2013 Pillar 3 Report

Incorporating the requirements of APS 330
as at 30 September 2013

National Australia Bank

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Contents

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1. Introduction

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

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

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

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

Capital Ratio Summary

The NAB Group's Common Equity Tier 1 (CET1) capital ratio of 8.43% at 30 September 2013 is consistent with the NAB Group's objective of maintaining a strong capital position.

	As at	
	30 Sep 13	**31 Mar 13**
Capital ratios (Level 2)	**%**	**%**
Common Equity Tier 1	8.43	8.22
Tier 1	10.35	10.19
Total	11.80	11.71

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

1.1 The NAB Group's Capital Adequacy Methodologies

The NAB Group operates in Australia, Asia, New Zealand, the United Kingdom and North America. The following table sets out the approach to the Basel Accord, which is applied across the NAB Group as at 30 September 2013.

The NAB Group's Basel Methodologies

Methodology Approach	Credit Risk	Operational Risk	Non-Traded Market Risk	Traded Market Risk
National Australia Bank Limited	Advanced IRB	AMA	IRRBB	Standardised and IMA
Bank of New Zealand	Advanced IRB	AMA	IRRBB	Standardised and IMA
Clydesdale Bank PLC	Standardised	Standardised	IRRBB	n/a
Great Western Bank	Standardised	Standardised	IRRBB	n/a

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

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

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

Great Western Bank (GWB) is regulated in the United States of America by the South Dakota Division of Banking, the Federal Deposit Insurance Corporation and the Federal Reserve System. GWB credit risk and operational risk RWA are subject to APRA Basel standardised methodology.

1.2 APS 330 Disclosure Governance

The NAB Group Disclosure and External Communications Policy defines Board and management accountabilities for *APS 330* disclosure, including processes and practices to ensure the integrity and timeliness of prudential disclosures and compliance with NAB Group policies.

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

1.3 Regulatory Reform

Basel Regulatory Reforms

APRA's Basel III capital reforms took effect on 1 January 2013.

In terms of Basel III liquidity requirements, the NAB Group's transition strategy is focused on the quality of liquid assets and the stability of the funding that underpins these measures.

In May 2013, APRA released an updated draft of the prudential standard *APS 210: Liquidity* on the implementation of the Basel III liquidity reforms in Australia. The final standard is expected to be released in the latter half of 2013.

The qualitative aspects of this standard are due to come into force from January 2014, while Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) compliance is expected to commence from January 2015 and January 2018 respectively.

APRA's draft standard has adopted a number of the inflow and outflow assumption changes announced by the Basel Committee on Banking Supervision (BCBS) in their final Basel III liquidity standard released in January 2013, including a reduced run-off assumption for Non-Financial Corporate deposits.

In contrast to the BCBS, APRA will not adopt a phased implementation to LCR compliance and no widening of the definition of High Quality Liquid Assets (HQLAs) is proposed for the purposes of LCR. APRA has previously released details regarding the use of the Committed Liquidity Facility (CLF), which is designed to address the shortfall of Level 1 liquid assets in Australia. The availability of the RBA's CLF remains central to APRA's proposed standard and engagement with APRA around the practical requirements concerning access to this facility continues.

Other Reform Proposals

In addition to the Basel Committee reforms, the NAB Group remains focused on other areas of regulatory change.

In the August 2013 Economic Statement the Government announced that it will establish a dedicated Financial Stability Fund to help meet any future cost of the Financial Claims Scheme.

Key reform proposals that may affect the NAB Group's capital and funding include:

- APRA is expected to implement a Domestic Systematically Important Banks (D-SIB) framework by 1 January 2016, with further detail expected during the first half of the 2014 financial year. Depending on the size of the D-SIB capital charge, there may be an impact on the NAB Group's capital targets and capital management strategy. This will be assessed once further information is received from APRA
- APRA's Level 3 conglomerate supervision proposals. Draft proposals for industry consultation were released in late 2012 covering risk exposures and group governance. A second consultation package covering capital adequacy, risk management and governance was released in May 2013. The capital proposals include a Level 3 prudential capital requirement determined by APRA, which will reflect all material risks to the group's APRA beneficiaries. APRA announced in August 2013 a 12-month transition period for the implementation of the Level 3 proposals; the prudential standards are now expected to be finalised by 1 January 2014, with full compliance by 1 January 2015
- The US Dodd-Frank Act, where requirements impacting the NAB Group under Title I have been released for consultation and are expected to take effect in 2015
- The UK Government's Financial Services (Bank Reform) Bill which is currently under consideration in Parliament. The Bill is wide ranging and seeks to enact the recommendations of the Independent Commission on Banking as amended following review by the Parliamentary Commission on Banking Standards. Once enacted, the reforms may affect the structure of banks and the amount of capital held in the UK business. The Bill is currently expected to receive Royal Assent during 2014 for full implementation by 2019.

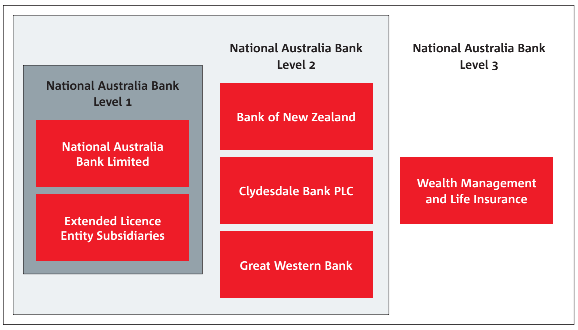
2. Scope of Application

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

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

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

NAB Group Consolidation for Regulatory Purposes



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

Wealth management and life insurance activities are excluded from the calculation of RWA and the related controlled entities are deconsolidated from the Level 2 Group for the purposes of calculating capital adequacy. Capital adequacy deductions are applied to the investments in, and profits of, these activities.

In addition, certain securitisation special purpose vehicles (SPVs) to which assets have been transferred in accordance with APRA's requirements as set out in *Prudential Standard APS 120: Securitisation (APS 120)* have been deconsolidated from the Level 2 Group for the purposes of this disclosure. For regulatory purposes, credit risk is removed from the sold assets and there is no requirement to hold capital against them.

Differences in Consolidation Arising Between the Regulatory and Accounting Approaches

For financial reporting, the NAB Group applies the International Financial Reporting Standards (IFRS) and consolidates all entities in which it has the power to govern the financial and operating policies so as to obtain benefit from their activities. This includes life insurance, funds management and securitisation SPVs used to house securitised assets. As noted above, these entities receive a different treatment for Level 2 regulatory consolidation purposes. A list of material controlled entities included in the consolidated NAB Group for financial reporting purposes can be found in the Company's 30 September 2013 Annual Financial Report.

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

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

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

Disclosure 2A: Scope of Application

There were no capital deficiencies in non-consolidated subsidiaries of the NAB Group as at 30 September 2013 or 31 March 2013.

