain appropriate and are updated as required. Secondary responsibility lies with Credit Risk who must ensure that the business uses the model consistently and that outcomes across different transactions are consistent. Internal and external auditors ensure that the approval process for the model and methodology are adequate.

Monitoring and Reporting

Finance functions perform regular measurement and reporting of securitisation and resecuritisation exposures, including revenue, capital, asset and facility limits and exceptions. Key elements of these reports are provided to the various risk committees.

Specialist securitisation areas monitor the quality of the pools of assets underlying securitisation or resecuritisation exposures and model the effect on the exposures. Material changes in credit quality of the assets or the exposures are reported to the risk function and, if required, to the relevant risk committees.

Accounting Treatment

In general, facilities provided to securitisation SPVs are treated the same way as facilities to any borrower or counterparty.

Interest income is recognised in the income statement using the effective interest method. Fees received which are directly attributable to the origination of the financial instrument are recognised as part of the effective interest method otherwise the fees are recognised on an accruals basis.

Most of these facilities fund NAB-sponsored securitisation SPVs which are consolidated by the Level 2 Group. On consolidation, the facilities are eliminated and the underlying liabilities and assets, including held to maturity investments in the SPVs, are brought onto the Level 2 Group's balance sheet. Held to maturity investments are accounted for at amortised cost, net of any provision for impairment.

Securitisation exposure held in trading book is recorded at fair value and unrealised profit or losses in respect of the fair value adjustments are recognised immediately in to the profit and loss account.

Securitisation exposure held in banking book is recorded at fair value and unrealised profit or losses in respect of the fair value adjustments are recognised in to the other comprehensive income.

Securitisation warehouse facilities provided to third party SPVs are accounted for at amortised cost, net of any provision for impairment.

Derivatives such as interest rate swaps, basis swaps or cross-currency swaps recorded at fair value and unrealised profit or losses in respect of the fair value adjustments are recognised immediately in to the profit and loss account.

In general, there is no difference in accounting treatment between securitisation and resecuritisation exposures.

Securitisation Risks

Risks arising from securitisation activities include credit, liquidity, market and operational risks. Interest rate risk and securities price risk are managed as part of the market and non-traded market risk processes. In some cases risks are assumed by acquiring securities or entering into facilities. In other cases risks are transferred through the securitisation of Level 2 Group assets. The Level 2 Group engages in credit risk mitigation on a case-by-case basis.

The Level 2 Group has certain exposures which are classed as resecuritisation exposures. These are predominantly, but not exclusively, contained in the SGA portfolio referred to above. The Level 2 Group does not specifically target resecuritisation exposures for investment.

Trading book securitisation exposures are not material at a Level 2 Group level. As such, these exposures are included in the tables below and are not separately disclosed within this document.

This section provides information about assets that the Level 2 Group manages as securitisations for third parties (clients) and for any retained exposure to assets securitised by the Level 2 Group.

Table 6.1A: Total Securitisation Exposures

This table shows the amount of securitisation exposures by facility and provides an indication of the relative extent to which the Level 2 Group has exposure to each type of asset within the securitisation SPV. This table does not provide information on Level 2 Group assets that have been sold to securitisations.

	As at 30 Sep 14				
	Total outstanding exposures				
	Non- originating ADI exposures	Originating ADI			
		Directly originated assets	Indirectly originated assets	ABCP facilities provided	Other (manager services)
	\$m	\$m	\$m	\$m	\$m
Underlying asset					
Residential mortgage	12,631	-	-	413	540
Credit cards and other personal loans	18	-	-	38	-
Auto and equipment finance	948	-	-	137	-
CDOs/CLOs ⁽¹⁾	-	-	-	-	815
Commercial mortgages	13	-	-	-	62
Corporate bonds	-	-	-	-	606
Other	535	-	-	-	234
Total underlying asset	14,145	-	-	588	2,257

⁽¹⁾ As at 30 September 2014, all exposures are traditional securitisations, where the pool of assets is assigned to an SPV, usually by a sale.

	As at 31 Mar 14				
	Total outstanding exposures				
	Non- originating ADI exposures	Originating ADI			
		Directly originated assets	Indirectly originated assets	ABCP facilities provided	Other (manager services)
	\$m	\$m	\$m	\$m	\$m
Underlying asset					
Residential mortgage	12,124	20	-	718	554
Credit cards and other personal loans	-	-	-	43	-
Auto and equipment finance	902	-	-	164	-
CDOs/CLOs ⁽¹⁾	-	-	-	-	1,101
Commercial mortgages	21	-	-	-	62
Corporate bonds	-	-	-	-	624
Other	570	-	-	-	342
Total underlying asset	13,617	20	-	925	2,683

⁽¹⁾ As at 31 March 2014, all exposures are traditional securitisations, where the pool of assets is assigned to an SPV, usually by a sale.

Table 6.1B: Type of Exposure

The following two tables provide information about assets that the Level 2 Group manages as securitisations (predominantly for third party clients) where the exposures are risk weighted under APS 120. These tables do not provide information on Level 2 Group assets that have been sold to securitisations whether or not the assets are risk weighted under APS 120. The table below breaks down the securitisation exposures by type of facility as defined in the Glossary.

Securitisation exposure type	As at 30 Sep 14			As at 31 Mar 14		
	On-balance sheet	Off-balance sheet	Total	On-balance sheet	Off-balance sheet	Total
	\$m	\$m	\$m	\$m	\$m	\$m
Liquidity facilities	-	2,153	2,153	-	2,259	2,259
Warehouse facilities	5,817	1,211	7,028	7,896	1,622	9,518
Credit enhancements	-	18	18	-	-	-
Derivative transactions	90	-	90	191	-	191
Securities	7,718	-	7,718	5,322	-	5,322
Credit derivatives transactions	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total securitisation exposures	13,625	3,382	17,007	13,409	3,881	17,290

Table 6.1C: Recent Third Party Securitisation Activity

This table provides information about new securitisation facilities provided in the six months to reporting date.

Securitisation exposure type	Notional amount of facilities provided	
	6 months ended 30 Sep 14	6 months ended 31 Mar 14
	\$m	\$m
Liquidity facilities	589	36
Warehouse facilities	265	871
Credit enhancements	18	-
Derivative transactions	29	36
Securities	3,775	1,448
Credit derivatives transactions	-	-
Other	-	-
Total new facilities provided	4,676	2,391

Table 6.1D: Exposures by Risk Weight

These tables show the risk weights for securitisation and resecuritisation exposures as calculated under APS 120, split between the RBA, the IAA, and Other.

Securitisation Exposures by Risk Weight

Securitisation exposures are on-balance and off-balance sheet risk positions held by the Level 2 Group arising from a securitisation, excluding exposures which have been classified as resecuritisations. Resecuritisation exposures are disclosed on the following page.

Risk weight bands	As at 30 Sep 14		As at 31 Mar 14	
	Exposure \$m	RWA \$m	Exposure \$m	RWA \$m
RBA				
≤10%	6,963	495	6,034	430
> 10% ≤ 25%	95	12	228	30
> 25% ≤ 35%	25	9	32	12
> 35% ≤ 50%	-	-	-	-
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	-	-	-	-
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
RBA sub-total	7,083	516	6,294	472
IAA				
≤10%	3,544	246	3,070	218
> 10% ≤ 25%	4,099	527	4,833	609
> 25% ≤ 35%	25	9	312	109
> 35% ≤ 50%	-	-	22	11
> 50% ≤ 75%	70	53	64	48
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	2	4	-	1
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	1	-	19	-
IAA sub-total	7,740	839	8,320	996
Other				
≤10%	29	2	31	2
> 10% ≤ 25%	251	43	301	50
> 25% ≤ 35%	3	1	3	1
> 35% ≤ 50%	105	52	98	49
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	528	528	713	713
> 100% ≤ 650%	182	254	17	77
> 650% ≤ 850%	-	-	-	-
1250%	72	905	147	1,889
Deductions	-	-	-	-
Other sub-total	1,170	1,785	1,310	2,781
Total	15,993	3,140	15,924	4,249

Resecuritisation Exposures by Risk Weight

Resecuritisation exposures are securitisation exposures in which the risk associated with an underlying pool of exposures is tranced and at least one of the underlying exposures is a securitisation exposure. In addition, an exposure to one or more resecuritisation exposures is a resecuritisation exposure.

Risk weight bands	As at 30 Sep 14		As at 31 Mar 14	
	Exposure \$m	RWA \$m	Exposure \$m	RWA \$m
RBA				
≤10%	-	-	-	-
> 10% ≤ 25%	-	-	-	-
> 25% ≤ 35%	-	-	-	-
> 35% ≤ 50%	-	-	-	-
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	-	-	-	-
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
RBA sub-total	-	-	-	-
IAA				
≤10%	-	-	-	-
> 10% ≤ 25%	3	1	3	-
> 25% ≤ 35%	-	-	-	-
> 35% ≤ 50%	5	2	4	2
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	16	35	16	78
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
IAA sub-total	24	38	23	80
Other				
≤10%	82	6	87	6
> 10% ≤ 25%	4	1	5	1
> 25% ≤ 35%	7	2	7	2
> 35% ≤ 50%	605	242	848	340
> 50% ≤ 75%	82	53	85	55
> 75% ≤ 100%	129	129	170	170
> 100% ≤ 650%	27	141	30	157
> 650% ≤ 850%	-	-	5	46
1250%	37	458	61	762
Deductions	-	-	-	-
Other sub-total	973	1,032	1,298	1,539
Total	997	1,070	1,321	1,619

Total Exposures by Risk Weight

This table is the sum of the tables 'Securitisation Exposures by Risk Weight' and 'Resecuritisation Exposures by Risk Weight' disclosed on the previous pages.

Risk weight bands	As at 30 Sep 14		As at 31 Mar 14	
	Exposure \$m	RWA \$m	Exposure \$m	RWA \$m
RBA				
≤10%	6,963	495	6,034	430
> 10% ≤ 25%	95	12	228	30
> 25% ≤ 35%	25	9	32	12
> 35% ≤ 50%	-	-	-	-
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	-	-	-	-
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
RBA sub-total	7,083	516	6,294	472
IAA				
≤10%	3,544	246	3,070	218
> 10% ≤ 25%	4,102	528	4,836	609
> 25% ≤ 35%	25	9	312	109
> 35% ≤ 50%	5	2	26	13
> 50% ≤ 75%	70	53	64	48
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	18	39	16	79
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	1	-	19	-
IAA sub-total	7,764	877	8,343	1,076
Other				
≤10%	111	8	118	8
> 10% ≤ 25%	255	44	306	51
> 25% ≤ 35%	10	3	10	3
> 35% ≤ 50%	710	294	946	389
> 50% ≤ 75%	82	53	85	55
> 75% ≤ 100%	657	657	883	883
> 100% ≤ 650%	209	395	47	234
> 650% ≤ 850%	-	-	5	46
1250%	109	1,363	208	2,651
Deductions	-	-	-	-
Other sub-total	2,143	2,817	2,608	4,320
Total	16,990	4,210	17,245	5,868

Table 6.1E: Exposures Deducted from Capital

The table below shows securitisation exposures that have been deducted from capital, divided into those that relate to securitisations of Level 2 Group assets and other securitisations.

	As at 30 Sep 14					Total	
	Deductions relating to ADI-originated assets securitised				Deductions relating to other securitisation exposures		Total
	Residential mortgage	Credit cards and other personal loans	Commercial loans	Other			
	\$m	\$m	\$m	\$m	\$m		\$m
Securitisation exposures deducted from capital ⁽¹⁾							
Deductions from Common Equity Tier 1 Capital	-	-	-	-	1	1	
Total securitisation exposures deducted from capital	-	-	-	-	1	1	

⁽¹⁾ These are exposures to the subordinated tranche (i.e. exposure to the first 10% of credit losses of a securitisation and where the exposure is not to the most senior tranche).

	As at 31 Mar 14					Total	
	Deductions relating to ADI-originated assets securitised				Deductions relating to other securitisation exposures		Total
	Residential mortgage	Credit cards and other personal loans	Commercial loans	Other			
	\$m	\$m	\$m	\$m	\$m		\$m
Securitisation exposures deducted from capital							
Deductions from Common Equity Tier 1 Capital	-	-	-	-	19	19	
Total securitisation exposures deducted from capital	-	-	-	-	19	19	

6.2 Level 2 Group Owned Securitised Assets

The Level 2 Group securitises its own assets for funding, liquidity risk and capital management purposes.

In doing this, the Level 2 Group acts as the originator, seller and servicer of assets from the Level 2 Group's balance sheet. This includes responsibility for collecting interest and principal on the securitised assets. The Level 2 Group may or may not retain an exposure to securitisation SPVs to which the Level 2 Group has sold assets. It may also manage or provide facilities for the securitisation (including credit enhancements, liquidity and funding facilities), roles which are outlined in *Section 6.1 Third Party Securitisation*.

This section includes information about the Level 2 Group's internal securitisation pools of residential mortgage-backed securities (RMBS). These securities have been developed as a source of contingent liquidity to support the Level 2 Group's liquid asset holdings outlined in *Section 9.1 Funding and Liquidity Risk*.

Structure and Organisation

GALCO and subsidiary ALCOs are responsible for the oversight of management's performance, and of the compliance and governance frameworks around balance sheet risks, including secured funding (which incorporates owned asset securitisation).

The GBSLR Policy and GBSLR Secured Funding Standard set out the principles and control framework for secured funding. Among other forms of secured funding, it applies to traditional securitisation, synthetic securitisation and a combination of the two.

The risk appetite for secured funding is reviewed annually and is set as part of the Level 2 Group Annual Funding Plan, approved by the Board.

