2011

BASEL II
PILLAR 3 DISCLOSURE

YEAR ENDED 30 SEPTEMBER 2011

APS 330: CAPITAL ADEQUACY &
RISK MANAGEMENT IN ANZ

ANZ

Important Notice

This document has been prepared by Australia and New Zealand Banking Group Limited (ANZ) to meet its disclosure obligations under the Australian Prudential Regulation Authority (APRA) APS 330 Capital Adequacy: Public Disclosure of Prudential Information.

This disclosure was prepared as at 30 September 2011. ANZ has a continuous disclosure policy, under which ANZ will immediately notify the market of any material price sensitive information concerning the Group, in accordance with legislative and regulatory disclosure requirements.

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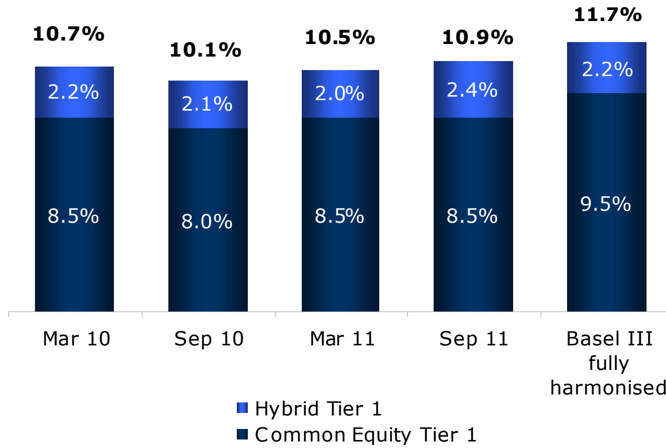
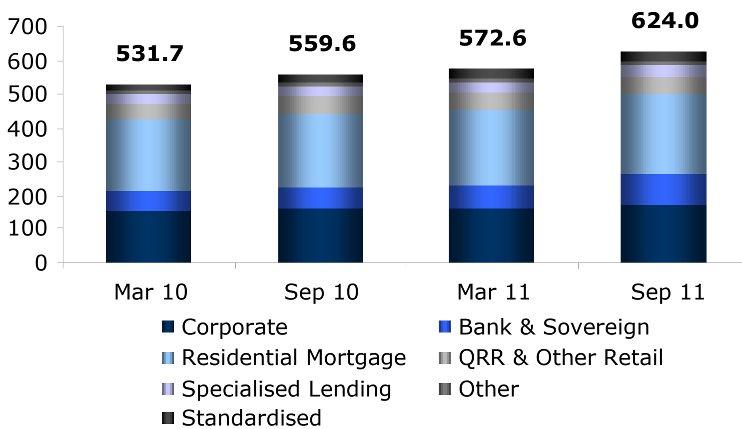
[1] Each table reference adopted in this document aligns to those required by APS 330 to be disclosed at year end.

Chapter 1 – Highlights



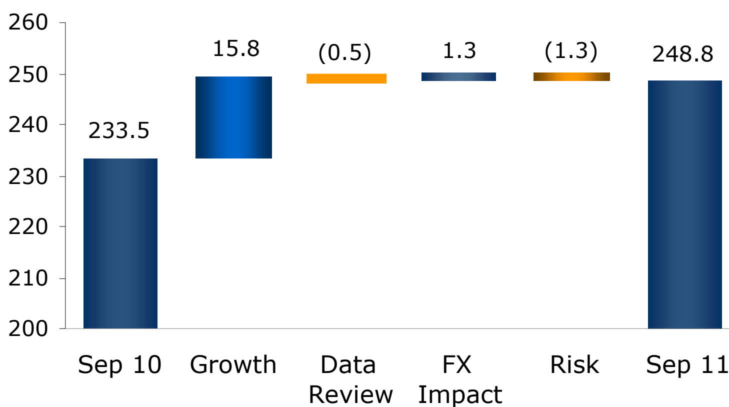
Strengthening capital position through organic capital generation

- Tier 1 capital position up 40bps since March 11, with recent CPS3 issuance and organic capital generation.
- ANZ well capitalised and positioned to manage transition to Basel III.



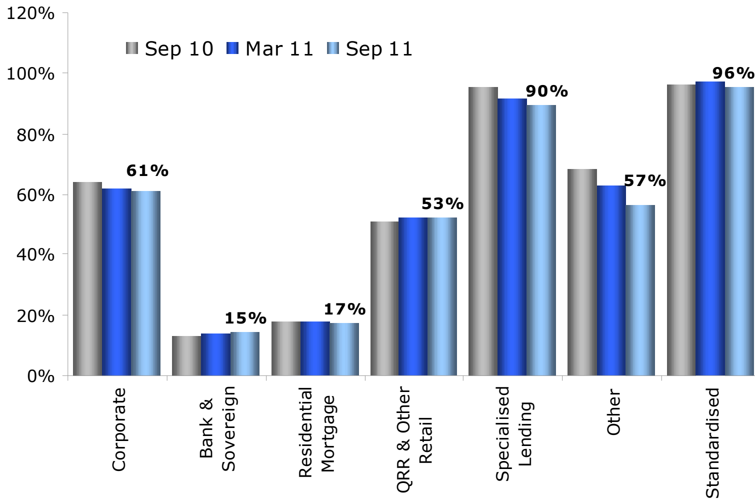
Growth in EAD of 9.0% to $624.0bn in 2H11

- Growth was across Residential Mortgages, Bank & Sovereign and Corporate exposures.



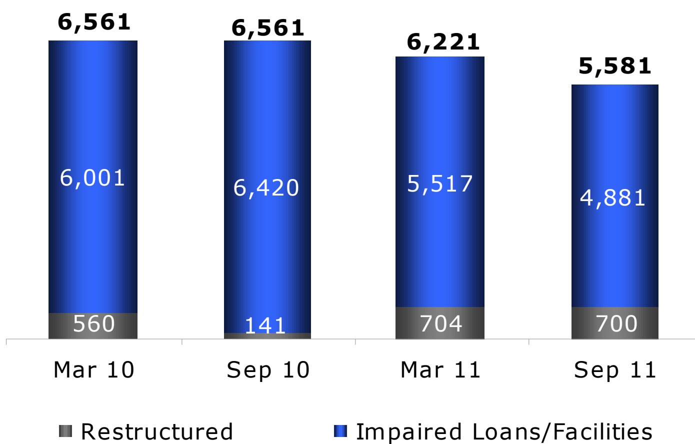
Credit Risk Weighted Assets (CRWA) up by $15.3bn since September 10

- Growth in CRWA has been driven by Corporate, Bank, Standardised and Specialised Lending asset classes, coupled with the impact of FX over the year.



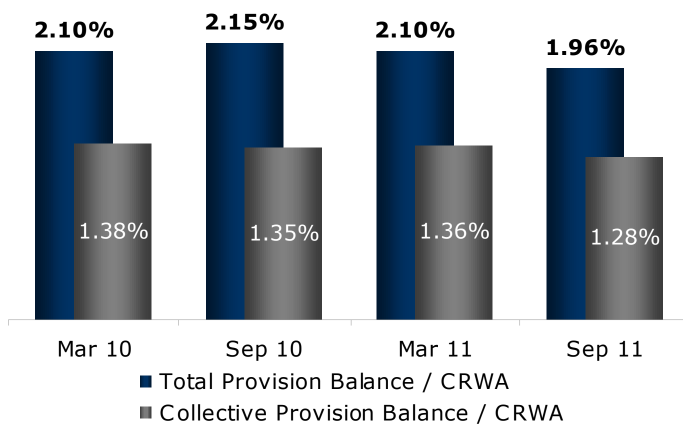
Portfolio average risk weight decreased by 0.9% from March 11 to 39.9% in September 11

- Risk improved slightly in Corporate by 0.7%.
- Risk also improved in several asset classes, particular in Other CRWAs, Specialised Lending and Standardised exposures (down 6.4%, 2.0% and 1.8% respectively).



Material decline in Impaired Assets since March 11

- Reduction driven by slow down in emergence of new impaired assets, coupled with sales, write-offs and recoveries.



Provision coverage ratios decreased slightly

- Collective provision balance has remained stable.
- Coverage ratios decreased slightly due to CRWA growth.

Chapter 2 – Introduction

Purpose of this document

This document has been prepared in accordance with the Australian Prudential Regulation Authority (APRA) ADI Prudential Standard (APS) 330 Capital Adequacy: Public Disclosure of Prudential Information (APS 330).

APS 330 mandates the release to the investment community and general public of information relating to capital adequacy and risk management practices. APS 330 has been established to implement Pillar 3 of the Basel Committee on Banking Supervision's framework for bank capital adequacy, known as 'Basel II'[2]. In simple terms, Basel II consists of three mutually reinforcing 'Pillars':

Pillar 1 Minimum capital requirement	**Pillar 2** Supervisory review process	**Pillar 3** Market discipline
Minimum capital requirements for Credit Risk, Operational Risk, Market Risk and Interest Rate Risk in the Banking Book	Firm-wide risk oversight, Internal Capital Adequacy Assessment Process (ICAAP), consideration of additional risks, capital buffers and targets and risk concentrations, etc	Regular disclosure to the market of qualitative and quantitative aspects of risk management, capital adequacy and underlying risk metrics

APS 330 requires the publication of various levels of information on a quarterly, semi-annual and annual basis. This document is the annual disclosure, which has the most comprehensive requirements.

Basel II in ANZ

In December 2007, ANZ received accreditation for the most advanced approaches permitted under Basel II for credit risk and operational risk, complementing its existing accreditation for market risk.

Verification of disclosures

These Pillar 3 disclosures have been verified in accordance with Board approved policy, including ensuring consistency with information contained in ANZ's Annual Report and in Pillar 1 returns provided to APRA. This Pillar 3 disclosure is not audited by ANZ's external auditor.

Comparison to ANZ's Annual Report

These disclosures have been produced in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with accounting policies adopted in ANZ's Annual Report. As such, there are differences in some common areas of disclosures. These differences are most pronounced in the credit risk disclosures, for instance:

- The principal method for measuring the amount at risk is Exposure at Default (EAD), which is the estimated amount of exposure likely to be owed on a credit obligation at the time of default. Under the Advanced Internal Ratings Based (IRB) approach in APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk, banks are accredited to provide their own estimates of EAD for all exposures (drawn, commitments or contingents) reflecting the current balance as well as the likelihood of additional drawings prior to default.
- Loss Given Default (LGD) is an estimate of the amount of losses expected in the event of default. LGD is essentially calculated as the amount at risk (EAD) less expected net recoveries from realisation of collateral as well as any post default repayments of principal and interest.
- Most credit risk disclosures split ANZ's portfolio into regulatory asset classes, which span areas of ANZ's internal divisional and business unit organisational structure.

Unless otherwise stated, all amounts are rounded to AUD millions.

[2] Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards: A Revised Framework, 2004.

Chapter 3 – Risk appetite and governance

Risk types

ANZ is exposed to a broad range of interrelated business risks. The main risks that directly impact determination of regulatory capital are as follows:

- Credit risk - the risk of financial loss resulting from the failure of ANZ's customers and counterparties to honour or perform fully the terms of a loan or contract.
- Market risk - the risk to ANZ's earnings arising from changes in interest rates, currency exchange rates and credit spreads, or from fluctuations in bond, commodity or equity prices. ANZ has grouped market risk into two broad categories to facilitate the measurement, reporting and control of market risk:
  - Traded market risk - the risk of loss from changes in the value of financial instruments due to movements in price factors for physical and derivative trading positions. Trading positions arise from transactions where ANZ acts as principal with clients or with the market.
  - Non-traded market risk (or balance sheet risk) - comprises Interest Rate Risk in the Banking Book and the risk to the AUD denominated value of ANZ's capital and earnings due to foreign exchange rate movements.
- Operational risk - the risk of loss resulting from inadequate or failed internal controls or from external events, including legal risk but excluding reputation risk[3].
- Equity risk - is the potential loss that may be incurred on equity investments in the banking book.
- Securitisation risk - the risk of credit related losses greater than expected due to a securitisation failing to operate as anticipated, or of the values and risks accepted or transferred, not emerging as expected.

Other key risks faced by ANZ, but which do not directly impact determination of regulatory capital, include:

- Strategic risk - is defined to be the potential for loss arising from a failure in ANZ's strategies. These include strategies designed to address or anticipate changes in the competitive, client, political or regulatory environments.
- Business risk - the risk of financial loss due to unexpected movements in volume, profit margin, and operating expenses (excluding risks elsewhere defined) arising from unexpected changes in the business environment, customer preferences and/or competitor actions.
- Liquidity risk - the risk that ANZ has insufficient capacity to fund increases in assets, or is unable to meet its payment obligations as they fall due, including repaying depositors or maturing wholesale debt.
- Compliance risk - is defined as the probability and impact of an event that results in a failure to act in accordance with laws or codes of conduct applicable to ANZ's businesses.
- Reputation risk - is defined as the risk of loss caused by adverse perceptions of ANZ held by the public, shareholders, investors, regulators, or rating agencies that directly or indirectly impact earnings, capital adequacy or value.

Risk appetite framework

ANZ's risk appetite is set by the Board and integrated within ANZ's strategic objectives. The risk appetite framework underpins fundamental principles of strong capitalisation, robust balance sheet and sound earnings, which protects ANZ's franchise and supports the development of an enterprise-wide risk culture.

[3] Regulatory Capital is calculated in accordance with the definition of Operational Risk outlined in APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk, and therefore excludes reputation risk considerations.

The framework provides an enforceable risk statement, on the amount of risk ANZ is willing to accept. It supports strategic and core business activities and customer relationships ensuring that:

- Only permitted activities are engaged in.
- The scale of permitted activities, and subsequent risk profile, does not lead to potential losses or earnings volatility that exceeds ANZ approved risk appetite.
- Risk is expressed quantitatively via limits and tolerances.
- Management focus is brought to bear on key and emerging risk issues and mitigating actions.
- Risk is linked to the business by informing, guiding and empowering the business in executing strategy.

Risk management governance

ANZ's Board has ultimate responsibility for risk management, and has three key committees focused on risks that impact regulatory capital.

Risk Committee	Assists the Board in the effective discharge of the Board's responsibilities for business, market, credit, equity and other investment, financial, operational, liquidity, compliance and reputation risk management.
Audit Committee	In addition to its role reviewing financial reporting principles and policies, controls and procedures, the Audit Committee also reviews prudential supervision procedures required by regulatory bodies relating to financial reporting and oversees the work of Internal Audit.
Governance Committee	Ensures an appropriate Board and Committee structure is in place. Reviews the development of and approves corporate governance policies and principles applicable to ANZ.

The Chair and members of these committees are non - executive directors, and are appointed by the Board. Internal Audit provides independent and objective assurance around ANZ's risk management and control effectiveness, and its primary reporting line is to the Audit Committee.

ANZ's Chief Executive Officer (CEO) creates and delegates powers to various executive management committees, several of which perform functions that support the Risk Committee. The executive committees most relevant to the risks described above and overall capital management at ANZ are as follows:

Group Asset and Liability Committee (GALCO)
GALCO is responsible for the oversight and strategic management of ANZ's balance sheet, liquidity and funding positions and capital management activities. This ensures they are aligned to adding shareholder value by managing and positioning the balance sheet consistent with ANZ's appetite for risk, maintaining ANZ's preferred AA rating category, and striving for best-practice corporate governance. Specifically, GALCO co-ordinates, approves and, where necessary, directs: • Liquidity and funding activities, to ensure that these are managed in a way consistent with ANZ's strategy and within ANZ's appetite for liquidity risk. • The management of ANZ's capital management framework to ensure that ANZ is adequately capitalised to cover its material risks and exposures in an efficient and effective manner. • Balance sheet management activities including management of non-traded related risks and exposures. In all cases this is in accordance with ANZ's risk appetite and limits defined by the Board, regulatory requirements, and international best practice. GALCO is chaired by ANZ's Chief Financial Officer (CFO) and meets at least six times per year. GALCO is supported by specialist committees that cover capital management and non-traded market risk, as well as regional asset and liability management committees.

Capital Management Policy Committee (CMPC)
CMPC is a sub-committee of GALCO, with responsibility for the oversight and control of ANZ's capital and portfolio measurement framework, addressing economic and regulatory capital requirements. CMPC is also responsible for making capital management and portfolio measurement related recommendations to GALCO. The Committee's main objective is to ensure ANZ's regulatory and economic capital management activities are aligned with GALCO's objectives, with focus on: • Internal Capital Adequacy Assessment Process (ICAAP), aligning capital levels and targets to risk appetite and policies and processes by which ANZ identifies, measures, monitors and manages risks. • Analysing economic capital in context of changes in material risks, emerging risks and/or methodology changes. • Stress testing reviews and updates. CMPC is chaired by ANZ's CFO (or in absence, ANZ's Chief Risk Officer (CRO)) and shall normally meet six times a year.
Credit and Market Risk Committee (CMRC)
CMRC is a senior executive management forum responsible for the oversight and control of credit and traded market risk and non-traded market risk. Its responsibilities and duties include: • Oversee the risk appetite framework. • Approve credit and market risk policies. • Oversee credit and market risk model performance. • Ensure comprehensive credit and market risk control, including handling of emerging issues. • Approve business writing strategies. • Review credit provisions. • Oversee credit portfolio composition, including large exposures, risk grade migration, risk concentrations and changes to delinquency patterns. • Set and oversee market risk limits. CMRC is chaired by ANZ's CRO and meets as required, and is supported by a specialist committee that covers credit ratings systems.
Credit Ratings System Oversight Committee (CRSOC)
CRSOC provides oversight and control of the Internal Ratings System for credit risk across ANZ. It provides governance over ratings models, as well as associated pricing and collections models or tools including: • Approving the content and design of the rating system, including models and methodology for Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD). • Prioritisation, monitoring and approval of model changes, enhancements and re-builds. • Performance monitoring of internal rating system models. • Monitor annual independent validation of use and performance of all models. CRSOC is chaired by the CRO Australia and shall normally meet six times a year. It supports CMPC and CMRC, and in turn is supported by working groups.
Operational Risk Executive Committee (OREC)
OREC is the primary senior executive management forum responsible for the oversight of the control environment managing compliance and operational risk. Its main responsibilities and duties include: • Endorse ANZ's Operational Risk Framework for approval by the Board Risk Committee. • Approve ANZ's Group Compliance Framework. • Approve Operational Risk policies and Compliance policies. • Monitor operational risk policies and compliance profiles, emerging risks, incidents, trends and remediation, including treatment plans for extreme risks. OREC is chaired by ANZ's CRO and currently meets five times per year.
Reputation Risk Committee (RRC)
The purpose of the RRC is to assist ANZ businesses, Risk, Compliance and Legal in partnership to effectively discharge their responsibility for managing reputation risk in relation to environmental, social, business, product and regulatory issues. RRC is chaired by ANZ's CRO and normally meets five times a year or as requested/required.

Chapter 4 – Group structure and capital adequacy

Table 1 Scope of application

Top corporate entity

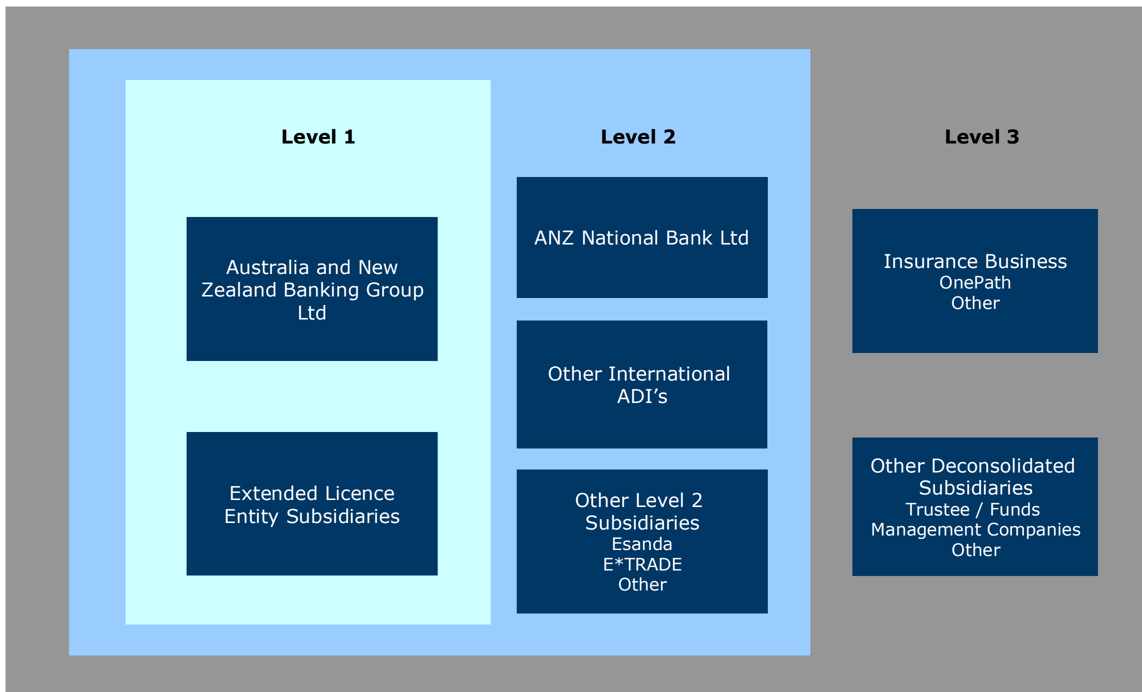
The top corporate entity in the reporting group is Australia and New Zealand Banking Group Limited.

