MACQUARIE BANK INTERNATIONAL LIMITED

PILLAR 3 DISCLOSURE
MACQUARIE BANK INTERNATIONAL LIMITED
31 MARCH 2014

Macquarie Bank International Limited ("MBI", "the Firm") is a bank incorporated in the UK in February 2008. It is authorised by the PRA to undertake banking and investment business activities. It is 100% owned by Macquarie Bank Limited ("MBL") which is incorporated in Australia and regulated by the Australian Prudential Regulation Authority ("APRA"). This document sets out the Pillar 3 disclosures for the Firm as at 31 March 2014. This is consistent with the basis under which the Firm produces its Financial Statements. MBI is required to produce its Pillar 3 disclosures as set out in Directive 2013/36/EU and Regulation (EU) No 575/2013. All amounts are in thousands Sterling unless specified otherwise.

Basel III was implemented in the UK from 1 January 2014, through both the European Capital Requirements Regulation ("CRR") and the Capital Requirements Directive ("CRD") and through the PRA's policy statement PS7/13 available at:

http://www.bankofengland.co.uk/pra/Pages/publications/implemcrdiv.aspx.

MBI is required to disclose information as set out in Part 8 of the CRR for Disclosure by Institutions ("CRD IV: Disclosure (Pillar 3)"). The following forms the basis of MBI's compliance with these requirements.

The remuneration disclosures for Pillar 3 are outlined in CRR Article 450. Macquarie's remuneration disclosures will encompass all Remuneration Codes for EMEA and will be published separately on the Macquarie website.

The disclosures for risk management objectives and policies for Pillar 3 are outlined in CRR Article 435. MBI is a member of the Macquarie Group, a global provider of banking, financial, advisory, investment and funds management services. All risks arising from MBI's activities are managed in accordance with Macquarie's global risk management framework. This framework has been formally adopted by the MBI Board. Further information on Macquarie's Risk Management Framework can be found in Macquarie Group Limited's 2014 Financial Statements at:

http://www.macquarie.com.au/mgl/au/about-macquarie-group/investor-relations/financial-disclosure/financial-reports/macquarie-group-limited-mqg

A Risk Management report is presented at the quarterly Board meetings in order to facilitate the information flow on risk to the management body.

Disclosures on Governance Arrangements

Directors of MBI hold the following number of directorships as at 31 March 2014:

David Fass (CEO – Macquarie EMEA) - 9,
Paul Plewman (Executive Director) – 23,
Timothy Wade (Non-Executive Director) – 11,
Andrew Williams (Non-Executive Director) – 7

As per MBI's charter, the minimum number of directors will be three and the majority of directors will be resident in the United Kingdom. It is intended that the following be members of the MBI Board:

CEO, Macquarie EMEA; Head of FICC Europe; and two independent non-executive directors.

MBI selects its members as per the global workforce diversity policy for the Macquarie Group. The Workforce Diversity policy is intended to define Macquarie's workforce diversity commitment and the structures in place to ensure it is realised. The principles contained in our Workforce Diversity policy are incorporated into our public statement "Our Commitment to Workforce Diversity" available at:

https://www.macquarie.com.au/dafiles/Internet/mgl/au/about-macquarie-group/diversity/documents/OurcommitmenttodiversityFINAL.pdf

MBI is a UK incorporated bank through which the Macquarie Group conducts banking and investment activities in Europe. MBI has established branches in Germany and Austria to support its continental European business activities. The more prominent activities within MBI are undertaken by the following business groups:

- **Fixed Income Currencies and Commodities Group ("FICC")** participates in a broad range of physical and financial trading activities in the UK and European Markets. FICC undertakes derivative trades with external counterparties, with corresponding back-to-back trades with Macquarie Bank Limited, London Branch ("MBL LB"). The Futures division in FICC provides a full range of execution and clearing services to corporate and institutional clients, providing access to major exchanges. It also provides futures services to other divisions within FICC and other affiliates within Macquarie Group. MBI is a general participant clearing member of European Commodity Clearing AG ("ECC") which is a clearing house for exchange and OTC transactions in European power and natural gas, emission rights and coal.