Clydesdale Bank PLC

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

Bank of New Zealand

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

BNZ is subject to the Basel Accord capital adequacy requirements applicable in New Zealand, mandated by the RBNZ. The capital ratios for BNZ presented in this report have been derived under the RBNZ's Capital Adequacy Framework (Internal Models Based Approach), which incorporates new Basel III capital adequacy standards that apply from 1 January 2013. Full Basel disclosures for BNZ are published separately under the Disclosure Statement regime applicable to banks incorporated in New Zealand.

Great Western Bank

GWB credit risk and operational risk RWA are subject to APRA Basel standardised methodology. IRRBB for GWB is calculated using the IRRBB internal model.

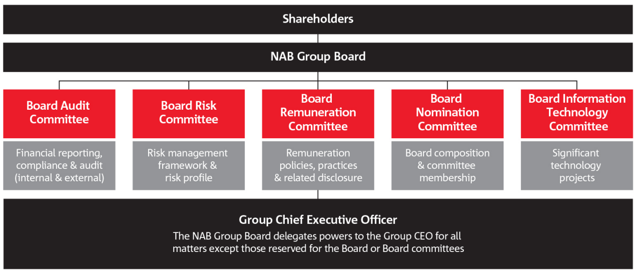
3. Risk Governance and Management

The NAB Group's corporate governance framework plays a key role in supporting the NAB Group's business operations and provides clear guidance on how authority is exercised within the NAB Group.

As a fundamental element of the NAB Group's culture and business practices, the framework provides guidance for effective decision-making in all areas of the NAB Group through:

- Strategic and operational planning
- Risk management and compliance
- Financial management and external reporting
- Succession planning and culture.

The corporate governance framework is represented diagrammatically below.



Board Governance

The Board of Directors of NAB (the Board) represents NAB's shareholders and is responsible for directing the NAB Group's affairs. Its central role is to create and deliver value by effectively governing the NAB Group's businesses, while meeting the interests of shareholders and other stakeholders through transparent reporting and active engagement. For example, the NAB Group takes seriously the importance of understanding its environmental and social impact, and the Board has established performance measures that are linked to senior executives' remuneration.

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

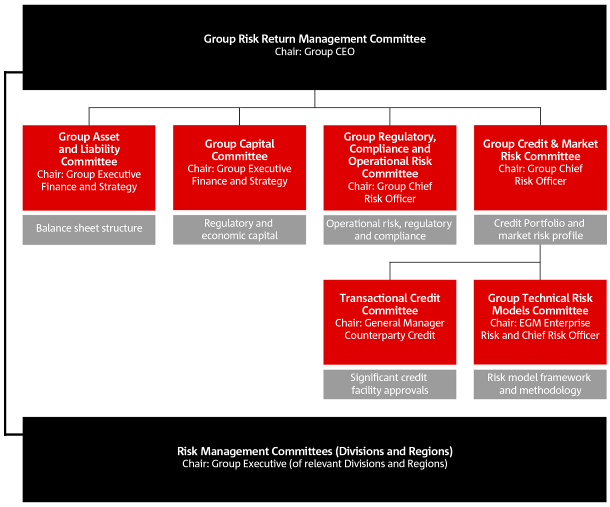
The Principal Board Risk Committee (PBRC) supports the framework for risk management across the NAB Group through:

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

Executive Governance

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

At an executive level, risk is overseen by the Group CEO through the Group Risk Return Management Committee (GRRMC) and its supporting sub-committees. Additionally, the NAB Group manages risk across all its divisions and each First Line division has a risk management committee, chaired by the relevant NAB Group Executive to support them in executing their risk management accountabilities (and in doing so contributes to an effective risk and control environment across their division). A diagram of the executive risk committee structure is represented below.



Cross divisional governance of material risks is supported by Enterprise Management committees, chaired by senior executives from across the NAB Group.

Additionally, the NAB Group has a dedicated global risk management function led by the Group Chief Risk Officer. The activities undertaken by the Risk function are performed both at a NAB Group level (whereby risks across all the NAB Group's businesses are aggregated) and at a division level (through Risk specialists embedded within the business).

Risk Management

Risk exists in all aspects of the NAB Group's business and the environment in which it operates. The NAB Group maintains a strong risk governance and oversight framework that originates at Board level and cascades down through the NAB Group.

The Board and its Risk Committees are responsible for the NAB Group's risk management framework and for the review and oversight of the NAB Group's risk profile within the context of the Board's risk appetite.

Risk is identified and managed as part of a Group-wide Risk management framework that starts with the Board approved strategy, Risk Appetite, Capital, Funding and Operational Plans. Risk Appetite is translated and cascaded to businesses qualitatively (through risk policies, standards and operating procedures) and quantitatively (through our risk limits, settings and decision authorities).

Compliance with the NAB Group's Risk Management Framework is non-negotiable. The NAB Group's operating model differentiates accountabilities using a 'three lines of defence' approach as follows:

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

Further details of risks associated with the NAB Group are set out in NAB's 2013 Annual Financial Report.

4. Capital

4.1 Capital Adequacy

Capital Objectives

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

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

Risk Identification and Measurement

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

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

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

Capital Planning

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

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

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

The Board sets capital targets above the internal risk-based assessment of capital. Target ranges are set by reference to factors such as the NAB Group's Risk Appetite Statement, and market, regulatory and rating agencies expectations. The NAB Group's current CET1 ratio target is above 7.5% and the NAB Group operates at a buffer to this target. These targets reflect the NAB Group's desire to maintain strong balance sheet settings and is consistent with investor risk appetite and global regulatory direction. The NAB Group continues to operate at a comfortable buffer to the Board target.

APRA advises the NAB Group of its Prudential Capital Ratio (PCR) which represents the minimum ratio of regulatory capital to total RWA. The PCR is not publicly disclosed.

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

Embedding Capital Requirements in Business Decisions

Capital requirements are taken into consideration in:

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

Governance, Reporting and Oversight

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

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

- strategic and operational planning process
- capital adequacy assessment and risk appetite
- stress testing and scenarios
- policies and frameworks
- capital management
- use of capital in the business.

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

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

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

Group Non-Traded Market Risk (GNTMR) is responsible for capital oversight and is independent of Treasury. GNTMR maintains a risk framework for effective oversight, supports stress testing of the NAB Group's capital position, supports capital planning and forecasting, and monitors capital activities to ensure compliance with the requirements of the NAB Group's capital framework.

Table 4.1A: Risk-Weighted Assets

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

	As at 30 Sep 13 RWA $m	As at 31 Mar 13 RWA $m
Credit risk [(1)]		
IRB approach		
Corporate (including SME)	105,115	105,166
Sovereign	1,452	1,127
Bank	11,785	10,755
Residential mortgage	59,527	58,062
Qualifying revolving retail	3,725	4,022
Retail SME	6,731	6,873
Other retail	3,343	3,446
Total IRB approach	**191,678**	**189,451**
Specialised lending (SL)	**53,193**	**54,192**
Standardised approach		
Australian and foreign governments	66	55
Bank	265	235
Residential mortgage	17,463	14,945
Corporate	23,973	21,771
Other	3,206	2,803
Total standardised approach	**44,973**	**39,809**
Other		
Securitisation	7,018	7,633
Equity [(2)]	-	-
Credit value adjustment	10,035	10,343
Central counterparty default fund contribution guarantee	263	197
Other [(3)]	7,514	5,892
Total other	**24,830**	**24,065**
Total credit risk	**314,674**	**307,517**
Market risk	5,191	5,899
Operational risk	34,749	33,332
Interest rate risk in the banking book	7,464	4,643
Total risk-weighted assets	**362,078**	**351,391**

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

(2) *Subject to Basel III capital reforms, all equity investments held by the Level 2 Group are treated as a deduction from capital and no longer attract RWA.*

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

Table 4.1B: Capital Ratios

The table below provides the key capital ratios for each significant Authorised Deposit-taking Institution (ADI) or overseas bank subsidiary.