Capital reporting and measurement

To ensure that an Authorised Deposit-taking Institution (ADI) is adequately capitalised on both a stand alone and group basis, APRA adopts a tiered approach to the measurement of an ADI's capital adequacy by assessing the ADI's financial strength at three levels:

- Level 1 - being the ADI i.e. Australia and New Zealand Banking Group Limited, consolidated with APRA approved subsidiaries, to form the ADI's Extended Licensed Entity (ELE).
- Level 2 - being the consolidated group for financial reporting purposes adjusted to exclude associates activities and certain subsidiaries excluded under APS 110 Capital Adequacy that undertake the following business activities:
  - Insurance businesses (including friendly societies and health funds).
  - Acting as manager, responsible entity, approved trustee, trustee or similar role in relation to funds management.
  - Non-financial (commercial) operations.
  - Securitisation special purpose vehicles to which assets have been transferred in accordance with APRA's requirements as set out in APS 120: Securitisation.
- Level 3 - the consolidated group for financial reporting purposes.

ANZ measures capital adequacy monthly and reports for prudential purposes on a Level 1 and Level 2 basis, however is not required to report on a Level 3 basis. This Pillar 3 report is based on the Level 2 prudential structure.



Refer to Note 38 of ANZ's 2011 Annual Report for a list of all material subsidiaries and a brief description of their key activities.

Accounting consolidation

The financial statements consolidate the financial statements of the company and all its subsidiaries where it is determined that there is a capacity to control. Where subsidiaries have been sold or acquired during the year, their operating results have been included to the date of disposal or from the date of acquisition. Control means the power to govern, directly or indirectly, the financial and operating policies of an entity so as to obtain benefits from its activities. All the facts of a particular situation are considered when determining whether control exists. Control is usually present when an entity has:

- Power over more than one-half of the voting rights of the other entity; or
- Power to govern the financial and operating policies of the other entity; or
- Power to appoint or remove the majority of the members of the board of directors or equivalent governing body; or
- Power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the entity.

In addition, potential voting rights that are presently exercisable or convertible are taken into account in determining whether control exists.

In relation to special purpose entities, control is deemed to exist where in substance:

- The majority of the residual risks and rewards from their activities accrue to the Group; or
- The Group control decision making powers so as to obtain the majority of the risks and rewards from their activities.

Refer to Note 1 of ANZ's 2011 Annual Report for a description of the principal accounting policies adopted in the preparation of ANZ's financial report.

Entities excluded from Level 2

Investments in entities deconsolidated from the Level 3 group to determine Level 2 for prudential purposes are deducted from regulatory capital and the assets of those entities are excluded from aggregate Risk Weighted Assets (RWA).

The material entities excluded from Level 3 to determine Level 2 are:

- **Insurance entities**

  OnePath (AU) Life Limited and OnePath (AU) General Insurance Limited
  OnePath (NZ) Insurance Holdings Limited and One Path (NZ) Life Limited
  ANZ Cover Insurance Pty Limited
  ANZ Lenders Mortgage Insurance Pty Limited

- **Trustee/Fund Manager**

  OnePath Funds Management Limited and OnePath Custodians Limited
  ANZ Trustees Limited

Restrictions on transfers of capital within ANZ

ANZ operates branches and locally incorporated subsidiaries in many countries. These operations are capitalised at an appropriate level to cover the risks in the business and to meet local prudential requirements. This level of capitalisation may be enhanced to meet local taxation and operational requirements. Any repatriation of capital from subsidiaries or branches is subject to meeting the requirements of the local prudential regulator and/or the local central bank.

Apart from ANZ's operations in New Zealand, local country capital requirements do not impose any material call on ANZ's capital base. ANZ undertakes banking activities in New Zealand principally through its wholly owned subsidiary, ANZ National Bank Limited (ANZ National), which is subject to minimum capital requirements as set by the Reserve Bank of New Zealand (RBNZ). The RBNZ has adopted the Basel II framework, effective from 1 January 2008, and ANZ National has been accredited to use the advanced approach for the calculation of credit risk and operational risk. ANZ National maintains a buffer above the minimum capital base required by the RBNZ. This capital buffer has been calculated via the ICAAP undertaken for ANZ National, to ensure ANZ National is appropriately capitalised under stressed economic scenarios.

Capital deficiencies in non-consolidated subsidiaries

The aggregate amount of any under-capitalisation of any non-consolidated subsidiary (or subsidiaries) that is required to be deducted from capital is nil (March 2011 and September 2010: nil).

Table 2 Capital structure

ANZ's regulatory capital calculation is governed by APRA's prudential standards which adopt a risk-based capital assessment framework, based on the Basel II capital measurement standards. This risk based approach requires eligible capital to be divided by total RWA, with the resultant ratio being used as a measure of an ADI's capital adequacy. APRA determines Prudential Capital Ratios (PCRs) for Tier 1 and Total Capital, with capital as the numerator and RWAs as the denominator.

APRA determines PCRs for Tier 1 and Total Capital at both Level 1 and Level 2 under its prudential standards APS 110. Eligible capital is defined by APS 111 – Capital Adequacy: Measurement of Capital, and the RWA calculations are predominantly contained in APS 113 – Capital Adequacy: Internal Ratings-based Approach to Credit Risk, APS 115 – Capital Adequacy: Advanced Measurement Approach to Operational Risk, APS 116 Capital Adequacy: Market Risk and APS 117 – Capital Adequacy: Interest Rate Risk in the Banking Book.

Regulatory capital is divided into Tier 1, carrying the highest capital elements, and Tier 2, which has lower capital elements, but still adds to the overall strength of the ADI.

Tier 1 capital is comprised of 'Fundamental' capital, 'Residual' capital, and 'Tier 1 deductions'. Fundamental capital comprises shareholders' equity adjusted for items which APRA does not allow as regulatory capital or classifies as lower forms of regulatory capital.

Fundamental capital includes the following significant adjustments:

- Residual Tier 1 capital instruments included within shareholders' equity are excluded.
- Reserves exclude the Hedging reserve and Available-for-sale revaluation reserve, and reserves of insurance, funds management and securitisation subsidiaries and associates excluded for Level 2 purposes.
- Retained earnings excludes retained earnings of insurance, funds management and securitisation subsidiaries and associates excluded for Level 2 purposes, but includes capitalised deferred fees forming part of loan yields that meet the criteria set out in the prudential standard.
- Current year (net of tax) earnings is net of any interim and special dividends paid during the current year and the expected dividend payments (net of the expected dividend reinvestment under the Dividend Reinvestment Plan and Bonus Option Plan) for ordinary shares and Residual capital instruments, and excludes profits of insurance, funds management and securitisation subsidiaries and associates excluded for Level 2 purposes.

Residual capital covers 'Non-innovative' and 'Innovative' hybrid Tier 1 instruments with limits restricting the volume that can be counted as Tier 1 capital.

ANZ has on issue four outstanding Non-innovative hybrid Tier 1 capital instruments:

- **ANZ Convertible Preference Shares**. On 30 September 2008 ANZ issued $1,081 million of convertible preference shares (CPS1), on 17 December 2009 ANZ issued $1,969 million of convertible preference shares (CPS2) and on 28 September 2011 ANZ issued $1,340 million of convertible preference shares (CPS3) that mandatorily convert into ordinary shares on 16 June 2014, 15 December 2016 and 1 September 2019 respectively, subject to certain conditions being satisfied. They may also convert earlier under certain circumstances and ANZ, subject to APRA's approval, has a right to convert CPS3 in its discretion on each semi-annual dividend payment date from 1 September 2017. In particular, CPS3 will mandatorily convert into ordinary shares if ANZ's Common Equity Capital Ratio[4] is equal to or less than 5.125% (or APRA determines that to be the case). The number of shares issued to a CPS3 holder on conversion following a breach of that ratio is limited to the Maximum Conversion Number of 10.2407 ordinary shares per CPS3 (although the CPS3 terms in respect of the Maximum Conversion Number may be amended once APRA's Basel III regulations are finalised). CPS3 may also be redeemed for cash on each semi-annual dividend payment date from 1 September 2017, subject to APRA's approval. The distributions are preferred, non-cumulative, payable quarterly (in respect of CPS1 and CPS2) and semi-annually (in respect of CPS3) and based on the 90 day (in respect of CPS1 and CPS2) and 180 day (in respect of CPS3) Australian Bank Bill Rate plus a margin of 250 basis points (in respect of CPS1) and 310 basis points (in respect of CPS2 and CPS3) and are subject to ANZ's Directors resolving to pay in their absolute discretion and other payment tests being satisfied. In a winding-up of ANZ, the convertible preference shares will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.
- **UK Stapled Securities**. On 15 June 2007 ANZ raised GBP450 million of non-cumulative mandatory convertible stapled securities. On 15 June 2012, or an earlier date under certain circumstances, the UK Stapled Securities will mandatorily convert into ordinary shares, subject to

[4] Common Equity Tier 1 is Tier 1 less Residual Tier 1 Capital.

certain conditions being satisfied. The distributions are non-cumulative at a fixed rate of 6.54% payable semi-annually. In a winding-up of ANZ, the ANZ preference shares forming part of the UK Stapled Securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.

ANZ has on issue two Innovative hybrid Tier 1 capital instruments:

- **US Trust Securities**. On 27 November 2003, ANZ issued USD750 million of non-cumulative trust securities with an initial call date of 15 December 2013 and a coupon rate of 5.36%. On 15 December 2013, ANZ has the right to redeem the US Trust Securities for cash, subject to APRA approval. If ANZ does not exercise this right, holders are entitled to require ANZ to exchange the US Trust Securities into ordinary shares. The distributions are non-cumulative payable semi-annually. In a winding-up of ANZ, the ANZ preference shares forming part of the US Trust Securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.
- **Euro Trust Securities**. On 13 December 2004, ANZ issued EUR500 million of non - cumulative trust securities raising $871 million, at the spot rate on the date of issue. Distributions are non-cumulative payable quarterly based upon the three month EURIBOR rate plus a margin of 66 basis points up until 15 December 2014, at which date ANZ has the right to redeem the Euro Trust Securities for cash (subject to APRA approval). After this date, the distribution rate is a rate based on the three month EURIBOR rate plus a margin of 166 basis points. In a winding-up of ANZ, the ANZ preference shares forming part of the Euro Trust securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.

For more information on these instruments, refer to the Loan Capital and Share Capital notes (Notes 27 and 28 respectively) in ANZ's 2011 Annual Report.

Tier 1 deductions include amounts deducted solely from Tier 1, mainly intangible assets i.e. goodwill, value in force as to insurance/investment business portfolios; capitalised software, capitalised brokerage and borrowing expenses, net deferred tax assets and deductions taken 50% from Tier 1 and 50% from Tier 2, which mainly include the tangible component of investment in other subsidiaries and investments in associates regulated by APRA, or their overseas equivalent, and the amount of Expected Losses (EL) in excess of Eligible Provisions for Loan Losses (net of tax).

Tier 2 capital is comprised of Upper and Lower Tier 2 capital, less capital deductions taken 50% from Tier 2 capital. Upper Tier 2 capital mainly comprises perpetual subordinated debt instruments, whilst Lower Tier 2 comprises dated subordinated debt instruments which have a minimum term of 5 years at issue date.

ANZ has two instruments that qualify as Upper Tier 2 capital:

- USD300 million note issued by ANZ on 30 October 1986 which pays a rate of 6 month LIBOR plus 15 basis points.
- NZD835 million note issued by ANZ National on 17 April 2008 which pays a fixed rate of 9.66% (incorporating a margin of 200 basis points) for five years payable semi-annually. At the first call date of 18 April 2013, if not called, the interest rate resets to a fixed rate at the five year swap rate plus 200 basis points. At the second call date of 18 April 2018, if not called, the interest rate resets to a floating rate at the 3 month Forward Rate Agreement rate plus 300 basis points. The Notes are callable on any interest payment date thereafter.

To qualify as Lower Tier 2 capital, the instrument must have a minimum original term of five years and the amount eligible for inclusion in capital is amortised on a straight line basis at a rate of 20% per annum over the last four years to maturity. For more details on these Lower Tier 2 capital instruments, refer to the Subordinated Notes section of the Loan Capital note (Note 27) in ANZ's 2011 Annual Report.

Total Capital is the sum of Tier 1 capital and Tier 2 capital.

Table 2: Capital Structure

The following table summarises ANZ's Level 2 capital position as at 30 September 2011:

Tier 1 capital	Sep 11 $M	Mar 11 $M	Sep 10 $M
Paid-up ordinary share capital	21,577	20,839	20,140
Reserves	(2,266)	(3,143)	(2,574)
Retained earnings	15,123	14,732	13,685
Non-controlling interests	41	64	64
Fundamental Tier 1 capital	**34,475**	**32,492**	**31,315**
Innovative Tier 1 capital	1,641	1,597	1,646
Non-innovative Tier 1 capital	5,111	3,751	3,787
Gross Tier 1 capital	**41,227**	**37,840**	**36,748**
Goodwill	(2,968)	(2,795)	(2,910)
Other deductions from Tier 1 capital only	(4,572)	(4,220)	(4,121)
50/50 deductions from Tier 1 capital	(3,071)	(3,055)	(3,026)
Deductions from Tier 1 capital	**(10,611)**	**(10,070)**	**(10,057)**
Net Tier 1 capital	**30,616**	**27,770**	**26,691**
Tier 2 capital			
Upper Tier 2 capital			
Perpetual subordinated notes	965	905	946
General reserve for impairment of financial assets net of attributable deferred tax asset[5]	266	264	280
Lower Tier 2 capital	5,042	6,201	6,644
Gross Tier 2 capital	**6,273**	**7,370**	**7,870**
Upper and lower Tier 2 capital deductions	(28)	(28)	(28)
50/50 deductions from Tier 2 capital	(3,071)	(3,055)	(3,026)
Deductions from Tier 2 capital	**(3,099)**	**(3,083)**	**(3,054)**
Net Tier 2 capital	**3,174**	**4,287**	**4,816**
Total capital base	**33,790**	**32,057**	**31,507**

Further information on capital structure can be found in Appendix 1.

[5] Under Basel II, "General reserve for impairment of financial assets net of attributable deferred tax asset" consists of the surplus of the general reserve for impairment of financial assets net of tax and/or the provisions attributable to the standardised portfolio.

Table 3 Capital adequacy

Capital management approach

ANZ pursues an active approach to capital management, which is designed to protect the interests of depositors, creditors and shareholders. This involves the ongoing review and Board approval of the level and composition of ANZ's capital base, assessed against the following key policy objectives:

- Regulatory compliance such that capital levels exceed APRA's PCRs both at Level 1 and Level 2[6] for Tier 1 and Total Capital, and the US Federal Reserve's minimum Tier 1 and Total Capital adequacy requirements at Level 2 via ANZ's Foreign Holding Company licence in the United States of America.
- Capital levels are aligned with the risks in the business and to meet strategic and business development plans through ensuring that available capital exceeds the level of Economic Capital required to support the Ratings Agency 'default frequency' confidence level for a "AA" credit rating category bank. Economic Capital is an internal estimate of capital levels required to support risk and unexpected losses above a desired target solvency level.
- Capital levels are commensurate with ANZ maintaining its preferred "AA" credit rating category for senior long-term unsecured debt given its risk appetite outlined in its strategic plan.
- An appropriate balance between maximising shareholder returns and prudent capital management principles.

ANZ achieves these objectives through the ICAAP whereby ANZ conducts detailed strategic and capital planning over a medium term time horizon.

Annually, ANZ conducts a detailed strategic planning process over a three-year time horizon. This process involves forecasting key economic variables which Divisions use to determine key financial data for their existing business. New strategic initiatives to be undertaken over the planning period and their financial impact are then determined. These processes are used for the following:

- A review of capital ratios, targets, and levels of different classes of capital against ANZ's risk profile and risk appetite outlined in the Strategic Plan. ANZ's capital targets reflect the key policy objectives above, and the desire to ensure that under specific stressed economic scenarios, capital levels are sufficient to remain above both Economic Capital and PCR requirements.
- Stress tests are performed under different economic conditions to ensure a comprehensive review of ANZ's capital position both before and after mitigating actions. The stress tests determine the level of additional capital (i.e. the 'capital buffer' above Pillar 1 minimum capital) needed to absorb losses that may be experienced during an economic downturn.
- Stress testing is integral to strengthening the predictive approach to risk management and is a key component in managing risks and business writing strategies. It creates greater understanding of the impacts on financial performance through modelling relationships and sensitivities between geographic, industry and business unit exposures under a range of macro economic scenarios. ANZ has a dedicated stress testing team within Risk Management that models and reports to management and the Board Risk Committee on a range of scenarios and stress tests.
- Results are subsequently used to:
  - Recalibrate ANZ's management targets for minimum and operating ranges for its respective classes of capital such that ANZ will remain compliant with APRA's PCRs and the US Federal Reserve's minimum Tier 1 and Total Capital requirements.
  - Identify the level of organic capital generation and hence determine current and future capital requirements for the Company (Level 1) and the Group (Level 2).

From these processes, a capital plan is developed and approved by the Board which identifies the capital issuance requirements, capital securities maturity profile and options around capital products, timing and markets to execute the Capital Plan under differing market and economic conditions.

The Capital Plan is maintained and updated through a monthly review of forecast financial performance, economic conditions and development of business initiatives and strategies. The Board and senior management are provided with monthly updates of ANZ's capital position. Any actions required to ensure ongoing prudent capital management are submitted to the Board for approval.

[6] In addition to the prudential capital oversight by APRA, ANZ's branch operations and major banking subsidiary operations are overseen by local regulators such as the Reserve Bank of New Zealand, the US Federal Reserve, the UK Financial Services Authority, the Monetary Authority of Singapore, the Hong Kong Monetary Authority and the China Banking Regulatory Commission who may impose minimum capitalisation rates on those operations.

Capital targets

Target ratios are set to be consistent with ANZ’s risk appetite and Economic Capital methodology, plus an allowance for the impact of relevant stress testing on the capital position. The approach ensures capital requirements are manageable and consistent with long term credit ratings and minimum prudential capital requirements, even during periods of stress.

Throughout the financial year, ANZ maintained compliance with the minimum Tier 1 and Total Capital ratios at Level 1 and Level 2 set by APRA, and the US Federal Reserve for Level 2, as well as applicable capitalisation rates set by local regulators in countries where ANZ operates branches and subsidiaries.

ANZ has adopted the Common Equity Tier 1 and Tier 1 capital ratios as its principal capital management targets at Level 2. Given recent difficult economic and financial market conditions, ANZ has maintained both ratios well above its minimum target.

Regulatory change

Following on from the December 2010 Basel Committee paper on prudential capital reforms, on 6 September 2011 APRA released a discussion paper detailing the implementation of Basel III capital reforms in Australia.

The discussion paper proposes to adopt the Basel III reforms with increased capital deductions from Common Equity Tier 1 capital, higher capital targets with prescribed minimum capital buffers; and tighter requirements around hybrid Tier 1 and Tier 2 securities. In addition to higher risk weightings for counterparty credit risk proposed by the December 2010 Basel Committee paper, the adjustments to ANZ’s capital ratios proposed by the discussion paper are set out below and APRA is proposing these become effective from January 2013. The APRA proposals generally adopt a more conservative approach and ANZ believes full alignment to Basel III would be more appropriate.

The Basel Committee is still to release final proposals for contingent capital and measures to address systematic and inter-connected risks – these are expected in 2012.

	Common Equity Tier 1 Capital	Tier 1 Capital	Total Capital
APRA September 2011 Basel II	**8.5%**	**10.9%**	**12.1%**
Plus: Dividend not provided for (net of DRP)	0.5%	0.5%	0.5%
Less: Tier 2 capital deductions moved to Common Equity Tier 1			
Investment in ADIs and overseas equivalents	(0.4%)	(0.4%)	-
Investment in ANZ insurance subsidiaries including OnePath	(0.4%)	(0.4%)	-
Expected losses in excess of eligible provisions	(0.2%)	(0.2%)	-
Other	(0.1%)	(0.1%)	(0.1%)
Less: 10% reduction of existing hybrid Tier 1 and Tier 2 securities[7]	-	(0.2%)	(0.4%)
	7.9%	**10.1%**	**12.1%**
Less: estimated increase in RWA[8]	(0.4%)	(0.5%)	(0.6%)
Pro forma ratio - should the APRA Basel III proposals be adopted	**7.5%**	**9.6%**	**11.5%**
Plus: adjustments to fully align to Basel III			
10% allowance for investments in insurance subsidiaries and ADIs including overseas equivalents	0.8%	0.7%	0.6%
Up to 5% allowance for deferred tax assets[9]	0.2%	0.2%	0.2%
Other capital items	0.2%	0.2%	0.3%
Pro forma Basel III (fully aligned capital)	**8.7%**	**10.7%**	**12.6%**
Plus: additional APRA Basel II conservative RWA methodologies			
Mortgage 20% LGD floor and others	0.6%	0.7%	0.7%
IRRBB RWA (APRA Pillar 1 approach)	0.2%	0.3%	0.4%
Pro forma Basel III fully aligned	**9.5%**	**11.7%**	**13.7%**

International capital ratio comparisons

One of the main purposes of the Pillar 3 disclosures is to facilitate comparisons of banks, both within and across jurisdictions.

International investors should be aware that there are a number of features of APRA's implementation of Basel II that have the effect of making key capital adequacy ratios appear lower than would be the case if they were calculated under the rules in other jurisdictions. The following table shows ANZ's estimation of its Common Equity Tier 1, Tier 1 and Total Capital adequacy ratios under UK rules (set by the FSA.