Management

Securitisation exposures, risks and capital must comply with the requirements outlined in *APS 120*. Compliance with the requirements of *APS 120* is achieved through ensuring that the Level 2 Group:

- deals with the SPV and its investors on an arm's length basis and on market terms and conditions
- clearly discloses the nature and limitations of its involvement in a securitisation
- takes the necessary precautions to ensure that the Level 2 Group does not give the perception that it will support a securitisation that is in excess of its explicit contractual obligations (i.e. implicit support).

Level 2 Group and subsidiary Treasuries have responsibility for the management of secured funding, including:

- secured funding strategy and plan development, incorporating the setting of funding indices and secured funding targets (forming part of the Annual Funding Plan)
- execution of securitisation transactions
- ongoing management of securitisation transactions.

At the Level 2 Group level, Group Treasury is also responsible for the oversight of secured funding plans

and strategies, and for ensuring that activities across the Level 2 Group are coordinated and Level 2 Group objectives are achieved.

The GBSLR team are responsible for the independent oversight of secured funding execution management conducted by the Level 2 Group and Subsidiary Treasuries, monitoring secured funding activity to ensure it is conducted within the requirements of the Level 2 Group's secured funding framework and policies.

Measurement

The Level 2 Group's measurement framework for own asset securitisation is consistent with the framework outlined in *Section 6.1 Third Party Securitisation*. Business unit finance and risk functions perform regular measurement and reporting in relation to owned asset securitisation, including the impact on capital, provisioning, outstanding issuance and run-off. Clydesdale and BNZ are also governed by local regulatory requirements and report owned asset securitisation to the PRA and RBNZ using their respective local regulatory methodologies.

Monitoring and Reporting

Reporting is conducted periodically including:

- pool performance for each securitisation transaction
- investor and regulatory reporting
- rating agency and financial reporting
- funding plan updates to GALCO and subsidiary ALCOs.

Any key issues arising are also presented to the GRRMC and PBRC each month via the GCRO report.

Accounting Treatment

Through its securitisation program, the Level 2 Group engages in two main activities:

- it packages and sells loans (principally housing mortgage loans) and other finance receivables as securities to investors through a series of securitisation vehicles
- it develops securities as a source of contingent liquidity to support the Level 2 Group's liquid asset holdings.

The Level 2 Group is entitled to any residual income of the securitisation SPVs after all payments to investors and costs of the program have been met.

The Level 2 Group is considered to hold the majority of the residual risks and benefits within the securitisation SPVs and all relevant financial assets continue to be held on the Level 2 Group balance sheet. A liability is recognised for the proceeds of the funding transaction. The transactions are therefore considered financings rather than sales.

Table 6.2A: Assets Securitised by the Level 2 Group

This table shows the classes of assets that have been securitised by the Level 2 Group. This table and table 6.2B may include assets which are sold to SPVs (1) which issue securities which meet the Reserve Bank of Australia's repurchase eligibility criteria; (2) which otherwise do not result in significant risk transfer and are considered on-balance sheet for regulatory purposes; or (3) in which significant risk transfer has taken place and which are considered off-balance sheet for regulatory purposes.

	As at 30 Sep 14				
	Total outstanding exposures securitised assets originated by ADI		Impaired assets relating to exposures securitised	Total past due assets from exposures securitised	ADI recognised loss from exposures securitised
	Traditional	Synthetic			
	\$m	\$m	\$m	\$m	\$m
Underlying asset ⁽¹⁾					
Residential mortgage ⁽²⁾	65,092	-	133	189	-
Credit cards	-	-	-	-	-
Auto and equipment finance	92	-	0	-	-
Commercial loans	-	-	-	-	-
Other	-	-	-	-	-
Total underlying asset	65,184	-	133	189	-

⁽¹⁾ The definition of impaired and past due assets is consistent with the definitions provided in the Glossary of this report.

⁽²⁾ Includes internal securitisation pools of RMBS that have been developed as a source of contingent liquidity to support the Level 2 Group's liquid asset holdings. The amount of these securitised assets is \$51,247 million (March 2014: \$37,655 million).

	As at 31 Mar 14				
	Total outstanding exposures securitised assets originated by ADI		Impaired assets relating to exposures securitised	Total past due assets from exposures securitised	ADI recognised loss from exposures securitised
	Traditional	Synthetic			
	\$m	\$m	\$m	\$m	\$m
Underlying asset					
Residential mortgage	52,890	-	103	199	-
Credit cards	-	-	-	-	-
Auto and equipment finance	148	-	2	-	-
Commercial loans	-	-	-	-	-
Other	-	-	-	-	-
Total underlying asset	53,038	-	105	199	-

Table 6.2B: Recent Securitisation Activity

This table shows the amount of assets sold by the Level 2 Group to securitisation SPVs and any gain or loss on sale.

	6 months ended 30 Sep 14			6 months ended 31 Mar 14		
	Amount securitised during period directly originated	Amount securitised during period indirectly originated	Recognised gain or loss on sale	Amount securitised during period directly originated	Amount securitised during period indirectly originated	Recognised gain or loss on sale
	\$m	\$m	\$m	\$m	\$m	\$m
Underlying asset ⁽¹⁾						
Residential mortgage	17,153	-	-	8,085	-	-
Credit cards	-	-	-	-	-	-
Auto and equipment finance	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total underlying asset	17,153	-	-	8,085	-	-

⁽¹⁾ The amount securitised during the period is securitisation undertaken for funding purposes, where no significant risk transfer has occurred.

Disclosure 6.2C: Securitisation Subject to Early Amortisation

Attachment G of APS 120 provides for specific regulatory treatment for securitisations of certain types of assets. As at 30 September 2014 and 31 March 2014, none of these securitisations have been undertaken by the Level 2 Group.

Disclosure 6.2D: Forthcoming Securitisation Activity by the Level 2 Group

The Level 2 Group has a securitisation strategy, and sets funding indices and securitisation targets as part of its Annual Funding Plan. The aim of the securitisation program is to ensure that the Level 2 Group is capital efficient and has diversity of funding and liquidity sources.

To support this strategy, the Level 2 Group has a business practice in which pools of assets originated by the Level 2 Group are available to be internally securitised (as a source of contingent liquidity) or externally securitised when market opportunities arise. The Level 2 Group continually assesses opportunities for securitisation of these assets.

This table provides information about forthcoming external securitisation deals entered into between 30 September 2014 and the disclosure date of this report.

	As at	As at
	30 Sep 14	31 Mar 14
	\$m	\$m
Underlying asset		
Residential mortgage	934	-
Credit cards	-	-
Auto and equipment finance	-	-
Commercial loans	-	-
Other	-	-
Total underlying asset	934	-

Disclosure 6.2E: Credit Risk Mitigation and Guarantors

APS 330 Table 12n requires disclosure of resecuritisation exposures retained or purchased, broken down according to the application of credit risk mitigation and exposures to guarantors. As at 30 September 2014, the Level 2 Group did not have any resecuritisation exposures to which credit risk mitigation is applied or exposures to guarantors.

7. Market Risk

Introduction

The Level 2 Group makes a distinction between traded and non-traded market risks for the purpose of managing market risk. This section relates to traded market risk. Non-traded market risk is discussed in *Section 9 Balance Sheet and Liquidity Risk*.

The Level 2 Group undertakes trading activities to support its clients and to profit in the short term from differences in markets, such as interest rates, foreign exchange rates, commodity prices, equity prices and credit spreads. Traded market risk is the potential for losses or gains to arise from trading activities undertaken by the Level 2 Group as a result of the movement of market prices.

The Level 2 Group's exposure to market risk arises out of its trading activities which are principally carried out by Product & Markets Fixed Income, Currencies & Commodities (FICC) and BNZ. This exposure is quantified for regulatory capital purposes using both the APRA-approved internal model approach and the standard method, details of which are provided below.

Other business units within the Level 2 Group do not conduct trading books. Clydesdale and GWB offer a range of treasury risk management products to their customers to assist with the customers' management of interest rate risk and foreign exchange risk. Any market risk associated with treasury risk management products offered by Clydesdale and GWB is managed by the NAB Group so that, other than immaterial positions, market risk positions are not held on the balance sheet of Clydesdale or GWB.

Structure and Organisation

The Level 2 Group's risk appetite in relation to market risk is determined by the Board and is expressed in the Group Risk Appetite Statement, and governed by the Traded Market Risk Policy and Standards.

The Market Risk Appetite Statement complements the Group Risk Appetite Statement by providing further depth on the allocation of risk appetite to asset classes, regions and trading desks as well as detailing permitted products and markets.

The overall framework of Traded Market Risk Policy, Standards and the Risk Appetite Statement provide direction for the monitoring, oversight, escalation and governance of traded market risk including delegated authorities, risk measurement, and reporting and control standards.

The PBRC, GRRMC, GCMRC and the Product & Markets RMC oversee market risk activities by monitoring key indicators, such as Value at Risk (VaR), back-testing exceptions, limit breaches, and significant market risk events.

The Product & Markets Market Risk Subcommittee monitors the traded market risk profile and exposures. It reviews and approves models, oversees compliance with market risk policies and reviews market risks for consistency with approved market risk settings and the Level 2 Group's Risk Appetite. It also escalates market risk issues to these committees as necessary.

Management

Group Market Risk is an independent unit, separate from the trading activities units, with responsibility for the daily measurement and monitoring of market risk exposures. Key market risk measurement and monitoring limits are outlined in the following paragraphs.

VaR estimates the likelihood that a given portfolio's losses will exceed a certain amount. The Level 2 Group uses VaR estimates for both regulatory capital calculations in accordance with *Prudential Standard APS 116: Capital Adequacy: Market Risk*, and for internal risk control purposes.

The Level 2 Group is accredited by APRA to use a historical simulation model to simulate the daily change in market factors. VaR is calculated for all trades on an individual basis using a full revaluation approach. For capital purposes, VaR for products modelled using the Internal Model is calculated in Australian dollars on a globally diversified basis in accordance with the following parameters:

- confidence level - 99 per cent one tail
- holding period - 10 days (1 day VaR scaled by square root of time)
- observation period - 550 days (unweighted, updated daily).

VaR limits are assigned to individual trading desks and regions or product lines in accordance with the Market Risk Appetite Statement.

Group Market Risk monitors positions daily against the relevant limits and escalates any breaches in accordance with Market Risk standards and procedures. Additionally, Group Market Risk performs backtesting analysis to assess the validity of the VaR numbers when compared to the underlying trading exposures and to escalate any anomalies that may arise. Results of the backtesting are overseen by the Market Risk Subcommittee.

Stress testing is carried out daily to test the profit and loss implications of extreme but plausible, scenarios, and also to reveal hidden sensitivities in the portfolio that only become transparent when modelling extreme market moves.

'Stop loss limits' represent trigger points at which an overnight or accumulated loss incurred by a trading desk would lead to escalation in accordance with agreed procedures.

Sensitivity and other market risk limits are set by Group Market Risk to manage market risk at a more granular level, for example to manage concentration risk. These limits are monitored by Product & Markets FICC and independently by Group Market Risk.

Product & Markets FICC are responsible for managing risk, in order to deliver profits, while ensuring compliance with all limits and policies.

Measurement

As detailed in the following table, the Level 2 Group uses both the Standard Method and the IMA for measuring traded market risk. There are two types of market risk measures related to regulatory capital:

- general market risk which is related to changes in the overall market prices
- specific market risk which is related to changes for the specific issuer.

In accordance with *APS 110*, the RWA equivalent for traded market risk using the IMA is the capital requirement multiplied by 12.5.

	Standard Method	Internal Model Approach
Calculation	As per <i>APS 116 Attachment B</i>	Internally developed VaR calculation
General Market Risk	Equities, Carbon, some Banking Book FX Risk	Foreign Exchange, Commodities, Credit, Interest Rate and Inflation Products
Specific Market Risk	All applicable products	

Table 7.1A: Standard Method Risk-Weighted Assets

	As at	
	30 Sep 14	31 Mar 14
	\$m	\$m
Risk-Weighted Assets		
Interest rate risk	772	895
Equity position risk	6	2
Foreign exchange risk	-	11
Commodity risk	2	2
Total risk-weighted assets - standard method	780	910

Table 7.1B: Total Risk-Weighted Assets

	As at	
	30 Sep 14	31 Mar 14
	\$m	\$m
Market risk		
Standard method	780	910
Internal model approach	4,143	4,881
Total market risk RWA	4,923	5,791

Table 7.1C: Internal Model Approach VaR

The following table provides information on the high, mean and low VaR over the reporting period and at period end.

	6 months ended 30 Sep 14			As at
	Mean value	Minimum value	Maximum value	30 Sep 14
	\$m	\$m	\$m	\$m
VaR at a 99% confidence level ⁽¹⁾				
Foreign exchange risk	5	1	9	6
Interest rate risk	7	4	14	5
Volatility risk	1	1	2	1
Commodities risk	-	-	-	-
Credit risk	4	2	5	3
Inflation risk	-	-	1	1
Diversification benefit	(7)	n/a	n/a	(8)
Total diversified VaR at a 99% confidence level	10	6	17	8
Other market risks ⁽²⁾	-	-	1	1
Total VaR for physical and derivative positions	10	6	18	9

⁽¹⁾ The maxima / minima by risk types are likely to occur during different days in the period. As such, the sum of these figures will not equal the total maximum / minimum VaR which is the maximum / minimum aggregate VaR position during the period.

⁽²⁾ Other market risks include exposures to various basis risks measured individually at a portfolio level.

	6 months ended 31 Mar 14			As at
	Mean value	Minimum value	Maximum value	31 Mar 14
	\$m	\$m	\$m	\$m
VaR at a 99% confidence level				
Foreign exchange risk	3	1	5	3
Interest rate risk	7	4	12	10
Volatility risk	1	1	1	1
Commodities risk	-	-	1	-
Credit risk	5	3	7	4
Inflation risk	-	-	-	-
Diversification benefit	(7)	n/a	n/a	(4)
Total diversified VaR at a 99% confidence level	9	7	14	14
Other market risks	-	-	1	-
Total VaR for physical and derivative positions	9	7	15	14

Table 7.1D: Internal Model Approach Stressed VaR

The following table provides information on the high, mean and low stressed VaR over the reporting period and at period end.