	As at	
	30 Sep 13	31 Mar 13
Capital ratios [(1)]	%	%
Level 2 Common Equity Tier 1 capital ratio	8.43%	8.22%
Level 2 Tier 1 capital ratio	10.35%	10.19%
Level 2 total capital ratio	11.80%	11.71%
Level 1 National Australia Bank Common Equity Tier 1 capital ratio	9.46%	9.33%
Level 1 National Australia Bank Tier 1 capital ratio	11.51%	11.39%
Level 1 National Australia Bank total capital ratio	13.02%	12.99%
Significant subsidiaries		
BNZ Common Equity Tier 1 capital ratio	8.86%	8.73%
BNZ Tier 1 capital ratio	10.67%	10.68%
BNZ total capital ratio	12.59%	12.76%
Clydesdale Tier 1 capital ratio	12.03%	11.78%
Clydesdale total capital ratio	18.29%	17.76%
GWB Tier 1 capital ratio	12.92%	12.40%
GWB total capital ratio	13.83%	13.58%

(1) Level 1 Group represents the extended licence entity. The Level 2 Group represents the consolidation of the NAB Group and all its subsidiary entities, other than non-consolidated subsidiaries as outlined in Section 2 Scope of Application of this report. Capital ratios for offshore banking subsidiaries reflect host regulator discretions. The BNZ capital ratios are calculated in accordance with the Basel III capital adequacy standards, which apply from 1 January 2013, whereas the capital ratios for Clydesdale and GWB have been calculated in line with their local regulatory framework that do not reflect the new capital requirements of Basel III.

4.2 Capital Structure

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

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

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

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

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

	As at	
	30 Sep 13	**31 Mar 13**
	$m	**$m**
Common Equity Tier 1 capital before regulatory adjustments	42,595	40,620
Total regulatory adjustments to Common Equity Tier 1	12,064	11,753
Common Equity Tier 1 Capital (CET1)	**30,531**	**28,867**
Additional Tier 1 Capital before regulatory adjustments	6,949	6,950
Total regulatory adjustments to Additional Tier 1 capital	-	-
Additional Tier 1 capital (AT1)	**6,949**	**6,950**
Tier 1 capital (T1 = CET1 + AT1)	**37,480**	**35,817**
Tier 2 Capital before regulatory adjustments	5,471	5,529
Total regulatory adjustments to Tier 2 capital	218	186
Tier 2 capital (T2)	**5,253**	**5,344**
Total capital (TC = T1 + T2)	**42,733**	**41,161**

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

5. Credit Risk

5.1 General Disclosure

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

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

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

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

Structure and Organisation

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

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

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

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

Management

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

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

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

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

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

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

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

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

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

Measurement

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

Monitoring and Reporting

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

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

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

Definitions of Default and Impairment

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

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

Impaired facilities consist of:

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

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

Specific provisions

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

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

Collective provisions

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

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

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

The NAB Group's collective provision is disclosed in the National Australia Bank Limited 30 September 2013 Annual Financial Report.

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

General reserve for credit losses

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

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

Write-offs

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

Table 5.1A: Credit Risk Exposures Summary

This table provides the amount of gross credit risk exposure subject to the Standardised and Advanced IRB approaches. The Level 2 Group has no credit risk exposures subject to the Foundation IRB approach. Gross credit risk exposure refers to the potential exposure as a result of a counterparty default before the application of credit risk mitigation. It is defined as the outstanding amount on drawn commitments plus a credit conversion factor on undrawn commitments on a given facility. For derivatives, the exposure is defined as the mark-to-market value plus a potential value of future movements.

For the IRB approach, Exposure at Default (EaD) is reported gross of specific provisions and partial write-offs and before the application of on-balance sheet netting and credit risk mitigation. For the Standardised approach, EaD is reported net of any specific provision and before the application of on-balance sheet netting and credit risk mitigation. Exposures exclude non-lending assets, equities, securitisation, Credit Value Adjustment (CVA) and the Central Counterparty (CCP) default fund contribution guarantee.

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

	As at 30 Sep 13					6 months ended 30 Sep 13
	Total exposure (EaD) (2)	Risk-weighted Assets	Regulatory expected loss	Impaired facilities (3)	Specific provisions (4)	Net write-offs
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach						
Corporate (including SME)	211,440	105,115	2,160	1,677	499	519
Sovereign	43,846	1,452	2	-	-	-
Bank	60,092	11,785	23	19	-	-
Residential mortgage	298,529	59,527	886	652	148	73
Qualifying revolving retail	11,095	3,725	240	-	-	97
Retail SME	16,876	6,731	238	163	81	44
Other retail	4,547	3,343	136	7	3	39
Total IRB approach	**646,425**	**191,678**	**3,685**	**2,518**	**731**	**772**
Specialised lending (SL)	**65,211**	**53,193**	**2,958**	**2,971**	**997**	**266**
Standardised approach						
Australian and foreign governments	4,071	66	-	31	-	-
Bank	10,458	265	-	-	-	-
Residential mortgage	38,023	17,463	-	150	32	9
Corporate	45,928	23,973	-	670	264	84
Other	3,744	3,206	-	7	6	30
Total standardised approach	**102,224**	**44,973**	**-**	**858**	**302**	**123**
Total	**813,860**	**289,844**	**6,643**	**6,347**	**2,030**	**1,161**

(1) *The General Reserve for Credit Losses (GRCL) at 30 September 2013 is calculated as follows:*

	$m
Collective provision for doubtful debts	*2,959*
Less collective provisions reported as additional regulatory specific provisions	*(459)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	*2,500*
Plus reserve created through a deduction from retained earnings	*539*
General reserve for credit losses (after-tax basis)	*3,039*

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

(3) *Impaired facilities includes $126 million of restructured loans (March 2013: $114 million) which includes $22 million of restructured fair value assets (March 2013: $nil million).*

Impaired facilities includes $533 million of gross impaired loans at fair value (March 2013: $341 million).

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

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

Specific provisions includes $190 million (March 2013: $126 million) of specific provisions on gross impaired loans at fair value.