- **Macquarie Funds Group ("MFG")** is involved in the ongoing management and administration functions for the Macquarie closed-ended funds and open-ended investment structures across Europe, through its branches in Germany and Austria.

- **Corporate Asset Finance Group ("CAF")** funds corporate loans acquired on the primary and secondary loan market**.** It sources predominately primary issuances and also dislocated debt opportunities from the secondary loan market in the US, UK and Europe**.**

CAPITAL ADEQUACY

The firm's capital resources and capital resources requirement as at 31 March 2014 comprised the following elements:

	31-Mar-14 £'000	31-Mar-13 £'000	31-Mar-12 £'000
Capital resources			
Ordinary share capital	200,000	200,000	200,000
Profit and loss account and other reserves	(17,506)	(18,680)	(21,376)
Total Common Equity Tier 1 Capital (CET1)/ Tier 1 Capital	182,494	181,320	178,624
Deductions from CET1 capital			
Significant investment	(20,311)	-	-
CET1 capital	162,183	181,320	178,624
Tier 2 Capital			
General/collective provisions	21	25	27
Total Tier 2 capital	21	25	27
Deductions from Tier 1 and Tier 2 capital			
Material holdings	-	(17,049)	-
Total Tier 1 & Tier 2 capital after deductions	162,204	164,296	178,651
Tier 3			
Net interim trading book profit and loss	-	64	261
Total Capital Resources	**162,204**	**164,360**	**178,912**
Capital resources requirement			
Credit risk	12,064	10,041	11,546
Concentration risk	3,633	6,043	4,170
Market risk			
- Forex PRR	87	368	577
Operational risk	1,889	1,777	1,576
Pillar 1 capital resources requirement	**17,673**	**18,229**	**17,869**
Pillar 2 capital resources requirement (32% of Pillar 1)	5,655	5,833	5,718
Capital planning buffer	18,600	18,600	18,600
Total Capital Resource Requirement	**41,928**	**42,662**	**42,187**
Tier 1 and Total Capital Ratio	31%	31%	34%

NB: These figured are now aligned to audited financial statements.

Reconciliation between Financial Statements and Pillar 3 disclosure	£'000
Total Shareholders Funds per Fin Stats	182,494
Less: Shares in group undertakings	(20,311)
Add: Collective allowance for credit losses	371
Less: Collective allowance for credit losses eligible for Tier 2 capital	(350)
	162,204

Capital Resources and Key Capital Ratios

The primary components of the MBI's regulatory capital base are:

- Ordinary equity;
- Retained earnings;
- General/collective provisions; and
- Deductions from capital primarily for significant investments in the common shares of unconsolidated financial institutions.

The following capital ratios have been calculated:

- Total capital ratio is computed as the ratio of total capital resources to total risk weighted assets; and
- Tier 1 capital ratio is computed as the ratio of Net Tier 1 Capital to total risk weighted assets.

Capital Resources Requirements

Of the risks that MBI faces, a significant portion of market risk and credit risk is backed out to MBL under risk transfer arrangements. An annual analysis of this and other relevant risks is undertaken along with an assessment of the capital required to be held behind material risks.

The main purpose of the annual assessment is to set out how MBI identifies and manages the risks to which it is exposed and to detail MBI's approach to determining its level of internal capital requirements over a three year projected period. This assessment is reviewed at least annually as part of the business planning cycle or following any significant change to the business strategy and/or its risk profile.

The assessment is prepared by RMG Prudential, Capital & Markets ("RMG PCM") London, in consultation with RMG Operational Risk, RMG Credit Risk, RMG Market Risk, RMG Compliance, Financial Management Group Finance London ("FMG Finance"), Group Treasury and business representatives of CAF, FICC and MFG.

Capital Resources Requirements: Pillar 1

The approach to calculating the capital resources requirements within MBI is made by reference to its categorisation as an institution. MBI's Pillar 1 capital resources requirement includes credit risk, counterparty credit risk, concentration risk, market risk and operational risk capital requirements.