	6 months ended 30 Sep 14			As at
	Mean value	Minimum value	Maximum value	30 Sep 14
	\$m	\$m	\$m	\$m
Stressed VaR at a 99% confidence level ⁽¹⁾				
Foreign exchange risk	10	1	24	9
Interest rate risk	15	7	22	13
Volatility risk	4	2	9	3
Commodities risk	-	-	1	-
Credit risk	20	15	23	17
Inflation risk	1	-	2	2
Diversification benefit	(25)	n/a	n/a	(24)
Total diversified VaR at a 99% confidence level	25	18	36	20
Other market risks ⁽²⁾	1	-	2	2
Total VaR for physical and derivative positions	26	18	38	22

⁽¹⁾ The maxima / minima by risk types are likely to occur during different days in the period. As such, the sum of these figures will not equal the total maximum/ minimum VaR which is the maximum/ minimum aggregate VaR position during the period.

⁽²⁾ Other market risks include exposures to various basis risks measured individually at a portfolio level.

	6 months ended 31 Mar 14			As at
	Mean value	Minimum value	Maximum value	31 Mar 14
	\$m	\$m	\$m	\$m
Stressed VaR at a 99% confidence level				
Foreign exchange risk	5	1	13	4
Interest rate risk	13	8	18	17
Volatility risk	5	1	9	8
Commodities risk	1	-	2	-
Credit risk	22	18	25	21
Inflation risk	1	1	1	1
Diversification benefit	(20)	n/a	n/a	(21)
Total diversified VaR at a 99% confidence level	27	17	34	30
Other market risks	1	-	1	-
Total VaR for physical and derivative positions	28	17	35	30

Monitoring and Reporting

VaR estimates are back-tested for reasonableness regularly. Back-testing is a process that compares the Level 2 Group’s daily VaR estimates against both theoretical and actual daily profit and loss (P&L) to ensure that model integrity is maintained.

The results of back-testing are reported to senior management, risk committees and the regulators. In addition to back-testing, the risk measurement model and all pricing models are subject to periodical reviews and independent validation at frequencies specified by the Group Model Risk Policy.

Back-testing Outliers

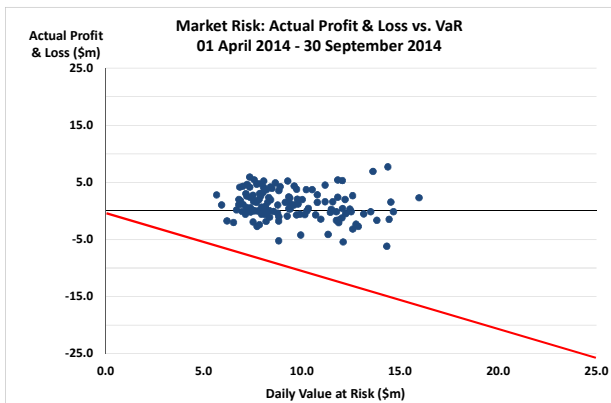
Back-testing, carried out by comparing the Level 2 Group’s daily VaR estimate against actual P&L numbers, identified no exceptions during the six month period to 30 September 2014 and no exceptions during the previous six month period to 31 March 2014. This remains within the model parameters and indicates acceptable operation of the VaR model within APRA’s guidelines.

Table 7.1E: Back-testing Results

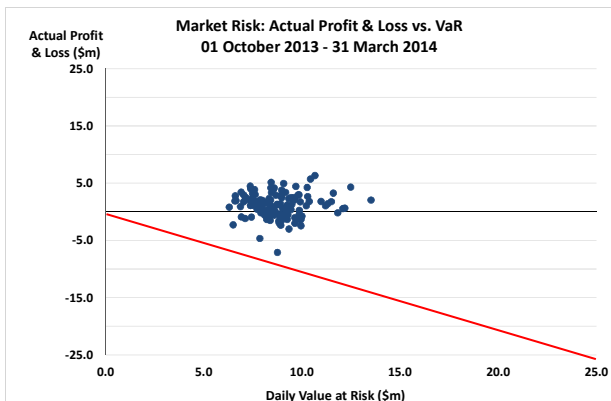
Comparison of VaR estimates to actual gains/losses	6 months ended 30 Sep 14	6 months ended 31 Mar 14
Number of “outliers” incurred for the trading portfolio	-	-

The following graph compares the Level 2 Group’s daily VaR estimates against actual P&L.

6 months ended 30 Sep 14



6 months ended 31 Mar 14



8. Operational Risk

Introduction

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This includes legal risk, but excludes strategic risk and reputational risk.

The primary objective for the management of operational risk is to ensure that where operational risk exists, it is identified, assessed and managed to acceptable levels, and at the same time, allows for the achievement of business and strategic objectives and compliance with our obligations.

Structure and Organisation

The PBRC, on the recommendation of the GRRMC, is responsible for approving and/or endorsing the:

- Group Operational Risk Framework (GORF)
- Group Operational Risk Appetite Statement
- Operational Risk Capital Calculation Model.

The NAB Group's Risk Governance structure provides the Board and PBRC with assurance over the performance of the overall risk management framework. This is primarily achieved through Group Operational Risk and Compliance (GOR&C) which provides the Board, PBRC, GRRMC, Group Regulatory Compliance Operational Risk Committee (GRCORC) and the Risk Leadership Team (RLT) with the information required to manage these responsibilities.

This flow of information ultimately allows the Board to discharge its responsibilities for managing the NAB Group's operational risk exposures.

Management

GOR&C provides the framework, policies, standards, processes and tools for the business to use in the identification, assessment, management, monitoring, measurement and reporting of operational risks.

Implementation of the GORF leads to:

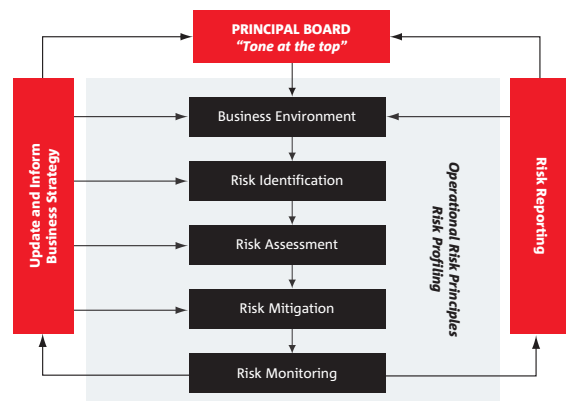
- all staff taking responsibility and ownership for managing the operational risk inherent in their day-to-day activities
- promoting and embedding a risk conscious culture and behaviour throughout the NAB Group
- consistency in the identification, assessment, management, monitoring, measurement and reporting of operational risk
- proactive identification and management of operational risks and events to contain: direct and indirect financial loss, disruption to business processes, and non-financial impacts including regulatory, reputation, customer and management remediation
- estimates of operational risk capital that reflect the operational risk profile of the NAB Group
- risk decisions being made on an informed basis, considering risk appetite and the capital implications, thereby enhancing awareness and/or acceptance of operational risks.

The NAB Group creates a risk conscious environment through promoting an operational risk culture:

- of effective integration of operational risk management into day-to-day business decisions
- where risk-awareness and questioning are supported (including the exercise of appropriate judgement in the identification and management of risk)
- of compliance, not only within the strict parameters of the law, delegated authorities and other compliance requirements, but also extending to doing what is right.

GORF applies to all entities within the NAB Group, as represented in the diagram below, including any outsourced services undertaken on behalf of any business within the NAB Group.

The NAB Group's Operational Risk Framework



The Enterprise Risk Policy, supporting standards and processes define the principles, minimum standards and processes for the management of operational risk throughout the NAB Group and support the GORF. The scope includes:

- Business Continuity Management
- Change Risk
- Event Management
- Information Security
- Model Risk
- Operational Risk Profiling
- Scenario Analysis
- Outsourcing
- Physical Security
- Travel Security
- Executive protection
- Anti-Fraud.

Additional standards/processes are developed when there is a critical need to manage a specific risk area.

Measurement

The NAB Group has been accredited to use its internal operational risk models and processes to determine regulatory capital for its Australian and New Zealand Banking operations. The NAB Group uses alternative standardised approach for Clydesdale and GWB. The NAB Group's AMA calculation of regulatory capital for operational risk uses data captured from:

- historical internal loss data which is representative of the NAB Group's operational loss profile
- scenario analysis data received from business and risk management professionals which considers potential extreme events faced by the NAB Group
- relevant data from losses incurred by other financial institutions and factors reflecting the business environment and internal controls.

The Operational Risk Capital Calculation Model is illustrated below as an end-to-end capital allocation process.

Calculation of Operational Risk Capital

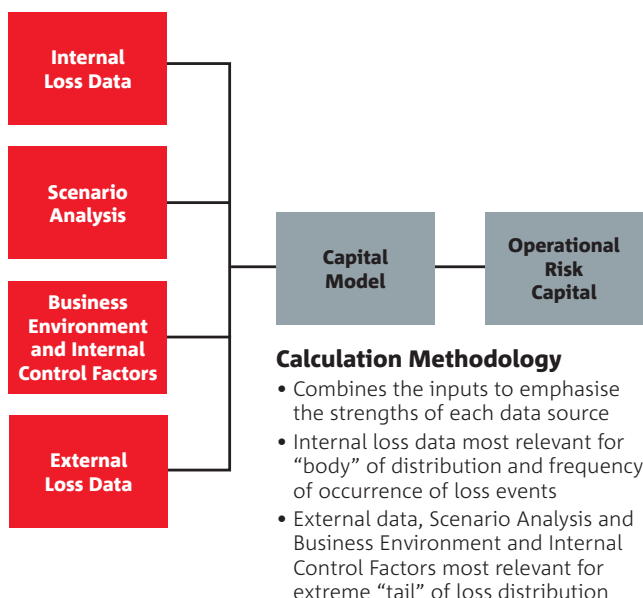


Table 8A: Total Risk-Weighted Assets

	As at	
	30 Sep 14	31 Mar 14
	\$m	\$m
Operational risk		
Standardised approach	3,992	3,997
Advanced measurement approach	32,542	32,283
Total operational risk RWA	36,534	36,280

Monitoring and Reporting

The success of the operational risk management processes is determined by the ability of management to articulate and consistently demonstrate behaviours that promote a strong risk awareness and culture throughout the NAB Group.

GOR&C provides the following reporting:

- monthly reporting on significant loss events, emerging issues, oversight, monitoring, and review activity. This information is included in the NAB Group CRO report which is provided to the GRRMC and PBRC
- monthly GOR&C insights based on external information. This is provided to Divisional risk teams
- 6 monthly GOR&C reports to the PBRC via GRRMC.

At times, the RLT and risk committees may also request GOR&C to report on topics of operational risk such as Business Continuity Management and physical security. GOR&C may also choose or be requested to undertake a deep dive review or provide analysis on a particular emerging issue or theme. Findings are reported to the requestor and, if material, escalated through the Risk Governance structure.

Risk Mitigation through Insurance

A key strategy to mitigate the financial impacts of operational risk exposures at the NAB Group level is the NAB Group's insurance program. This NAB Group function maintains and monitors the NAB Group's insurance program within a defined risk appetite and ensures that it aligns with the NAB Group's current and projected operational risk exposures. The quantitative modelling and measurement of the NAB Group's operational risk profile forms a significant input into the design of the NAB Group's insurance cover.

The regulatory capital measure for operational risk does not include any adjustment for insurance.

Regulatory and Compliance Management

The NAB Group is committed to complying with all applicable laws, regulations, licences, codes and rules, and to building constructive regulatory relationships.

Accordingly, the NAB Group has in place dedicated frameworks, policies, standards and processes that are designed to ensure the effective management of regulatory and compliance obligations across the NAB Group.

9. Balance Sheet and Liquidity Risk

Balance Sheet and Liquidity Risk (BSLR) is primarily concerned with the management of various structural, non-traded market risks within the Level 2 Group's balance sheet. Non-traded market risk arises from the Level 2 Group's banking book activity and includes capital risk, non-traded equity risk, interest rate risk, funding risk (secured and unsecured), liquidity risk and foreign exchange risk.

Structure and Organisation

The Board approved risk appetite limits are outlined in the GBSLR Policy, ancillary Standards and Limits Schedule, which provide direction for the management, measurement, monitoring, oversight, reporting and governance of non-traded market risks. The PBRC approves the GBSLR Policy.

The PBRC and GRRMC receive regular reporting on balance sheet management activities, along with monthly reporting of non-traded market risk compliance and activity.

The GALCO and subsidiary ALCOs review risk management strategies, compliance with risk limits and controls and remedial action undertaken for limit breaches. They approve the GBSLR Standards and models relating to balance sheet and non-traded market risks.

With the exception of non-traded equity risk, Level 2 Group and relevant subsidiary Treasuries are responsible for the management of non-traded market risks. For non-traded equity risk, individual business lines that have been allocated equity risk limits are responsible for managing their risk exposures.

GBSLR and subsidiary BSLR teams provide independent operational oversight over the non-traded market risk framework. GBSLR is the owner of the GBSLR Policy and ancillary Standards and oversees the operation of APRA approved models to meet regulatory requirements.

Further information on the management of GBSLR is included in the following sections of this report:

- section 4.1 Capital Adequacy
- section 6.2 Level 2 Group Owned Securitised Assets
- section 9.1 Funding and Liquidity Risk
- section 9.2 Interest Rate Risk in the Banking Book
- section 9.3 Equities Banking Book Position
- section 9.4 Foreign Exchange Risk in the Banking Book.

9.1 Funding and Liquidity Risk

Introduction

Liquidity risk is the risk of the Level 2 Group being unable to meet its financial obligations as they fall due. These obligations include:

- repayment of deposits
- repayment of borrowings and loan capital as they mature
- payment of operating expenses and taxes
- payment of dividends to shareholders
- ability to fund the NAB Group's strategic plan and growth initiatives.