	As At			
	Sep 11 FSA	**Sep 11**	**Mar 11**	**Sep 10**
Common Equity Tier 1	11.4%	8.5%	8.5%	8.0%
Tier 1	14.0%	10.9%	10.5%	10.1%
Tier 2	0.9%	1.2%	1.6%	1.8%
Total capital	14.9%	12.1%	12.1%	11.9%
Risk weighted assets $M	257,512	279,964	264,236	264,242

For Tier 1 capital, the major reasons for the differences are that FSA:

- Does not require a deduction for accrued dividends (although APRA does give credit for expected shares to be issued under a dividend reinvestment plan).
- Does not require a Tier 1 deduction for certain capitalised expenses and net deferred tax assets.

[7] From 1 January 2013 transitional treatment for existing securities on issue will apply. The maximum that can be included in the respective capital base is 90% of the volume of eligible transitional Tier 1 and Tier 2 securities on issue at 31 December 2012. The cap will reduce by 10 percentage points each year until 1 January 2022.

[8] Excludes additional RWA for Market Risk and Securitisation applicable to APRA enhancements to the Basel II framework effective 1 January 2012 and potential impacts arising from APRA's yet to be released Basel III liquidity reforms.

[9] Including alignment of deferred tax asset associated with EL in excess of Eligible Provisions calculation to Basel III methodology.

- Allows the comparison of EL to Eligible Provisions for Loan Loss to be made on a gross basis and any excess is then tax effected, whereas APRA require EL to be compared to Eligible Provisions for Loan Losses net of tax, and any excess to be taken as 50% Tier 1 deduction and a 50% Tier 2 deduction.
- Has a more favourable treatment for investments in associates and insurance and funds management subsidiaries.

For RWA, the major reasons for the differences are:

- APRA has set a 20% floor on the downturn LGD for mortgages (as compared with the 10% minimum set by the FSA).
- FSA does not require IRRBB to be a Pillar I requirement so it is excluded from prudential capital adequacy ratios.
- Differences in the treatment of specialised property lending, equity and margin lending products.

The Australian Bankers' Association (ABA) has released a detailed fact sheet[10] documenting the differences between the Australian and UK rules and the implications for prudential capital ratios.

[10] bankers.asn.au

Table 3: Capital Ratios and Risk Weighted Assets[11] [12]

Risk Weighted Assets (RWA)

Risk weighted assets	Sep 11 $M	Mar 11 $M	Sep 10 $M
Subject to Advanced Internal Rating Based (IRB) approach			
Corporate	106,120	98,393	101,940
Sovereign	4,365	3,217	2,720
Bank	9,456	6,958	6,135
Residential Mortgage	41,041	40,126	38,708
Qualifying Revolving Retail	7,468	7,552	7,205
Other Retail	19,240	18,485	17,899
Credit risk weighted assets subject to Advanced IRB approach	**187,690**	**174,731**	**174,607**
Credit risk Specialised Lending exposures subject to slotting approach	**27,757**	**26,799**	**26,605**
Subject to Standardised approach			
Corporate	22,484	20,680	20,560
Residential Mortgage	845	406	567
Qualifying Revolving Retail	2,344	2,207	2,279
Other Retail	1,650	1,710	1,396
Credit risk weighted assets subject to Standardised approach	**27,323**	**25,003**	**24,802**
Credit risk weighted assets relating to securitisation exposures	1,136	1,209	2,091
Credit risk weighted assets relating to equity exposures	1,399	1,635	1,577
Other assets	3,523	3,869	3,835
Total credit risk weighted assets	**248,828**	**233,246**	**233,517**
Market risk weighted assets	3,046	2,547	5,652
Operational risk weighted assets	19,651	18,331	17,383
Interest rate risk in the banking book (IRRBB) risk weighted assets	8,439	10,112	7,690
Total risk weighted assets	**279,964**	**264,236**	**264,242**

Capital ratios (%)			
Level 2 Total capital ratio	**12.1%**	**12.1%**	**11.9%**
Level 2 Tier 1 capital ratio	**10.9%**	**10.5%**	**10.1%**
Level 1: Extended licensed entity Total capital ratio	**12.3%**	**12.6%**	**12.3%**
Level 1: Extended licensed entity Tier 1 capital ratio	**11.5%**	**11.4%**	**11.0%**
Other significant Authorised Deposit-taking Institution (ADI) or overseas bank subsidiary:			
ANZ National Bank Limited - Total capital ratio	**12.7%**	**12.9%**	**13.1%**
ANZ National Bank Limited - Tier 1 capital ratio	**10.0%**	**9.6%**	**9.7%**

[11] Specialised Lending exposures subject to slotting approach are those where the main servicing and repayment is from the asset being financed, and includes specified commercial property development/investment lending, project finance and object finance.

[12] ANZ National Bank Limited’s capital ratios have been calculated in accordance with Reserve Bank of New Zealand prudential standards.

Credit Risk Weighted Assets (CRWA)

Total CRWA increased by $15.3 billion (6.6%) from September 2010 to $248.8 billion. The key impacts on CRWA were an increase of $4.1 billion (4.1%) in IRB Corporate driven by growth in Institutional assets and increases of $3.3 billion (54.1%) in IRB Bank and $2.5 billion (10.2%) in Standardised assets driven by growth in Asia.

Market Risk and IRRBB RWA

The decrease in Market Risk of $2.6 billion (46.1%) is attributed to a combination of increased portfolio diversification and reduction of volatility in the market risk model. The increase in IRRBB over the year of $749 million (9.7%) was due to the realisation of previously embedded gains. The increase in operational RWA over the year is due to an update to unexpected loss scenarios for all divisions, an additional six months of external loss data to the end of December 2010 and internal loss data to the end of June 2011.

Types of exposures in each Basel asset class

The following table details the types of exposures in each Basel asset class:

Basel Asset Class	Typical Types of Exposures
Corporate	Individually rated and managed exposures not covered under other categories – mainly lending and off-balance sheet facilities provided to larger companies, partnerships and other bodies
Sovereign	Exposures to sovereigns and central banks. Includes direct exposures e.g. bond holdings and indirect e.g. exposures guaranteed by sovereign Export Credit Agencies (ECAs)
Bank	Exposures to non-Group bank counterparties. Includes bond holdings and deposits with other banks, trade finance exposures and guarantees provided by other banks
Residential Mortgages	Retail exposures secured by residential properties – mainly home loans, investment loans and equity manager facilities
Qualifying Revolving Retail	Retail managed consumer credit card exposures with customer limits less than $100,000
Other Retail	Retail managed exposures other than mortgage and qualifying revolving – includes personal loans, consumer and small business lending, retail small business lending
Specialised Lending	Exposures where the main servicing and repayment is from the asset being financed. Includes specified commercial property development/investment lending, project finance and object finance
Standardised	Lending exposures where IRB models cannot be applied – mainly local business lending and personal lending in Asia and the Pacific
Securitisation	Exposures to securitisation vehicles – mainly liquidity and funding facilities provided to third party securitisations and securitisation bond exposures
Equity	Holding of third party equities where not consolidated or deducted from capital
Other Assets	Mainly fixed assets and margin lending

Chapter 5 – Credit risk

Table 4 Credit risk – General disclosures

Definition of credit risk

Credit risk is defined as the risk of financial loss resulting from the failure of ANZ's customers and counterparties to honour or perform fully the terms of a loan or contract.

Regulatory approval to use the Advanced Internal Ratings-based approach

ANZ has been given approval by APRA to use the Advanced Internal Ratings-based approach to credit risk, under APS 113. There are however several small portfolios (mainly retail and local corporates in Asia Pacific) where ANZ applies the Standardised approach to credit risk, under APS 112 Capital Adequacy: Standardised Approach to Credit Risk.

Credit risk management framework and policies

ANZ has a comprehensive framework to manage credit risk and support sound growth for appropriate returns. The framework is top down, being defined by credit principles and policies. Credit policies and procedures cover all aspects of the credit life cycle such as transaction structuring, risk grading, initial approval, ongoing management and problem debt management, as well as specialist policy topics. The effectiveness of the credit risk management framework is assessed through various compliance and monitoring processes. These, together with portfolio selection, define and guide the credit process, organisation and staff.

Organisation

As described in Chapter 3, the CMRC is a senior executive level credit risk committee. The CRSOC supports the CMRC, by providing group-wide scrutiny of ANZ's credit rating system.

The primary responsibility for prudent and profitable management of credit risk assets and customer relationships rests with the business units. An independent credit risk management function is staffed by risk specialists. Independence is achieved by having all credit risk staff ultimately report to the CRO, even where they are embedded in business units. Risk provides independent credit assessment and approval on lending decisions, and also performs key roles in portfolio management such as development and validation of credit risk measurement systems, loan asset quality reporting, and development of credit policies.

The authority to make credit decisions is delegated by the Board to the CEO who in turn delegates authority to the CRO. The CRO in turn delegates some of his credit discretion to individuals as part of a 'cascade' of authority from senior to the most junior credit officers. Within ANZ, credit approval for almost all judgemental lending is made on a 'dual approval' basis, jointly by the business writer in the business unit and the respective independent credit risk officer. Programmed credit assessment typically covers retail and some small business lending, and refers to the automated assessment of credit applications using a combination of scoring (application and behavioural), policy rules and external credit reporting information. Where an application does not meet the automated assessment criteria it will be referred out for manual assessment, with assessors considering the decision tool recommendation. Individuals must complete appropriate ongoing accreditation training in order to be granted and retain a credit discretion. Credit discretions are reviewed on an annual basis, and may be varied based on the holder's performance.

Portfolio direction and performance

The credit risk management framework contains several important portfolio direction and performance tools which enable Risk to play a fundamental role in monitoring the direction and performance of the portfolio. These include:

- Business writing strategies that are prepared by the businesses and set out appetite, planned portfolio growth, capital usage and risk/return profile, and also identify areas that may require attention to mitigate and improve risk management.
- Regular portfolio reviews.
- Exposure concentration limits, covering single customers, industries and cross border risk, to ensure a diversified portfolio.

ANZ uses portfolio monitoring and analysis tools, technologies and techniques to assist with portfolio risk assessment and management. These assist in:

- Monitoring, analysing and reporting ANZ's credit risk profile and progress in meeting portfolio objectives.
- Calculating and reporting ANZ's collective provision, economic capital, EL, regulatory RWA and regulatory expected loss.
- Assessing impact of emerging issues, and conducting ad hoc investigations and analysis.
- Validating rating/scoring tools and credit estimates.
- Ongoing review and refinement of ANZ's credit risk measurement and policy framework.

Reporting – overview and definitions

Credit risk management information systems, reporting and analysis are managed centrally and at the divisional and business unit level.

Periodic reporting provides confirmation of the effectiveness of processes, highlights emerging issues requiring attention and allows monitoring of portfolio trends by all levels of management and the Board.

Examples of reports include EAD, portfolio mix, risk grade profiles and migrations, RWAs, large exposure reporting, credit watch and control lists, impaired assets and provisions. Within the retail segments, monthly reporting packs are prepared that focus on such aspects as scoring and delinquency/slippage monitoring.

Past due facilities

Facilities where a contractual payment has not been met or the customer is outside of contractual arrangements are deemed past due. Past due facilities include those operating in excess of approved arrangements or where scheduled repayments are outstanding but do not include impaired assets.

Impaired assets

Facilities are classified as impaired when there is doubt as to whether the contractual amounts due, including interest and other payments, will be met in a timely manner. Impaired assets include impaired facilities, and impaired derivatives. Impaired derivatives have a credit valuation adjustment (CVA), which is a market assessment of the credit risk of the relevant counterparties.

Restructured items

Restructured items comprise facilities in which the original contractual terms have been modified for reasons related to the financial difficulties of the customer. Restructuring may consist of reduction of interest, principal or other payments legally due, or an extension in maturity beyond those typically offered to new facilities with similar risk.

Collective provisions

As well as holding individual provisions for credit loss, ANZ also holds a collective provision to cover credit losses which have been incurred but have not yet been specifically identified.

Calculation of the collective provision involves placing exposures in pools of similar assets with similar risk characteristics. The required collective provision is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the collective pool and includes

an allowance for inherent risk associated with the design and use of models. The initial calculation from historical loss experience may be adjusted based on current observable data such as changed economic conditions, and to take account of the impact of inherent risk of large concentrated losses within the portfolio.

The methodology underpinning calculation of collective provision from historical experience is predominantly based around the product of an exposure's PD, LGD and EAD[13]. ANZ uses slightly different PD, LGD and EAD factors in the calculation of regulatory capital and regulatory EL[14], due to the different requirements of APRA and accounting standards. The key differences are:

- ANZ must use more conservative LGD assumptions for regulatory capital purposes, such as the 20% LGD floor for retail mortgages and downturn LGD factors.
- ANZ must use cycle-adjusted PDs for regulatory capital purposes, but uses point-in-time estimates to calculate provisions.

Essentially these differences reflect the effects of the credit cycle on credit losses. Point-in-time refers to losses at any given point in the credit cycle, cycle-adjusted refers to adjusting estimates to reflect a full credit cycle and downturn refers to losses at the worst of the cycle and is the most conservative estimate to use. Regardless of the adjustments, the starting point for all estimates is the output of the rating/scoring models and tools to satisfy the in use test[15].

Individual provisions

Individual provisions are assessed on a case-by-case basis for all individually managed impaired assets taking into consideration factors such as the realisable value of security (or other credit mitigants), the likely return available upon liquidation or bankruptcy, legal uncertainties, estimated costs involved in recovery, the market price of the exposure in secondary markets and the amount and timing of expected receipts and recoveries.

Write-offs

Facilities are written off against the related provision for impairment when they are assessed as partially or fully uncollectable, and after proceeds from the realisation of any collateral have been received. Where individual provisions recognised in previous periods have subsequently decreased or are no longer required, such impairment losses are reversed in the current period income statement.

Basel II definition of default

ANZ uses the standard APRA definition of default, so that a default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:

- ANZ considers that the obligor is unlikely to pay[16] its credit obligations to ANZ in full, without recourse by ANZ to actions such as realising available security.
- The obligor is at least 90 days past due on a credit obligation to ANZ.

Specific provision and general reserve for credit losses

Due to definitional differences, there is a difference in the split between ANZ's individual provision and collective provision for accounting purposes and the specific provision and general reserve for credit losses (GRCL) for regulatory purposes. This does not impact total provisions, and essentially relates to the classification of collectively assessed provisions on defaulted accounts. The disclosures in this document are based on individual provision and collective provision, for ease of comparison with other published results.

[13] PD, LGD and EAD are explained in Table 6.

[14] Regulatory EL is explained in Table 6.

[15] One of the key criteria for regulatory acceptance of a rating model is that the outputs must be used in a wide range of ongoing management activities, to demonstrate that the model is used in day-to-day management of exposures and not just for regulatory capital calculation.

[16] Elements to be taken as indications of unlikeliness to pay include the factors relating to impairment (irrespective of whether the credit obligations are well secured) or ANZ selling the credit obligation at a material credit-related economic loss.

Table 4(b): Period end and average Exposure at Default[17 18 19]

	Sep 11				
Advanced IRB approach	Risk Weighted Assets $M	Exposure at Default $M	Average Exposure at Default for half year $M	Individual provision charge for half year $M	Write-offs for half year $M
Corporate	106,120	173,245	166,079	150	151
Sovereign	4,365	52,540	44,759	-	-
Bank	9,456	42,308	38,641	32	-
Residential Mortgage	41,041	234,882	230,771	41	44
Qualifying Revolving Retail	7,468	21,219	21,120	130	154
Other Retail	19,240	29,563	29,051	150	173
Total Advanced IRB approach	**187,690**	**553,757**	**530,421**	**503**	**522**
Specialised Lending	**27,757**	**30,921**	**30,064**	**85**	**114**
Standardised approach					
Corporate	22,484	22,487	21,964	6	15
Residential Mortgage	845	2,155	1,655	5	3
Qualifying Revolving Retail	2,344	2,332	2,062	(2)	10
Other Retail	1,650	1,620	1,455	23	54
Total Standardised approach	**27,323**	**28,594**	**27,136**	**32**	**82**
Total	**242,770**	**613,272**	**587,621**	**620**	**718**

[17] Exposure at Default in Table 4 includes Advanced IRB, Specialised Lending and Standardised exposures, however does not include Securitisation, Equities or Other Assets exposures. Exposure at Default in Table 4 is net of credit risk mitigation such as guarantees, credit derivatives, netting and financial collateral.

[18] Some prior period comparatives have been restated to reflect reclassification between asset classes and industries.

[19] Average Exposure at Default for half year is calculated as the simple average of the balances at the start and the end of each six month period. Some prior period comparatives have been restated to reflect reclassification between asset classes and industries.

Mar 11					
Advanced IRB approach	Risk Weighted Assets $M	Exposure at Default $M	Average Exposure at Default for half year $M	Individual provision charge for half year $M	Write-offs for half year $M
Corporate	98,393	158,912	158,568	191	263
Sovereign	3,217	36,977	36,038	-	-
Bank	6,958	34,974	33,828	(8)	-
Residential Mortgage	40,126	226,659	223,356	23	40
Qualifying Revolving Retail	7,552	21,020	20,892	115	135
Other Retail	18,485	28,538	28,410	133	142
Total Advanced IRB approach	**174,731**	**507,080**	**501,092**	**454**	**580**
Specialised Lending	**26,799**	**29,207**	**28,521**	**107**	**56**
Standardised approach					
Corporate	20,680	21,440	21,361	25	2
Residential Mortgage	406	1,154	1,317	1	-
Qualifying Revolving Retail	2,207	1,791	1,816	4	25
Other Retail	1,710	1,289	1,201	19	40
Total Standardised approach	**25,003**	**25,674**	**25,695**	**49**	**67**
Total	**226,533**	**561,961**	**555,308**	**610**	**703**

Sep 10					
Advanced IRB approach	Risk Weighted Assets $M	Exposure at Default $M	Average Exposure at Default for half year $M	Individual provision charge for half year $M	Write-offs for half year $M
Corporate	101,940	158,224	156,670	209	196
Sovereign	2,720	35,099	34,943	-	-
Bank	6,135	32,681	30,317	(5)	-
Residential Mortgage	38,708	220,055	214,282	65	65
Qualifying Revolving Retail	7,205	20,764	20,580	109	134
Other Retail	17,899	28,283	28,266	140	156
Total Advanced IRB approach	**174,607**	**495,106**	**485,057**	**518**	**551**
Specialised Lending	**26,605**	**27,835**	**27,349**	**173**	**144**
Standardised approach					
Corporate	20,560	21,282	18,807	14	1
Residential Mortgage	567	1,479	1,307	4	-
Qualifying Revolving Retail	2,279	1,841	923	(3)	7
Other Retail	1,396	1,112	836	38	27
Total Standardised approach	**24,802**	**25,714**	**21,872**	**53**	**35**
Total	**226,014**	**548,655**	**534,277**	**744**	**730**

Table 4(c): Geographic distribution of Exposure at Default

	Sep 11			
Portfolio Type	Australia $M	New Zealand $M	Asia Pacific, Europe and Americas $M	Total $M
Corporate	112,908	36,789	46,035	**195,732**
Sovereign	15,728	7,732	29,080	**52,540**
Bank	21,211	4,852	16,245	**42,308**
Residential Mortgage	190,815	44,071	2,151	**237,037**
Qualifying Revolving Retail	21,219	-	2,332	**23,551**
Other Retail	22,175	7,438	1,570	**31,183**
Specialised Lending	24,224	5,929	768	**30,921**
Total exposures	**408,280**	**106,811**	**98,181**	**613,272**

	Mar 11			
Portfolio Type	Australia $M	New Zealand $M	Asia Pacific, Europe and Americas $M	Total $M
Corporate	107,394	34,881	38,077	**180,352**
Sovereign	15,427	6,102	15,448	**36,977**
Bank	17,772	2,582	14,620	**34,974**
Residential Mortgage	185,462	41,206	1,145	**227,813**
Qualifying Revolving Retail	21,020	-	1,791	**22,811**
Other Retail	21,726	6,819	1,282	**29,827**
Specialised Lending	22,742	5,651	814	**29,207**
Total exposures	**391,543**	**97,241**	**73,177**	**561,961**

	Sep 10			
Portfolio Type	Australia $M	New Zealand $M	Asia Pacific, Europe and Americas $M	Total $M
Corporate	105,484	37,698	36,324	**179,506**
Sovereign	13,565	7,373	14,161	**35,099**
Bank	17,077	2,958	12,646	**32,681**
Residential Mortgage	178,566	41,565	1,403	**221,534**
Qualifying Revolving Retail	20,764	-	1,841	**22,605**
Other Retail	21,374	6,908	1,112	**29,394**
Specialised Lending	22,015	5,320	500	**27,835**
Total exposures	**378,845**	**101,822**	**67,987**	**548,654**

Table 4(d): Industry distribution of Exposure at Default [20] [21]

Sep 11

Portfolio Type	Agriculture, Forestry, Fishing & Mining $M	Business Services $M	Construction $M	Entertainment, Leisure & Tourism $M	Financial, Investment & Insurance $M	Government and Official Institutions $M	Manufacturing $M	Personal $M	Property Services $M	Wholesale Trade $M	Retail Trade $M	Transport & Storage $M	Other $M	Total $M
Corporate	33,844	8,160	5,903	10,080	20,309	1,724	34,296	558	16,268	19,079	13,232	9,299	22,980	**195,732**
Sovereign	85	-	89	-	25,272	25,220	223	177	497	28	-	27	922	**52,540**
Bank	-	-	-	-	42,151	-	16	-	42	10	-	42	47	**42,308**
Residential Mortgage	-	-	-	-	-	-	-	237,037	-	-	-	-	-	**237,037**
Qualifying Revolving Retail	-	-	-	-	-	-	-	23,551	-	-	-	-	-	**23,551**
Other Retail	2,420	1,757	2,490	823	307	8	878	15,786	828	638	1,984	1,007	2,257	**31,183**
Specialised Lending	309	-	679	145	186	-	247	6	24,706	-	-	2,343	2,300	**30,921**
Total exposures	**36,658**	**9,917**	**9,161**	**11,048**	**88,225**	**26,952**	**35,660**	**277,115**	**42,341**	**19,755**	**15,216**	**12,718**	**28,506**	**613,272**
% of Total	6.0%	1.6%	1.5%	1.8%	14.4%	4.4%	5.8%	45.2%	6.9%	3.2%	2.5%	2.1%	4.6%	100.0%

Mar 11

Portfolio Type	Agriculture, Forestry, Fishing & Mining $M	Business Services $M	Construction $M	Entertainment, Leisure & Tourism $M	Financial, Investment & Insurance $M	Government and Official Institutions $M	Manufacturing $M	Personal $M	Property Services $M	Wholesale Trade $M	Retail Trade $M	Transport & Storage $M	Other $M	Total $M
Corporate	32,324	8,004	5,790	8,908	17,600	1,302	30,240	1,196	14,800	17,778	12,155	8,697	21,558	**180,352**
Sovereign	115	-	39	-	17,493	17,511	110	316	468	2	-	29	894	**36,977**
Bank	-	-	-	-	34,781	-	15	1	21	21	-	47	88	**34,974**
Residential Mortgage	-	-	-	-	-	-	-	227,813	-	-	-	-	-	**227,813**
Qualifying Revolving Retail	-	-	-	-	-	-	-	22,811	-	-	-	-	-	**22,811**
Other Retail	2,337	1,731	2,415	786	303	7	855	15,067	870	612	1,952	1,000	1,892	**29,827**
Specialised Lending	217	-	380	153	160	-	223	6	23,936	-	-	2,088	2,044	**29,207**
Total exposures	**34,993**	**9,735**	**8,624**	**9,847**	**70,337**	**18,820**	**31,443**	**267,210**	**40,095**	**18,413**	**14,107**	**11,861**	**26,476**	**561,961**
% of Total	6.2%	1.7%	1.5%	1.8%	12.5%	3.3%	5.6%	47.5%	7.1%	3.3%	2.5%	2.1%	4.7%	100.0%

[20] Property Services includes Commercial property operators, Residential property operators, Retirement village operators/developers, Real estate agents, Non-financial asset investors and Machinery and equipment hiring and leasing.

