



Notice varying the conditions on NOHC authority

Banking Act 1959

To: Macquarie Group Limited ABN 94 122 169 279 (the body corporate)

Since the body corporate holds an authority to be a NOHC under subsection 11AA(2) of the *Banking Act 1959* (the Act) and the authority is subject to conditions,

I, Clare Gibney, General Manager, under paragraph 11AAA(1)(b) of the Act, vary the conditions imposed on the NOHC authority in the manner specified in the Schedule.

This notice commences on 1 January 2022.

Dated: 16 December 2021

Clare Gibney¹
General Manager
Banking Division

Interpretation

APRA means the Australian Prudential Regulation Authority.

NOHC is short for non-operating holding company and has the meaning given in subsection 5(1) of the Act.

NOHC authority has the meaning given in subsection 5(1) of the Act.

¹ A delegate of APRA.

Schedule

The existing condition(s) which are to be varied:

12. The Authorised NOHC may undertake a “corporate centre” role, including group treasury activities, risk management, settlements, information technology, human resources, financial reporting and other group services such as company secretarial. These roles may also be performed by service subsidiaries of the NOHC formed for that purpose. Where centralised treasury functions are undertaken by the Authorised NOHC:

- (f) the ADI Group’s funding from the Authorised NOHC must not exceed 20% of the ADI Group’s total funding.

The condition(s) as varied are:

12. The Authorised NOHC may undertake a “corporate centre” role, including group treasury activities, risk management, settlements, information technology, human resources, financial reporting and other group services such as company secretarial. These roles may also be performed by service subsidiaries of the NOHC formed for that purpose. Where centralised treasury functions are undertaken by the Authorised NOHC:

- (f) the ADI Group’s funding, measured at level 1 and 2, from the Authorised NOHC must not exceed 8.0% of total ADI Group funding subject to APRA approved adjustments. For the avoidance of doubt, netting is not permitted within the calculation.

A decision to impose conditions or additional conditions, or vary conditions, on an authority is a decision to which Part VI of the Act applies. You may request APRA reconsider the decision in accordance with subsection 51B(1) of the Act. The request for reconsideration must be made in writing, must set out the reasons for making the request, and must be given to APRA within 21 days after the day on which you first received notice of this decision, or within such further period as APRA allows. If you are dissatisfied with the outcome of APRA’s reconsideration of the decision, you may, subject to the *Administrative Appeals Tribunal Act 1975*, apply to the Administrative Appeals Tribunal for review of the reconsidered decision

APRA is required to publish this notice in the *Gazette*.

Schedule of consolidated conditions

Schedule – conditions imposed on the authority:

Interpretation

1. In these conditions, including the annexures:

Act means the *Banking Act 1959*;

ADI means Macquarie Bank Limited ABN 46 008 583 542;

ADI Group means the group of companies in the Macquarie Group at Level 2 of which the ADI NOHC is the parent company;

ADI Group capital requirement means capital requirement calculated by applying the ADI's Board-approved internal minimum Tier 1 capital ratio to total risk-weighted exposures (or, from the Basel II commencement date, total risk-weighted assets) at Level 2, as determined by applying all applicable prudential standards to the ADI, which must be met by Tier 1 capital, in which regard the respective proportions of Fundamental Tier 1 capital, Residual Tier 1 capital and Innovative Tier 1 capital must comply with APS 111;

ADI NOHC means the non-operating holding company which is the immediate holding company of the ADI;

AIFRS means the accounting standards made by the Australian Accounting Standards Board on 15 July 2004 (and subsequent revisions) and known as the Australian equivalents to International Financial Reporting Standards;

APS (followed by a number) identifies a specific prudential standard, and a reference to a particular prudential standard includes a reference to a prudential standard that replaces it;

Authorised NOHC means Macquarie Group Limited ABN 94 122 169 279;

Basel II commencement date means 1 January 2008 or the date on which the prudential standards implementing the revised international capital framework for banks, known as "Basel II", begin to apply;

Board means board of directors;

ECM means Economic Capital Model determined in accordance with the ECM Agreement;

ECM Agreement means the agreement made between the Macquarie Group and APRA in Annexure 1 to these conditions;

eligible capital means the sum of:

- (a) eligible share capital;
- (b) reserves;
- (c) retained earnings;
- (d) eligible non-innovative Residual Tier 1 capital; and
- (e) eligible hybrid capital;

eligible hybrid capital:

- (a) for the ADI Group, means Innovative Tier 1 capital within the meaning of APS 111; and
- (b) for the Non-ADI Group, means hybrid capital that meets the conditions in Annexure 2 to these conditions;

eligible non-innovative Residual Tier 1 capital means non-innovative Residual Tier 1 capital within the meaning of APS 111;

eligible share capital:

- (a) for the ADI Group, means share capital that qualifies as Fundamental Tier 1 capital under APS 111; and
- (b) for the Non-ADI Group, means paid-up capital issued by entities in the Macquarie Group to parties external to the Macquarie Group that is recognised as share capital applying ordinary Australian accounting standards, conventions and practices;

Fundamental Tier 1 capital has the meaning in APS 111;

Innovative Tier 1 capital has the meaning in APS 111;

Level 2 means the consolidated banking group comprising the ADI, the ADI NOHC and all their subsidiary entities other than non-consolidated subsidiaries within the meaning of APS 110;

Level 3 has the meaning in APS 110;

Level 3 MCR has the meaning in paragraph 2;

Macquarie Group means the group of companies of which the Authorised NOHC is the parent company;

Macquarie Group restructure means the restructure under which the ADI becomes a subsidiary of the Authorised NOHC;

NOHC means non-operating holding company;

Non-ADI Group means all companies in the Macquarie Group other than the companies in the ADI Group. For clarification this definition also excludes subsidiaries of the ADI NOHC that are non-consolidated for APRA regulatory capital purposes;

Non-ADI Group capital requirement means the capital requirement for the Non-ADI Group, determined using the ECM;

prudential standard has the meaning in the Act;

reserves means:

- (a) for the ADI Group, reserves that qualify as Fundamental Tier 1 capital under APS 111;
- (b) for the Non-ADI Group:
 - (i) share based payment reserves, to the extent that they qualify as Fundamental Tier 1 capital under APS 111; and
 - (ii) foreign currency translation reserves all at face value and recognised in accordance with AIFRS; unless otherwise agreed by APRA in writing;

Residual Tier 1 capital has the meaning in APS 111;

retained earnings:

- (a) for the ADI Group, has the meaning in APS 111;
- (b) for the Non ADI Group, means amounts recognised as retained earnings in accordance with AIFRS;

service company means a subsidiary of the Authorised NOHC which predominantly provides services to the Macquarie Group, such as (without limitation) risk management, financial operations, human resources or information technology;

Tier 1 capital has the meaning in APS 111.

Capital

2. Subject to paragraph 3, the Authorised NOHC must ensure that the Macquarie Group complies with a minimum capital requirement at Level 3 (**Level 3 MCR**) equal to the sum of the dollar value of:
 - (a) the ADI Group capital requirement; and
 - (b) the Non-ADI Group capital requirement.
3. The Authorised NOHC's Level 3 MCR will be reduced by an initial transitional amount of \$187 million. This transitional amount will be amortised on a straight line basis to a reduction of nil by 31 December 2008.
4. In applying the ECM to the Non-ADI Group, no value may be given to the inter-group diversification benefit (i.e. between the ADI Group and Non-ADI Group).
5. The Authorised NOHC must ensure that eligible capital held by the Macquarie Group at all times equals or exceeds the Level 3 MCR.
6. The Authorised NOHC must have a rigorous process in place to ensure that all material changes to the ECM are submitted to the Authorised NOHC's Board for approval. This process must include, at a minimum, clear definitions of materiality and trigger events for Board approvals or other interventions.

Quality of Capital

7. The Authorised NOHC must ensure that the Macquarie Group's eligible share capital, retained earnings and reserves are not less than 75% of the Level 3 MCR.
8. The Authorised NOHC must ensure, at all times, that the Macquarie Group has sufficient Level 3 eligible capital:
 - (a) of an equivalent to, or higher quality than, that necessary to meet the ADI Group capital requirement; and
 - (b) after deducting the capital necessary to meet the ADI Group capital requirement – of an equivalent to, or higher quality than, that necessary to meet the Non-ADI Group capital requirement.
9. The criteria for defining eligible hybrid capital set out in Annexure 2 will be applied to hybrid capital instruments used to meet the Non-ADI Group capital requirement.

Note 1: Once APRA develops industry-wide prudential policy on eligible capital for non-banking businesses in a non-operating holding company structure and this comes into force, APRA will consider any transitional arrangements that may be necessary. However, APRA does not propose to grandfather the interim arrangements set out in the above conditions.

Note 2: The Level 3 capital framework outlined in conditions 2 to 9 is an interim arrangement pending the development and implementation by APRA of industry-wide Non-Operating Holding Company Prudential Standards. At the inception of such Prudential Standards, APRA may impose transitional capital arrangements. APRA does not propose that the interim arrangements set out in these conditions be grandfathered.