Funding risk is the risk which arises due to change in appetite and capacity of the market to provide adequate long-term and short-term funds to meet the Level 2 Group's strategic plans and objectives at an acceptable cost. This includes the risk of over-reliance on any source of funding, which due to a lack of diversified funding sources jeopardises the Level 2 Group's ability to raise funds at acceptable costs under adverse business conditions.

The objectives of the Level 2 Group in managing its funding and liquidity risks are:

- to ensure that the current and future payment obligations of the Level 2 Group are met as they become due
- to retain adequate liquidity buffers in the Level 2 Group and subsidiary balance sheets so as to withstand severe market and institutional disruptions
- to meet planned business funding needs over a three-year forward horizon
- to maintain access to global short-term and long-term debt capital markets and global secured funding markets consistent with the target credit ratings of the Level 2 Group and its subsidiaries
- to diversify funding sources in terms of maturity, currency, instrument, investor type, geographic region and by the issuing entity.

Management

Target funding indices are set by the GALCO at both the NAB Group and subsidiary levels, and communicated for approval by the Board in the annual Group Funding Plan. The target indices measure and monitor customer funding and wholesale term funding levels.

The Group Funding Plan outlines the Level 2 Group's funding strategy and targets for a three-year period. In addition the plan outlines the key funding and liquidity metrics which Treasury manage towards, including a wholesale refinancing and cash flows days' positive target.

The GBSLR Policy, Liquidity and Funding Standards and Group Limits Schedule detail the Board's risk appetite

and guiding principles regarding liquidity and funding. In addition, they define the framework to ensure that the Level 2 Group can meet its current and future payment obligations as they become due under diverse operating scenarios and the framework to ensure that Level 2 Group and subsidiary balance sheet management practices do not introduce unacceptable levels of funding risk.

The NAB Group and relevant subsidiary Treasuries are responsible for managing funding and liquidity risk for the Level 2 Group. This includes the development and execution of liquidity and funding strategies consistent with the Group Funding Plan, mandates and limits in place.

The NAB Group and subsidiary BSLR teams are independent of Treasury and are responsible for liquidity and funding risk measurement and monitoring, developing and maintaining systems and models to support monitoring, and reporting of liquidity and funding compliance against limits.

Measurement

Liquidity risk is measured, managed and monitored on a cash flow basis, using scenario analysis, gap analysis and stress testing, and addresses all regulatory requirements. Key scenarios include going concern, offshore market closure and local market disruption.

Although managed on an individual currency basis, operational liquidity is measured and reported in accordance with cumulative cash flow mismatch limits. Mismatch limits are set for defined time buckets and scenarios. Concentration levels of funding sources, investor base and maturity terms are also monitored to avoid excessive concentration.

Monitoring and Reporting

Funding and liquidity risk are measured and monitored on a daily basis, with any non-compliance escalated to the GALCO and Group CRO. Monthly results are reported to Group and subsidiary ALCOs, GRRMC and PBRC. The NAB Group has clearly defined escalation procedures whereby liquidity events, both systemic and name specific, are monitored and appropriate actions outlined against triggers.

Regulatory Change

The Liquidity Coverage Ratio (LCR) is a key focus for the Group, with compliance required from 1 January 2015. The LCR measures the liquidity required in a severe stress scenario over a 30-day period. Compliance with the LCR is progressing in line with the Group Funding Plan, including the increase of liquidity assets and ensuring sufficient available collateral to access the Reserve Bank of Australia's CLF.

9.2 Interest Rate Risk in the Banking Book

Introduction

Interest Rate Risk in the Banking Book (IRRBB) arises from changes in market interest rates that adversely impact the NAB Group's financial condition in terms of earnings (net interest income) or economic value of the balance sheet. This includes:

- Repricing Risk, arising from changes to the overall level of interest rates and inherent mismatches in the repricing term of banking book items
- Yield Curve Risk, arising from a change in the relative level of interest rates for different tenors and changes in the slope or shape of the yield curve
- Basis Risk, arising from differences between the actual and expected interest margins on banking book items over the implied cost of funds of those items
- Optionality Risk, arising from the existence of stand-alone or embedded options in banking book items, to the extent that the potential for those losses is not included in the above risk types.

The objective of the NAB Group's framework is to ensure that IRRBB is managed to optimise and stabilise the NAB Group's economic value and earnings over an investment horizon.

Management

The Board approves the risk appetite for IRRBB, and sets the overall limits for VaR and Earnings at Risk (EaR).

The key elements of the management framework for IRRBB include:

- the GBSLR Policy and GBSLR IRRBB Standard define the compliance and management framework to ensure that all interest rate risk positions in the banking book are identified, measured, managed and reported, and are aligned to the requirements of *Prudential Standard APS 117: Capital Adequacy: Interest Rate Risk in the Banking book*
- the NAB Group and subsidiary Treasuries are responsible for managing the interest rate risk profile of the balance sheet in line with the approved risk appetite. This includes development and execution of interest rate risk management strategies
- Funds Transfer Pricing (FTP) is a mechanism in place to transfer interest rate risk out of originating business units and into the Treasury functions for the management of interest rate risk
- the NAB Group and subsidiary BSLR teams are responsible for IRRBB monitoring and oversight and are independent of Treasury. They maintain a risk framework for IRRBB and have responsibility for IRRBB measurement of exposures, compliance monitoring and reporting. The system and model for IRRBB measurement is managed by operations
- periodic reporting to management and governance committees of IRRBB exposures and compliance.

Measurement

The NAB Group has been accredited by APRA to use its internal model for the measurement of IRRBB. Interest rate risk is measured, managed and monitored using both the valuation approach and the earnings approach.

The principal metrics used to measure and monitor IRRBB are as follows:

Measurement	Definition
VaR	The potential loss in economic value implied by the static balance sheet that arises from changes to the current yield curve based upon historical observations for a given holding period and confidence level.
EaR	The potential loss in earnings implied by the static balance sheet over a 12-month forecast period, that arises from changes in the current yield curve based on historical observations for a given holding period and confidence level.
Market Value	The present value of all known future cash flows implied by the static balance sheet on both a spot and historically cumulative basis.
Embedded Value	The economic gain or loss implied by the static balance sheet which equates to the market value less the book value, less accrued interest.
Economic Value Sensitivity (EVS)	The potential impact of a one basis point parallel decrease in interest rates on the present value of all known future cash flows implied by the static balance sheet.
Net Interest Income Sensitivity (NIIS)	The potential impact of a one basis point parallel decrease in interest rates on the earnings over a 12-month forecast period implied by the static balance sheet.

VaR and EaR are measured with a three-month holding period and 99% confidence level for internal reporting purposes.

To complement these static measures, a series of stress tests are also modelled, measuring the impact of large parallel and non-parallel yield curve shocks.

The NAB Group incorporates behavioural modelling where contractual-based modelling is inappropriate for measuring IRRBB, such as for prepayments, non-bearing interest accounts, rate locks and CET1. Any changes to the assumptions require subsidiary ALCO or GALCO approval.

IRRBB regulatory capital includes a value for repricing and yield curve risk, basis risk, optionality risk and embedded value. The components of IRRBB regulatory capital are calculated using a historical VaR simulation using at least eight years of historical data at a 99% confidence level, one-year investment term of capital, and a 12-month holding period.

Monitoring and Reporting

The IRRBB metrics are measured and monitored on a monthly basis as a minimum. Compliance with limits is reported to subsidiary ALCOs, GALCO, GRRMC and PBRC on a monthly basis. IRRBB regulatory capital is also calculated monthly.

Table 9.2A: Interest Rate Risk in the Banking Book

This table provides the increase or decrease in economic value for upward and downward rate shocks broken down by currency.

	As at 30 Sep 14		As at 31 Mar 14	
	200 bp parallel increase	200 bp parallel decrease	200 bp parallel increase	200 bp parallel decrease
	\$m	\$m	\$m	\$m
Change in economic value ⁽¹⁾				
AUD	(118)	142	(26)	37
CHF	-	-	(2)	2
EUR	(3)	3	(8)	8
GBP	(78)	83	(143)	150
HKD	-	-	-	-
JPY	-	-	-	-
NZD	(129)	133	(15)	17
USD	16	24	99	(67)
Other	11	(11)	14	(14)
Total change in economic value	(301)	374	(81)	133

⁽¹⁾ The Level 2 Group's major currencies are modelled on an individual basis. The remaining immaterial currencies are aggregated and modelled using a single yield curve. The 200 basis point interest rate shock results include earnings offset.

Table 9.2B: Total Risk-Weighted Assets

	As at	
	30 Sep 14	31 Mar 14
	\$m	\$m
IRRBB risk-weighted assets	7,821	6,814

9.3 Equities Banking Book Position

Introduction

Non-traded equity risk refers to the direct loss that may be incurred as a result of reduction in the fair value of an equity investment in the NAB Group’s banking book. Fair value represents mark-to-market valuations derived from market prices or independent valuation and methodologies.

The objective of the NAB Group in managing non-traded equity risk is to protect the value of equity investments over the long term and to create value within an approved risk appetite. Key strategies include:

- strategic investments
- capital gains
- distressed debt management (e.g. Debt for Equity swaps).

Management

Equity risk appetite limits are reflected in the Group Risk Appetite Statement and the Group Limits Schedule. The Equity Risk Standard defines the compliance and management framework in relation to undertaking, measurement, monitoring and reporting equity investments outside of the trading book. It applies to both direct equity investments and equity underwriting activities.

Business units with a non-traded equity risk limit are responsible for managing equity risk in line with the requirements of the non-traded equity risk framework. Business units and their risk committees are responsible for monitoring of, and compliance with, all material risks, and ensuring that all commercial and risk aspects of the transactions are addressed.

The GBSLR team is responsible for maintaining independent oversight of the non-traded equity risk framework, including independent review of proposed equity transactions for compliance under the equity risk delegated authority, oversight of the periodic valuation and impairment assessments of investments, and monitoring and reporting of equity investment against limits.

Measurement

In line with Group Accounting Policy, changes in the value of equity investments in the banking book are recognised in profit and loss, or equity reserve accounts depending on their accounting treatment of individual investments. Market Data is used to value equities where there is an observable liquid market to provide fair valuation. For equities with no observable market data, a valuation is provided by the business with oversight provided by the Equity Revaluation Committee.

Monitoring and Reporting

Monthly reports are provided to senior management and risk committees. The overall monitoring and reporting framework is shown below.

Monitoring and Reporting Framework

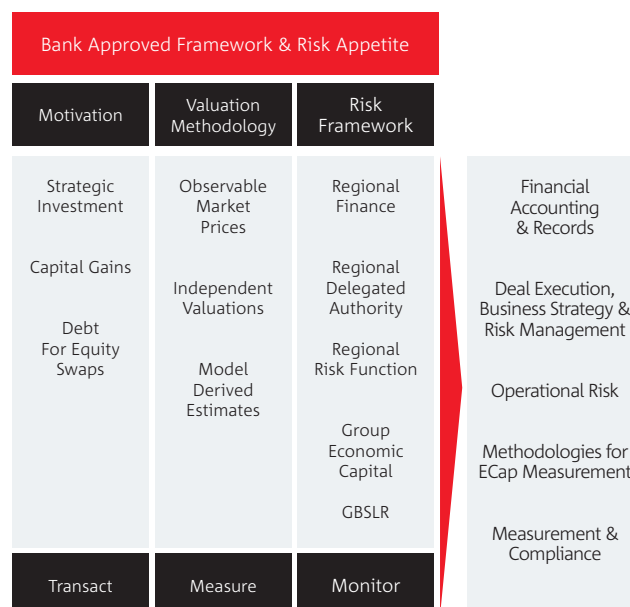


Table 9.3A: Equities Banking Book Position

This table provides the value of investments disclosed in the balance sheet, as well as the fair value of those investments.

	As at 30 Sep 14		As at 31 Mar 14	
	Carrying value ⁽¹⁾	Fair value ⁽²⁾	Carrying value	Fair value
	\$m	\$m	\$m	\$m
Total listed equities (publicly traded)	30	30	91	91
Total unlisted equities	556	555	546	546

⁽¹⁾ Carrying value as recorded in the Balance Sheet, in accordance with accounting standards.

⁽²⁾ The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, fair value is established by using a valuation technique.

Table 9.3B: Gains and Losses on Equity Investments

This table provides the realised (actual) gains/losses arising from sales and liquidations in the six months to 30 September 2014 recognised through the profit and loss account. Unrealised (expected) gains/losses which were previously included in Tier 1 and Tier 2 capital represent gains/losses recognised in the balance sheet but not through the profit and loss account.

	6 months ended	
	30 Sep 14	31 Mar 14
	\$m	\$m
Gains (losses) on equity investments		
Cumulative realised gains (losses) in reporting period	2	(1)
Total unrealised gains (losses)	27	(47)
Total unrealised gains (losses) included in Common Equity Tier 1, Tier 1 and/or Tier 2 Capital	166	188

Disclosure 9.3C: Equity Investments Subject to Grandfathering Provision

The Level 2 Group does not have any equity investments that are subject to grandfathering provisions.

9.4 Foreign Exchange Risk in the Banking Book

The NAB Group's banking book has exposure to risk arising from currency movements as a result of participation in the global financial markets and international operations. Foreign Exchange Risk in the Banking Book (FXRBB) arises from both operating business activities and structural foreign exchange exposures from foreign investments and capital management activities. Currency movements can impact profit and loss, cash flows and the balance sheet.

The NAB Group's objective in relation to foreign exchange risk is to protect the NAB Group's capital ratio from the impact of currency movements, and to manage non-structural foreign exchange risk within risk appetite. The NAB Group's main structural foreign exchange exposures are due to its investment in BNZ and Clydesdale.