[21] Other industry includes Health & Community Services, Education, Communication Services, Electricity, Gas & Water Supply, and Personal & Other Services.

	Sep 10													
Portfolio Type	Agriculture, Forestry, Fishing & Mining $M	Business Services $M	Construction $M	Entertainment, Leisure & Tourism $M	Financial, Investment & Insurance $M	Government and Official Institutions $M	Manufacturing $M	Personal $M	Property Services $M	Wholesale Trade $M	Retail Trade $M	Transport & Storage $M	Other $M	Total $M
Corporate	34,876	7,815	5,742	9,045	16,395	1,348	28,603	2,557	15,782	15,919	11,707	8,045	21,672	**179,506**
Sovereign	28	1	20	98	16,477	17,101	255	196	152	2	-	28	741	**35,099**
Bank	-	-	4	-	32,430	-	-	-	16	35	-	26	170	**32,681**
Residential Mortgage	-	-	-	-	-	-	-	221,534	-	-	-	-	-	**221,534**
Qualifying Revolving Retail	-	-	-	-	-	-	-	22,605	-	-	-	-	-	**22,605**
Other retail	2,335	1,709	2,381	762	301	9	838	14,839	902	604	1,908	1,012	1,794	**29,394**
Specialised Lending	187	-	430	154	254	-	236	-	22,461	-	-	1,915	2,198	**27,835**
Total exposures	**37,426**	**9,525**	**8,577**	**10,059**	**65,857**	**18,458**	**29,932**	**261,731**	**39,313**	**16,560**	**13,615**	**11,026**	**26,575**	**548,654**
% of Total	6.8%	1.7%	1.6%	1.8%	12.0%	3.4%	5.5%	47.7%	7.2%	3.0%	2.5%	2.0%	4.8%	100.0%

Table 4(e): Residual contractual maturity of Exposure at Default[22]

Portfolio Type	Sep 11 < 12 mths $M	1 - 5 years $M	> 5 years $M	No Maturity Specified $M	Total $M
Corporate	89,079	87,020	19,516	117	**195,732**
Sovereign	22,399	25,598	4,543	-	**52,540**
Bank	23,341	18,843	124	-	**42,308**
Residential Mortgage	2,062	4,475	201,426	29,074	**237,037**
Qualifying Revolving Retail	-	-	-	23,551	**23,551**
Other Retail	10,913	13,387	6,580	303	**31,183**
Specialised Lending	11,922	15,407	3,550	42	**30,921**
Total exposures	**159,716**	**164,730**	**235,739**	**53,087**	**613,272**

Portfolio Type	Mar 11 < 12 mths $M	1 - 5 years $M	> 5 years $M	No Maturity Specified $M	Total $M
Corporate	84,032	76,952	19,289	79	**180,352**
Sovereign	19,111	14,565	3,301	-	**36,977**
Bank	17,960	16,844	170	-	**34,974**
Residential Mortgage	1,985	4,190	193,177	28,461	**227,813**
Qualifying Revolving Retail	-	-	-	22,811	**22,811**
Other Retail	9,962	13,108	6,137	620	**29,827**
Specialised Lending	10,604	15,304	3,255	44	**29,207**
Total exposures	**143,654**	**140,963**	**225,329**	**52,015**	**561,961**

Portfolio Type	Sep 10 < 12 mths $M	1 - 5 years $M	> 5 years $M	No Maturity Specified $M	Total $M
Corporate	81,511	78,005	19,746	244	**179,506**
Sovereign	18,778	14,199	2,122	-	**35,099**
Bank	16,999	15,469	213	-	**32,681**
Residential Mortgage	1,850	4,210	187,467	28,007	**221,534**
Qualifying Revolving Retail	-	-	-	22,605	**22,605**
Other Retail	9,924	13,051	5,701	718	**29,394**
Specialised Lending	9,603	14,833	3,380	19	**27,835**
Total exposures	**138,665**	**139,767**	**218,629**	**51,593**	**548,654**

[22] No Maturity Specified predominately includes credit cards and residential mortgage equity manager accounts.

Table 4(f) part (i): Impaired assets[23 24], Past due loans[25], Provisions and Write-offs by Industry sector

	Sep 11					
Industry Sector	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for half year $M	Write-offs for half year $M
Agriculture, Forestry, Fishing & Mining	-	1,122	174	288	71	17
Business Services	-	311	29	102	34	18
Construction	-	103	42	49	27	30
Entertainment Leisure & Tourism	-	45	11	19	3	3
Financial, Investment & Insurance	-	229	10	40	(17)	14
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	-	768	30	132	1	63
Personal	-	1,012	1,296	525	303	397
Property Services	35	1,031	113	232	124	116
Retail Trade	-	113	44	63	13	16
Transport & Storage	2	88	14	35	11	12
Wholesale Trade	-	300	23	150	71	13
Other	1	421	48	62	(21)	19
Total	**38**	**5,543**	**1,834**	**1,697**	**620**	**718**

	Mar 11					
Industry Sector	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for half year $M	Write-offs for half year $M
Agriculture, Forestry, Fishing & Mining	-	1,361	217	245	83	17
Business Services	-	203	36	87	21	25
Construction	-	128	41	50	12	8
Entertainment Leisure & Tourism	-	46	7	18	2	5
Financial, Investment & Insurance	-	303	6	60	33	64
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	2	894	27	186	9	24
Personal	-	990	1,384	541	261	345
Property Services	31	1,223	96	233	148	161
Retail Trade	-	114	40	64	16	29
Transport & Storage	2	102	40	37	3	6
Wholesale Trade	-	332	21	95	3	5
Other	6	484	40	101	19	14
Total	**41**	**6,180**	**1,955**	**1,717**	**610**	**703**

[23] Impaired derivatives include a credit valuation adjustment (CVA) of $68 million, being a market value based assessment of the credit risk of the relevant counterparties (March 2011: $71 million; September 2010: $77 million).

[24] Impaired loans / facilities include restructured items of $700 million for customer facilities in which the original contractual terms have been modified for reasons related to the financial difficulties of the customer. Restructuring may consist of reduction of interest, principal or other payments legally due, or an extension in maturity materially beyond those typically offered to new facilities with similar risk (March 2011: $704 million; September 2010: $141 million).

[25] Past due loans ≥ 90 days includes $1,593 million well secured loans (March 2011: $1,810 million; September 2010: $1,416 million).

Industry Sector	Sep 10 Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for half year $M	Write-offs for half year $M
Agriculture, Forestry, Fishing & Mining	2	1,197	165	217	73	35
Business Services	-	218	50	102	16	21
Construction	-	98	35	44	23	47
Entertainment Leisure & Tourism	-	49	9	21	5	5
Financial, Investment & Insurance	-	448	11	96	23	80
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	2	402	22	197	7	31
Personal	-	1,084	1,057	611	311	341
Property Services	41	1,831	88	257	179	72
Retail Trade	-	171	37	79	23	12
Transport & Storage	-	80	23	38	10	9
Wholesale Trade	-	353	18	101	13	14
Other	6	578	40	112	61	63
Total	**51**	**6,510**	**1,555**	**1,875**	**744**	**730**

Table 4(f) part (ii): Impaired asset, Past due loans, Provisions and Write-offs

	Sep 11 Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for half year $M	Write-offs for half year $M
Portfolios subject to Advanced IRB approach						
Corporate	25	2,767	206	611	150	151
Sovereign	-	-	-	-	-	-
Bank	-	83	-	53	32	-
Residential Mortgage	-	599	1,150	189	41	44
Qualifying Revolving Retail	-	-	86	-	130	154
Other Retail	-	341	153	210	150	173
Total Advanced IRB approach	**25**	**3,790**	**1,595**	**1,063**	**503**	**522**
Specialised Lending	**13**	**1,106**	**75**	**225**	**85**	**114**
Portfolios subject to Standardised approach						
Corporate	-	388	119	193	6	15
Sovereign	-	-	-	-	-	-
Bank	-	-	-	-	-	-
Residential Mortgage	-	26	1	10	5	3
Qualifying Revolving Retail	-	75	7	75	(2)	10
Other Retail	-	158	37	131	23	54
Total Standardised approach	**-**	**647**	**164**	**409**	**32**	**82**
Total	**38**	**5,543**	**1,834**	**1,697**	**620**	**718**

Mar 11	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for half year $M	Write-offs for half year $M
Portfolios subject to Advanced IRB approach						
Corporate	22	3,123	186	617	191	263
Sovereign	-	-	-	-	-	-
Bank	-	81	-	17	(8)	-
Residential Mortgage	-	555	1,211	182	23	40
Qualifying Revolving Retail	-	-	93	-	115	135
Other Retail	-	352	160	222	133	142
Total Advanced IRB approach	**22**	**4,111**	**1,650**	**1,038**	**454**	**580**
Specialised Lending	**19**	**1,404**	**60**	**252**	**107**	**56**
Portfolios subject to Standardised approach						
Corporate	-	401	195	188	25	2
Sovereign	-	-	-	-	-	-
Bank	-	-	-	-	-	-
Residential Mortgage	-	14	2	6	1	-
Qualifying Revolving Retail	-	79	12	84	4	25
Other Retail	-	171	36	149	19	40
Total Standardised approach	**-**	**665**	**245**	**427**	**49**	**67**
Total	**41**	**6,180**	**1,955**	**1,717**	**610**	**703**

Sep 10	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for half year $M	Write-offs for half year $M
Portfolios subject to Advanced IRB approach						
Corporate	33	3,331	233	751	209	196
Sovereign	-	-	-	-	-	-
Bank	-	97	-	28	(5)	-
Residential Mortgage	-	574	881	215	65	65
Qualifying Revolving Retail	-	-	84	-	109	134
Other Retail	-	362	139	225	140	156
Total Advanced IRB approach	**33**	**4,364**	**1,337**	**1,219**	**518**	**551**
Specialised Lending	**18**	**1,509**	**65**	**214**	**173**	**144**
Portfolios subject to Standardised approach						
Corporate	-	298	97	156	14	1
Sovereign	-	-	-	-	-	-
Bank	-	-	-	-	-	-
Residential Mortgage	-	21	3	6	4	-
Qualifying Revolving Retail	-	106	13	106	(3)	7
Other Retail	-	212	40	174	38	27
Total Standardised approach	**-**	**637**	**153**	**442**	**53**	**35**
Total	**51**	**6,510**	**1,555**	**1,875**	**744**	**730**

Table 4(g): Impaired assets[26] [27], Past due loans[28] and Provisions by Geography

	Sep 11				
Geographic region	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	35	3,457	1,523	908	2,147
New Zealand	-	1,421	242	402	528
Asia Pacific, Europe and America	3	665	69	387	501
Total	**38**	**5,543**	**1,834**	**1,697**	**3,176**

	Mar 11				
Geographic region	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	37	3,899	1,611	938	2,144
New Zealand	2	1,634	246	406	544
Asia Pacific, Europe and America	2	647	98	373	489
Total	**41**	**6,180**	**1,955**	**1,717**	**3,177**

	Sep 10				
Geographic region	Impaired derivatives $M	Impaired loans/ facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	51	4,232	1,234	977	2,021
New Zealand	-	1,582	238	469	612
Asia Pacific, Europe and America	-	696	83	429	520
Total	**51**	**6,510**	**1,555**	**1,875**	**3,153**

[26] Impaired derivatives include a credit valuation adjustment (CVA) of $68 million, being a market value based assessment of the credit risk of the relevant counterparties (March 2011: $71 million; September 2010: $77 million).

[27] Impaired loans / facilities include restructured items of $700 million for customer facilities in which the original contractual terms have been modified for reasons related to the financial difficulties of the customer. Restructuring may consist of reduction of interest, principal or other payments legally due, or an extension in maturity materially beyond those typically offered to new facilities with similar risk (March 2011: $704 million; September 2010: $141 million).

[28] Past due loans ≥ 90 days includes $1,593 million well secured loans (March 2011: $1,810 million; September 2010: $1,416 million).

Table 4(h): Reconciliation of changes in Provisions[29]

Collective Provision	Half year Sep 11 $M	Half year Mar 11 $M	Half year Sep 10 $M
Balance at start of period	3,177	3,153	3,037
Charge to income statement	(58)	65	(40)
Provisions acquired	-	-	191
Adjustments for exchange rate fluctuations	57	(41)	(35)
Total Collective Provision	**3,176**	**3,177**	**3,153**
Individual Provision			
Balance at start of period	1,717	1,875	1,593
Charge to income statement for loans and advances	599	594	744
Provisions acquired	-	-	355
Adjustments for exchange rate fluctuations	51	(43)	(68)
Discount unwind	(82)	(103)	(104)
Bad debts written-off	(718)	(703)	(730)
Recoveries of amounts previously written off	130	97	85
Total Individual Provision	**1,697**	**1,717**	**1,875**
Total Provisions for Credit Impairment	**4,873**	**4,894**	**5,028**

Specific Provision Balance and General Reserve for Credit Losses[30]

	Sep 11		
	Specific Provision Balance $M	General Reserve for Credit Losses $M	Total $M
Collective Provision	375	2,801	3,176
Individual Provision	1,697	-	1,697
Total Provision for Credit Impairment			**4,873**

	Mar 11		
	Specific Provision Balance $M	General Reserve for Credit Losses $M	Total $M
Collective Provision	271	2,906	3,177
Individual Provision	1,717	-	1,717
Total Provision for Credit Impairment			**4,894**

	Sep 10		
	Specific Provision Balance $M	General Reserve for Credit Losses $M	Total $M
Collective Provision	233	2,920	3,153
Individual Provision	1,875	-	1,875
Total Provision for Credit Impairment			**5,028**

[29] Charge to income statement for loans and advances do not include Individual Provision charge related to impairment on Available-For-Sale assets. Individual Provision charge on impairment on Available-For-Sale assets is included in Adjustments for exchange rate fluctuations (September 2011: $21 million; March 2011: $16 million; September 2010: $1 million).

[30] There is a difference in the split between ANZ's Individual Provision and Collective Provision for accounting purposes and Specific Provision balance and General Reserve for Credit Losses (GRCL) for regulatory purposes, due to definitional differences. This difference does not impact total provisions, and essentially relates to the classification of collectively assessed provisions on defaulted accounts. The disclosures in this document are based on Individual Provision and Collective Provision, for ease of comparison with ANZ's other published results.

Table 5 Credit risk – Disclosures for portfolios subject to the Standardised approach and supervisory risk weighting in the IRB approach

Use of external rating agencies (External Credit Assessment Institutions)

ANZ has not used external ratings as an input into risk weighting for portfolios under the Standardised approach, as these are mainly Retail portfolios and hence are not rated by external rating agencies.

Table 5(b): Exposure at Default by risk bucket

Risk weight **Standardised approach exposures**	Sep 11 $M	Mar 11 $M	Sep 10 $M
0%	-	-	-
20%	4	2	3
35%	1,939	1,148	1,177
50%	61	-	292
75%	68	-	1
100%	26,439	24,368	24,239
150%	84	156	2
>150%	-	-	-
Capital deductions	-	-	-
Total	**28,594**	**25,674**	**25,714**
Other Asset exposures			
0%	-		-
20%	1,431	1,746	1,625
35%	-	-	-
50%	-	-	-
75%	-	-	-
100%	3,237	3,520	3,510
150%	-	-	-
>150%	-	-	-
Capital deductions	-	-	-
Total	**4,668**	**5,266**	**5,135**
Specialised Lending exposures			
0%	1,508	1,500	1,660
70%	10,221	9,218	6,993
90%	13,211	12,279	12,026
115%	4,623	4,615	5,189
250%	1,358	1,595	1,968
Total	**30,921**	**29,207**	**27,836**
Equity exposures			
300%	1	2	-
400%	349	407	394
Total	**350**	**409**	**394**

Table 6 Credit risk – Disclosures for portfolios subject to Advanced IRB approaches

Portfolios subject to the Advanced IRB (AIRB) approach

The following table summarises the types of borrowers and the rating approach adopted within each of of ANZ's AIRB portfolios:

IRB Asset Class	Borrower Type	Rating Approach
Corporate	Corporations, partnerships or proprietorships that do not fit into any other asset class	AIRB
Sovereign	Central governments Central banks Certain multilateral development banks	AIRB
Bank	Banks[31] In Australia only, other authorised deposit-taking institutions (ADI) incorporated in Australia	AIRB
Residential Mortgages	Exposures secured by residential property	AIRB
Qualifying Revolving Retail	Consumer credit cards <$100,000 limit	AIRB
Other Retail	Small business lending Other lending to consumers	AIRB
Specialised Lending	Income Producing Real Estate[32] Project finance Object finance	AIRB – Supervisory Slotting[33]
Equity		AIRB – fixed risk weights
Other Assets	All other assets not falling into the above classes e.g. margin lending, fixed assets	AIRB – fixed risk weights

In addition, ANZ has applied the Standardised approach to some portfolio segments (mainly retail and local corporates in Asia Pacific) where currently available data does not enable development of advanced internal models for PD, LGD and EAD estimates. Under the Standardised approach, exposures are mapped to several regulatory risk weights, mainly based on the type of counterparty and its external rating.

ANZ applies its full normal risk measurement and management framework to these segments for internal management purposes, such as for economic capital. Standardised segments will be migrated to AIRB if they reach a volume that generates sufficient data for development of advanced internal models.

ANZ has not applied the Foundation IRB approach to any portfolios.

The ANZ rating system

As an AIRB bank, ANZ's internal models generate the inputs into regulatory capital adequacy to determine the risk weighted exposure calculations for both on and off-balance sheet exposures, including undrawn portions of credit facilities, committed and contingent exposures and EL calculations. ANZ's internal models are used to generate the three key risk components that serve as inputs to the IRB approach to credit risk:

- PD is an estimate of the level of the risk of borrower default. Borrower ratings are derived by way of rating models used both at loan origination and for ongoing monitoring.
- EAD is defined as the expected facility exposure at the date of default.

[31] The IRB asset classification of investment banks is Corporate, rather than Bank.

[32] Since 2009, APRA has agreed that some large, well-diversified commercial property exposures may be treated as Corporate exposures, in line with the original Basel Committee's definition of Specialised Lending.

[33] ANZ uses an internal assessment which is mapped to the appropriate Supervisory Slot.

- LGD is an estimate of the potential economic loss on a credit exposure, incurred as a consequence of obligor default and expressed as a percentage of the facility's EAD. When measuring economic loss, all relevant factors are taken into account, including material effects of the timing of cash flows and material direct and indirect costs associated with collecting on the exposure, including realisation of collateral.

Effective maturity is also calculated as an input to the risk weighted exposure calculation for bank, sovereign and corporate IRB asset classes.