	As at 31 Mar 13					6 months ended 31 Mar 13
	Total exposure (EaD)	Risk-weighted Assets	Regulatory expected loss	Impaired facilities	Specific provisions	Net write-offs
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach						
Corporate (including SME)	201,813	105,166	3,564	1,732	702	317
Sovereign	34,561	1,127	2	-	-	-
Bank	61,091	10,755	67	28	-	-
Residential mortgage	287,324	58,062	998	691	160	43
Qualifying revolving retail	11,199	4,022	231	-	-	87
Retail SME	17,083	6,873	300	171	87	28
Other retail	4,463	3,446	134	10	5	43
Total IRB approach	**617,534**	**189,451**	**5,296**	**2,632**	**954**	**518**
Specialised lending (SL)	**66,309**	**54,192**	**3,006**	**2,676**	**797**	**308**
Standardised approach						
Australian and foreign governments	3,585	55	-	30	-	-
Bank	9,359	235	-	-	-	-
Residential mortgage	31,170	14,945	-	117	25	8
Corporate	49,023	21,771	-	640	231	104
Other	3,279	2,803	-	6	2	38
Total standardised approach	**96,416**	**39,809**	**-**	**793**	**258**	**150**
Total	**780,259**	**283,452**	**8,302**	**6,101**	**2,009**	**976**

(1) *The General Reserve for Credit Losses (GRCL) at 31 March 2013 is calculated as follows:*

	$m
Collective provision for doubtful debts	*3,049*
Less collective provisions reported as additional regulatory specific provisions	*(481)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	*2,568*
Plus reserve created through a deduction from retained earnings	*544*
General reserve for credit losses (after-tax basis)	*3,112*

Credit Exposures by Measurement Approach

Table 5.1B: Total and Average Credit Risk Exposures

This table provides the amount of gross credit risk exposure subject to the Standardised and Advanced IRB approaches. The Level 2 Group has no credit risk exposures subject to the Foundation IRB approach. Gross credit risk exposure refers to the potential exposure as a result of a counterparty default prior to the application of credit risk mitigation. It is defined as the outstanding amount on drawn commitments plus a credit conversion factor on undrawn commitments on a given facility. For derivatives, the exposure is defined as the mark-to-market value plus a potential value of future movements. The average credit risk exposure is the sum of the gross credit risk exposure at the beginning of the reporting period plus the gross credit risk exposure at the end of the reporting period divided by two.

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

	As at 30 Sep 13				6 months ended 30 Sep 13
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Total exposure	Average total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	117,941	47,997	45,502	211,440	206,626
Sovereign	32,834	694	10,318	43,846	39,204
Bank	27,541	1,177	31,374	60,092	60,591
Residential mortgage	257,439	41,090	-	298,529	292,927
Qualifying revolving retail	5,452	5,643	-	11,095	11,147
Retail SME	13,211	3,665	-	16,876	16,979
Other retail	3,250	1,297	-	4,547	4,505
Total IRB approach	**457,668**	**101,563**	**87,194**	**646,425**	**631,979**
Specialised lending (SL)	**56,379**	**7,246**	**1,586**	**65,211**	**65,760**
Standardised approach					
Australian and foreign governments	3,901	170	-	4,071	3,828
Bank	10,425	25	8	10,458	9,909
Residential mortgage	35,169	2,854	-	38,023	34,597
Corporate	21,240	3,002	21,686	45,928	47,475
Other	3,569	175	-	3,744	3,512
Total standardised approach	**74,304**	**6,226**	**21,694**	**102,224**	**99,321**
Total	**588,351**	**115,035**	**110,474**	**813,860**	**797,060**

	As at 31 Mar 13				6 months ended 31 Mar 13
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Total exposure	Average total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	116,461	46,676	38,676	**201,813**	**195,566**
Sovereign	27,534	744	6,283	**34,561**	**36,799**
Bank	27,031	855	33,205	**61,091**	**60,138**
Residential mortgage	247,946	39,378	-	**287,324**	**283,327**
Qualifying revolving retail	5,641	5,558	-	**11,199**	**11,173**
Retail SME	13,365	3,718	-	**17,083**	**17,225**
Other retail	3,265	1,198	-	**4,463**	**4,476**
Total IRB approach	**441,243**	**98,127**	**78,164**	**617,534**	**608,704**
Specialised lending (SL)	**56,825**	**7,661**	**1,823**	**66,309**	**63,350**
Standardised approach					
Australian and foreign governments	3,439	146	-	**3,585**	**3,710**
Bank	9,310	25	24	**9,359**	**10,244**
Residential mortgage	29,305	1,865	-	**31,170**	**33,665**
Corporate	19,337	2,701	26,985	**49,023**	**39,210**
Other	3,130	149	-	**3,279**	**3,400**
Total standardised approach	**64,521**	**4,886**	**27,009**	**96,416**	**90,229**
Total	**562,589**	**110,674**	**106,996**	**780,259**	**762,283**

Table 5.1C: Exposures by Geography

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

	As at 30 Sep 13				
	Australia	United Kingdom	New Zealand	Other [(1)]	Total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	143,194	26,491	28,199	13,556	211,440
Sovereign	33,372	1,775	3,728	4,971	43,846
Bank	27,822	18,842	3,645	9,783	60,092
Residential mortgage	269,517	-	29,012	-	298,529
Qualifying revolving retail	11,095	-	-	-	11,095
Retail SME	15,007	-	1,869	-	16,876
Other retail	2,280	-	2,267	-	4,547
Total IRB approach	**502,287**	**47,108**	**68,720**	**28,310**	**646,425**
Specialised lending (SL)	**49,212**	**9,433**	**5,584**	**982**	**65,211**
Standardised approach					
Australian and foreign governments	-	1,923	-	2,148	4,071
Bank	-	10,209	-	249	10,458
Residential mortgage	1,419	33,600	3	3,001	38,023
Corporate	4,171	25,968	18	15,771	45,928
Other	1,084	2,431	-	229	3,744
Total standardised approach	**6,674**	**74,131**	**21**	**21,398**	**102,224**
Total exposure (EaD)	**558,173**	**130,672**	**74,325**	**50,690**	**813,860**

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

	As at 31 Mar 13				
	Australia	United Kingdom	New Zealand	Other	Total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	141,452	24,837	24,950	10,574	201,813
Sovereign	24,839	2,961	2,997	3,764	34,561
Bank	31,196	17,222	2,835	9,838	61,091
Residential mortgage	261,692	-	25,632	-	287,324
Qualifying revolving retail	11,199	-	-	-	11,199
Retail SME	15,356	-	1,727	-	17,083
Other retail	2,359	-	2,104	-	4,463
Total IRB approach	**488,093**	**45,020**	**60,245**	**24,176**	**617,534**
Specialised lending (SL)	**50,789**	**9,224**	**5,158**	**1,138**	**66,309**
Standardised approach					
Australian and foreign governments	-	1,663	-	1,922	3,585
Bank	-	9,206	-	153	9,359
Residential mortgage	1,527	27,083	4	2,556	31,170
Corporate	4,050	26,400	13	18,560	49,023
Other	1,032	2,041	-	206	3,279
Total standardised approach	**6,609**	**66,393**	**17**	**23,397**	**96,416**
Total exposure (EaD)	**545,491**	**120,637**	**65,420**	**48,711**	**780,259**