MBI calculates credit risk and market risk (related to Foreign Exchange Position Risk requirements) using the standardised approaches and operational risk under the basic indicator approach, as laid out under the CRR. The counterparty credit risk mark to market method is used to measure exposure value for counterparty credit risk. This primarily covers derivative exposures. The exposure values for reverse repurchase transactions uses the Financial Collateral Comprehensive Method.

Credit risk (including counterparty credit risk) arises on the cash balances that MBI has placed with MBL and external banks, exposures on account of lending and trading transactions arising from CAF and FICC activities. Most of these credit risks are transferred to MBL via a risk transfer arrangement. Where available, the credit ratings assigned to counterparties by one or more eligible rated agencies are used in the calculation of risk weighted capital requirements for credit risk. Rating agencies used by Macquarie are Moody's, Standard & Poor's and Fitch. Currently such ratings are available for exposures arising in MBL, as a result of the risk transfer arrangement and banks (primarily in UK) with which MBI deposits surplus cash. Counterparty credit risk on trading book exposures is managed under existing credit risk policy.

As at 31 March 2014, MBI's credit risk (including counterparty credit risk on trading book exposures amounted to £3.1m) capital requirement amounted to £12.1 m.

Geographic and Exposure Class Breakdown of Exposures and Credit Risk as at 31 March 2014

Exposure Class	Geographic Location	Exposure pre-credit risk mitigation pre-CCF £'000	Credit Risk £'000
Corporates	Americas	31	2
Corporates	Asia	14,191	3
Corporates	Europe	249,815	6,219
Institutions	Europe	76,076	1,211
Other Items	Europe	3,719	494
Governments	Europe	30,851	-
Institutions	Australia	93,847	4,135
Total		468,530	12,064

Exposures by residual maturity as at 31 March 2014

Exposure post-credit risk mitigation post-CCF (£'000)	0-3 months	3-6 months	6-12 months	1-5 Years	> 5 Years	N/A	Total
Exposure class							
Central government	29,678	-	-	-	-	1,173	**30,851**
Institutions	114,451	45,569	11,353	13,815	-	4,130	**189,319**
Corporates	58,063	-	-	-	19,737	-	**77,799**
Other items	318	-	-	-	1,241	2,160	**3,719**
Total	**202,510**	**45,569**	**11,353**	**13,815**	**20,978**	**7,463**	**301,689**

Exposures by Industry Type as at 31 March 2014

Industry Type	Post-CRM Post CCF Exposure £'000
Banks	171,462
Central Clearing Counterparty	13,791
Central Government	30,851
Electricity, Gas and Water Supply	7,471
Financial Intermediaries and auxiliary serv	34,430
Mining and Quarrying	42
Others	2,492
Professional, Scientific and Technical	301
Real Estate	22
Retail Trade	183
Transportation, storage and communicatio	40,062
Wholesale trade	581
Total	**301,688**

Exposures before and after credit risk mitigation and average exposures as at 31 March 2014

Exposure Class	Exposure post-credit risk mitigation pre-CCF £'000	Average exposure post-credit risk mitigation post-CCF £'000
Central governments	30,851	30,000
Corporates	101,293	74,180
Institutions	216,584	169,494
Other items	3,719	4,198
Total	**352,447**	**277,872**

Net exposures to counterparty credit risk for derivative contracts

Particulars	£'000
Foreign exchange contracts	294
Interest rate contracts	30,011
Commodities contracts	31,625
Gross positive fair value of contracts	**61,930**
Netting benefits	(14,706)
Net current credit exposure	**47,224**
Potential Future Credit Exposure	65,634
Collateral held	(27,161)
Net derivative current credit exposure	**85,697**

MBI attracts a market risk requirement on balances denominated in foreign currencies (foreign currency position risk requirement). As at 31 March 2014, MBI's market risk capital requirement amounted to £0.1m.