ANZ's rating system has two separate and distinct dimensions that:

- Measure the PD, which is expressed by the Customer Credit Rating (CCR), reflecting the ability to service and repay debt.
- Measure the LGD as expressed by the Security Indicator (SI) ranging from A to G. The SI is calculated by reference to the percentage of loan covered by security which can be realised in the event of default. This calculation uses standard ratios to adjust the current market value of collateral items to allow for historical realisation outcomes. The security-related SIs are supplemented with a range of other SIs which cover such factors as cash cover, mezzanine finance, intra-group guarantees and sovereign backing as ANZ's LGD research indicates that these transaction characteristics have different recovery outcomes. ANZ's LGD also includes recognition of the different legal and insolvency regimes in different countries, where this has been shown to influence recovery outcomes.

ANZ's corporate PD master scale is made up of 27 rating grades. Each level/grade is separately defined and has a range of default probabilities attached to it. The PD master scale enables ANZ's rating system to be mapped to the gradings of external rating agencies, using the PD as a common element after ensuring that default definitions and other key attributes are aligned. The following table demonstrates this alignment (for one year PDs):

ANZ CCR	Moody's	Standard & Poor's	PD Range
0+ to 1-	Aaa to < A1	AAA to < A+	0.0000 - 0.0346%
2+ to 3+	A1 to < Baa2	A+ to < BBB	0.0347 - 0.1636%
3= to 4=	Baa2 to < Ba1	BBB to < BB+	0.1637 - 0.5108%
4- to 6-	Ba1 to < B1	BB+ to < B+	0.5109 - 3.4872%
7+ to 8+	B1 to < Caa	B+ to < CCC	3.4873 - 10.0928%
8=	Caa	CCC	10.0929 - 99.9999%
8-, 9 and 10	Default	Default	100%

In the retail asset classes, most facilities utilise credit rating scores. The scores are calibrated to PD, so the PD master scale gives ANZ a common language to understand and manage credit risk. For retail asset class exposures, the LGD dimension is recognised through the process of pooling retail exposures into homogenous groups.

ANZ also uses specialised PD master scale/mappings for the sovereign and bank asset classes, based predominantly on the corporate master scale.

Use of internal estimates other than for regulatory capital purposes

ANZ's rating system is a fundamental part of credit management and plays a key role in:

- Lending discretions.
- Minimum origination standards.
- Concentration limits.
- Portfolio reporting.
- Customer profitability measurement.
- Collective provision measurement.
- Management of deteriorating customers (where certain CCR/SI combinations trigger increasing scrutiny).
- Pricing decisions.

PD, LGD and EAD are used in the calculation of economic capital and in the collective provisioning process. Regulatory and economic capital are calculated from the same data sources and starting from the same basis, however there are some differences between the factors used because several aspects of ANZ's rating system are adjusted in accordance with APRA requirements for regulatory capital purposes. The most significant of these adjustments are the use for regulatory capital purposes

of downturn LGDs; the imposition of a 20% LGD floor for exposures secured by Australian residential real estate and the mandatory use of the supervisory slotting approach for project finance and most commercial real estate exposures.

Controls surrounding the ratings system

ANZ's rating system and credit risk estimates are governed by the Board Risk Committee and several executive management committees, and are underpinned by a comprehensive framework of controls that operate throughout ANZ. All policies, methodologies, model designs, model reviews, validations, responsibilities, systems and processes supporting the ratings systems are documented, and subject to review by Internal Audit.

The design, build and implementation of credit rating models resides with a specialist Group-level team. The use (including overrides) and performance of credit rating models is monitored by the relevant business and their counterparts in Risk, and validated annually by a separate specialist Group-level function. This cycle of design, build, implementation, monitoring and validation is overseen by the CRSOC, and informs the need for new models or recalibration of existing models.

Risk grades are an integral part of reporting to the Board and executives.

In addition, the use of the rating system's outputs in key business unit performance measures in processes such as provisioning and the allocation of economic capital ensures that the rating system receives robust input from the business units, not just the specialist modelling areas.

Rating process by asset class

Building reliable and accurate rating tools requires balancing of many factors including data availability (external data may be used in some circumstances, where it is relevant), the size of the segment (the more customers within the segment, the more likely that statistically reliable models can be built), and the need to be able to validate the model. Rating tool approaches include:

- Statistical models producing a PD or a LGD, which are developed from internal or external data on defaults.
- Statistical models producing an internal rating, which involve calibrating ANZ's models to external rating data where data on defaults is insufficient for statistical purposes (such as banks).
- Hybrid statistical and expert models producing an internal rating, which use a mixture of default data and expert input.
- Expert models/processes that produce an internal rating, including external rating agency replication models.

Ongoing data collection and testing processes ensure enhanced or new models are introduced as required to maintain and improve the accuracy and reliability of rating processes.

Regardless of what credit risk rating tool is used, lending staff rating a customer are required to review the model-generated PD (or CCR) and take into account any out-of-model factors or policy overlays to decide whether or not to override the model rating. Overrides of a rating model to a better rating require approval from the independent credit risk function. The significance of the model for risk grading varies with the customer segment: models will dominate risk grading of homogenous, simple and data-rich segments such as in Retail, however for complex, specialised business segments expert knowledge and the highly customised nature of transactions will influence the rating outcome.

The following table summarises the types of internal rating approaches used in ANZ:

IRB Asset Class	Borrower type	Rating Approach
Corporate	Corporations, partnerships or proprietorships that do not fit into any other asset class	Mainly statistical models Some use of expert models and policy processes
Sovereign	Central governments Central banks Certain multilateral development banks	External rating and expert judgement
Bank	Banks In Australia only, other ADIs incorporated in Australia	Statistically-based models Review of all relevant and material information including external ratings
Residential Mortgages	Exposures secured by residential property	Statistical models
Qualifying Revolving Retail	Consumer credit cards <$100,000 limit	Statistical models
Other Retail	Small business lending Other lending to consumers	Statistical models
Specialised Lending	Income Producing Real Estate Project finance Object finance	Supervisory Slotting[34]

For the Retail Basel asset class (Residential Mortgages, Qualifying Revolving Retail and Other Retail Exposures) the large number of relatively homogenous exposures enable the development of statistically robust application scoring models for use at origination and behavioural scoring for ongoing management. The scores are calibrated to PD, so the PD master scale gives ANZ a common language to understand and discuss credit risk. LGD is recognised through the process of pooling retail exposures into homogenous groups.

Estimation of LGD and EAD

ANZ's LGD modelling takes into account data on secured recovery, unsecured recovery rates and debt seniority, geography and internal management costs from several major data sources. Internal data is used as the basis for LGD estimation in the retail asset class, and is supplemented by external data for the corporate asset class. Given the scarcity of internal data for Bank and Sovereign Basel asset classes, LGD modelling for these classes is primarily based on external data.

EAD represents the expected facility exposure at the date of default, including an estimate of additional drawings prior to default, as well as post-default drawings that were legally committed to prior to default.

[34] Specialised Lending exposures are rated with internal rating tools to produce a PD and LGD. These are used in internal processes, but not for regulatory capital purposes where the exposures are mapped to Supervisory Slots.

Table 6(d): Non Retail Exposure at Default subject to Internal Ratings Based (IRB) approach[35] [36] [37]

Sep 11	AAA < A+ $M	A+ < BBB $M	BBB < BB+ $M	BB+ < B+ $M	B+ < CCC $M	CCC $M	Default $M	**Total $M**
Exposure at Default								
Corporate	7,201	40,330	56,956	58,128	5,276	1,897	3,457	**173,245**
Sovereign	46,017	2,772	40	3,343	366	-	2	**52,540**
Bank	33,733	2,988	4,267	1,171	2	80	67	**42,308**
Total	**86,951**	**46,090**	**61,263**	**62,642**	**5,644**	**1,977**	**3,526**	**268,093**
% of Total	32.4%	17.2%	22.9%	23.4%	2.1%	0.7%	1.3%	100.0%
Undrawn commitments (included in above)								
Corporate	2,296	19,103	17,295	10,118	490	196	125	**49,623**
Sovereign	962	208	7	38	2	-	-	**1,217**
Bank	217	66	80	13	-	1	-	**377**
Total	**3,475**	**19,377**	**17,382**	**10,169**	**492**	**197**	**125**	**51,217**
Average Exposure at Default								
Corporate	0.527	1.017	0.378	0.218	0.460	0.244	0.797	**0.275**
Sovereign	13.725	6.688	0.728	6.182	16.718	-	0.149	**7.610**
Bank	0.665	0.857	2.367	1.472	0.051	14.973	1.868	**0.615**
Exposure-weighted average Loss Given Default (%)								
Corporate	56.9%	60.9%	48.4%	35.8%	40.7%	46.0%	33.6%	**46.9%**
Sovereign	2.7%	5.3%	27.6%	55.3%	40.7%	-	54.8%	**6.4%**
Bank	62.4%	64.2%	65.2%	65.3%	35.0%	69.9%	64.2%	**62.9%**
Exposure-weighted average risk weight (%)								
Corporate	15.8%	37.9%	54.7%	70.4%	130.0%	215.7%	193.5%	**61.3%**
Sovereign	0.4%	1.9%	35.3%	109.1%	124.5%	-	724.5%	**8.3%**
Bank	14.1%	19.3%	59.0%	105.8%	115.0%	326.6%	160.5%	**22.4%**

[35] In accordance with APS 330, EAD in Table 6(d) includes Advanced IRB exposures; however does not include Specialised Lending, Standardised, Securitisation, Equities or Other Assets exposures. Specialised Lending is excluded from Table 6(d) as it follows the Supervisory Slotting treatment, and a breakdown of risk weightings is provided in Table 5(b).

[36] Average EAD is calculated as total EAD divided by the total number of credit risk generating exposures.

[37] Exposure-weighted average risk weight (%) is calculated as RWA divided by EAD.

	Mar 11							
	AAA < A+ $M	A+ < BBB $M	BBB < BB+ $M	BB+ < B+ $M	B+ < CCC $M	CCC $M	Default $M	**Total $M**
Exposure at Default								
Corporate	6,079	36,019	48,978	55,696	5,883	2,551	3,706	**158,912**
Sovereign	32,441	1,796	67	2,443	228	-	2	**36,977**
Bank	28,537	3,450	2,230	637	3	3	114	**34,974**
Total	**67,057**	**41,265**	**51,275**	**58,776**	**6,114**	**2,554**	**3,822**	**230,863**
% of Total	29.0%	17.9%	22.2%	25.5%	2.6%	1.1%	1.7%	100.0%
Undrawn commitments (included in above)								
Corporate	1,949	15,253	15,180	9,493	481	326	113	**42,795**
Sovereign	913	117	20	40	4	-	-	**1,094**
Bank	190	16	60	11	-	-	-	**277**
Total	**3,052**	**15,386**	**15,260**	**9,544**	**485**	**326**	**113**	**44,166**
Average Exposure at Default								
Corporate	0.643	1.012	0.361	0.199	0.404	0.332	0.800	**0.241**
Sovereign	9.492	5.183	0.594	4.271	15.475	-	0.145	**4.902**
Bank	0.615	0.957	1.824	0.601	0.045	0.114	3.093	**0.578**
Exposure-weighted average Loss Given Default (%)								
Corporate	57.3%	60.1%	46.6%	35.8%	40.8%	46.2%	36.3%	**45.8%**
Sovereign	2.5%	4.3%	30.9%	53.7%	40.8%	-	59.0%	**6.2%**
Bank	62.2%	61.3%	63.6%	63.9%	34.1%	66.7%	64.8%	**62.2%**
Exposure-weighted average risk weight (%)								
Corporate	16.5%	36.0%	51.5%	70.6%	128.7%	215.2%	183.6%	**61.9%**
Sovereign	0.4%	1.4%	49.5%	111.1%	131.7%	-	781.8%	**8.7%**
Bank	14.3%	19.2%	58.9%	111.2%	123.1%	311.8%	156.0%	**19.9%**

	Sep 10							
	AAA < A+ $M	A+ < BBB $M	BBB < BB+ $M	BB+ < B+ $M	B+ < CCC $M	CCC $M	Default $M	**Total $M**
Exposure at Default								
Corporate	6,423	30,304	48,335	59,584	6,611	2,951	4,015	**158,223**
Sovereign	30,545	2,271	40	1,981	260	-	2	**35,099**
Bank	28,084	2,365	1,505	610	10	13	94	**32,681**
Total	**65,052**	**34,940**	**49,880**	**62,175**	**6,881**	**2,964**	**4,111**	**226,003**
% of Total	28.8%	15.5%	22.1%	27.5%	3.0%	1.3%	1.8%	100.0%
Undrawn commitments (included in above)								
Corporate	1,455	15,973	15,872	10,690	666	339	159	**45,154**
Sovereign	952	167	4	39	1	-	-	**1,163**
Bank	76	17	35	51	-	-	-	**179**
Total	**2,483**	**16,157**	**15,911**	**10,780**	**667**	**339**	**159**	**46,496**
Average Exposure at Default								
Corporate	0.675	1.003	0.300	0.253	0.415	0.323	0.772	**0.274**
Sovereign	11.458	6.774	0.882	4.371	29.044	-	0.153	**6.404**
Bank	0.621	0.950	1.913	0.511	0.143	38.725	7.831	**0.532**
Exposure-weighted average Loss Given Default (%)								
Corporate	59.2%	59.6%	46.4%	37.3%	40.5%	44.5%	39.5%	**45.6%**
Sovereign	2.6%	4.9%	38.2%	54.9%	42.3%	-	59.0%	**6.1%**
Bank	62.7%	64.0%	63.7%	54.9%	61.4%	66.5%	64.2%	**62.7%**
Exposure-weighted average risk weight (%)								
Corporate	18.4%	34.4%	50.4%	75.1%	129.2%	208.1%	162.3%	**64.4%**
Sovereign	0.4%	2.0%	60.8%	110.4%	126.3%	-	781.7%	**7.7%**
Bank	13.8%	21.9%	58.9%	105.7%	205.6%	324.5%	160.5%	**18.8%**

Table 6(d): Retail Exposure at Default subject to Advanced Internal Ratings Based (IRB) approach by risk grade

Sep 11	0.00% <0.11% $M	0.11% <0.30% $M	0.30% <0.51% $M	0.51% <3.49% $M	3.49% <10.09% $M	10.09% <100.00% $M	Default $M	**Total $M**
Exposure at Default								
Residential Mortgage	4,685	152,771	19,362	44,367	7,035	4,765	1,897	**234,882**
Qualifying Revolving Retail	10,800	319	1,884	4,956	2,069	1,035	156	**21,219**
Other Retail	38	3,669	1,452	17,359	5,429	890	726	**29,563**
Total	**15,523**	**156,759**	**22,698**	**66,682**	**14,533**	**6,690**	**2,779**	**285,664**
% of Total	5.4%	54.9%	7.9%	23.3%	5.1%	2.3%	1.0%	100.0%
Undrawn commitments (included in above)								
Residential Mortgage	576	18,062	1,286	3,296	291	279	4	**23,794**
Qualifying Revolving Retail	8,374	318	1,208	2,120	576	114	17	**12,727**
Other Retail	35	2,593	905	2,670	275	67	4	**6,548**
Total	**8,985**	**20,973**	**3,398**	**8,086**	**1,141**	**461**	**25**	**43,069**
Average Exposure at Default								
Residential Mortgage	0.102	0.223	0.182	0.180	0.187	0.175	0.256	**0.193**
Qualifying Revolving Retail	0.011	0.006	0.010	0.009	0.008	0.008	0.008	**0.010**
Other Retail	0.006	0.010	0.012	0.014	0.009	0.007	0.034	**0.012**
Exposure-weighted average Loss Given Default (%)								
Residential Mortgage	22.9%	20.2%	21.4%	20.7%	20.4%	20.6%	21.3%	**20.4%**
Qualifying Revolving Retail	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	**73.2%**
Other Retail	72.1%	61.4%	56.0%	44.5%	51.6%	65.2%	57.8%	**49.4%**
Exposure-weighted average risk weight (%)								
Residential Mortgage	5.1%	6.9%	14.6%	27.8%	74.6%	113.2%	238.9%	**17.5%**
Qualifying Revolving Retail	4.7%	11.1%	13.8%	38.5%	104.8%	205.4%	294.2%	**35.2%**
Other Retail	18.1%	29.0%	38.3%	58.1%	81.3%	158.4%	236.5%	**65.1%**

	Mar 11							
	0.00% <0.11% $M	0.11% <0.30% $M	0.30% <0.51% $M	0.51% <3.49% $M	3.49% <10.09% $M	10.09% <100.00% $M	Default $M	**Total $M**
Exposure at Default								
Residential Mortgage	4,200	149,533	17,368	42,250	6,851	4,566	1,891	**226,659**
Qualifying Revolving Retail	10,723	300	1,865	4,769	2,131	1,071	161	**21,020**
Other Retail	39	3,502	1,407	16,667	5,255	951	717	**28,538**
Total	**14,962**	**153,335**	**20,640**	**63,686**	**14,237**	**6,588**	**2,769**	**276,217**
% of Total	5.4%	55.5%	7.5%	23.1%	5.2%	2.4%	1.0%	100.0%
Undrawn commitments (included in above)								
Residential Mortgage	535	17,307	1,773	2,715	271	234	9	**22,844**
Qualifying Revolving Retail	8,327	299	1,195	2,086	597	120	15	**12,639**
Other Retail	35	2,449	871	2,306	254	67	3	**5,985**
Total	**8,897**	**20,055**	**3,839**	**7,107**	**1,122**	**421**	**27**	**41,468**
Average Exposure at Default								
Residential Mortgage	0.095	0.210	0.155	0.182	0.184	0.170	0.240	**0.186**
Qualifying Revolving Retail	0.011	0.006	0.010	0.009	0.008	0.007	0.008	**0.010**
Other Retail	0.007	0.010	0.012	0.014	0.009	0.007	0.030	**0.012**
Exposure-weighted average Loss Given Default (%)								
Residential Mortgage	22.7%	20.2%	20.4%	20.8%	20.3%	20.6%	21.3%	**20.4%**
Qualifying Revolving Retail	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	**73.2%**
Other Retail	72.0%	60.3%	55.5%	44.0%	51.6%	65.3%	58.0%	**49.1%**
Exposure-weighted average risk weight (%)								
Residential Mortgage	4.9%	7.0%	15.0%	28.7%	74.1%	112.7%	240.8%	**17.7%**
Qualifying Revolving Retail	4.7%	11.0%	13.6%	37.8%	105.8%	205.3%	317.7%	**35.9%**
Other Retail	17.6%	28.0%	37.7%	57.3%	81.2%	157.8%	229.0%	**64.8%**

	Sep 10							
	0.00% <0.11% $M	0.11% <0.30% $M	0.30% <0.51% $M	0.51% <3.49% $M	3.49% <10.09% $M	10.09% <100.00% $M	Default $M	**Total $M**
Exposure at Default								
Residential Mortgage	4,152	143,452	16,817	43,586	6,174	4,294	1,581	**220,056**
Qualifying Revolving Retail	10,596	290	1,925	4,901	1,953	958	141	**20,764**
Other Retail	37	3,439	1,377	16,781	5,133	877	639	**28,283**
Total	**14,785**	**147,181**	**20,119**	**65,268**	**13,260**	**6,129**	**2,361**	**269,103**
% of Total	5.5%	54.7%	7.5%	24.3%	4.9%	2.3%	0.9%	100.0%
Undrawn commitments (included in above)								
Residential Mortgage	523	16,527	1,705	2,859	249	219	9	**22,091**
Qualifying Revolving Retail	8,248	289	1,265	2,243	600	112	14	**12,771**
Other Retail	34	2,430	880	2,328	255	62	2	**5,991**
Total	**8,805**	**19,246**	**3,850**	**7,430**	**1,104**	**393**	**25**	**40,853**
Average Exposure at Default								
Residential Mortgage	0.100	0.206	0.155	0.182	0.180	0.166	0.255	**0.183**
Qualifying Revolving Retail	0.011	0.006	0.010	0.009	0.008	0.007	0.008	**0.010**
Other Retail	0.006	0.010	0.011	0.014	0.009	0.007	0.035	**0.012**
Exposure-weighted average Loss Given Default (%)								
Residential Mortgage	22.7%	20.2%	20.4%	20.8%	20.3%	20.6%	21.6%	**20.4%**
Qualifying Revolving Retail	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	**73.2%**
Other Retail	72.2%	62.0%	56.6%	44.7%	48.4%	65.5%	56.5%	**49.0%**
Exposure-weighted average risk weight (%)								
Residential Mortgage	4.9%	7.1%	15.1%	28.7%	74.6%	113.6%	239.8%	**17.6%**
Qualifying Revolving Retail	4.8%	11.3%	14.0%	38.7%	106.5%	205.7%	316.7%	**34.7%**
Other Retail	18.4%	28.6%	38.2%	58.3%	76.4%	159.4%	199.4%	**63.3%**

Table 6(e): Actual Losses by portfolio type

	Half year Sep 11	
Basel Asset Class	Individual provision charge $M	Write-offs $M
Corporate	150	151
Sovereign	-	-
Bank	32	-
Residential Mortgage	41	44
Qualifying Revolving Retail	130	154
Other Retail	150	173
Total Advanced IRB	**503**	**522**
Specialised Lending	85	114
Standardised approach	32	82
Total	**620**	**718**

	Half year Mar 11	
Basel Asset Class	Individual provision charge $M	Write-offs $M
Corporate	191	263
Sovereign	-	-
Bank	(8)	-
Residential Mortgage	23	40
Qualifying Revolving Retail	115	135
Other Retail	133	142
Total Advanced IRB	**454**	**580**
Specialised Lending	107	56
Standardised approach	49	67
Total	**610**	**703**

	Half year Sep 10	
Basel Asset Class	Individual provision charge $M	Write-offs $M
Corporate	209	196
Sovereign	-	-
Bank	(5)	-
Residential Mortgage	65	65
Qualifying Revolving Retail	109	134
Other Retail	140	156
Total Advanced IRB	**518**	**551**
Specialised Lending	173	144
Standardised approach	53	35
Total	**744**	**730**

Table 6(f): Analysis of expected versus actual losses by portfolio type

	Sep 10 One year regulatory expected loss estimate $M	Sep 11 Actual losses for 12 months (Write-offs) $M
Corporate	1,453	414
Sovereign	21	-
Bank	22	-
Residential Mortgage	593	84
Qualifying Revolving Retail	404	289
Other Retail	805	315
Specialised Lending	1,257	170
Total Advanced IRB and Specialised Lending	**4,555**	**1,272**

	Mar 10 One year regulatory expected loss estimate $M	Mar 11 Actual losses for 12 months (Write-offs) $M
Corporate	1,522	460
Sovereign	20	-
Bank	22	-
Residential Mortgage	587	105
Qualifying Revolving Retail	420	269
Other Retail	815	298
Specialised Lending	1,301	200
Total Advanced IRB and Specialised Lending	**4,687**	**1,332**

	Sep 09 One year regulatory expected loss estimate $M	Sep 10 Actual losses for 12 months (Write-offs) $M
Corporate	1,644	636
Sovereign	7	-
Bank	58	8
Residential Mortgage	561	117
Qualifying Revolving Retail	396	262
Other Retail	813	330
Specialised Lending	1,050	280
Total Advanced IRB and Specialised Lending	**4,529**	**1,633**

The regulatory EL shown above represents estimated credit loss from defaults over a one-year horizon (computed as the product of PD, EAD and LGD) plus the individual provision balance. The actual loss measures are write-offs for the following year. While these metrics provide some insight into the predictive accuracy of estimations and calculations underpinning ANZ's regulatory EL, any comparison has limitations due to definitional differences e.g.:

- The parameters PD, EAD and LGD underlying the regulatory EL calculation represent estimates based on APRA requirements which include the use of a downturn LGD floor of 20% for mortgages, and supervisory slotting approach for project finance, object finance and non-diversified real estate. Regulatory EL also includes the individual provision balance on defaulted exposures.
- Regulatory EL is a measure of expected credit losses at the start of the year, whereas write-offs relate to a fluctuating portfolio and are recorded throughout the year.
- There is typically a time lag between default and write-offs representing the workout period where recovery options are identified and pursued.