The Board approves the risk appetite for FXRBB, setting the overall VaR limit. In addition, with guidance from the PBRC, it monitors and reviews the adequacy of the NAB Group's foreign exchange risk compliance and management framework developed by management.

The key elements of the management framework for FXRBB include:

- the GBSLR Policy and FXRBB Standard define the compliance and management framework to ensure all foreign exchange positions (both structural and non-structural) in the banking book are identified, measured, managed and reported
- the NAB Group and subsidiary Treasuries are responsible for the development and execution of foreign exchange risk management strategies
- GBSLR and subsidiary BSLR teams provide independent oversight. They are responsible for monitoring and oversight to ensure FXRBB is managed in compliance with the Policy and requirements of the Standard
- periodic reporting to management and governance committees of FXRBB exposures and compliance.

10. Detailed Capital Disclosures

10.1 Common Disclosure Template – Regulatory Capital

This table provides the post 1 January 2018 Basel III common disclosure requirements for APS 330 (Attachment A). Regulatory adjustments under Basel III are disclosed in full as implemented by APRA. The information contained within the table below should be read in conjunction with section 10.2 Regulatory Balance Sheet and section 10.3 Reconciliation between the Common Disclosure Template and the Level 2 Regulatory Balance Sheet.

	As at 30 Sep 14 \$m
Common Equity Tier 1 Capital: instruments and reserves	
1 Directly issued qualifying ordinary shares (and equivalent for mutually-owned entities) capital	25,523
2 Retained earnings	20,262
3 Accumulated other comprehensive income (and other reserves)	(1,467)
4 Directly issued capital subject to phase out from CET1 (only applicable to mutually-owned companies)	-
5 Ordinary share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-
6 Common Equity Tier 1 Capital before regulatory adjustments	44,318
Common Equity Tier 1 Capital: regulatory adjustments	
7 Prudential valuation adjustments	1
8 Goodwill (net of related tax liability)	5,203
9 Other intangibles other than mortgage-servicing rights (net of related tax liability)	2,326
10 Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	-
11 Cash-flow hedge reserve	(49)
12 Shortfall of provisions to expected losses	337
13 Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	-
14 Gains and losses due to changes in own credit risk on fair valued liabilities	(253)
15 Defined benefit superannuation fund net assets	112
16 Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	-
17 Reciprocal cross-holdings in common equity	-
18 Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the ADI does not own more than 10% of the issued share capital (amount above 10% threshold)	-
19 Significant investments in the ordinary shares of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	-
20 Mortgage service rights (amount above 10% threshold)	-
21 Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	-
22 Amount exceeding the 15% threshold	-
23 of which: significant investments in the ordinary shares of financial entities	-
24 of which: mortgage servicing rights	-
25 of which: deferred tax assets arising from temporary differences	-
APRA specific regulatory adjustments	
26 National specific regulatory adjustments (sum of rows 26a, 26b, 26c, 26d, 26e, 26f, 26g, 26h, 26i and 26j)	4,927
26a of which: treasury shares	(8)
26b of which: offset to dividends declared under a dividend reinvestment plan (DRP), to the extent that the dividends are used to purchase new ordinary shares issued by the ADI	-
26c of which: deferred fee income	-
26d of which: equity investments in financial institutions not reported in rows 18, 19 and 23	2,453
26e of which: deferred tax assets not reported in rows 10, 21 and 25	1,743
26f of which: capitalised expenses	139
26g of which: investments in commercial (non-financial) entities that are deducted under APRA prudential requirements	10
26h of which: covered bonds in excess of asset cover in pools	-
26i of which: undercapitalisation of a non-consolidated subsidiary	-
26j of which: other national specific regulatory adjustments not reported in rows 26a to 26i	590
27 Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	-
28 Total regulatory adjustments to Common Equity Tier 1	12,604
29 Common Equity Tier 1 Capital (CET1)	31,714

	As at 30 Sep 14 \$m
Additional Tier 1 Capital: instruments	
30 Directly issued qualifying Additional Tier 1 instruments	3,199
31 of which: classified as equity under applicable accounting standards	-
32 of which: classified as liabilities under applicable accounting standards	3,199
33 Directly issued capital instruments subject to phase out from Additional Tier 1	4,845
34 Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-
35 of which: instruments issued by subsidiaries subject to phase out	-
36 Additional Tier 1 Capital before regulatory adjustments	8,044
Additional Tier 1 Capital: regulatory adjustments	
37 Investments in own Additional Tier 1 instruments	-
38 Reciprocal cross-holdings in Additional Tier 1 instruments	-
39 Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the ADI does not own more than 10% of the issued share capital (amount above 10% threshold)	-
40 Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
41 National specific regulatory adjustments (sum of rows 41a, 41b and 41c)	-
41a of which: holdings of capital instruments in group members by other group members on behalf of third parties	-
41b of which: investments in the capital of financial institutions that are outside the scope of regulatory consolidations not reported in rows 39 and 40	-
41c of which: other national specific regulatory adjustments not reported in rows 41a and 41b	-
42 Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	-
43 Total regulatory adjustments to Additional Tier 1 Capital	-
44 Additional Tier 1 Capital (AT1)	8,044
45 Tier 1 Capital (T1 = CET1 + AT1)	39,758
Tier 2 Capital: instruments and provisions	
46 Directly issued qualifying Tier 2 instruments	-
47 Directly issued capital instruments subject to phase out from Tier 2	4,498
48 Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group T2)	-
49 of which: instruments issued by subsidiaries subject to phase out	-
50 Provisions	548
51 Tier 2 Capital before regulatory adjustments	5,046
Tier 2 Capital: regulatory adjustments	
52 Investments in own Tier 2 instruments	75
53 Reciprocal cross-holdings in Tier 2 instruments	-
54 Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the ADI does not own more than 10% of the issued share capital (amount above 10% threshold)	-
55 Significant investments in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
56 National specific regulatory adjustments (sum of rows 56a, 56b and 56c)	8
56a of which: holdings of capital instruments in group members by other group members on behalf of third parties	-
56b of which: investments in the capital of financial institutions that are outside the scope of regulatory consolidation not reported in rows 54 and 55	8
56c of which: other national specific regulatory adjustments not reported in rows 56a and 56b	-
57 Total regulatory adjustments to Tier 2 Capital	83
58 Tier 2 Capital (T2)	4,963
59 Total Capital (TC = T1 + T2)	44,721
60 Total risk weighted assets based on APRA standards	367,652

		As at 30 Sep 14 \$m
Capital ratios and buffers		
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	8.63%
62	Tier 1 (as a percentage of risk weighted assets)	10.81%
63	Total capital (as a percentage of risk weighted assets)	12.16%
64	Buffer requirement (minimum CET1 requirement of 4.5% plus capital conservation buffer of 2.5% plus any countercyclical buffer requirements expressed as a percentage of risk-weighted assets)	7.00%
65	of which: capital conservation buffer requirement	2.50%
66	of which: ADI-specific countercyclical buffer requirements	n/a
67	of which: G-SIB buffer requirement	n/a
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	n/a
National minima (if different from Basel III)		
69	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum)	n/a
70	National Tier 1 minimum ratio (if different from Basel III minimum)	n/a
71	National total capital minimum ratio (if different from Basel III minimum)	n/a
Amounts below the thresholds for deduction (not risk-weighted)		
72	Non-significant investments in the capital of other financial entities	574
73	Significant investments in the ordinary shares of financial entities	1,879
74	Mortgage servicing rights (net of related tax liability)	-
75	Deferred tax assets arising from temporary differences (net of related tax liability)	1,743
Applicable caps on the inclusion of provisions in Tier 2		
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	548
77	Cap on inclusion of provisions in Tier 2 under standardised approach	753
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	-
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	1,549
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)		
80	Current cap on CET1 instruments subject to phase out arrangements	-
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-
82	Current cap on AT1 instruments subject to phase out arrangements	4,845
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	628
84	Current cap on T2 instruments subject to phase out arrangements	4,498
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	278

10.2 Level 2 Regulatory Balance Sheet

The table shows the NAB Group's Balance Sheet and the Level 2 Regulatory Balance Sheet.

	NAB Group Balance Sheet As at 30 Sep 14 \$m	Adjustments \$m	Level 2 Regulatory Balance Sheet As at 30 Sep 14 \$m	Template Reference / Reconciliation Table
Assets				
Cash and liquid assets	41,034	(2,786)	38,248	
Due from other banks	39,088	(2)	39,086	
Trading derivatives	57,389	1,172	58,561	
Trading securities	44,212	-	44,212	
Investments - available for sale	43,386	(7)	43,379	
Investments - held to maturity	2,919	(1,214)	1,705	
Investments relating to life insurance business	85,032	(85,032)	-	
Other financial assets at fair value	84,488	-	84,488	
Hedging derivatives	5,488	-	5,488	
Loans and advances	434,725	(57)	434,668	
Due from customers on acceptances	23,437	-	23,437	
Current tax assets	-	-	-	
Property, plant and equipment	1,952	(6)	1,946	
Goodwill and other intangible assets	7,720	(4,276)	3,444	Table A
Deferred tax assets	1,617	(647)	970	
Investment in non-consolidated entities	-	5,960	5,960	Table A
Due from controlled entities	-	1,873	1,873	
Other assets	10,814	(855)	9,959	
Total assets	883,301	(85,877)	797,424	
Liabilities				
Due to other banks	45,204	(420)	44,784	
Trading derivatives	55,858	2	55,860	
Other financial liabilities at fair value	28,973	-	28,973	
<i>of which:</i>				
Change in own credit worthiness	253	-	253	Row 14
Hedging derivatives	3,445	(9)	3,436	
Deposits and other borrowings	476,208	5	476,213	
Liability on acceptances	61	-	61	
Life policy liabilities	71,701	(71,701)	-	
Current tax liabilities	729	(10)	719	
Provisions	2,914	(175)	2,739	
Bonds, notes and subordinated debt	118,165	(1,769)	116,396	
Other debt issues	4,686	-	4,686	
<i>of which:</i>				
Convertible preference share	3,199	-	3,199	Row 32
Defined benefit superannuation plan liabilities	12	-	12	
External unitholders' liability	14,123	(14,123)	-	
Deferred tax liabilities	-	(1,130)	(1,130)	
Due to controlled entities	-	367	367	
Other liabilities	13,314	1,742	15,056	
Total liabilities	835,393	(87,221)	748,172	
Net assets	47,908	1,344	49,252	

	NAB Group Balance Sheet As at 30 Sep 14 \$m	Adjustments \$m	Level 2 Regulatory Balance Sheet As at 30 Sep 14 \$m	Template Reference / Reconciliation Table
Equity				
Issues and paid-up ordinary share capital	24,049	1,474	25,523	Row 1
Other contributed equity	4,331	0	4,331	
Contributed equity	28,380	1,474	29,854	
General reserve for credit losses	601	-	601	
Asset revaluation reserve	81	-	81	
Foreign currency translation reserve	(1,936)	(4)	(1,940)	
Cash flow hedge reserve	(55)	6	(49)	Row 11
Equity-based compensation reserve	277	-	277	
Available for sale investments reserve	166	(2)	164	
Other reserves	(1,467)	-	(1,467)	Row 3
Reserves	(866)	-	(866)	
Retained profits	20,377	(115)	20,262	Row 2
Total equity (parent entity interest)	47,891	1,359	49,250	
Non-controlling interest in controlled entities	17	(16)	1	
Total equity	47,908	1,343	49,251	

10.3 Reconciliation between the Common Disclosure Template and Level 2
Regulatory Balance Sheet

Table A	As at 30 Sep 14 \$m	Template Reference
Goodwill and other intangible assets	3,444	
Investment in non-consolidated entities	5,960	
Total	9,404	
<i>Less</i>		
DTL for other intangible assets	(4)	
Goodwill (net of related tax liability)	5,203	Row 8
Other intangibles other than mortgage-servicing rights (net of related tax liability)	2,326	Row 9
Net tangible assets of investment in non-consolidated entities	1,879	
<i>Add</i>		
Insignificant equity investment in financial institutions	574	
Total equity investment in financial institutions	2,453	Row 26d

10.4 Material Entities Excluded from Level 2 Regulatory Balance Sheet

Table 10.4A: Insurance and Fund Management Entities

	As at 30 Sep 14	
	Total Assets \$m	Total Liabilities \$m
National Wealth Management Holdings Limited	9,259	2,083
National Australia Financial Management Limited	6,677	7
MLC Holdings Limited	3,837	-
MLC Investments Limited	107	27
MLC Limited	75,803	73,247
National Australia Trustees Limited	16	1

Table 10.4B: Securitisation Entities

	As at 30 Sep 14	
	Total Assets \$m	Total Liabilities \$m
TSL (USA)	313	313
Quasar No. 14 Trust	301	301
Titan NZ (MRP Bonds) Trust	224	224
Titan NZ Funding Trust	223	223

11. Remuneration

The NAB Group provides detailed information specific to senior executive remuneration in the *Remuneration Report* section of NAB's 2014 Annual Financial Report available online at www.nab.com.au.

Individuals within this disclosure have been identified consistent with the definitions provided in paragraph 17 of *APS 330* and paragraph 48(a) and (c) of *Prudential Standard CPS 510 Governance* (CPS 510).

	Number of individuals ⁽¹⁾	Definition
Senior Managers	24	Members of the NAB Group Executive Leadership Team (ELT), senior managers who are members of the NAB GRRMC and business line Chief Risk Officers.
Material Risk Takers	23	Executives of the NAB Group who can substantially impact the financial performance and capital position of the Level 2 Group.

⁽¹⁾ There were 28 senior managers and 17 material risk takers identified for the 2013 disclosure.

11.1 Remuneration Governance

The Remuneration Committee (the Committee) has been established by the Board. Its Charter (which is approved by the Board) sets out the membership, responsibilities, authority and activities of the Committee. The full Charter is available online at www.nab.com.au. Information on the governance, operations and activities of the Committee are detailed in the *Corporate Governance* section of NAB's Annual Financial Report available online at www.nab.com.au.