Prudential Standards

10. The Authorised NOHC must comply with:
 - (a) APS 210, as if the Authorised NOHC were an ADI. In applying this prudential standard, the Authorised NOHC must be able to demonstrate that it has taken into account the needs of all members of the Macquarie Group in establishing its liquidity management strategy, but the standard does not apply directly to other members of the Non-ADI Group;
 - (b) APS 310, as if the Authorised NOHC were an ADI; and
 - (c) APS 231 and APS 232, to the extent that they relate to the activities of the ADI or the Authorised NOHC.

11. The paragraphs of APS 222 relating to badging and disclosure are to apply to the Authorised NOHC and other companies in the Macquarie Group. The Authorised NOHC and Macquarie Group members may use the Macquarie logo and brand provided the relevant disclosure requirements are met.

Authorised NOHC Activities

12. The Authorised NOHC may undertake a “corporate centre” role, including group treasury activities, risk management, settlements, information technology, human resources, financial reporting and other group services such as company secretarial. These roles may also be performed by service subsidiaries of the NOHC formed for that purpose. Where centralised treasury functions are undertaken by the Authorised NOHC:
 - (a) there must be separate liquidity policies for the ADI and the Authorised NOHC;
 - (b) there must be separate and distinct funding programmes for the ADI, Authorised NOHC and any other Macquarie Group entities requiring external funding;
 - (c) there must be clearly defined processes to ensure external counterparties are fully aware of which Macquarie Group entity is being represented by a treasury person, including the providing separate offering documentation and ensuring that transaction confirmations clearly identify the appropriate counterparty;
 - (d) there must be separate correspondent banking arrangements for the ADI and Authorised NOHC, although these may be held with the ADI who may offer to provide banking services to various members of the Non-ADI Group. There must also be separate security clearing accounts and custody arrangements for the ADI and the Authorised NOHC such as with Austraclear, Clearstream and Euroclear;
 - (e) the ADI, in any role as banker to the Authorised NOHC, must ensure that its processes and systems result in the clear identification and segregation of cash flows to the ultimate beneficiary of transactions; and
 - (f) the ADI Group’s funding, measured at level 1 and 2, from the Authorised NOHC must not exceed 8.0% of total ADI Group funding subject to APRA approved adjustments. For the avoidance of doubt, netting is not permitted within the calculation.
13. Any overseas banking subsidiary that the Macquarie Group establishes must be wholly-owned, directly or indirectly, by the ADI NOHC unless otherwise approved by APRA in writing.

Reporting

14. The Authorised NOHC must provide APRA with quarterly reporting, in a form acceptable to APRA, of its Level 3 MCR and eligible capital. Each report must be provided within 20 business days of the end of the quarter to which it relates, or within such further time as APRA may approve in writing.
15. Approval by the Board of the Authorised NOHC will be sought for any significant changes to the ECM assumptions or methodology. Any such changes and the effect on the Level 3 MCR must be provided to APRA within 14 days of the Authorised NOHC Board's approvals.
16. The Macquarie Group must also report to APRA on a quarterly basis, in a form acceptable to APRA, on:
 - (a) the liquidity position of the Macquarie Group;
 - (b) intra-group exposures between the Authorised NOHC and other Macquarie Group members;
 - (c) large exposures of the Macquarie Group, based on its own large exposures framework; and
 - (d) the balance sheet of the Authorised NOHC and of the consolidated Macquarie Group.

Each report must be provided within 20 business days of the end of the quarter to which it relates, or within such further time as APRA may approve in writing.

17. The CEO of the Authorised NOHC must provide APRA with an attestation no later than 3 months after the end of each financial year of the Authorised NOHC that the requirements of these conditions in relation to the amount and quality of capital have been complied with at all times during the financial year to which the attestation relates. At the same time, the Authorised NOHC's external auditor must provide APRA with a written opinion as to:
 - (a) whether the approved capital methodology has been applied at all times; and
 - (b) the reliability of the quarterly reporting.

Operation

18. These conditions take effect from the day on which the ADI becomes a subsidiary (within the meaning of section 46 of the *Corporations Act 2001*) of the Authorised NOHC.

Annexure 1

The essential elements of the ECM Agreement are as follows:

The ECM calculates a measure the Macquarie Group (Macquarie) calls “economic risk” for use in capital adequacy assessment. This is the amount of capital and earnings required to protect Macquarie against insolvency to a standard commensurate with its credit rating, and is calculated for each material component of risk faced by Macquarie.

The components that are relevant to the Non-ADI Group are:

- equity risk;
- credit risk;
- operational risk;
- market risk;
- liquidity risk;
- risk on intangible assets and equity investments forming part of business operations; and
- risk on fixed assets.

These components are summed, then adjusted for the impact of diversification between risk types and forward earnings stressed for a severe downturn.