Table 7 Credit risk mitigation disclosures

Main types of collateral taken by ANZ

Collateral is used to mitigate credit risk, as the secondary source of repayment in case the counterparty cannot meet its contractual repayment obligations[38]. Types of collateral typically taken by ANZ include:

- Security over residential, commercial, industrial or rural property.
- Fixed and floating charges over business assets.
- Security over specific plant and equipment.
- Charges over listed shares, bonds or securities.
- Charges over cash deposits.
- Guarantees and pledges.

In some cases, such as where the customer risk profile is considered very sound or by the nature of the product (for instance, small limit products such as credit cards), a transaction may not be supported by collateral.

Credit policy and processes set out the acceptable types of collateral, as well as a process by which additional instruments and/or asset types can be considered for approval. ANZ's credit risk modelling areas use historical internal loss data and other relevant external data to assist in determining the discount that each type would be expected to incur in a forced sale. The discounted value is used in the determination of a SI for LGD purposes.

Policies and processes for collateral valuation and management

ANZ has well established policies and processes around collateral valuation and management. The concepts of legal enforceability, certainty and current valuation are central to collateral management.

In order to achieve legal enforceability and certainty, ANZ uses standard collateral instruments or has specific documentation drawn up by external legal advisers, and where applicable, security interests are registered. The use of collateral management systems also provides certainty that the collateral has been properly taken, registered and stored.

In order to rely on the valuation of collateral assets, ANZ has developed comprehensive rules around acceptable types of valuations (including who may value an asset), the frequency of revaluations and standard extension ratios for typical asset types. Upon receipt of a new valuation, the information is used to recalculate the SI (or to reassess the adequacy of the provision, in the case of an impaired asset), thereby ensuring that the exposure has an updated LGD attached to it for risk quantification purposes.

Guarantee support

Guarantee support for lending proposals are an integral component in transaction structuring for ANZ. The guarantee of a financially strong party can help improve the PD of a transaction through its explicit support of the weaker rated borrower.

Guarantees that are recognised for risk rating purposes may be provided by parties that include associated entities, banks, sovereigns or individuals. Credit policy provides threshold parameters to determine acceptable counterparties in achieving risk grade enhancement of the transaction.

The suitability of the guarantor is determined by risk rating that guarantor. Not all guarantees or guarantors are recognised for risk grade enhancement purposes.

Use of credit derivatives for risk mitigation

ANZ uses purchased credit derivatives to mitigate credit risk by lowering exposures to reference entities that generate high concentration risk exposures or to improve risk return performance.

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[38] For some products, the collateral provided is fundamental to its structuring so is not strictly the secondary source of repayment. For example, lending secured by trade receivables is typically repaid by the collection of those receivables.

Only certain credit derivatives such as credit default swaps (CDS) are recognised for risk mitigation purposes in the determination of regulatory capital. A CDS entails the payment by one party in exchange for credit default protection payment if a credit default event on a reference asset occurs. Standard, legally enforceable documentation applies.

For regulatory capital purposes, ANZ only recognises protection using credit derivatives where they meet several policy and regulatory requirements around the strength of the protection offered such as being irrevocable.

A CDS may only be transacted with banks, ANZ-related conduits and non-bank financial institutions that have been credit assessed and approved by a designated specialist credit officer. All parties must meet minimum credit standards and be allocated a related credit limit. In the event that the creditworthiness of a credit protection provider falls below the minimum required to provide effective protection, the protection is no longer recognised as an effective risk mitigant for regulatory purposes.

The use of netting

Netting is a form of credit risk mitigation in that it reduces EAD, by offsetting a customer’s positive and negative balances with ANZ.

In order to apply on-balance sheet netting, the arrangement must be specifically documented with the customer and meet a number of legally enforceable requirements.

Netting is also used where the credit exposure arises from off balance sheet market related transactions. For close-out netting to be utilised with counterparties, a legally enforceable eligible netting agreement in an acceptable jurisdiction must be in place. This means that each transaction is aggregated into a single net amount and transactions are netted to arrive at a single overall sum.

Transaction structuring to mitigate credit risk

Besides collateral, guarantee support and derivatives described above, credit risk mitigation can also be furthered by prudent transaction structuring. For example, the risk in project finance lending can be mitigated by lending covenants, loan syndication and political risk insurance.

Concentrations of credit risk mitigation

Taking collateral raises the possibility that ANZ may inadvertently increase its risk by becoming exposed to collateral concentrations. For example, in the same way that an over-exposure to a particular industry may mean that a bank is more sensitive to the fortunes of that industry, an over-exposure to a particular collateral asset type may make ANZ more sensitive to the performance of that asset type.

ANZ does not believe that it has any material concentrations of collateral types, given the well diversified nature of its portfolio and conservative asset extension ratios.

Table 7(b): Credit risk mitigation on Standardised approach portfolios – collateral[39]

	Sep 11				
	Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Standardised approach					
Corporate	23,353	866	-	22,487	3.7%
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential Mortgage	2,155	-	-	2,155	0.0%
Qualifying Revolving Retail	2,332	-	-	2,332	0.0%
Other Retail	1,621	1	-	1,620	0.0%
Total	**29,461**	**867**	**-**	**28,594**	**2.9%**

	Mar 11				
	Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Standardised approach					
Corporate	22,216	776	-	21,440	3.5%
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential Mortgage	1,154	-	-	1,154	0.0%
Qualifying Revolving Retail	1,791	-	-	1,791	0.0%
Other Retail	1,290	1	-	1,289	0.1%
Total	**26,451**	**777**	**-**	**25,674**	**2.9%**

	Sep 10				
	Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Standardised approach					
Corporate	22,050	768	-	21,282	3.5%
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential Mortgage	1,479	-	-	1,479	0.0%
Qualifying Revolving Retail	1,841	-	-	1,841	0.0%
Other Retail	1,112	-	-	1,112	0.0%
Total	**26,482**	**768**	**-**	**25,714**	**2.9%**

[39] Eligible Collateral can include cash collateral (cash, certificates deposits and bank bills issued by the lending ADI), gold bullion and highly rated debt securities.

Table 7(c): Credit risk mitigation – guarantees and credit derivatives[40]

Sep 11	Exposure $M	Exposures covered by Guarantees $M	Exposures covered by Credit Derivatives $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Advanced IRB					
Corporate (incl. Specialised Lending)	206,904	14,844	126	204,166	7.2%
Sovereign	45,967	108	-	52,540	0.2%
Bank	46,269	4,336	-	42,308	9.4%
Residential Mortgage	234,882	-	-	234,882	0.0%
Qualifying Revolving Retail	21,219	-	-	21,219	0.0%
Other Retail	29,563	-	-	29,563	0.0%
Total	**584,804**	**19,288**	**126**	**584,678**	**3.3%**
Standardised approach					
Corporate	22,487	-	-	22,487	0.0%
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential Mortgage	2,155	-	-	2,155	0.0%
Qualifying Revolving Retail	2,332	-	-	2,332	0.0%
Other Retail	1,620	-	-	1,620	0.0%
Total	**28,594**	**-**	**-**	**28,594**	**0.0%**

Mar 11	Exposure $M	Exposures covered by Guarantees $M	Exposures covered by Credit Derivatives $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Advanced IRB					
Corporate (incl. Specialised Lending)	190,749	13,634	140	188,119	7.2%
Sovereign	30,376	74	-	36,977	0.2%
Bank	39,084	4,352	-	34,974	11.1%
Residential Mortgage	226,660	-	-	226,659	0.0%
Qualifying Revolving Retail	21,020	-	-	21,020	0.0%
Other Retail	28,538	-	-	28,538	0.0%
Total	**536,427**	**18,060**	**140**	**536,287**	**3.4%**
Standardised approach					
Corporate	21,440	-	-	21,440	0.0%
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential Mortgage	1,154	-	-	1,154	0.0%
Qualifying Revolving Retail	1,791	-	-	1,791	0.0%
Other Retail	1,289	-	-	1,289	0.0%
Total	**25,674**	**-**	**-**	**25,674**	**0.0%**

[40] Table 7(c) shows the exposure amount by asset class gross and net of the impact of guarantees and credit derivatives.

	Sep 10				
	Exposure $M	Exposures covered by Guarantees $M	Exposures covered by Credit Derivatives $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Advanced IRB					
Corporate (incl. Specialised Lending)	192,037	16,497	229	186,059	8.7%
Sovereign	25,365	30	-	35,099	0.1%
Bank	36,666	4,236	-	32,681	11.6%
Residential Mortgage	220,055	-	-	220,055	0.0%
Qualifying Revolving Retail	20,764	-	-	20,764	0.0%
Other Retail	28,282	-	-	28,282	0.0%
Total	**523,169**	**20,763**	**229**	**522,940**	**4.0%**
Standardised approach					
Corporate	21,282	-	-	21,282	0.0%
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential Mortgage	1,479	-	-	1,479	0.0%
Qualifying Revolving Retail	1,841	-	-	1,841	0.0%
Other Retail	1,112	-	-	1,112	0.0%
Total	**25,714**	**-**	**-**	**25,714**	**0.0%**

Table 8 General disclosures for derivatives and counterparty credit risk

Definition of counterparty credit risk

Counterparty credit risk is present in market instruments (derivatives and forward contracts), and comprises:

- Settlement risk, which arises where one party makes payment or delivers value in the expectation but without certainty that the counterparty will perform the corresponding obligation in a bilateral contract at settlement date.
- Market replacement risk (pre-settlement risk), which is the risk that a counterparty will default during the life of a derivative contract and that a loss will be incurred in covering the position.

ANZ transacts market instruments with the following counterparties:

- End users – would typically use over the counter derivative instruments provided by ANZ to manage price movement risk associated with their core business activity.
- Professional counterparties – ANZ may hedge price movement risks by entering into transactions with professional counterparties that conduct two way (buy and sell) business.

Counterparty credit risk requires a different method to calculate EAD because actual and potential market movements impact ANZ's exposure or replacement cost. The markets covered by this treatment include interest rates, foreign exchange, CDS, equities and commodities.

Counterparty credit risk governance

ANZ's counterparty credit risk management is governed by its credit principles, policies and procedures. The Counterparty Credit Risk function is responsible for determining the counterparty credit risk exposure methodology applied to market instruments, in the framework for counterparty credit limit management, measurement and reporting. Limits are approved by the appropriate CAD holder.

Counterparty credit risk measurement and reporting

The general approach is to calculate future exposure as the sum of the mark-to-market value of the exposure, plus the sum of the notional principal multiplied by the potential credit risk exposure (PCRE).

ANZ measures counterparty credit risk exposure for positive mark-to-market positions i.e. the cost to ANZ to replace an outstanding contract with counterparty based on its current market value if counterparty defaulted on its obligations.

PCRE factors recognise that prices may change over the remaining period to maturity, and that risk decreases as the contract's remaining term to maturity decreases. In general terms PCRE is calculated by applying a risk weighting or volatility factor to the face value of the notional principal of individual trades.

PCRE factors are also used by credit officers when establishing credit limits, to ensure the potential volatility of the transactions' values is recognised. Counterparty credit risk is calculated daily and excesses above approved limits are reported to account controllers and risk officers for action.

Credit valuation adjustment

Over the life of a derivative instrument, ANZ uses a CVA model to adjust fair value to take into account the impact of counterparty credit quality. The methodology calculates the present value of expected losses over the life of the financial instrument as a function of PD, LGD, expected credit risk exposure and an asset correlation factor.

Impaired derivatives are also subject to a CVA.

Wrong way risk

ANZ's management of counterparty credit risk also considers the possibility of wrong way risk, which emerges when a counterparty's PD is adversely correlated with market risk factors. ANZ's credit policies and independent transaction evaluation by Credit Risk are central to managing wrong way risk.

Counterparty credit risk mitigation

ANZ's primary tools to mitigate counterparty credit risk include:

- A bilateral netting master agreement (e.g. an ISDA) allowing close-out netting of exposures in a portfolio with offsetting contracts, with a single net payment with the same legal counterparty.
- Use of collateral agreements in some transactions based on standard market documentation (i.e. ISDA master agreement with credit support annex) that governs the amount of collateral required to be posted or received by ANZ throughout the life of the contract. Some agreements are linked to external credit ratings which means in the event of a party's (ANZ or a counterparty) external rating being downgraded, it would likely be required to lodge collateral.
- Use of right to break clauses in master agreement or in trade confirmation to reduce term of long dated derivative trades.
- Independent limits setting, credit exposure control, monitoring and reporting of excesses against approved credit limits.
- Additional termination triggers (close out of exposure) such as credit rating downgrade clauses and change in ownership clauses being included in documentation.
- Linking covenants and events of default in existing loan facility agreement to master agreement.
- Use of credit derivatives to hedge counterparty credit risk exposure.
- Settlement through Continuous Linked Settlement (CLS) to eliminate settlement risk for foreign exchange transactions with CLS members.

In the event of a downgrading of ANZ's rating by one notch from AA to AA-, as at 30 September 2011, ANZ would have been required to lodge USD145 million additional collateral with its counterparties.

Chapter 6 – Securitisation

Table 9 Securitisation disclosures

Definition of securitisation

A securitisation is a financial 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,[41] typically holders of debt securities, with each class or tranche reflecting a different degree of credit risk. This stratification of credit risk means that one class of creditors is entitled to receive payments from the pool before another class. Securitisations may be categorised as:

- Traditional securitisations, where legal ownership of the underlying asset pool is transferred into a Special Purpose Vehicle (SPV), which finances the purchase by issuing debt instruments (notes) to investors, with principal and interest paid from realisation of or regular cash flows from the assets. The SPV assets are insulated from bankruptcy of the seller or servicer.
- Synthetic securitisations, where credit risk is transferred to a third party but legal ownership of the underlying assets remain with the originator e.g. by using credit derivatives or guarantees.

Regulatory capital approaches used in ANZ's securitisation activities

For securitisation exposures held in ANZ's banking book,[42] ANZ applies an IRB approach (as outlined in APS 120) to determine the regulatory capital charge.

Chapter 7 outlines regulatory capital treatment for securitisation exposures held in ANZ's trading book.

Securitisation activities

ANZ's key securitisation activities are:

- Securitisation of ANZ originated assets – use of securitisation as a funding, liquidity and capital management tool and may or may not involve the transfer of credit risk i.e. may or may not provide regulatory capital relief.
- Securitisation of third-party originated assets.
- Provision of facilities and services to securitisations e.g. liquidity, funding derivatives and/or credit support, structuring and arranging services, conduit management and (via ANZ Capel Court Limited) trust management services.
- Investment in securities - ANZ may purchase notes issued from securitisation.

Governance of securitisation activities

Governance of securitisation activities is overseen by the Board and executive committees described in Chapter 3, and managed in accordance with the credit risk and market risk frameworks described in Chapters 5 and 7.

Many functions within ANZ are involved in securitisation activities given the range of activities undertaken and risks that need to be managed. For origination and structuring, ANZ has a specialist securitisation team with independent risk personnel overseeing operations. Credit decisions require joint risk and business approval. The securitisation team must be involved in all non-trading securitisation transactions across ANZ, which ensures consistent expert treatment.

When ANZ is investing in instruments issued from securitisation programs, the Global Markets business manages them as they do for any other part of that allocated portfolio.

The revised APS 120 is effective 1 January 2012, and ANZ acknowledges that it will align its framework to reflect the updated standard.

[41] APRA's definition of securitisation includes certain cases where only one tranche or class of creditors is serviced by the cash flow from the pool of assets.

[42] Exposures are classified into either the trading book or the banking book. In general terms, the trading book consists of positions in financial instruments and commodities held with trading intent or in order to hedge other elements of the trading book, and the banking book contains all other exposures. Banking book exposures are typically held to maturity, in contrast to the shorter term, trading nature of the trading book.

Risk measurement and reporting of securitisation exposures

In accordance with APS 120, ANZ has a hierarchy of approaches available to quantify the credit risk of banking book securitisation exposures. The most common approach used is the Internal Assessment Approach, where ANZ uses a rating agency-type methodology which takes into account historical performance of assets and other (asset-specific) considerations such as underwriting standards.

A conservative LGD and EAD is applied to this rating for economic capital.

All facilities provided to or investments in securitisation programs are reviewed at least annually, including the risk grade. ANZ undertakes its own internal risk assessments for securitisation exposures and supplements this assessment with external rating agency ratings and/or methodology.

The type and frequency of reporting on ANZ's securitisation exposures is as follows:

- Facilities to securitisation programs are reported using standard credit reporting systems, distinguished by appropriate product codes. The regular reporting frequency for most of these systems is monthly.
- In addition, all exposures to SPVs are reported to the CMRC on a six-monthly basis. Utilisation of liquidity facilities are reported internally on a weekly basis.
- Investments in securitisations are reported through the trading book or other investment reporting systems.

Accounting policies

Any SPV in which ANZ has involvement is assessed for control under the requirements of AASB Interpretation 112 Consolidation – Special Purpose Entities. Where control is determined to exist, the SPV is consolidated into ANZ's financial statements. Financial instruments held and issued either from SPVs consolidated by ANZ or those held or issued to a non-consolidated SPV are recognised and valued using the principles of AASB 139 Financial Instruments: Recognition and Measurement.

Derecognition of any transferred ANZ originated assets is determined based on the derecognition principles of AASB 139. Assets may be fully or partially derecognised when substantially all the risks and rewards are transferred to the SPV and control of the asset is not retained.

For synthetic securitisations, any transferred credit exposure is recognised through the fair value measurement of the segregated embedded or stand-alone credit derivative established within the structure.

Use of external rating agencies

ANZ typically uses Standard & Poor's, Moody's Investor Services and/or Fitch Ratings for securitisations.

Table 9(d): Traditional and synthetic securitisation Exposure at Default[43] [44]

Traditional securitisations

	Sep 11			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	162	-	-	2,469
Credit cards and other personal loans	-	-	-	10
Auto and equipment finance	-	-	-	1,066
Commercial loans	-	-	-	4
Other	-	-	-	2,076
Total	**162**	**-**	**-**	**5,625**

Synthetic securitisations

Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**-**	**-**	**-**	**-**

Aggregate of traditional and synthetic securitisations

Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	162	-	-	2,469
Credit cards and other personal loans	-	-	-	10
Auto and equipment finance	-	-	-	1,066
Commercial loans	-	-	-	4
Other	-	-	-	2,076
Total	**162**	**-**	**-**	**5,626**

[43] For the ANZ originated and Third party originated columns the value shown is the current outstanding value of the assets originated. For the Facilities provided column the value shown is the EAD of facilities extended to securitisation undertaken by third parties where ANZ does not act as an originator.

[44] Total EAD in Table 9(d) varies from that presented in remaining tables by $45 million. This amount is included in total asset value of ANZ originated securitisations, however is excluded from facilities provided in Table 9(d) to avoid double counting.