As at the date of this report, the Committee was comprised of four independent non-executive directors (including the Chairman of the Committee). The Committee met 13 times during 2014.

The Committee Chairman receives an annual fee of \$50,000 and other members of the Committee receive an annual fee of \$22,500 for membership of the Committee. Fees were reviewed during 2014. As a result of the review, the Board decided, having considered the advice of the Committee's external remuneration consultant, to increase the fees paid for the Committee. The increased fees recognises the additional responsibilities for the Committee over recent years due to additional regulatory requirements and to align with market. The annual Chairman fee will increase to \$55,000 and the annual non-executive director fee to \$25,000 from 1 October 2014.

Use of External Advisers

Where appropriate, the Committee seeks and considers advice directly from external advisers, who are independent of management.

The Committee retained Mr Walmsley of 3 degrees consulting to review and provide recommendations and advice on remuneration and governance matters including recommendations on senior executive remuneration.

Scope of the Remuneration Policy

NAB Group operates a global remuneration policy (the Policy) that applies to NAB and all its controlled entities. The Policy covers all employees, including senior managers and material risk takers. The NAB Group's overall philosophy is to adopt, where possible, a methodology, which links remuneration directly to the performance and behaviour of an employee, the NAB Group's results and shareholder outcomes.

This disclosure relates to senior managers and material risk takers of the Level 2 Group, for the financial year ended 30 September 2014.

11.2 Remuneration Processes

Remuneration Policy

The NAB Group's Policy uses a range of components to focus employees on achieving the NAB Group's strategy and business objectives. The Policy is designed to:

- attract, recognise, motivate and retain high performers
- provide competitive, fair and consistent rewards, benefits and conditions
- reward achievement of short and long-term individual objectives and business strategy
- align the interests of employees and shareholders through ownership of NAB securities.

Reward consists of:

- fixed remuneration provided as cash and benefits (including employer superannuation)
- short-term incentive (STI) reflecting both individual and business performance for the current year that supports the longer-term strategy of the NAB Group
- long-term incentive (LTI) provided to help align management decisions with the long-term prosperity of the NAB Group through the use of challenging external performance hurdles.

The mix of fixed and variable reward is balanced to ensure that fixed remuneration provides a sufficient level of remuneration so that the variable reward components (STI and LTI) can be fully flexible, including the possibility of paying no variable reward.

The remuneration mix at target is based on market information and practices. In any year, the actual mix may vary from target, given the overlay of business performance and relative individual performance.

Individual target reward must be approved by the Board for the ELT and any other senior executives of the NAB Group (as determined by the Board).

In addition, the Board will approve and monitor remuneration structures for senior managers and material risk takers. Individual target reward for other senior managers and material risk takers is approved by the appropriate senior manager in line with the Policy.

More details on STI and LTI arrangements are provided in *Section 11.4 Linking Performance and Remuneration* and *Section 11.5 Adjusting Remuneration for Longer-Term Performance*.

Other features of the Policy

Malus

The Board has absolute discretion, subject to compliance with the law, to adjust any STI reward, LTI award and other performance-based components of remuneration downwards, or to zero, to protect the financial soundness of NAB. In addition, the Board may vary vesting of deferred incentives and long-term incentives if the NAB Group's financial performance or risk management have significantly deteriorated over the vesting period. A qualitative overlay may be applied that reflects the NAB Group's management of business risks, shareholder expectations and the quality of the financial results. This discretion can be applied at any time and may impact unvested equity awards and performance-based rewards yet to be awarded, whether in cash or equity. In exercising its discretion, the Board will consider whether the rewards are appropriate given later individual or business performance. Malus may apply to any employees across the Group, by division, by role and/or employee, depending on circumstances.

Minimum shareholding policy

Members of the ELT are required to accumulate and retain NAB equity over a five year period from commencement in an ELT role, to the value of two times fixed remuneration for the Group CEO and Managing Director and one times fixed remuneration for other senior executives. Details of senior executive shareholdings in NAB are set out in the NAB's 2014 Annual Financial Report available online at www.nab.com.au.

Commencement, retention and guaranteed incentives

Commencement awards enable buy-out of unvested equity from previous employment. The amount, timing and performance hurdles relevant to any such awards are based on satisfactory evidence. The awards are primarily provided in the form of shares or performance rights, subject to performance hurdles, restrictions and certain forfeiture conditions, including forfeiture on resignation, unique to each offer. Guaranteed incentives or bonuses do not support the NAB Group's performance-based culture and are not provided as part of the NAB Group's Policy.

The NAB Group provides retention awards for key employees in roles where retention is critical over a medium-term timeframe (two to three years). These are normally provided in the form of shares or performance rights, subject to a restriction period, achievement of

individual performance standards and forfeiture conditions, including forfeiture on resignation.

Remuneration policy review

The Committee reviewed the Policy during 2014 to:

- introduce a minimum shareholding policy for the ELT ensuring that shareholder and senior executives' interests are more closely aligned
- reduced the maximum opportunity available under the STI plan for senior executives from 260% to 175%
- accommodate updates for UK regulatory changes.

Risk and Financial Control Employees

Risk and financial control employees (as defined in paragraph 48(b) of *CPS 510*) are critical to effective management of risk across the NAB Group.

Independence from the business for these employees is assured through:

- structuring total remuneration to ensure that variable reward is not significant enough to encourage inappropriate behaviours while remaining competitive with the external market
- the Risk or Finance function determining remuneration decisions, and not the business they support
- performance measures and targets set align with the NAB Group and/or specific to the function
- NAB Group performance and / or function performance being a key component for calculating employee incentive payments.

The Committee reviews remuneration structures for these employees and oversees the overall reward outcomes for employees in these roles at least annually.

11.3 Remuneration and Risk

Risk exists in every aspect of the business and throughout the NAB Group's operating environment. The NAB Group identifies and manages its risks as part of a Group-wide risk management framework. The risk management framework supports the successful implementation of the NAB Group's strategies and allows the NAB Group to run a sustainable, resilient business that is responsive to its changing environment. The NAB Group's remuneration strategy, reward framework, policies and practices are designed to support the risk management framework and align rewards with risk outcomes.

The NAB Group regularly assesses risks so that appropriate action can be taken to manage them, within the Board approved risk appetite.

Risk Measures

A number of risk measures exist across each of the NAB Group's key categories of risk, including but not limited to:

Risk Category	Definition	Key Measures
Credit	The potential that a counterparty or customer will fail to meet its obligations to the NAB Group in accordance with agreed terms	<ul style="list-style-type: none"> - Economic capital limits - Credit concentration limits e.g. single large exposures, industries, countries and products - Portfolio indicators in respect to credit quality having regard to probability of default, loss given default and exposure at default and a range of more granular measures applicable to the nature of the credit risk (e.g. loan to valuation ratios, days past due, impairments and write-offs)
Operational	Inadequate or failed internal processes, people and systems or external events	<ul style="list-style-type: none"> - Economic capital limits - Operational risk tolerances in respect to risk event types (e.g. number of loss events and near misses) - Operational Risk and Control Self-Assessment rating
Non Traded Market	The NAB Group's banking book activities e.g. capital, funding, liquidity, interest rate, foreign exchange and equity	<ul style="list-style-type: none"> - Economic capital limits - VaR and EaR limits - Operational limits linked to a range of activities and risks (e.g. liquidity coverage ratio, customer and stable funding indexes, CET1 capital)
Traded Market	The NAB Group's trading activities, including proprietary trading, as a result of adverse movements in market prices	<ul style="list-style-type: none"> - Economic capital limits - Trading desk limits and settings (e.g. stop loss limits) - Globally diversified VaR and inner stress limits
Life Insurance	Claims exceeding those anticipated in the premiums collected and underlying investment income earned	<ul style="list-style-type: none"> - Economic capital limits - Operational targets (e.g. for claims, lapses and solvency)
Regulatory and Compliance	Failing to identify, influence and monitor changes in the regulatory environment, failing to comply with laws, regulations and licence conditions, and damaging the NAB Group's relationship with its regulators	<ul style="list-style-type: none"> - A range of measures linked to regulatory and compliance obligations (e.g. number of material breaches, time to respond to review findings, identification and management of regulatory changes in line with plan)
Defined Benefit Pension	The NAB Group's defined benefit pension scheme being in deficit (i.e. the assets available to meet pension liabilities are at a value below current and future pension scheme obligations)	<ul style="list-style-type: none"> - Economic capital limits - VaR
Strategic Positioning	Strategic choices and their ongoing viability, including improper management of the assumed or embedded risks within the strategic choices	<ul style="list-style-type: none"> - Economic capital limits
Strategic Execution	Failing to execute the chosen strategy, including understanding the dependencies of success for the strategy and the NAB Group's responsiveness to changes to these factors	<ul style="list-style-type: none"> - Economic capital limits

Aligning Risk and Remuneration

STI and LTI reward outcomes reflect risk at a number of levels:

Individual scorecards – Employees have specific risk related measures relevant to their role and aligned with the Risk Appetite Statement where appropriate. The employee’s performance against these risk measures is captured, in part, through the employee’s STI reward. Employees who participate in the LTI Plan and who do not meet minimum performance requirements will not be eligible for LTI.

Compliance Gateway – Supports the NAB Group’s risk and compliance culture. Employees who do not pass the compliance expectations of their role will have their STI reduced in part, or in full, depending on the severity of the breach and may not participate in the LTI Plan and/or may have deferred STI and/or LTI lapsed.

STI pool measures – The financial measures used to determine the STI pool capture a number of material risks (see Section 11.4 Linking Performance and Remuneration for further discussion on how the financial measures take account of risk).

Risk adjustment of business outcomes – The Committee may recommend to the Board adjustment of the financial outcomes upon which STI and LTI rewards are determined based on a qualitative overlay that reflects the NAB Group’s management of business risks, shareholder expectations and the quality of the financial results.

There have been no changes to the nature and type of key measures used to account for risks and how they impact remuneration during 2014.

11.4 Linking Performance and Remuneration

Short-Term Incentives

STI rewards are determined based on a combination of business and individual performance.

Business performance is measured by a mix of growth in cash earnings, Return on Equity (ROE), and Return on Total Allocated Equity (ROTAE). These measures reasonably capture the effects of a number of material risks and minimise actions that promote short-term results at the expense of longer term business growth and success. STI pools are calculated at the NAB Group and major business segment using the following key performance measures:

Performance Measures	
Group	- Group cash earnings (40%) - ROE (30%) - Group ROTAE (30%)
Business Segment	- Business cash earnings (40%) - ROTAE (60%)

An employee’s performance is assessed against agreed measures and targets relevant to their role. Performance measures are set as part of NAB Group’s longer-term strategy development process, which cascade to each employee’s scorecard. The scorecard measures under each business driver are selected for their alignment to NAB Group’s strategic direction.

The key performance measures used for senior executives of the NAB Group and cascaded to employees throughout the NAB Group in 2014 were:

Key Business Driver	Measures
Financial and risk management	- Group cash earnings - ROE - ROTAE - Common Equity Tier 1 ratio - Risk appetite
Strategic projects	- Technology - Customer model implementation - Non-core business strategy
Employees and culture	- Employee engagement - Diversity targets
Customer and community	- Customer satisfaction - Reputation

Providing a portion of the STI reward as deferred equity and cash, allows time to confirm that the initial business and individual performance outcomes are realised if not, and for STI reward to be adjusted downwards.

STI plans link to NAB Group and business performance by delivering smaller STI pools when performance is less than target and larger STI pools when performance is above target.

Executive Long-Term Incentive Plan

The Executive LTI Plan helps to drive management decisions concerning the long-term prosperity of the NAB Group. The Executive LTI Plan has three to five year performance periods (from 2012 the minimum is four years).

The performance measures for the LTI awarded in 2014 are:

- NAB’s Total Shareholder Return (TSR) performance relative to the TSR performance of each company in the S&P/ASX Top 50 Index as at 1 October 2014; and
- NAB’s TSR performance relative to the TSR performance of a selection of financial services companies in the S&P/ASX 200.

A list of the companies used for the LTI performance measures can be found online at www.nab.com.au. NAB’s TSR ranking compared to the peer groups will determine the proportion of performance rights that will vest.

The use of TSR directly links the employee’s LTI reward to shareholder value over the medium to long-term.

Adjustment of Remuneration

Poor performance during a performance period will be reflected in the STI awarded or amount of LTI that vests at the end of the vesting period. If performance is significantly weak, this may result in no STI being awarded and/or no LTI vesting.

The Committee, in consultation with the PBRC, reviews financial and risk outcomes at the end of the performance year and recommends to the Board, the size of the STI pool, taking into account a qualitative overlay that reflects the NAB Group's management of business risks (see Section 11.3 Remuneration and Risk), shareholder expectations and the quality of the financial results.

11.5 Adjusting Remuneration for Longer-Term Performance

Longer-term performance is reflected in the design of NAB Group's STI and LTI arrangements.

STI plans contain annual performance metrics that are set to achieve the NAB Group's longer term strategy. Deferral of a portion of the STI reward allows for the reward to be adjusted after the initial performance assessment to reflect longer-term performance outcomes.

The NAB Group's LTI plan has a minimum four year performance period to align senior management decisions with the achievement of sustained positive performance by NAB Group.

Deferral arrangements

STI rewards are subject to deferral for all senior managers and material risk takers depending on the STI plan and jurisdictional requirements:

Role Grouping	Deferral Arrangement
Group CEO Group Executive Other Senior Managers and Material Risk Takers (not in categories below)	50% of STI is deferred equally over 2 years
Group Executives who have ceased employment, Senior Managers and Material Risk Takers (not in categories below)	25% of STI is deferred for 1 year
Senior UK Code Staff	60% (Code Staff earning more than £500,000 variable remuneration) or 50% of STI is deferred for either 2 or 3 years
Financial Markets Specialist Incentive Plan (SIP)	50% of STI deferred equally over 2 years

Note: Other deferral arrangements apply to employees not identified as senior managers or material risk takers.