Concentration risk arises from MBI's lending or trading activities. As MBI's exposures are predominately to MBL, MBI is considered to have a concentration risk exposure to MBL. As at 31 March 2014, MBI's concentration risk capital requirement amounted to £3.6m. As a result of the FCA's Advanced Risk Responsive Operating Framework ("ARROW") and Supervisory Review and Evaluation Process ("SREP") in 2011, it was deemed necessary for MBI to hold additional Pillar 2 capital against this risk. MBI currently, and on an ongoing basis will hold an additional 32% of its Pillar 1 capital requirements as Pillar 2 capital. The additional concentration risk capital component is included within this 32% Pillar 2 add-on.

MBI operates within a global framework which is applied consistently across all business lines within the Macquarie Group for the identification, monitoring, management and reporting of operational risk. Within this framework, senior management is required to consider and evaluate those scenarios that could result in significant operational loss. This approach forms the basis of the assessment of MBI's operational risk capital adequacy which is made under the adoption of the basic indicator approach. As at 31 March 2014 MBI's operational risk capital requirement was £1.9m.

Capital Resources Requirements: Pillar 2

Following the FSA's ARROW review conducted in August 2011, the FSA advised MBI of an update to its original Internal Capital Guidance requirements. MBI is now required to hold Pillar 2 capital at a minimum of 32% of MBI's Pillar 1 capital requirement, representing charges for Interest Rate Risk in the Banking Book and Concentration risks to MBL. In addition to the Pillar 2 requirements, MBI is also required to hold a capital planning buffer of £18.6m at all times. Assessment of the Pillar 2 requirement is supported by appropriate stress testing and scenario analysis and is reviewed and approved at least annually by the MBI Board.

MBI is subject to MBL's management and reporting framework for interest rate risk. MBL's approach is that lending areas do not take outright interest rate risk and that, wherever possible, interest rate risks arising in MBI are transferred to MBL and managed within traded Market risk limits. Some residual interest rate risks remain in the Banking book as an unavoidable consequence of doing business. These are subject to limits that are approved and monitored by RMG PCM.

RMG PCM estimates the effects of a 200bp parallel shift in the yield curve on a monthly basis. Over the twelve months to 31 March 2014, a 200bp upward shift in the yield curve would result in an IRRBB exposure to MBI of £0.7m and vice versa. The exposure is primarily on account of GBP and Euro currency. As a result, MBI holds Pillar 2 capital against this exposure.

MBI has held capital resources in excess of both its Pillar 1 and Pillar 2 capital requirements at all times in the past financial year.

Credit risk mitigation

MBI transfers most of the credit risks arising as a result of its business activities to MBL via a risk transfer arrangement. The external credit ratings of MBI's exposures to corporates, institutions and sovereigns have been mapped to credit quality steps to determine the appropriate risk weights according to PRA guidance. MBI ensures that the credit risk mitigation techniques used (such as netting, taking collateral and guarantees) are legally enforceable through taking appropriate legal opinions for the jurisdictions in which it does business.

MBI complies with the Macquarie Group policy with regards to on and off balance sheet netting arrangements.

The table below illustrates the balance sheet exposure values by exposure class and risk weights, before and after application of credit risk mitigation and the average amount of exposures:

Risk Weighted exposures pre and post credit risk mitigation by exposure classes and risk weights as at 31 March 2014

Risk Weight	Exposure Class	Exposure pre-credit risk mitigation pre-CCF	Exposure post-credit risk mitigation pre-CCF	Exposure post-credit risk mitigation post-CCF	Risk Weighted Exposure
0%	Central governments	30,851	30,851	30,851	-
2%	Institutions	1,651	1,651	1,651	33
4%	Institutions	9,661	9,661	9,661	386
20%	Institutions	78,833	78,833	78,833	15,767
50%	Institutions	77,299	123,959	96,694	48,347
	Other items	1,241	1,241	1,241	621
100%	Corporates	264,038	101,293	77,799	77,799
	Institutions	-	-	-	-
	Other items	424	424	424	424
250%	Other items	2,054	2,054	2,054	5,136
Other risk weights	Institutions	2,479	2,479	2,479	2,286
Total		**468,531**	**352,447**	**301,687**	**150,799**