Traditional securitisations

	Mar 11			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	184	-	-	1,641
Credit cards and other personal loans	-	-	-	18
Auto and equipment finance	-	-	-	808
Commercial loans	-	-	-	21
Other	-	-	-	2,434
Total	**184**	**-**	**-**	**4,922**

Synthetic securitisations

Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**-**	**-**	**-**	**-**

Aggregate of traditional and synthetic securitisations

Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	184	-	-	1,641
Credit cards and other personal loans	-	-	-	18
Auto and equipment finance	-	-	-	808
Commercial loans	-	-	-	21
Other	-	-	-	2,434
Total	**184**	**-**	**-**	**4,922**

Traditional securitisations	Sep 10			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	211	-	-	1,908
Credit cards and other personal loans	-	-	-	18
Auto and equipment finance	-	-	-	542
Commercial loans	-	-	-	22
Other	-	-	-	2,887
Total	**211**	**-**	**-**	**5,377**

Synthetic securitisations

Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**-**	**-**	**-**	**-**

Aggregate of traditional and synthetic securitisations

Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	211	-	-	1,908
Credit cards and other personal loans	-	-	-	18
Auto and equipment finance	-	-	-	542
Commercial loans	-	-	-	22
Other	-	-	-	2,887
Total	**211**	**-**	**-**	**5,377**

Table 9(e): Impaired and Past due loans relating to ANZ originated securitisations

	Sep 11			
Underlying asset	ANZ originated $M	Impaired $M	Past due $M	Losses recognised for the six months ended $M
Residential mortgage	162	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**162**	**-**	**-**	**-**

	Mar 11			
Underlying asset	ANZ originated $M	Impaired $M	Past due $M	Losses recognised for the six months ended $M
Residential mortgage	184	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**184**	**-**	**-**	**-**

	Sep 10			
Underlying asset	ANZ originated $M	Impaired $M	Past due $M	Losses recognised for the six months ended $M
Residential mortgage	211	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**211**	**-**	**-**	**-**

Table 9(f): Securitisation – Exposure at Default by exposure type[45]

Securitisation exposure type	**Sep 11** $M	**Mar 11** $M	**Sep 10** $M
Liquidity facilities	1,748	2,002	2,529
Funding facilities	2,684	2,486	2,549
Underwriting facilities	-	-	-
Lending facilities	-	-	-
Credit enhancements	25	26	25
Holdings of securities (excluding trading book)	1,213	453	319
Other	-	-	-
Total	**5,670**	**4,967**	**5,422**

[45] Credit enhancement facilities are second loss facilities and benefit from credit enhancement from a third party first loss provider.

Table 9(g) part (i): Securitisation – Exposure at Default by risk weight band

	Sep 11	
Securitisation risk weights	Exposure at Default $M	Risk weighted assets $M
≤ 25%	4,752	505
>25 ≤ 35%	87	30
>35 ≤ 50%	-	-
>50 ≤ 75%	162	83
>75 ≤ 100%	428	429
>100 ≤ 650%	51	89
1250% (Deduction)	190	-
Total	**5,670**	**1,136**

	Mar 11	
Securitisation risk weights	Exposure at Default $M	Risk weighted assets $M
≤ 25%	3,914	469
>25 ≤ 35%	90	32
>35 ≤ 50%	-	-
>50 ≤ 75%	185	98
>75 ≤ 100%	536	536
>100 ≤ 650%	49	74
1250% (Deduction)	193	-
Total	**4,967**	**1,209**

	Sep 10	
Securitisation risk weights	Exposure at Default $M	Risk weighted assets $M
≤ 25%	3,230	369
>25 ≤ 35%	146	51
>35 ≤ 50%	20	10
>50 ≤ 75%	186	98
>75 ≤ 100%	1,482	1,482
>100 ≤ 650%	54	81
1250% (Deduction)	304	-
Total	**5,422**	**2,091**

Table 9(g) part (ii): Securitisation – Aggregate securitisation exposures by risk weight band

	Sep 11		
Securitisation exposures deducted from Capital	Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	**Total $M**
Residential mortgage	-	-	-
Credit cards and other personal loans	-	-	-
Auto and equipment finance	-	-	-
Commercial loans	-	-	-
Other	95	95	190
Total	**95**	**95**	**190**

	Mar 11		
Securitisation exposures deducted from Capital	Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	**Total $M**
Residential mortgage	-	-	-
Credit cards and other personal loans	-	-	-
Auto and equipment finance	-	-	-
Commercial loans	-	-	-
Other	96	96	192
Total	**96**	**96**	**192**

	Sep 10		
Securitisation exposures deducted from Capital	Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	**Total $M**
Residential mortgage	-	-	-
Credit cards and other personal loans	-	-	-
Auto and equipment finance	-	-	-
Commercial loans	-	-	-
Other	152	152	304
Total	**152**	**152**	**304**

Table 9(h) and 9(i): Security exposures subject to early amortisation or using Standardised approach

ANZ does not have any Securitisation exposures subject to early amortisation or using Standardised approach.

Table 9(j): Securitisation – Summary of current year's activity by underlying asset type and facility[46]

	For the six months to 30 Sep 11		
	Original value securitised		
Securitisation activity by underlying asset type	ANZ originated $M	Third party originated $M	Recognised gain or loss on sale $M
Residential mortgage	-	3,016	-
Credit cards and other personal loans	-	16	-
Auto and equipment finance	-	902	-
Commercial loans	-	-	-
Other	-	-	-
Total	**-**	**3,934**	**-**

Securitisation activity by facility provided	Notional amount $M
Liquidity facilities	-
Funding facilities	98
Underwriting facilities	-
Lending facilities	-
Credit enhancements	-
Holdings of securities (excluding trading book)	625
Other	-
Total	**723**

	For the six months to 31 Mar 11		
	Original value securitised		
Securitisation activity by underlying asset type	ANZ originated $M	Third party originated $M	Recognised gain or loss on sale $M
Residential mortgage	-	1,525	-
Credit cards and other personal loans	-	157	-
Auto and equipment finance	-	695	-
Commercial loans	-	-	-
Other	-	-	-
Total	**-**	**2,377**	**-**

Securitisation activity by facility provided	Notional amount $M
Liquidity facilities	-
Funding facilities	235
Underwriting facilities	-
Lending facilities	-
Credit enhancements	-
Holdings of securities (excluding trading book)	157
Other	-
Total	**392**

[46] For the ANZ originated and Third party originated columns the value shown is the current outstanding value of the assets originated. For the Facilities provided column the value shown is the EAD of facilities extended to securitisation undertaken by third parties where ANZ does not act as an originator.

Securitisation activity by underlying asset type	For the six months to 30 Sep 10		
	Original value securitised		
	ANZ originated $M	Third party originated $M	Recognised gain or loss on sale $M
Residential mortgage	-	971	-
Credit cards and other personal loans	-	139	-
Auto and equipment finance	-	830	-
Commercial loans	-	-	-
Other	-	152	-
Total	**-**	**2,092**	**-**

Securitisation activity by facility provided	Notional amount $M
Liquidity facilities	-
Funding facilities	599
Underwriting facilities	-
Lending facilities	-
Credit enhancements	-
Holdings of securities (excluding trading book)	29
Other	-
Total	**628**

Chapter 7 – Market risk

Table 11 Market risk – Internal models approach

Definition and scope of market risk

Market risk may stem from ANZ's trading and balance sheet activities and is the risk to ANZ's earnings arising from changes in interest rates, foreign exchange rates and credit spreads, or from fluctuations in bond, commodity or equity prices.

Market risk management of IRRBB is described in Chapter 10 and therefore excluded from this Chapter.

Regulatory approval to use the Internal Models Approach

ANZ has been approved by APRA to use the Internal Models Approach (IMA) under APS 116 for all trading portfolios except for specific interest rate risk and electricity trading. ANZ uses the Standardised approach to market risk capital for these two subsets.

Governance of market risk

The Board Risk Committee oversight of market risk is supported by the CMRC as described in Chapter 3.

The Market Risk function is a specialist risk management unit independent of the business that is responsible for:

- Designing and implementing policies and procedures to ensure market risk exposures are managed within the appetite and limit framework set by the Board.
- Measuring and monitoring market risk exposures, and approving counterparty and associated risks.
- The ongoing effectiveness and appropriateness of the risk management framework.

Traded market risk

The Traded, Foreign Exchange and Commodity Market Risk Policy and accompanying procedures (together the "TFC Framework") governs the management of traded market risk and its key components include:

- A clear definition of the trading book.
- A comprehensive set of requirements that promote the proactive identification and communication of risk.
- A robust Value at Risk (VaR) quantification approach supplemented by comprehensive stress testing.
- A comprehensive limit framework that controls all material market risks.
- An independent Markets Risk function with specific responsibilities.
- Regular and effective reporting of market risk to executive management and the Board.

Measurement of market risk

ANZ's traded market risk management framework incorporates a risk measurement approach to quantify the magnitude of market risk within trading books. This approach and related analysis identifies the range of possible outcomes that can be expected over a given period of time and establishes the relative likelihood of those outcomes.

ANZ's key tools to measure and manage traded market risk on a daily basis are VaR estimates, sensitivities measures and stress tests. VaR is calculated using a historical simulation with a 500 day observation period. Traded VaR is calculated at 97.5% confidence interval, one-day holding period for trading activities for internal purposes and 99% confidence interval, ten-day holding period for the calculation of regulatory capital. All material market risk factors and all trading portfolios are captured within the VaR model, with the exception of interest rate risk – specific risk and electricity trading, for which capital is calculated using the Standardised approach described in Table 10(b).

ANZ also undertakes a wide range of stress tests to the Group trading portfolio and to individual trading portfolios. Standard stress tests are applied daily and measure the potential loss impact arising from applying the largest market movements during the previous seven years over specific holding periods. Holding periods used to calculate stress parameters differ and reflect the relative liquidity of each product type.

Results from stress testing on plausible severe scenarios are calculated monthly and potential losses are reported to the CMRC.

VaR and stress tests are also supplemented by cumulative loss limits and detailed control limits. Cumulative loss limits ensure that in the event of continued losses from a trading activity, the trading activity is stopped and senior management reviews before trading is resumed. Where necessary, detailed control limits such as sensitivity or position limits are also in place to ensure appropriate control is exercised over a specific risk or product.

Comparison of VaR estimates to gains/losses

Back testing involves the comparison of calculated VaR exposures with profit and loss data to identify the frequency of instances when trading losses exceed the calculated VaR. For APRA backtesting purposes, VaR is calculated at the 99% confidence interval with a one-day holding period.

Back testing is conducted daily, and outliers are analysed to understand if the issues are the result of trading decisions, systemic changes in market conditions or issues related to the VaR model i.e. historical data or model calibration.

ANZ uses actual and hypothetical profit and loss data. Hypothetical data is designed to remove the impacts of intraday trading and sales margins. It is calculated as the difference between the value of the prior day portfolio at prior day closing rates and the value at current day closing rates. Markets Finance calculates actual profit and loss while Market Risk calculates hypothetical profit and loss.

The following table discloses the high, mean and low VaR values over the reporting period and at period end, and a comparison of VaR estimates with actual gains/losses over the reporting period.

Table 11(d): Value at Risk (VaR) over the reporting period[47] [48]

Value at Risk (VaR)	Six months ended 30 Sep 11			
	Mean $M	Maximum $M	Minimum $M	Period end $M
Equities	1.0	2.5	0.5	2.5
Interest rate	8.1	16.1	4.2	4.7
Foreign exchange	3.4	7.9	1.6	6.0
Commodity	2.2	4.2	1.0	1.4
Credit	5.6	8.5	3.1	3.4

Value at Risk (VaR)	Six months ended 31 Mar 11			
	Mean $M	Maximum $M	Minimum $M	Period end $M
Equities	-	-	-	-
Interest rate	10.8	14.9	7.4	8.3
Foreign exchange	3.1	6.0	1.5	3.3
Commodity	2.5	4.0	1.6	3.3
Credit	5.2	7.9	2.4	7.1

Value at Risk (VaR)	Six months ended 30 Sep 10			
	Mean $M	Maximum $M	Minimum $M	Period end $M
Equities	-	-	-	-
Interest rate	18.7	24.9	11.1	11.2
Foreign exchange	1.6	3.2	1.1	2.6
Commodity	2.3	3.7	1.6	2.1
Credit	3.2	4.9	2.2	3.0

[47] Regulatory VaR is calculated at 97.5% confidence level for a one-day holding period.

[48] The Foreign exchange VaR excludes foreign exchange translation exposures outside of the trading book. (Non Trading translation risk includes translation of the net mark-to-market of the structured credit business).

Reporting of market risk

Market Risk reports results of daily VaR and stress testing to senior management in Market Risk and the Global Markets business. Market Risk will escalate details of any limit breach to the appropriate discretion holder within Market Risk and to Group Risk expediently, and report to the CMRC monthly.

Market Risk monitors and analyses back testing results daily and reports results to the CMRC quarterly.

Mitigation of market risk

The Market Risk team's responsibilities, including the reporting and escalation processes described above, is fundamental to how market risk is managed. Market Risk has presence in all the major dealing operations centres in Australia, New Zealand, Asia, Europe and America.

Commodities risk

Commodity price risk arises as a result of movement in prices of various commodities. All exposures are transferred to the trading book and centrally managed by the Global Markets business and monitored by Market Risk in accordance with the TFC framework.

Foreign exchange risk

Foreign exchange risk arises as a result of movements in relative values of various currencies.

Exposures from ANZ's normal operating business and trading activities are recorded in core multi-currency systems and managed within the trading book in accordance with the TFC framework.

Structural exposures from foreign investments and capital management activities are managed in accordance with policies approved by the Board Risk Committee, with the main objective of ensuring that ANZ's capital ratio is largely protected from changes in foreign exchange. As at 30 September 2011, ANZ's investment in ANZ National is the main source of the structural foreign exchange exposure.

Table 10 Market risk – Standardised approach

ANZ uses the standard model approach to measure market risk capital for interest rate risk – specific risk[49] and electricity trading risk factors. For internal purposes only ANZ also uses an internal model for electricity.

For interest rate risk – specific risk, ANZ's internal VaR model captures general interest rate and credit spread risk for all products, but not the credit spread risk associated with individual issuers of interest rate products.

Table 10(b): Market risk – Standardised approach[50]

	Sep 11 $M	Mar 11 $M	Sep 10 $M
Interest rate risk	141	111	126
Equity position risk	4	7	10
Foreign exchange risk	-	-	-
Commodity risk	15	6	10
Total	**160**	**124**	**146**
Risk Weighted Assets equivalent	**2,000**	**1,553**	**1,822**

[49] Specific risk is the risk that the value of a security will change due to issuer-specific factors. It applies to interest rate and equity positions related to a specific issuer.

[50] RWA equivalent is the capital requirement multiplied by 12.5 in accordance with APS 110.

Chapter 8 – Operational risk

Table 12 Operational risk

Definition of operational risk

Within ANZ, operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and/or systems or from external events. This definition includes legal risk, and the risk of reputation loss or damage arising from inadequate or failed internal processes, people and systems, but excludes strategic risk and regulatory risk.

Regulatory approval to use the advanced measurement approach

ANZ has been authorised by APRA to use the advanced measurement approach (AMA) for calculation of operational risk capital requirements under APS 115. This methodology applies across all of ANZ.

Operational risk governance and structure

The roles of the Board Risk Committee and OREC are described in Chapter 3.

The oversight of operational risk management is conducted via three clearly articulated layers of risk management "Three Lines of Defence".

	Responsible area	**Key responsibilities**
First line of defence	Business / Enablement	• Primary accountability for the understanding of key risks and related control environment. • Undertake day-to-day management of risks, related decision-making and reporting. • Promote a strong risk culture of adhering to thresholds, managing risk exposure and making sustainable risk decisions. • Ensure operational risk information is up-to-date and reflective of the true operational risk position.
Second line of defence	Divisional Risk	• Provide independent oversight and guidance to enable consistent application of the operational risk measurement and management framework (ORMMF). • Coordinate, oversight and report on material operational risks and change initiatives. • Contribute to the identification of systemic issues and risk collation across the Division.
	Group Risk	• Independent function responsible for overarching risk oversight across the bank. • Set Group operational risk appetite statements. • Develop and maintain relevant policies and procedures to support consistent execution and continuing appropriateness of ORMMF. • Monitor and report compliance with ORMMF, consider and approve any exception requests. • Source external loss data. • Lead scenario analysis and operational risk capital calculation process. • Central point of contact with regulators. • Provide global insight and commentary on consolidated bank wide view and identify group wide exposures and trends.
Third line of defence	Internal Audit	• Provide independent and objective assurance to management and ANZ Board regarding compliance with policy and regulatory requirements. • Perform objective assessments across all geographies, Divisions, Lines of Business and processes. • Ensure independent review of the adequacy of the ORMMF is undertaken.

Operational risk principles

ANZ has developed a comprehensive framework to manage operational risk which includes the following operational risk management principles:

- Principle 1: Operational risk is recognised as a primary risk within ANZ and has a governance structure responsible for maintaining risk governance oversight.
- Principle 2: ANZ believes risk management is everyone's responsibility and encourages a culture of prompt escalation of risk to staff sufficiently senior to drive resolution. This culture is supported by clearly articulated roles and responsibilities to ensure effective measurement and management of operational risk.
- Principle 3: ANZ's Board has approved the operational risk appetite, including thresholds for risk assessment and reporting that determines the risk boundaries within which the business must operate to set its strategy.
- Principle 4: ANZ periodically identifies and assesses its exposure to material operational risk within all existing and new products, processes, projects and systems, and assesses the key controls in place to manage these risks.
- Principle 5: ANZ incorporates analysis of loss, incident and control failure into improving the underlying control environment by defining clearly articulated risk response strategies.
- Principle 6: ANZ holds capital commensurate with its operational risk, and maintains comprehensive and well documented operational risk capital processes for calculating its operational risk capital, including monitoring for material changes to capital exposure.
- Principle 7: ANZ maintains a comprehensive and sustainable approach for monitoring and reporting relevant operational risk data, and monitors material changes to operational risk exposure, including Key Risk Indicators (KRIs), to support the proactive management of operational risk across the Group.
- Principle 8: ANZ has appropriate review processes to continuously evaluate the effectiveness and relevance of its operational risk measurement and management processes to meet organisational needs and regulatory requirements.
- Principle 9: ANZ ensures effective integration of day-to-day operational risk management with outputs from the operational risk measurement processes, to support risk based decision making.

ANZ's operational risk framework is delivered through:

- Level 1 ANZ Board Operational Risk Policy (the Principles) – approved by the Board Risk Committee, sets the operational risk principles for governing the overall measurement and management of operational risk across ANZ.
- Level 2 Global Operational Risk Measurement and Management Policy (the Policy) – approved by the Board Risk Committee, outlines the core standards, roles and responsibilities and minimum requirements of the way in which operational risk is measured and managed, in line with Level 1 ANZ Board Operational Risk Policy and APS 115.
- Level 2A Global Operational Risk Procedures (the Procedures) – owned by Group Operational Risk, provide the procedures to support the consistent application of Level 1 and Level 2 Global Operational Risk Policies across ANZ. The procedures are further augmented by tools, templates, systems and on-going training.

Operational risk management

Given the wide scope of operational risk, a robust operational risk management framework and sound internal control environment are essential to risk management. The operational risk framework provides the direction for managing operational risk in terms of specifying the accountabilities of business unit line management and staff, Divisional and Group Operational Risk functions, and the role of Internal Audit in the management of operational risk at ANZ.

Day-to-day management of operational risk is the responsibility of business unit line management and staff. This includes:

- Primary accountability for the understanding of key risks and related control environment.
- Analysis of identified risks, including assessing the inherent and residual risk after consideration of controls currently in place. This requires analysis of the potential consequences of failing to deal with the risks, the likelihood of the risks being realised and the effectiveness of the key controls in place to prevent or mitigate the risk.
- Evaluation of the risk to determine whether it is within Board approved risk appetite.
- Identification and implementation of risk treatment options to improve the key controls over the risk for those risks that are outside the risk appetite. When the preferred risk treatment option is selected the risk treatment plan is documented.

- Ensure operational risk information is up to date and reflective of the true operational risk position.
- Monitoring and review of treatment plans, operational risks and controls, including testing the key controls and reporting on the current operational risk profile.
- Promote a strong risk culture of adhering to thresholds, managing risk exposure and making sustainable risk decisions.
- Dedicated Divisional and Group Corporate Centre Risk Governance teams play a support, monitoring, oversight and challenge role with Internal Audit providing independent assurance and review.

Operational risk mitigation

In line with industry practice, ANZ obtains insurance cover from third party and captive providers for those operational risks where cost-effective premiums can be obtained. ANZ's AMA operational risk regulatory capital does not utilise insurance mitigation under APS 115.

Business disruption is a critical risk to a bank's ability to operate, so ANZ has comprehensive business continuity, recovery and crisis management plans. The intention of the business continuity and recovery plans is to ensure critical business functions can be maintained, or restored in a timely fashion, in the event of material disruptions arising from internal or external events.

Crisis management planning at Group and country levels supplement business continuity plans in the event of a broader Group or country crisis. Crisis management plans include crisis team structures, roles, responsibilities and contact lists, and are subject to testing.

Operational risk reporting

ANZ maintains a comprehensive and sustainable approach for monitoring and reporting relevant operational risk data, including KRIs, to support the proactive management of operational risk across the Group.

Operational risks from the business must be reported and escalated to senior management in a timely manner as per the defined risk acceptance criteria and thresholds.

Material operational risk information (including actual losses, near misses and breaches) must be received by appropriate senior management and committees (Divisional Risk Committee or OREC) on a timely basis, in a form and format that will aid in the monitoring and control of the operational risks and which supports risk based decision making. Information to be reported includes; internal loss data and trend analysis, risk and key control assessment outcomes, KRIs, scenario analysis outcomes, capital outcomes, sensitivity analysis results, policy breaches and any other information to ensure effective monitoring of the framework implementation.