Table 5.1D: Exposures by Industry

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

	As at 30 Sep 13												
	Accommodation, cafes, pubs and restaurants	Agriculture, forestry, fishing and mining	Business services and property services	Commercial property	Construction	Finance and insurance	Manufacturing	Personal	Residential mortgages	Retail and wholesale trade	Transport and storage	Other [(2)]	Total
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach													
Corporate (including SME)	7,649	38,093	11,400	10,959	7,226	55,569	18,411	310	-	24,380	13,210	24,233	211,440
Sovereign	-	-	-	-	-	15,810	-	-	-	-	-	28,036	43,846
Bank	-	-	-	-	-	58,945	-	-	-	-	-	1,147	60,092
Residential mortgage	-	-	-	-	-	-	-	-	298,529	-	-	-	298,529
Qualifying revolving retail	-	-	-	-	-	-	-	11,095	-	-	-	-	11,095
Retail SME	973	3,955	2,119	504	1,859	787	1,104	104	-	3,023	814	1,634	16,876
Other retail	-	-	-	-	-	-	-	4,547	-	-	-	-	4,547
Total IRB approach	**8,622**	**42,048**	**13,519**	**11,463**	**9,085**	**131,111**	**19,515**	**16,056**	**298,529**	**27,403**	**14,024**	**55,050**	**646,425**
Specialised lending (SL)	**25**	**198**	**112**	**57,057**	**732**	**342**	**119**	**44**	**-**	**9**	**1,831**	**4,742**	**65,211**
Standardised approach													
Australian and foreign governments	-	-	-	20	-	1,581	-	-	-	-	-	2,470	4,071
Bank	-	-	-	-	-	10,458	-	-	-	-	-	-	10,458
Residential mortgage	-	-	-	-	-	-	-	-	38,023	-	-	-	38,023
Corporate	1,759	4,479	2,324	1,293	650	22,515	2,610	23	-	3,097	914	6,264	45,928
Other	3	6	18	3	8	1	6	3,640	-	13	2	44	3,744
Total standardised approach	**1,762**	**4,485**	**2,342**	**1,316**	**658**	**34,555**	**2,616**	**3,663**	**38,023**	**3,110**	**916**	**8,778**	**102,224**
Total exposure (EaD)	**10,409**	**46,731**	**15,973**	**69,836**	**10,475**	**166,008**	**22,250**	**19,763**	**336,552**	**30,522**	**16,771**	**68,570**	**813,860**

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

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

	As at 31 Mar 13												
	Accommodation cafes, pubs and restaurants	Agriculture, forestry, fishing and mining	Business services and property services	Commercial property	Construction	Finance and insurance	Manufacturing	Personal	Residential mortgages	Retail and wholesale trade	Transport and storage	Other	Total
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach													
Corporate (including SME)	7,969	36,403	11,357	10,289	7,250	48,894	18,756	341	-	24,555	11,984	24,015	201,813
Sovereign	-	-	-	-	-	10,410	-	-	-	-	-	24,151	34,561
Bank	-	-	-	-	-	59,858	-	-	-	-	-	1,233	61,091
Residential mortgage	-	-	-	-	-	-	-	-	287,324	-	-	-	287,324
Qualifying revolving retail	-	-	-	-	-	-	-	11,199	-	-	-	-	11,199
Retail SME	1,009	3,974	2,147	560	1,873	765	1,098	96	-	3,091	825	1,645	17,083
Other retail	-	-	-	-	-	-	-	4,463	-	-	-	-	4,463
Total IRB approach	**8,978**	**40,377**	**13,504**	**10,849**	**9,123**	**119,927**	**19,854**	**16,099**	**287,324**	**27,646**	**12,809**	**51,044**	**617,534**
Specialised lending (SL)	**30**	**227**	**216**	**58,240**	**721**	**399**	**117**	**6**	**-**	**16**	**1,811**	**4,526**	**66,309**
Standardised approach													
Australian and foreign governments	-	-	-	18	-	1,450	-	-	-	-	-	2,117	3,585
Bank	-	-	-	-	-	9,359	-	-	-	-	-	-	9,359
Residential mortgage	-	-	-	-	-	-	-	-	31,170	-	-	-	31,170
Corporate	1,769	3,717	2,297	1,186	620	27,580	2,362	23	-	2,908	830	5,731	49,023
Other	3	4	15	3	7	1	5	3,170	-	11	2	58	3,279
Total standardised approach	**1,772**	**3,721**	**2,312**	**1,207**	**627**	**38,390**	**2,367**	**3,193**	**31,170**	**2,919**	**832**	**7,906**	**96,416**
Total exposure (EaD)	**10,780**	**44,325**	**16,032**	**70,296**	**10,471**	**158,716**	**22,338**	**19,298**	**318,494**	**30,581**	**15,452**	**63,476**	**780,259**

Table 5.1E: Exposures by Maturity

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

	As at 30 Sep 13			
	<12 months	1 – 5 years	>5 years	No specified maturity [1]
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	93,003	90,496	21,933	6,008
Sovereign	17,802	6,125	19,871	48
Bank	40,519	10,112	9,398	63
Residential mortgage	45,734	7,377	244,876	542
Qualifying revolving retail	-	-	-	11,095
Retail SME	5,692	6,897	3,630	657
Other retail	188	1,204	757	2,398
Total IRB approach	**202,938**	**122,211**	**300,465**	**20,811**
Specialised lending (SL)	**25,017**	**31,852**	**5,775**	**2,567**
Standardised approach				
Australian and foreign governments	457	130	3,434	50
Bank	8,278	229	91	1,860
Residential mortgage	2,896	3,906	31,137	84
Corporate	30,344	8,776	6,391	417
Other	1,193	1,422	233	896
Total standardised approach	**43,168**	**14,463**	**41,286**	**3,307**
Total exposure (EaD)	**271,123**	**168,526**	**347,526**	**26,685**

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

	As at 31 Mar 13			
	<12 months	1 – 5 years	>5 years	No specified maturity
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	83,592	90,287	21,876	6,058
Sovereign	12,135	5,133	17,222	71
Bank	42,741	11,035	7,197	118
Residential mortgage	47,010	7,500	232,321	493
Qualifying revolving retail	-	-	-	11,199
Retail SME	5,711	7,057	3,687	628
Other retail	205	1,165	899	2,194
Total IRB approach	**191,394**	**122,177**	**283,202**	**20,761**
Specialised lending (SL)	**24,575**	**32,854**	**6,308**	**2,572**
Standardised approach				
Australian and foreign governments	391	154	3,013	27
Bank	7,581	166	152	1,460
Residential mortgage	2,059	3,312	25,751	48
Corporate	35,573	7,928	5,245	277
Other	1,099	1,230	192	758
Total standardised approach	**46,703**	**12,790**	**34,353**	**2,570**
Total exposure (EaD)	**262,672**	**167,821**	**323,863**	**25,903**