Deferred STI amounts are generally provided in either shares or performance rights.

For UK Code Staff, half of any 'up-front' cash STI payments is provided as equity subject to a six month

retention period and a further six month retention period applies to deferred STI and LTI after performance conditions have been satisfied. The retained amounts are restricted from being sold, transferred or exercised by the employee during the retention period. No further performance conditions apply to retention equity.

Deferred STI and unvested LTI may be further adjusted as described in Section 11.2 Remuneration Processes - Malus.

Once an award has vested or the performance restrictions have ceased, no further adjustment or 'Malus' applies.

11.6 Forms of Variable Remuneration

The NAB Group provides variable remuneration in the following forms:

Form	Use
Cash	<ul style="list-style-type: none"> - All or a portion of the STI award that relates to the current performance year - Portion of the 2013 UK LTI - Occasionally for deferred STI where an employee is entitled to receive deferred STI but has ceased employment with NAB Group prior to allocation of any shares or performance rights - Retention and recognition awards - Commencement awards.
Shares	<ul style="list-style-type: none"> - Deferred STI (except as noted otherwise). - General employee share offers - Retention and recognition awards - Commencement awards.
Performance rights	<ul style="list-style-type: none"> - Deferred STI for some employees for jurisdictional reasons - Deferred STI for executives receiving an LTI award - LTI awards - Retention and recognition awards - Commencement awards.

Generally, NAB Group aims to provide deferred STI and LTI awards as equity to align the interests of employees and shareholders. Performance rights are provided where NAB Group does not consider it appropriate to pay dividends during deferral or restriction periods.

The mix of different forms of variable remuneration is dependent on the employee's role and external market relativities.

All employees are eligible to participate in an STI plan. STI awards will generally be provided in a combination of cash and equity as described above in Deferral Arrangements (see Section 11.5 Adjusting Remuneration for Longer Term Performance).

LTI awards are provided to senior executives of NAB Group. Not all senior managers or material risk takers will participate in the LTI program. Senior managers and material risk takers who do not participate in the LTI program will generally receive deferred STI shares.

Retention, recognition and commencement awards are provided to an employee depending on circumstances. The quantum and form will vary depending on the specific circumstances at the time of the award.

11.7 Quantitative Remuneration Disclosures

Table 11.7A: Total Value of Remuneration Awards ⁽¹⁾

	As at 30 Sep 14				As at 30 Sep 13			
	Senior Managers		Material Risk Takers		Senior Managers		Material Risk Takers	
	Unrestricted	Deferred	Unrestricted	Deferred	Unrestricted	Deferred	Unrestricted	Deferred
	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Fixed remuneration								
Cash-based ⁽²⁾	19,450	-	9,602	-	17,844	-	6,833	-
Other ⁽³⁾	765	-	619	-	842	-	496	-
Variable remuneration ⁽⁴⁾								
Cash-based ⁽⁵⁾	5,887	-	5,660	-	6,656	-	6,825	-
Shares and share-linked instruments ⁽⁶⁾	-	8,241	-	7,628	-	18,685	-	7,964

⁽¹⁾ Prepared in accordance with APS 330 Attachment E Table 18A. There were no amounts of fixed remuneration paid in shares or share-linked instruments. Cash-based deferred variable remuneration was awarded during 2014, however in accordance with the relevant accounting standard (AASB 119) no portion of this amount has been accrued in 2014. No other forms of variable remuneration were provided.

⁽²⁾ Includes cash salary, cash allowances, short-term compensated absences (such as annual leave entitlements accrued but not taken during the year), motor vehicle benefits, parking and other benefits (including any related fringe benefits tax).

⁽³⁾ Other fixed remuneration includes employer contributions to superannuation (in Australia) and National Insurance Contributions (in the UK) and long service leave entitlements accrued but not taken during the year. The long service leave entitlements are recognised as accruing on an annual basis subject to an actuarial calculation.

⁽⁴⁾ 24 (2013: 26) senior managers and 23 (2013: 16) material risk takers received variable remuneration in respect of the relevant year. In 2013, some senior managers and material risk takers did not receive variable remuneration as they ceased employment with the NAB Group during the relevant year.

⁽⁵⁾ The cash component of the STI received in respect of the relevant year.

⁽⁶⁾ Shares and share-linked instruments amounts are determined based on the grant date fair value amortised on a straight line basis over the expected vesting period. The amount shown is the portion relating to the relevant year accounting expense accrual and includes amounts relating to the relevant year and prior year awards.

Table 11.7B: Deferred Remuneration

	As at 30 Sep 14		As at 30 Sep 13	
	Senior Managers	Material Risk Takers	Senior Managers	Material Risk Takers
	\$000	\$000	\$000	\$000
Total outstanding deferred remuneration ⁽¹⁾	36,435	19,279	63,389	20,427
Cash-based	659	-	586	339
Shares and share-linked instruments	35,776	19,279	62,803	20,088
Paid out during the year ⁽²⁾	22,358	11,812	17,000	7,220
Reductions due to explicit adjustments ⁽³⁾	(47,108)	(4,203)	(12,311)	(62)
Reductions due to implicit adjustments ⁽⁴⁾	-	-	(1,097)	(268)

⁽¹⁾ The value of deferred cash awards is the grant value and for deferred equity awards is the grant fair value. Outstanding deferred remuneration provided as shares and share-linked instruments is fully exposed to ex post explicit and/or implicit adjustments.

⁽²⁾ Includes the value of vested awards using the closing share price of NAB shares on the vesting date for all senior managers and material risk takers during the relevant year.

⁽³⁾ Includes any reductions to awards as a result of forfeitures and lapses due to failure to meet performance hurdles, resignations, or malus adjustments for all senior managers and material risk takers during the relevant year. The value was calculated using the closing share price of NAB shares on the forfeiture or lapsing date.

⁽⁴⁾ There were no reductions to awards vested during the relevant year due to the downward movement of NAB's share price since the grant date for all senior managers and material risk takers.

Table 11.7C: Other Remuneration ⁽¹⁾

	As at 30 Sep 14				As at 30 Sep 13			
	Senior Managers		Material Risk Takers		Senior Managers		Material Risk Takers	
	No. of individuals	Total amount \$000	No. of individuals	Total amount \$000	No. of individuals	Total amount \$000	No. of individuals	Total amount \$000
Commencement awards ⁽²⁾	1	6,500	-	-	-	-	1	760
Termination payments ⁽³⁾	1	1,707	-	-	2	1,696	1	242

⁽¹⁾ No senior managers or material risk takers received a guaranteed bonus during 2013.

⁽²⁾ The full value of these awards and payments is shown with no expensing adjustments made.

⁽³⁾ Termination payments are made in accordance with the relevant NAB Enterprise Agreement and/or the employee's employment agreement. Employees may also retain shares and performance rights in accordance with the relevant terms and conditions of each grant, which remain subject to the relevant performance hurdles and restriction periods. These arrangements are in line with the NAB Group's policy and practice in such circumstances.

12. Glossary

Term	Description
ABCP	Asset-Backed Commercial Paper being a form of commercial paper that is collateralised by other financial assets. It is a short-term debt instrument created by an issuing party (typically a bank or other financial institution).
ADI	Authorised Deposit-taking Institution.
Advanced IRB approach (IRB)	The Advanced Internal Ratings Based (IRB) approach refers to the processes employed by the NAB 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.
AMA	Advanced Measurement Approach (AMA) is the risk estimation process used for the NAB Group's operational risk. It combines internally developed risk estimation processes with an integrated risk management process, embedded within the business with loss event management.
APRA	Australian Prudential Regulation Authority.
APS	Prudential Standards issued by APRA applicable to ADIs.
Alternative Standardised Approach (ASA)	Alternative Standardised Approach is the risk estimation process used for the NAB Group's operational risk.
Back-testing	Back-testing refers to the process undertaken to monitor performance of the NAB Group's risk models. Historical data is used to compare the actual outcomes to the expected outcomes. Theoretical (or hypothetical) back-testing refers to the process whereby the trading positions at the end of the preceding day are revalued using the end-of-day rates for that day and then again at the succeeding day's closing rates. The difference between the two mark-to-market values of the portfolio which represents the profit and loss that would have occurred had there been no transactions on the day, is compared with the VaR. VaR is also compared with the actual daily traded profit and loss as a cross-check of the reasonableness of the theoretical portfolio movement.
Basel Accord	The Basel regulatory framework (which includes Basel II, Basel 2.5 and Basel III) is the global benchmark for assessing banks' capital adequacy. The guidelines are aimed at promoting a more resilient banking system through the development of capital adequacy standards that are more accurately aligned with the individual risk profile of institutions, by offering greater flexibility for supervisors to recognise and encourage the use of more sophisticated risk management techniques.
BIPRU	BIPRU refers to the UK PRA's requirements and guidance for accreditation under the Basel Accord. It refers to the Prudential Sourcebook for Banks, Building Societies and Investment Firms.
Board	Principal Board of Directors of NAB.
Capital adequacy	Capital adequacy is the outcome of identifying and quantifying the major risks the NAB Group is exposed to, and the capital that the NAB Group determines as an appropriate level to hold for these risks, as well as its strategic and operational objectives, including its target credit rating.
CDO	Collateralised Debt Obligation.
Central Counterparty (CCP)	A clearing house which interposes itself, directly or indirectly, between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer.
CLO	Collateralised Loan Obligation.
Committed Liquidity Facility (CLF)	The Reserve Bank of Australia will establish a committed liquidity facility (CLF) as part of Australia's implementation of the Basel III liquidity reform, which will provide high-quality liquidity to commercial banks to assist them in meeting the Basel III liquidity requirements.
Common Equity Tier 1 (CET1)	Common equity is recognised as the highest quality component of capital. It is subordinated to all other elements of funding, absorbs losses as and when they occur, has full flexibility of dividend payments and has no maturity date. It is predominately comprised of common shares; share premium; retained earnings; undistributed current year earnings; as well as other elements as defined under <i>Prudential Standard APS 111 Capital Adequacy: Measurement of Capital</i> .
Compliance Gateway	All employees must satisfy threshold measures for compliance which reflect a range of internal and external regulatory requirements.
Corporate (including SME)	Corporate (including SME) consists of corporations, partnerships or proprietorships not elsewhere classified and includes non-banking entities held by banks.
Credit derivatives	Credit derivatives include single-name credit default and certain total rate of return swaps, cash funded credit linked notes and first-to-default and second-to-default credit derivative basket products. ADIs may also recognise many more complex credit derivatives that do not fall into the list above, that have been approved by APRA.
Credit derivative transactions	In relation to securitisation exposures, credit derivative transactions are those in which the credit risk of a pool of assets is transferred to the NAB Group, usually through the use of credit default swaps.
Credit enhancements	Credit enhancements are arrangements in which the NAB Group holds a securitisation exposure that is able to absorb losses in the pool, providing credit protection to investors or other parties to the securitisation. A first loss credit enhancement is available to absorb losses in the first instance. A second loss credit enhancement is available to absorb losses after first loss credit enhancements have been exhausted.
Credit Value Adjustment (CVA)	A capital charge to reflect potential mark-to-market losses due to counterparty migration risk on bilateral OTC derivative contracts.
The Credit Risk function	All areas reporting directly to the Chief Credit Officer including Credit Insight & Appetite, Credit Frameworks, Credit Oversight, Counterparty Credit and Strategic Business Services.
Default Fund	Clearing members' funded or unfunded contributions towards, or underwriting of, a CCP's mutualised loss sharing arrangements.
Derivative transactions	In relation to securitisation exposures, derivative transactions include interest rate and currency derivatives provided to securitisation SPVs, but do not include credit derivative transactions.