ANZ's advanced measurement approach

Group Operational Risk is responsible for maintaining ANZ's AMA for operational risk measurement and capital allocation.

Operational risk capital is held to protect depositors and shareholders of the bank from rare and severe unexpected losses. In order to quantify the overall operational risk profile, ANZ maintains and calculates operational risk capital (including regulatory and economic capital), on at least a six monthly basis. The capital is calculated using scaled External Loss Data, Internal Loss Data and scenarios as a direct input and risk registers as an indirect input.

ANZ typically models capital at a divisional or geographic layer. Once calculated, the capital is allocated to lines of business according to risk exposure (key allocation drivers). Understanding the make up of the key allocation drivers allows lines of business to consider capital impacts when making decisions. Accordingly, capital allocations are structured to encourage businesses to effectively manage their operational risk exposures e.g. improve controls, reduce losses etc.

In the event of an 'off cycle' scenario review, a recalculation is performed within the relevant cell of the model, to judge the sensitivity of the change on capital. The outcomes of the off-cycle calculation are shared with executive management and decisions are made as to whether to adjust capital or incorporate a scenario change in to the next capital update. This ensures that capital levels are responsive to material changes in risk levels across ANZ.

Capital modelling uses the following expected and unexpected losses as data inputs:

- Minimum of five years of historical internal losses captured and reported in the Bank-wide Operational Loss Database (BOLD).
- Relevant external losses, sourced from Algo First Op Data (includes losses >USD1 million) a recognised industry database. This data is suitably scaled using internally developed rules to ensure relevance to ANZ's size and operations.
- Scenario analysis, unexpected potential loss estimates for severe but plausible risk events.

ANZ does not use expected loss offsets for the purposes of regulatory capital modelling and does not recognise the risk-mitigating effect of insurance in determining operational risk capital.

Operational risk modelling is performed at the divisional or geographic level for applicable Basel risk event types. Operational risk capital is derived using probability distributions and calculated using Monte Carlo simulations using a mathematical method called a loss distribution approach.

Operational risk modelling is performed by a specialist central function. Operational risk capital is derived using probability distributions and calculated using Monte Carlo simulations at the division and event type level referred to as a modelling cell. The data inputs are combined for each cell using a loss distribution approach and include the following:

- Historical internal losses captured and reported in an internal loss database.
- Relevant external losses sourced from a reputable industry supplier. This data is suitably scaled using internally developed rules to ensure relevance to ANZ's size and operations.
- Scenario analysis data for severe but plausible risk events, elicited in workshops with risk and business professionals.

Capital outcomes include:

- Operational risk regulatory capital to meet the regulatory capital soundness standard based on a 99.9% confidence interval in accordance with APS 115.
- Economic Capital based on a 99.97% confidence interval.

Compliance

Group Compliance has global oversight responsibility for the ANZ Compliance Framework, and each division has responsibility for embedding the framework into its business operations, identifying all regulatory compliance obligations, and escalating when breaches occur. The Compliance framework fosters an integrated approach where staff are responsible and accountable for compliance, either within their job role, or within their area of influence.

Chapter 9 – Equities

Table 13 Equities – Disclosures for banking book positions

Definition and categorisation of equity investments held in the banking book

Equity risk is the potential loss that may be incurred on equity investments in the banking book. ANZ's equity exposures in the banking book are primarily categorised as follows:

- Equity investments that are taken for strategic reasons - These transactions represent strategic business initiatives and include ANZ's investments in and partnership arrangements with financial institutions in Asia. These investments are undertaken only after extensive analysis and due diligence by Group Strategy, internal specialists and external advisors, where appropriate. Board approval is required prior to committing to any investments over delegated authorities, and all regulatory notification requirements are met. Performance of these investments is monitored by both the owning business unit and Group Strategy to ensure that it is within expectations and the values of the investments are tested at least annually for impairment.
- Equity investments on which capital gains are expected - These transactions are originated and managed by dedicated equity finance teams. These transactions represent funding solutions for known customers of ANZ and are governed by specific policies. ANZ ensures that the investment in these entities does not constitute a controlling interest in the relevant business.
- Equity investments made as the result of a work out of a problem exposure - From time to time, ANZ will take an equity stake in a customer as part of a work out arrangement for problem exposures. These investments are made only where there is no other viable option available and form an immaterial part of ANZ's equity exposures.

Valuation of and accounting for equity investments in the banking book

In line with Group Accounting Policy the accounting treatment of equity investments depends on whether ANZ has significant influence over the investee.

Investments in associates

Where significant influence is assessed, the investment is classified as an Investment in Associate in the financial statements. ANZ adopts the equity method of accounting for associates. ANZ's share of the results of associates is included in the consolidated income statement. The associate investments are recognised at cost plus ANZ's share of post acquisition net assets. Interests in associates are reviewed annually for impairment, using either market value, or a discounted cash flow methodology to assess value in-use.

APRA requires that equity accounted earnings from associates, including strategic investments in partnerships are excluded from regulatory capital until received in the form of a dividend.

Available-for-Sale Investments

Where ANZ does not have significant influence over the investee, the investment is classified as Available-for-Sale (AFS). The investment is initially recognised at fair value plus transaction costs. Changes in the fair value of the investments are recognised in an equity reserve with any impairment recognised in the income statement. When the asset is sold the cumulative gain or loss relating to the asset held in the AFS revaluation reserve is transferred to the income statement.

Table 13(b) and 13(c): Equities – Types and nature of Banking Book investments

Equity investments	Sep 11 $M Balance sheet value	Fair value
Value of listed (publicly traded) equities	1,985	2,179
Value of unlisted (privately held) equities	1,976	2,011
Total	**3,961**	**4,190**

Equity investments	Mar 11 $M Balance sheet value	Fair value
Value of listed (publicly traded) equities	1,861	2,818
Value of unlisted (privately held) equities	1,789	1,825
Total	**3,650**	**4,643**

Equity investments	Sep 10 $M Balance sheet value	Fair value
Value of listed (publicly traded) equities	1,903	2,831
Value of unlisted (privately held) equities	1,514	1,566
Total	**3,417**	**4,397**

Table 13(d) and 13(e): Equities – gains (losses)

Gains (losses) on equity investments	Half Year Sep 11 $M	Half Year Mar 11 $M	Half Year Sep 10 $M
Cumulative realised gains (losses) from disposals and liquidations in the reporting period	24	5	23
Cumulative realised losses from impairment and writedowns in the reporting period	(15)	(37)	(8)
Total unrealised gains (losses)	49	1	(80)
Total unrealised gains (losses) included in Gross Tier 1/Tier 2 capital	-	-	-

Table 13(f): Equities Risk Weighted Assets

Risk Weighted Assets	Sep 11 $M	Mar 11 $M	Sep 10 $M
Equity investments subject to a 300% risk weight	3	6	1
Equity investments subject to a 400% risk weight	1,396	1,629	1,576
Total RWA - Equity	**1,399**	**1,635**	**1,577**
Aggregate amount of equity investments subject to:			
Supervisory provisions	-	-	-
Grandfathering provisions	-	-	-

Chapter 10 – Interest Rate Risk in the Banking Book

Table 14 Interest Rate Risk in the Banking Book

Definition of interest rate risk in the banking book

Interest rate risk in the banking book (IRRBB) relates to the potential adverse impact of changes in market interest rates on ANZ's future net interest income. The risk generally arises from:

- Repricing and yield curve risk - the risk to earnings or market value as a result of changes in the overall level of interest rates and/or the relativity of these rates across the yield curve.
- Basis risk - the risk to earnings or market value arising from volatility in the interest margin applicable to banking book items.
- Optionality risk - the risk to earnings or market value arising from the existence of stand-alone or embedded options in banking book items.

Regulatory capital approach

ANZ has received approval from APRA to use the IMA for the calculation of regulatory capital for IRRBB, under APS 117.

Governance

The Board Risk Committee has established a risk appetite for IRRBB and delegated authority to the GALCO to manage the strategic position (capital investment term) and oversee the interest rate risk arising from the repricing of asset and liabilities (mismatch risk) in the banking book. GALCO has delegated the management of this mismatch risk to the Global Markets business.

Market Risk is the independent function responsible for:

- Designing and implementing policies and procedures to ensure that IRRBB exposure is managed within the limit framework set by the Board Risk Committee.
- Monitoring and measuring IRRBB market risk exposure, compliance with limits and policies.
- Ensuring ongoing effectiveness and appropriateness of the risk management framework.

Management framework

IRRBB is managed under a comprehensive measurement and reporting framework, supported by an independent Market Risk function. Key components of the framework include:

- A comprehensive set of policies that promote proactive risk identification and communication.
- Funds Transfer Pricing framework to transfer interest rate risk from business units so it can be managed by the Global Markets business and monitored by Market Risk.
- Quantifying the magnitude of risks and controlling the potential impact that changes in market interest rates can have on the net interest income and balance sheet fair value of ANZ.
- An independent Market Risk function with specific responsibilities.
- Regular and effective reporting of IRRBB to executive management and the Board.

Measurement of interest rate risk in the banking book

ANZ uses the following principal techniques to quantify and monitor IRRBB:

- Interest Rate Sensitivity - this is an estimate of the change in economic value of the banking book due to a 1 basis point move in a specific part of the yield curve.
- Earnings at risk (EaR) - this is an estimate of the amount of income that is at risk from interest rate movements over a given holding period, expressed to a 97.5% or 99% level of statistical confidence.
- Value at risk (VaR) - this is an estimate of the impact of interest rate changes on the banking book's market value, expressed to a 97.5% (internal purposes) or 99% (regulatory purposes) level of statistical confidence for a given holding period.
- Market Value loss limits - this mitigates the potential for embedded losses within the banking book.

- Stress testing - standard and extraordinary tests are used to highlight potential risk which may not be captured by VaR, and how the portfolio might behave under extraordinary circumstances.

The calculations used to quantify IRRBB require assumptions to be made about the repricing term of exposures that do not have a contractually defined repricing date, such as deposits with no set maturity dates, and prepayments. Changes to these assumptions require GALCO approval.

Where relevant, IRRBB techniques recognise foreign currency effects as all measures are expressed in Australian dollars.

Basis and optionality risks are measured using Monte Carlo simulation techniques, to generate a theoretical worst outcome at a specified confidence level (typically 99%) less the average outcome.

Reporting of interest rate risk in the banking book

Market Risk analyses the output of ANZ's VaR and EaR calculations daily. Stress tests are calculated monthly. Compliance with the risk appetite and limit framework is reported to CMRC, GALCO and the Board Risk Committee.

IRRBB regulatory capital is calculated monthly.

ANZ's interest rate risk in the banking book capital requirement

The IRRBB regulatory capital requirement includes a value for repricing and yield curve risk, basis and optionality risks based on a 99% confidence interval, one year holding period and a six year historical data set.

Embedded losses also make up the capital requirement and are calculated as the difference between the book value of banking book items and the current economic value.

Results of standard shock scenario

The Basel II framework sets out a standard shock scenario of a 200 basis point parallel shift change in interest rates, in order to establish a comparable test across banks.

Table 14(b) that follows shows the results of this test by currency of the exposures outside the trading book.

Table 14(b): Interest Rate Risk in the Banking Book

Standard Shock Scenario Stress Testing: Interest rate shock applied	Change in Economic Value Sep 11 $M	Mar 11 $M	Sep 10 $M
AUD			
200 basis point parallel increase	53	28	128
200 basis point parallel decrease	(54)	(24)	(135)
NZD			
200 basis point parallel increase	22	(8)	(1)
200 basis point parallel decrease	(25)	5	(0)
USD			
200 basis point parallel increase	(30)	(54)	(18)
200 basis point parallel decrease	12	39	11
GBP			
200 basis point parallel increase	(6)	(3)	(8)
200 basis point parallel decrease	3	2	3
Other			
200 basis point parallel increase	20	21	(25)
200 basis point parallel decrease	1	(7)	16
IRRBB regulatory capital	**675**	**809**	**615**
IRRBB regulatory RWA	**8,439**	**10,112**	**7,690**

Stress testing methodology

Stress tests within ANZ include standard and extraordinary tests. These tests are used to highlight potential risk which may not be captured by VaR, and how the portfolio might behave under extraordinary circumstances. Standard stress tests include statistically derived scenarios based on historical yield curve movements. These combine parallel shocks with twists and bends in the curve to produce a wide range of hypothetical scenarios at high statistical confidence levels, with the single worst scenario identified and reported. Extraordinary stress tests include interest rate moves from historical periods of stress as well as stresses to assumptions made about the repricing term of exposures. The rate move scenarios include daily changes over the stressed periods and the worst theoretical losses over the selected periods are each reported. Stresses of the repricing term assumptions investigate scenarios where actual repricing terms are vastly different to those modelled.

Chapter 11 – Liquidity risk

Overview

Liquidity risk is the risk that ANZ has insufficient capacity to fund increases in assets or is unable to meet its payment obligations as they fall due, including repaying depositors or maturing wholesale debt. The timing mismatch of cash flows and the related liquidity risk is inherent in all banking operations and is closely monitored by ANZ.

Governance

The management of ANZ's liquidity and funding risk is overseen by the Board Risk Committee and GALCO, in accordance with ANZ's liquidity policy framework.

Scenario modelling

The Global Financial Crisis highlighted the importance of differentiating between stressed and normal market conditions in a name-specific crisis, and the different behaviour that offshore and domestic wholesale funding markets can exhibit during market stress events. Scenario modelling stresses site and total bank cashflow projections against multiple 'survival horizons'. (A 'survival horizon' is the period that ANZ is required to remain cash flow positive under a specific scenario or stress.) Scenarios modelled are either prudential requirements, i.e. a 'going-concern' scenario or 'name crisis' scenario; or Board approved events including 'name-specific' stresses and 'funding market' events. Under these scenarios, customer and wholesale balance sheet asset/liability flows are stressed.

Funding

ANZ manages its funding profile using a range of funding metrics and balance sheet disciplines. This approach is designed to ensure that an appropriate proportion of the Group's assets are funded by stable funding sources including core customer deposits, longer-dated wholesale funding (with a remaining term exceeding one year) and equity. This includes targeting a diversified funding base, avoiding undue concentrations by investor type, maturity, market source and currency.

Customer deposits and other funding liabilities increased by 16% to $308.2 billion and now represents 61% of all funding, an increase of 3% from 30 September 2010.

$18.0 billion of term wholesale debt (with a remaining term greater than one year), including $2.4 billion of pre-funding executed during full year 2010, was issued during the 2011 financial year. In addition, ANZ raised $1.34 billion in hybrid capital, taking the total term debt and hybrid issuance for the 2011 financial year to $19.4 billion. As at 30 September 2011, term wholesale funding represented 12% of total funding, a decrease from 16% as at 30 September 2010 (partly due to 2011 financial year pre-funding completed during 2010 financial year as funding was replaced with customer deposits and Tier 1 capital).

ANZ maintained access to all major global wholesale funding markets during 2011.

Over 70% of term funding requirements were completed during the first half, before market conditions began to deteriorate. Benchmark term debt issues were completed in AUD, USD, JPY, CHF, CAD and NZD.

All short-term wholesale funding needs were comfortably met, despite an increase in volatility in offshore markets and a general shortening of tenor preference from US money market investors.

The weighted average tenor of new term debt issuance was 4.7 years (unchanged year-on-year).

The weighted average cost of new term debt issuance during 2011 declined marginally (4 basis points) relative to 2010. Average portfolio costs remain substantially above pre-crisis levels and continue to increase as maturing term wholesale funding is replaced at higher spreads.

Over the past year strong customer deposit growth and stable term debt issuance has allowed ANZ to maintain a low reliance on short-term wholesale funding markets. The proportion of total funding sourced from short-term wholesale funding markets was unchanged at 12% between 30 September 2010 and 30 September 2011.

Liquidity portfolio

The Group holds a diversified portfolio of cash and high credit quality securities that may be sold or pledged to provide same-day liquidity. This portfolio helps protect the Group's liquidity position by providing cash in a severely stressed environment. All assets held in this portfolio are securities eligible for repurchase under agreements with the applicable central bank (i.e. 'repo eligible').

At 30 September 2011 the volume of eligible securities available, post any repurchase (i.e. 'repo') discounts applied by the applicable central bank, was $71.4 billion. In addition, the liquidity portfolio provided cover against over one year of offshore wholesale debt maturities.

The Liquidity portfolio is well diversified by counterparty, currency, and tenor. Under the liquidity policy framework securities purchased must be of a similar or better credit quality to ANZ's external long-term or short-term credit ratings and continue to be repo eligible.

Supplementing the prime liquid asset portfolio, the Group holds:

- Additional central bank deposits with the US Federal Reserve and Bank of Japan of $10.3 billion.
- Secondary sources of liquidity including Australian Government securities, Australian State Government securities and gold of $9.6 billion.
- Additional cash and other securities to satisfy local country regulatory liquidity requirements.

Appendix 1 – Detail of capital structure

Fundamental Tier 1 capital		Sep 11 $M		Mar 11 $M		Sep 10 $M
Paid-up ordinary share capital		21,577		20,839		20,140
Reserves						
Foreign currency translation reserve	(2,418)		(3,299)		(2,742)	
Share and share option reserve	174		156		168	
Transactions with non-controlling interest reserve	(22)					
Total reserves		(2,266)		(3,143)		(2,574)
Prudential retained earnings						
Retained earnings including current year earnings	17,787		16,766		15,921	
Accumulated retained profits and reserves of insurance, funds management and securitisation entities and associates	(1,679)		(1,269)		(1,312)	
Dividend not provided for	(1,999)		(1,662)		(1,895)	
Deferred fee revenue including fees deferred as part of loan yields	414		398		402	
Accrual for Dividend Reinvestment Plans	600		499		569	
Total prudential retained earnings		15,123		14,732		13,685
Non-controlling interests		41		64		64
Total		**34,475**		**32,492**		**31,315**

Deductions from Tier 1 capital		Sep 11 $M		Mar 11 $M		Sep 10 $M
Goodwill		(2,968)		(2,795)		(2,910)
Other deductions from Tier 1 capital						
Intangible component of investment in OnePath Australia and New Zealand (excluding prudential goodwill)	(2,071)		(2,059)		(2,043)	
Capitalised software and other intangible assets	(1,549)		(1,323)		(1,169)	
Capitalised expenses including loan and lease origination fees, capitalised securitisation establishment costs and costs associated with debt raisings	(688)		(666)		(655)	
Applicable deferred tax assets (excluding the component relating to the general reserve for impairment of financial assets)	(136)		(154)		(235)	
Mark-to-market impact of own credit spread	(128)		(18)		(19)	
Total other deductions from Tier 1 capital		(4,572)		(4,220)		(4,121)
50/50 deductions from Tier 1 capital						
Investment in ANZ insurance subsidiaries	(200)		(200)		(198)	
Investment in funds management entities	(29)		(29)		(36)	
Investment in OnePath Australia and New Zealand	(906)		(901)		(845)	
Investment in other Authorised Deposit-taking Institutions and overseas equivalents	(1,151)		(1,162)		(988)	
Investment in other commercial operations	(2)		(8)		(21)	
Expected loss in excess of eligible provisions	(475)		(473)		(560)	
Other	(308)		(282)		(378)	
Total 50/50 deductions from Tier 1 capital		(3,071)		(3,055)		(3,026)
Total deductions from Tier 1 capital		**(10,611)**		**(10,070)**		**(10,057)**

Deductions from Tier 2 capital		**Sep 11** $M		**Mar 11** $M		**Sep 10** $M
Upper and lower Tier 2 capital deductions		(28)		(28)		(28)
50/50 deductions from Tier 2 capital						
Investment in ANZ insurance subsidiaries	(200)		(200)		(198)	
Investment in funds management entities	(29)		(29)		(36)	
Investment in OnePath Australia and New Zealand	(906)		(901)		(845)	
Investment in other Authorised Deposit Taking Institutions and overseas equivalents	(1,151)		(1,162)		(988)	
Investment in other commercial operations	(2)		(8)		(21)	
Expected loss in excess of eligible provisions	(475)		(473)		(560)	
Other	(308)		(282)		(378)	
Total 50/50 deductions from Tier 2 capital		(3,071)		(3,055)		(3,026)
Total deductions from Tier 2 capital		**(3,099)**		**(3,083)**		**(3,054)**

Appendix 2 – ANZ Bank (Europe) Limited

ANZ Bank (Europe) Limited (ANZBEL) is a 100% owned and controlled subsidiary of ANZ, and is regulated by the Financial Services Authority (FSA). ANZBEL is subject to similar Pillar 3 requirements as ANZ, under the FSA's Prudential Source Book for Banks, Building Societies and Investment Firms (BIPRU). The FSA has granted ANZBEL a Pillar 3 Disclosure waiver direction, which can be found on the FSA website: fsa.gov.uk/pubs/waivers/bipru_waivers.pdf.

In line with the FSA waiver direction, ANZBEL will rely on disclosures in this document to satisfy most of its Pillar 3 disclosure obligations. The following FSA requirements are not mirrored in APS 330 or included in this disclosure document, and as such are required by the FSA to be reported on an individual basis in the annual ANZBEL Statutory Accounts:

- BIPRU 11.5.4R (4) - Disclosure of the firm's minimum capital requirements covering position, foreign exchange, commodity, counterparty and concentration risks.
- BIPRU 11.5.12R – Disclosure: Market Risk.

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