Credit Provisions and Losses

Table 5.1F: Provisions by Asset Class

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

	As at 30 Sep 13			6 months ended 30 Sep 13	
	Impaired facilities (2)	Past due facilities ≥90 days	Specific provisions (3)	Charges for specific provisions	Net write-offs
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	1,677	358	499	348	519
Sovereign	-	-	-	-	-
Bank	19	-	-	-	-
Residential mortgage	652	1,190	148	58	73
Qualifying revolving retail	-	81	-	93	97
Retail SME	163	108	81	35	44
Other retail	7	58	3	38	39
Total IRB approach	**2,518**	**1,795**	**731**	**572**	**772**
Specialised lending (SL)	**2,971**	**375**	**997**	**346**	**266**
Standardised approach					
Australian and foreign governments	31	14	-	-	-
Bank	-	-	-	-	-
Residential mortgage	150	119	32	13	9
Corporate	670	127	264	99	84
Other	7	33	6	44	30
Total standardised approach	**858**	**293**	**302**	**156**	**123**
Total	**6,347**	**2,463**	**2,030**	**1,074**	**1,161**

(1) *The General Reserve for Credit Losses (GRCL) at 30 September 2013 is calculated as follows:*

	$m
Collective provision for doubtful debts	*2,959*
Less collective provisions reported as additional regulatory specific provisions	*(459)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	*2,500*
Plus reserve created through a deduction from retained earnings	*539*
General reserve for credit losses (after-tax basis)	*3,039*

(2) *Impaired facilities includes $126 million of restructured loans (March 2013: $114 million) which includes $22 million of restructured fair value assets (March 2013: $nil million).*

Impaired facilities includes $533 million of gross impaired fair value assets (March 2013: $341 million).

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

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

Specific provisions includes $190 million (March 2013: $126 million) of specific provisions on gross impaired loans at fair value.

	As at 31 Mar 13			6 months ended 31 Mar 13	
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	Charges for specific provisions	Net write-offs
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	1,732	362	702	315	317
Sovereign	-	-	-	-	-
Bank	28	-	-	-	-
Residential mortgage	691	1,236	160	49	43
Qualifying revolving retail	-	72	-	89	87
Retail SME	171	118	87	25	28
Other retail	10	45	5	39	43
Total IRB approach	**2,632**	**1,833**	**954**	**517**	**518**
Specialised lending (SL)	**2,676**	**469**	**797**	**406**	**308**
Standardised approach					
Australian and foreign governments	30	17	-	-	-
Bank	-	-	-	-	-
Residential mortgage	117	120	25	10	8
Corporate	640	132	231	120	104
Other	6	21	2	42	38
Total standardised approach	**793**	**290**	**258**	**172**	**150**
Total	**6,101**	**2,592**	**2,009**	**1,095**	**976**

(1) *The General Reserve for Credit Losses (GRCL) at 31 March 2013 is calculated as follows:*

	$m
Collective provision for doubtful debts	*3,049*
Less collective provisions reported as additional regulatory specific provisions	*(481)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses	*2,568*
Plus reserve created through a deduction from retained earnings	*544*
General reserve for credit losses (after-tax basis)	*3,112*

Factors Impacting Loss Experience in the Preceding Period

Non-Impaired facilities 90+ Days Past Due

90+ Days Past Due (90+ DPD) facilities reduced marginally during the September 2013 half year mainly in the IRB portfolio and Specialised Lending.

The reduction was mostly evident in the IRB Mortgage and Specialised Lending asset classes in Business Banking due to the migration of defaulted assets to impaired status and a lower level of new assets being classified as 90+ DPD. In local currency terms, the UK Banking and NAB UK CRE portfolios also experienced a lower level of 90+ DPD facilities as an outcome of the stabilisation of operating conditions, run-off activity and the migration of exposures to impaired status.

The above reductions have been partially offset by an increase in the level of 90+ DPD facilities in Personal Banking.

Impaired facilities

Impaired facilities increased during the September 2013 half year. This was driven by increased impairments in Specialised Lending and the Standardised portfolio, partially offset by a general reduction across the IRB asset classes.

The increase in Specialised Lending impaired facilities was partly due to a single large impairment in Wholesale Banking during the June 2013 quarter.

In addition, the NAB UK CRE portfolio has also experienced a rise in impaired facilities, which was mainly a result of the foreign exchange movements following the weakening of the AUD during the September 2013 half year. In local currency terms, there has been a reduction in impaired facilities in the NAB UK CRE portfolio, reflecting a stabilisation of operating conditions during the September 2013 half year.

In Business Banking, a reduction in impaired facilities occurred in the IRB portfolio and in Specialised Lending mainly due to successful work-outs of long-term problem loans and higher write-offs.

Charges for specific provisions

During the September 2013 half year, total charges for specific provisions reduced marginally compared to the March 2013 half year. The decrease was observed mainly in Specialised Lending and in the Standardised Corporate portfolio, partially offset by an increase across the IRB portfolio.

The reduction in charges for specific provisions was the net impact of:

- a decline in new impaired facilities and increased write-offs in Business Banking. Although a reduction in charges for specific provisions was experienced in Specialised Lending, this was partially offset by higher charges in the Corporate (including SME) portfolio
- a decrease in charges for specific provisions in the UK Banking and NAB UK CRE portfolios, as challenging operating conditions have shown signs of stabilisation during the September 2013 half year
- a single large impairment in Wholesale Banking.

Net Write-Offs

Net write-offs increased during the September 2013 half year in the IRB portfolio predominantly in the Corporate (including SME) and Residential Mortgage asset classes in Business Banking. This was partially offset by lower write-offs in the UK Banking and NAB UK CRE portfolios.

Table 5.1G (i): Loss Experience

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

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

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

	As at 30 Sep 13	
	Exposure weighted average actual loss (net write-offs) [(1)]	**Exposure weighted average regulatory expected loss** [(2)]
	$m	**$m**
IRB approach		
Corporate (including SME)	792	3,195
Sovereign	-	14
Bank	12	80
Residential mortgage	120	830
Qualifying revolving retail	192	221
Retail SME	82	312
Other retail	95	152
Total IRB approach	**1,293**	**4,804**

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

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

	As at 31 Mar 13	
	Exposure weighted average actual loss (net write-offs) [(1)]	**Exposure weighted average regulatory expected loss** [(2)]
	$m	**$m**
IRB approach		
Corporate (including SME)	850	3,090
Sovereign	-	2
Bank	12	67
Residential mortgage	130	830
Qualifying revolving retail	184	235
Retail SME	82	316
Other retail	94	161
Total IRB approach	**1,352**	**4,701**

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

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

Accuracy of Risk Estimates

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

A full explanation of the Internal Ratings Process and the application of credit risk models to calculate Probability of Default (PD), Exposure at Default (EaD) and Loss Given Default (LGD) is provided within Section 5.3 of this report.

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

This table provides a comparison of internal estimates of long-run PD with actual default rates averaged over a period of four years to 30 September 2013. Averages of actual and estimated PD are calculated from customers not in default at the beginning of the financial year and averaged out over the four year observation period. The EaD ratio compares the estimated downturn EaD at the beginning of the financial year against the actual default amount.