Term	Description
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 NAB Group would incur in the event of a default. It is used in the calculation of RWA.
Earnings at Risk (EaR)	Earnings at Risk (EaR) is a mathematical technique that uses statistical analysis of historical data to estimate the likelihood that a given portfolio's net interest margin losses will exceed a certain amount over a 12 month period.
Economic capital	Economic capital represents the NAB Group's internal assessment of the amount of capital required to protect against potential unexpected future losses arising from its business activities, in line with its target credit rating.
Economic profit	Economic profit represents cash earnings less capital costs whereby capital costs is allocated equity multiplied by the cost of equity.
ELE	The Extended Licensed Entity (ELE) comprises the ADI itself and any APRA approved subsidiary entities assessed as effectively part of a single 'stand-alone' entity, as defined in <i>Prudential Standard APS 222 Associations with Related Entities</i> .
Eligible financial collateral	Eligible financial collateral, under the standardised approach, will be the amount of cash collateral, netting and eligible bonds and equities. Eligible financial collateral, under the IRB approach, for corporate, sovereign and bank portfolios, is limited to the collateral items detailed in paragraphs 4 and 23 of Attachment G of APS 112. Recognition of eligible financial collateral is subject to the minimum conditions detailed in that same Attachment, paragraph 6.
Fair value	Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.
Foundation IRB (FIRB)	Foundation Internal Ratings Based (FIRB) approach refers to an alternative approach to advanced IRB defined under the Basel Accord 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.
General Reserve for Credit Losses (GRCL)	The general reserve for credit losses (GRCL) is an estimate of the reasonable and prudent expected credit losses over the remaining life of the portfolio and on non-defaulted assets. The reserve is a compliance requirement under <i>Prudential Standard APS 220 Credit Quality</i> .
GRCL calculation methodology	The GRCL is calculated as a collective provision for doubtful debts, excluding securitisation and provision on default no-loss assets. The difference between the GRCL and accounting collective provision is covered with an additional top-up, created through a transfer from retained earnings to reflect losses expected as a result of future events that are not recognised in the NAB Group's collective provision for accounting purposes. All collective provisions on defaulted or otherwise non-performing assets, regardless of expected loss, are reported as additional regulatory specific provisions.
Group cash earnings	Group cash earnings is defined as net profit attributable to owners of the Company, adjusted for the items NAB considers appropriate to better reflect the underlying performance of the Group. In September 2014 cash earnings has been adjusted for the following: <ul style="list-style-type: none"> - Distributions - Treasury shares - Fair value and hedge ineffectiveness - Deferred Acquisition Cost (DAC) discount rate variation - Amortisation of acquired intangible assets.
Guarantees	Guarantors under the standardised approach are recognised according to <i>APS 112 Attachment F paragraph 3</i> . The secured portion of an exposure is weighted according to the risk weight appropriate to the guarantor and the unsecured portion is weighted according to the risk weight applicable to the original counterparty (Refer to <i>Attachment A</i> for the appropriate risk weights). Under the IRB approach, for corporate, sovereign and bank portfolios, the ADI may recognise credit risk mitigation in the form of guarantees and credit derivatives according to the FIRB substitution approach where an ADI uses supervisory estimates of LGD (refer to <i>APS 113 Attachment B paragraph 49</i>), an AIRB substitution approach where the ADI has approval from APRA to use its own estimates of LGD (refer to <i>APS 113 Attachment B paragraph 60</i>) and, for certain exposures, a double default approach (refer to <i>APS 113 Attachment B paragraph 67</i>). An ADI may decide, separately for each eligible exposure, to apply either the relevant substitution approach or the double default approach. For retail portfolios there are two approaches for the recognition of credit risk mitigation in the form of guarantees and credit derivatives under the retail IRB approach, a substitution approach (refer to <i>APS 113 Attachment C paragraph 19</i>) and, for certain exposures, a double default approach (refer to <i>APS 113 Attachment C paragraph 28</i>). An ADI may decide separately for each eligible exposure to apply either the substitution approach or the double default approach.
IAA	Internal Assessment Approach.
ICAAP	Internal Capital Adequacy Assessment Process (ICAAP) is the mechanism developed and used by the NAB Group to determine capital requirements as outlined under Basel III. It results in the NAB Group identifying and assessing all risks to which it is exposed and allocating an appropriate level of capital to each.
IFRS	International Financial Reporting Standards.
IMA	Internal Model Approach (IMA) describes the approach used in the assessment of traded market risk. The NAB Group uses, under approval from APRA, the IMA to calculate general market risk for all transactions in the trading book other than those covered by the Standard Method.
Impaired facilities	Impaired facilities consist of Retail loans (excluding unsecured portfolio-managed facilities) which are contractually 90 days or more past due with security insufficient to cover principal and arrears of interest revenue. Unsecured portfolio managed facilities are classified as impaired assets when they become 180 days past due (if not written off) as per ARF 220 instructions; Non-retail loans that are contractually 90 days or more past due and/or sufficient doubt exists about the ultimate ability to collect principal and interest; and Impaired off-balance sheet credit exposures, where current circumstances indicate that losses may be incurred.

Term	Description
Investment earnings on Retained Earnings (IoRE)	Investment earnings (net of tax) on shareholders' retained profits and capital from life businesses, net of capital funding costs, IoRE is comprised of three items: <ul style="list-style-type: none"> – Investment earnings on surplus assets which are held in the Statutory Funds to meet capital adequacy requirements under the <i>Life Insurance Act 1995</i> (Cth); – Interest on deferred acquisition costs (net of reinsurance) included in insurance policy liabilities resulting from the unwind of discounting; and Less the borrowing costs of any capital funding initiatives.
IoRE discount rate variation	The profit impact of a change in value of deferred acquisition costs (net of reinsurance) included in insurance policy liabilities resulting from a movement in the inflation adjusted risk-free discount rate.
IRB approach	The internal ratings based (IRB) approach refers to the processes employed by the NAB Group to estimate credit risk. This is achieved through the use of internally developed models to assess the potential credit losses using the outputs from the probability of default, loss given default and exposure at default models.
IRRBB	Interest rate risk in the banking book.
Level 2 Group	The Level 2 Group, being NAB and the entities it controls subject to certain exceptions set out in <i>Section 2 Scope of Application</i> of this report.
Level 3 conglomerate Group	Contains APRA-regulated entities with material operations across more than one APRA-regulated industry and/or unregulated entities.
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.
Liquidity Coverage Ratio (LCR)	The LCR ratio measures the amount of unencumbered high quality liquid assets along with CLF eligible collateral that can be converted to cash to meet its liquidity needs for a 30 day calendar day time period under a severe liquidity stress scenario.
Liquidity facilities	Liquidity facilities are provided by the NAB Group to an SPV for the primary purpose of funding any timing mismatches between receipts of funds on underlying exposures and payments on securities issued by the SPV (asset liquidity facilities), or to cover the inability of the SPV to roll over ABCP (standby liquidity facilities).
Loan to value ratio	Loan to Value Ratio (LVR) is the ratio between the loan and value of the security provided.
Malus	Malus allows NAB to stop vesting of all or part of deferred remuneration. Malus adjustments to remuneration may be done at NAB's discretion, or may be controlled by a pre-set formula. Malus arrangements do not reverse vesting after it has already occurred, so they have no force after the end of the deferral period.
Masterscale	Masterscale is a consistent series of grades applied to credit exposures that allows the NAB Group to place every credit exposure into a specific grade or range that represents the likelihood of a credit default. This allows comparison of customers and portfolios.
Material risk taker	Consistent with <i>paragraph 17 of APS 330 and paragraph 48(c) of Prudential Standard CPS 510 Governance (CPS 510)</i> , individuals (other than Senior Managers) who have a significant portion of total remuneration based on performance and whose activities, individually or collectively, may affect the financial soundness of the Level 2 Group.
NAB	National Australia Bank Limited ABN 12 004 044 937.
NAB Group	NAB and its controlled entities.
Net Stable Funding Ratio (NSFR)	NSFR is a measure announced as part of the Basel III liquidity reforms that will apply from January 2018. The ratio establishes a minimum acceptable amount of stable funding (the portion of those types and amounts of equity and liability financing expected to be reliable sources of funds over a one-year time horizon under conditions of extended stress) based on the liquidity characteristics of an ADI's assets and activities over a one-year horizon. Finalised requirements are still to be outlined by the Basel Committee and APRA.
Net write-offs	Write-offs on loans at amortised cost and Fair Value loans net of recoveries.
Non-retail credit	Non-retail credit broadly refers to credit exposure to business customers. It excludes retail credit defined below.
Non-traded book	Non-traded book refers to the investment in securities held by the NAB Group through to maturity.
The Operational Risk function	All areas reporting directly to the General Manager, Operational Risk and Compliance.
Past due facilities ≥ 90 days	Past due facilities ≥ 90 days consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
Performance rights	A performance right is a right to acquire one NAB ordinary share, once the performance right has vested based on achievement of the related performance hurdle or at the Board's discretion. Each performance right is issued at no charge to the employee. To acquire a share, the holder must exercise the right but there is no exercise price to be paid. Performance rights may be used instead of performance shares due to jurisdictional reasons for awards such as deferred STI and commencement and other retention programs. The terms and conditions, including lapsing, will vary for each particular grant. Performance rights are issued by NAB. No dividend income is provided to the employee until the end of the restriction period and the performance conditions have been met and the performance rights are exercised.
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 NAB Group in the next 12 months.
Point in Time	Point in Time (PIT) within this document refers to risk models that estimate the likelihood of default and resulting loss over a 12-month period having regard to the current economic conditions.
Qualifying revolving retail exposures	For the purposes of regulatory reporting, credit cards are referred to as qualifying revolving retail.
RBA	Ratings-Based Approach.
Regulatory capital	Regulatory capital is the total capital held by the NAB Group as a buffer against potential losses arising from the business the NAB Group operates in. Unlike economic capital, it is calculated based on guidance and standards provided by the NAB Group's regulators, including APRA. It is designed to support stability in the banking system and protect depositors.

Term	Description
Regulatory expected loss	Regulatory Expected Loss (EL) is a calculation of the estimated loss that may be experienced by the NAB Group over the next 12 months. Regulatory EL calculations are based on the PD, LGD and EaD values of the portfolio at the time of the estimate which include stressed LGDs for economic conditions. As such, regulatory EL is not an estimate of long-run average expected loss.
Resecuritisation	Resecuritisation exposures are securitisation exposures in which the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitisation exposure. In addition, an exposure to one or more resecuritisation exposures is a resecuritisation exposure.
Retail credit	For the purposes of managing credit, two broad categories are used: retail credit and non-retail credit. This reflects the different approaches to the sales and ongoing management of credit and is consistent with the approach required under the Basel Accord. Retail credit refers to the credit provided to retail or personal customers. For the purposes of regulatory capital, retail credit is categorised into four groups: residential mortgages, credit cards (or qualifying revolving credit), retail SME and other.
Return on Equity (ROE)	ROE is calculated as cash earnings divided by average shareholders' equity, excluding non-controlling interests and other equity instruments and adjusted for treasury shares. It allows for risk to the extent that actual equity aligns with target equity and Risk Weighted Assets (RWA). RWA measures the risk exposure of NAB Group's assets that are used to determine quantitative minimum capital requirements. ROE also measures inorganic growth.
Return on Total Allocated Equity (ROTAE)	ROTAE is a function of cash earnings, combined divisional Risk-Weighted Assets (and by capital adequacy for Wealth Management) and target regulatory capital ratios.
Risk appetite	Risk appetite defines the level of risk the NAB Group is prepared to accept as part of its business. The resulting level of risk is a direct input into the NAB Group's capital requirements.
Risk-Weighted Assets (RWA)	A quantitative measure of the NAB Group's risk, required by the APRA risk-based capital adequacy framework, covering credit risk for on- and off-balance sheet exposures, market risk, operational risk and interest rate risk in the banking book.
Securities	Securities include the purchase of securitisation debt securities for either trading or banking book purposes.
Securitisation	Structured finance technique which involves pooling and packaging cash-flow converting financial assets into securities that can be sold to investors.
Senior executives	Persons who are (or were) members of the Executive Leadership Team, including executive directors.
Senior managers	Consistent with <i>paragraph 17 of APS 330 and paragraph 48(a) of Prudential Standard CPS 510 Governance (CPS 510)</i> , senior managers are Responsible Persons under the NAB Group's Fit and Proper Policy, including members of the NAB Group Executive Committee, senior managers who are members of the NAB Group Risk Return Management Committee and business line Chief Risk Officers. Non-executive directors of the NAB Group and NAB's appointed auditor are excluded.
Shares	Shares are NAB ordinary shares, allocated at no charge to the employee, which provide dividend income to the employee from allocation. The shares are held on trust for at least one year, are restricted from trading and may be fully or partially forfeited if individual or business performance warrants. The shares are forfeited if the participant fails to meet the Compliance Gateway, or if they resign or are dismissed prior to vesting. The shares may be retained on cessation of employment in other circumstances. Shares have no exercise price.
SME	Small and medium sized enterprises.
SGA	Specialised Group Assets.
Specific provisions	Specific provisions for prudential purposes include all provisions for impairment assessed on an individual basis in accordance with IFRS excluding securitisation.
Sponsor	The entity that establishes the securitisation SPVs including ABCP conduits and often provides other services.
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.
Statutory Fund	A Statutory Fund is a fund that is established in the records of a life company; and relates solely to the life insurance business of NAB or a particular part of that business.
Stress testing	Stress testing refers to a technique whereby the NAB Group's capital position is assessed against a number of different scenarios used to determine the movement on expected losses and subsequent impact on capital.
S&P/ASX Top 50 Index	A Standard & Poors (S&P)/ASX capitalisation index comprised of the 50 largest companies by market capitalisation in Australia.
Through the cycle	Through the Cycle (TtC) within this document refers to risk models that estimate the likelihood of default and resulting loss over a 12-month period having regard to the impact of an economic downturn.
Tier 1 Capital	Tier 1 Capital comprises the highest quality components of capital that fully satisfy all of the characteristics outlined under APRA's prudential framework. It provides a permanent and unrestricted commitment of funds, are freely available to absorb losses, do not impose any unavoidable servicing charge against earnings, and rank behind the claims of depositors and other creditors in the event of winding-up.
Tier 1 Capital ratio	Tier 1 Capital as defined by APRA divided by risk-weighted assets.
Tier 2 Capital	Tier 2 Capital includes other components of capital that, to varying degrees, fall short of the quality of Tier 1 capital but nonetheless contribute to the overall strength of an entity as a going concern. It is divided into: Upper Tier 2 capital comprising components of capital that are essentially permanent in nature, including some forms of hybrid capital instrument; and Lower Tier 2 capital comprising components of capital that are not permanent.
Tier 2 Capital ratio	Tier 2 Capital as defined by APRA divided by risk-weighted assets.
Total Shareholder Return (TSR)	TSR is a concept used to compare the performance of different companies' securities over time. It combines share price appreciation and dividends paid to show the total return to the shareholder. The absolute size of the TSR will vary with stock markets, but the relative position reflects the market perception of overall performance relative to a reference group.
Traded book	Traded book refers to the NAB Group's investment portfolio that is traded or exchanged in the market from time to time that reflects market opportunities.

Term	Description
UK Code Staff	Comprises categories of employees, identified by the UK Remuneration Code regulation, including senior management, risk takers, employees engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on Clydesdale's or the NAB Group's UK operations risk profile.
Value at Risk (VaR)	Value at Risk (VaR) is a mathematical technique that uses statistical analysis of historical data to estimate the likelihood that a given portfolio's losses will exceed a certain amount.
Warehouse facilities	Warehouse facilities are lending facilities provided by the NAB Group to an SPV for the financing of exposures in a pool. These may be on a temporary basis pending the issue of securities or on an on-going basis.
Write-offs	Write-offs represent credit losses in accordance with accounting rules.

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