The ADI Group will remain subject to APRA’s ADI capital framework under the prudential standards as in force from time to time, including the need to meet minimum Tier 1 and minimum capital ratios under the prudential standards. The following description relates only to the calculation of Level 3 capital:

1. Capital requirements

- a. The Level 3 MCR will be calculated as the ADI Group capital requirement (i.e. the ADI’s Board-approved internal minimum regulatory Tier 1 capital requirement of the ADI Group) plus the Non-ADI Group capital requirement (i.e. the Net Economic Risk of the Non-ADI Group).
- b. Where the ADI or a member of the Non-ADI Group issues capital directly to external parties and that capital meets the entity’s stand-alone capital requirement, this may be counted towards satisfaction of the Level 3 MCR, provided the requirements in the conditions relating to the quality of capital are met.
- c. The ADI Group capital requirement will be calculated as X% of risk-weighted assets plus Tier 1 deductions, where “X” is Macquarie’s internal minimum Tier 1 capital ratio as set by the ADI’s Board and notified to APRA.
- d. Net Economic Risk of the Non-ADI Group will be calculated as Economic Risk, per the Authorised NOHC’s Board-approved Economic Capital Model, less Non-ADI Group Stressed Forward Earnings.

- e. The capital impact of transactions internal to the Macquarie Group will be eliminated at the NOHC level. Similarly, intra-group holdings of capital will be eliminated.
- f. Loans and direct credit substitutes provided by the Authorised NOHC to subsidiaries within the group will have no incremental capital impact on the Authorised NOHC. This is to avoid double-counting of capital requirements and is implicit in the building block approach.
- g. The Authorised NOHC must ensure that the Macquarie Group holds capital against any transactions the Authorised NOHC or service companies enter into, other than those transactions discussed above, for their own purposes e.g. to hedge interest rate or foreign exchange rate exposure. The capital for these transactions will be calculated using the ECM.

2. Eligible Capital

- a. The capital requirement computed above will be compared to total eligible capital calculated as:
 - eligible share capital (at paid-up value);
 - reserves;
 - retained earnings;
 - eligible non-innovative Residual Tier 1 capital (at paid-up value); and
 - eligible hybrid capital (at paid-up value);
- b. Eligible hybrid capital, and any other Tier 1 capital, used to meet the ADI Group capital requirement must meet APRA's criteria for inclusion in the Tier 1 capital of the ADI.
- c. Eligible hybrid capital to meet the Non-ADI Group capital requirement will need to meet criteria specified in Annexure 2.

Note: This will be an interim arrangement, to apply until APRA's new NOHC Level 3 capital regime is in force.

Annexure 2

Eligible hybrid capital for the Non-ADI Group must contain the following characteristics and features:

- Ability to absorb losses within the Macquarie Group.
- Provides a permanent and unrestricted commitment of funds from third parties which is repayable for cash consideration only with regulatory approval;
 - Non-defaultable – i.e. non-repayment of interest or principal does not trigger default; and
 - Subordinated – ranks behind claims of all other creditors in the event of a winding up.
- The holders of any eligible hybrid capital instrument shall have no contractual rights of set-off between the instrument and any claims by the Macquarie Group on the holders of the instrument.
- Term – the term of the instrument must meet the following criteria:
 - the instrument is perpetual, with no call date for at least 5 years;
 - if structured as legal form debt, a term of approximately 50 years or such other term (of at least 10 years) as is required in the relevant jurisdiction to ensure deductibility of interest may be applied;
 - a coupon step-up at the call date will be permissible if in line with market norms for the type of security issued;
 - normal tax and regulatory event calls will be permitted; and
 - repayment / redemption at call or maturity will only be permissible with regulator approval.
- Coupon – the coupon of the instrument must meet the following criteria:
 - the instrument offers a margin (over fixed or floating rate benchmark) fixed at time of issue;
 - the instrument may convert from fixed to floating rate, providing the floating rate margin is set at time of issue;
 - any step-up margin must be set at time of issue. Unless APRA determines in writing in relation to a particular class of instrument, there is no prescribed limitation on the step-up margin, provided it reflects norms at time of issue for the type of security to be issued; and
 - the instrument provides for mandatory deferral, either non-cumulative or cumulative non-compounding (but deferral must not constitute an event of default).
- Subordination – the subordination of the instrument must meet the following criteria:
 - the instrument may rank ahead of ordinary shares;

- the instrument may rank no better than pari-passu with similar deeply subordinated instruments (including preference shares);
- the instrument must rank behind subordinated debt and unsecured creditors; and
- there is no mandatory conversion to preference shares on occurrence of a regulatory event (as that term is commonly defined).