	As at 30 Sep 13		
	Average Estimated PD %	Average Actual PD %	Ratio of estimated to actual EAD
IRB approach			
Corporate (including SME)	1.83	2.24	1.1
Sovereign [(1)]	0.39	0.20	1.3
Bank [(1)]	0.30	0.26	1.1
Residential mortgage [(2)]	0.94	0.88	1.0
Qualifying revolving retail	1.60	1.57	1.0
Retail SME	1.98	2.38	1.1
Other retail	2.28	2.88	1.0

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

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

	As at 31 Mar 13		
	Average Estimated PD [(1)] %	Average Actual PD [(1)] %	Ratio of estimated to actual EAD
IRB approach			
Corporate (including SME)	1.83	2.18	1.0
Sovereign	0.39	0.18	1.1
Bank	0.30	0.40	1.0
Residential mortgage	1.02	0.83	1.0
Qualifying revolving retail	1.70	1.45	1.1
Retail SME	1.97	2.27	1.1
Other retail	2.39	2.79	1.0

(1) *These values provide a comparison of internal estimates of long-run PD with actual default rates averaged over a period of four years to 31 March 2013.*

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

This table provides comparison of internal estimates of downturn LGD with actual losses which were evidenced during the four years to 30 September 2013. Actual LGD was calculated using net write-offs from defaults during the four year observation period with the most recent defaults excluded to allow sufficient time for the workout of the asset and recognition of any losses. For defaults relating to qualifying revolving retail and other retail, this period is the most recent twelve months and for all other asset classes the period is the most recent two years. Estimates are calculated using the downturn LGD at the beginning of the financial year.

	As at 30 Sep 13	
	Average estimated downturn LGD	Average actual LGD
	%	%
IRB approach		
Corporate (including SME) [(1)]	35.9	27.7
Sovereign [(2)]	45.0	-
Bank [(2)]	-	-
Residential mortgage [(3)]	20.7	2.9
Qualifying revolving retail	87.1	68.4
Retail SME	37.1	22.0
Other retail	75.1	54.0

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

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

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

	As at 31 Mar 13	
	Average estimated downturn LGD [(1)]	Average actual LGD [(1)]
	%	%
IRB approach		
Corporate (including SME)	36.5	23.1
Sovereign	45.0	-
Bank	59.6	-
Residential mortgage	20.7	3.7
Qualifying revolving retail	87.2	67.9
Retail SME	38.1	19.3
Other retail	72.8	53.3

(1) *These values provide a comparison of internal estimates of downturn LGD with actual losses which were evidenced during the four years to 31 March 2013.*

Table 5.1H: Provisions by Industry

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

	As at 30 Sep 13			6 months ended 30 Sep 13	
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	Charges for specific provisions	Net write-offs
	$m	$m	$m	$m	$m
Industry sector					
Accommodation, cafes, pubs and restaurants	328	46	136	71	69
Agriculture, forestry, fishing and mining	663	130	160	117	99
Business services and property services	242	84	70	54	71
Commercial property	2,724	425	858	321	289
Construction	241	53	98	37	49
Finance and insurance	121	40	45	3	19
Manufacturing	278	46	94	79	82
Personal	13	163	11	149	167
Residential mortgages	802	1,309	180	71	82
Retail and wholesale trade	221	80	116	20	115
Transport and storage	109	19	23	19	41
Other	605	68	239	133	78
Total	**6,347**	**2,463**	**2,030**	**1,074**	**1,161**

Additional regulatory specific provision			459

	As at 31 Mar 13			6 months ended 31 Mar 13	
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	Charges for specific provisions	Net write-offs
	$m	$m	$m	$m	$m
Industry sector					
Accommodation, cafes, pubs and restaurants	334	50	129	63	60
Agriculture, forestry, fishing and mining	554	177	147	97	53
Business services and property services	210	56	86	61	61
Commercial property	2,589	509	756	403	296
Construction	281	56	83	60	22
Finance and insurance	160	27	37	(2)	3
Manufacturing	296	37	96	58	122
Personal	13	142	11	154	164
Residential mortgages	808	1,356	185	59	51
Retail and wholesale trade	362	79	217	83	48
Transport and storage	114	28	67	27	45
Other	380	75	195	32	51
Total	**6,101**	**2,592**	**2,009**	**1,095**	**976**

Additional regulatory specific provision			481

Table 5.1I: Provisions by Geography

	As at 30 Sep 13			
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	General reserve for credit losses
	$m	$m	$m	$m
Geographic region				
Australia (1)	3,153	1,707	797	1,743
United Kingdom	2,725	491	1,087	885
New Zealand	360	243	132	258
Other (2)	109	22	14	73
Total	**6,347**	**2,463**	**2,030**	**2,959**

Regulatory specific provisions	459	(459)
Less tax effect		-
Plus reserve created through retained earnings		539
General reserve for credit losses (3)		**3,039**

(1) *The Australian geography contains an economic cycle adjustment.*

(2) *'Other' comprises North America and Asia.*

(3) *The GRCL balance allocated across geographic regions of $2,959 million includes $2,178 million of provisions on loans at amortised cost and $781 million of provisions held on assets at fair value.*

	As at 31 Mar 13			
	Impaired facilities	Past due facilities ≥90 days	Specific provisions	General reserve for credit losses
	$m	$m	$m	$m
Geographic region				
Australia	3,209	1,824	1,034	1,887
United Kingdom	2,457	535	818	861
New Zealand	335	211	141	230
Other	100	22	16	71
Total	**6,101**	**2,592**	**2,009**	**3,049**

Regulatory specific provisions	481	(481)
Less tax effect		-
Plus reserve created through retained earnings		544
General reserve for credit losses (1)		**3,112**

(1) *The GRCL balance allocated across geographic regions of $3,049 million includes $2,291 million of provisions on loans at amortised cost and $758 million of provisions held on assets at fair value.*

Table 5.1J: Movement in Provisions

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

	6 months ended 30 Sep 13	6 months ended 31 Mar 13
	$m	$m
General reserve for credit losses		
Collective provision balance at start of period	2,291	2,346
Total charge to income statement for impairment loss	757	1,042
Net transfer to specific provision	(989)	(1,055)
Recoveries	-	-
Balances written off	-	-
Acquisition of controlled entities	-	-
Foreign currency translation and other adjustments	119	(42)
Collective provision on loans at amortised cost	2,178	2,291
Plus provisions held on assets at fair value [(1)]	781	758
Less additional regulatory specific provisions	(459)	(481)
Less tax effect	-	-
Plus reserve created through retained earnings	539	544
General reserve for credit losses	**3,039**	**3,112**
Specific provisions		
Balance at start of period	1,883	1,873
Net transfer from general reserve for credit losses	989	1,055
Bad debts recovered	73	87
Bad debts written off	(1,234)	(1,063)
Acquisition of controlled entities	-	-
Foreign currency translation and other adjustments	129	(69)
Specific provisions excluding provisions for assets at fair value	1,840	1,883
Specific provisions held on assets at fair value	190	126
Additional regulatory specific provisions	459	481
Total regulatory specific provisions	**2,489**	**2,490**
Total provisions	**5,528**	**5,602**

[(1)] *Provisions held on assets at fair value are presented gross of $14 million regulatory specific provisions for assets held at fair value (March 2013: $15 million).*

5.2 Standardised and Supervisory Slotting Portfolios

Standardised Credit Risk Portfolios

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

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

External Rating Grade Classification

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

Table 5.2A: Standardised Exposures by Risk Weight

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

	As at 30 Sep 13		As at 31 Mar 13	
	Credit exposure before risk mitigation $m	Credit exposure after risk mitigation $m	Credit exposure before risk mitigation $m	Credit exposure after risk mitigation $m
Standardised approach – risk weights				
0%	31,719	13,462	37,029	12,385
2%	3	3	783	783
4%	2,814	2,814	681	681
20%	1,382	1,302	1,231	1,165
35%	27,672	27,472	21,471	21,256
50%	4,703	4,865	4,088	4,225
75%	2,210	2,210	2,264	2,263
100%	31,040	29,884	28,199	27,294
150%	681	673	670	659
Total standardised approach (EaD)	**102,224**	**82,685**	**96,416**	**70,711**

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

Table 5.2B: Standardised Exposures by Risk Grade

	As at 30 Sep 13		As at 31 Mar 13	
Asset class by rating grade	**Credit exposure before risk mitigation $m**	**Credit exposure after risk mitigation $m**	**Credit exposure before risk mitigation $m**	**Credit exposure after risk mitigation $m**
Australian and foreign governments				
Credit rating grade 1	3,613	3,831	3,211	3,411
Credit rating grade 2	14	14	13	13
Unrated	444	8	361	7
Sub-total	4,071	3,853	3,585	3,431
Bank				
Credit rating grade 1	9,912	9,918	8,871	8,877
Credit rating grade 2	296	478	264	425
Credit rating grade 3	38	38	37	37
Unrated	212	24	187	20
Sub-total	10,458	10,458	9,359	9,359
Residential mortgage				
Unrated	38,023	37,957	31,170	31,113
Sub-total	38,023	37,957	31,170	31,113
Corporate				
Credit rating grade 2	671	614	724	696
Credit rating grade 3	2	2	2	2
Unrated	45,255	26,121	48,297	22,892
Sub-total	45,928	26,737	49,023	23,590
Other				
Unrated	3,744	3,680	3,279	3,218
Sub-total	3,744	3,680	3,279	3,218
Total standardised approach (EaD)	**102,224**	**82,685**	**96,416**	**70,711**

Portfolios Subject to Supervisory Risk Weights in the IRB Approaches

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

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

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

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

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

Table 5.2C: Supervisory Slotting by Risk Weight

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

	As at	
	30 Sep 13	31 Mar 13
	Exposure after risk mitigation $m	Exposure after risk mitigation $m
IRB supervisory slotting – unexpected loss risk weights		
70%	27,284	27,533
90%	24,203	24,314
115%	7,415	7,932
250%	1,403	1,465
Default	4,671	4,725
Total IRB supervisory slotting (EaD)	**64,976**	**65,969**

5.3 Internal Ratings Based Portfolios

General Disclosure on the Internal Rating Based System (IRB)

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

The NAB Group's internal ratings system measures credit risk using: Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EaD). Distinct PD, EaD and LGD models exist for the retail and non-retail credit portfolios, based on asset categories and customer segments.

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

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

Internal Risk Rating and External Ratings

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

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

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

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

Internal Ratings Process Overview

Probability of Default (PD)

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

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

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

Loss Given Default (LGD)

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

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

Exposure at Default (EaD)

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

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

Use of PD, LGD and EaD

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

Credit Rating System Control

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

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

Non-Retail Credit - Internal Ratings Process

Non-Retail – PD Models

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

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

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

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

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

Non-Retail – EaD Models

EaD is calculated according to the facility type.

EaD = Balance + Credit Conversion Factor x Undrawn Limit

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

Non-Retail – LGD Models

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

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

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

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

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

Retail Credit - Internal Ratings Process

Retail Credit – PD Models

Retail PD models are developed using the following:

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

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

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

Retail Credit – EaD Models

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

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

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

Retail Credit – LGD Models

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

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

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

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

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

Portfolios Subject to IRB Approach

Table 5.3A: Non-Retail Exposure by Risk Grade

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

	As at 30 Sep 13						
	PD risk grade mapping						
External credit rating equivalent	**Aa3 and above**	**A1, A2, A3**	**Baa1, Baa2, Baa3**	**Ba1, Ba2**	**Ba3, B1**	**B2 and below**	**Default**
	0<0.03%	**0.03<0.1%**	**0.1<0.5%**	**0.5<2.0%**	**2.0<5.0%**	**5.0<99.9%**	**100%**
IRB approach	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
Total exposure							
Corporate	-	39,934	77,769	64,949	20,292	5,127	3,369
Sovereign	37,282	5,992	548	13	11	-	-
Bank	-	56,456	2,439	1,024	128	9	36
Total exposure (EaD)	**37,282**	**102,382**	**80,756**	**65,986**	**20,431**	**5,136**	**3,405**
Undrawn commitments							
Corporate	-	9,435	18,932	9,581	2,768	396	158
Sovereign	309	247	116	3	3	-	-
Bank	-	797	178	4	2	-	17
Total undrawn commitments (1)	**309**	**10,479**	**19,226**	**9,588**	**2,773**	**396**	**175**

IRB approach							
Average EaD ($m) (2)							
Corporate	-	1.37	0.63	0.34	0.22	0.19	0.40
Sovereign	22.99	2.27	1.45	0.06	0.03	-	-
Bank	-	1.92	1.36	2.65	1.40	0.14	2.01
Exposure weighted average LGD (%)							
Corporate	-	30.6 %	35.1 %	30.2 %	33.2 %	34.9 %	42.1 %
Sovereign	4.8 %	21.8 %	44.2 %	44.7 %	43.3 %	-	-
Bank	-	37.6 %	42.8 %	13.7 %	58.4 %	2.2 %	39.7 %
Exposure weighted average risk weight (%)							
Corporate	-	17.4 %	41.3 %	58.0 %	82.1 %	128.5 %	152.2 %
Sovereign	1.1 %	11.6 %	58.3 %	83.8 %	118.3 %	-	-
Bank	-	17.4 %	55.7 %	21.2 %	173.6 %	11.1 %	391.5 %

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

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

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	As at 31 Mar 13						
	PD risk grade mapping						
External credit rating equivalent	**Aa3 and above**	**A1, A2, A3**	**Baa1, Baa2, Baa3**	**Ba1, Ba2**	**Ba3, B1**	**B2 and below**	**Default**
	0<0.03%	**0.03<0.1%**	**0.1<0.5%**	**0.5<2.0%**	**2.0<5.0%**	**5.0<99.9%**	**100%**
IRB approach	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
Total exposure							
Corporate	-	33,256	70,936	66,625	20,137	6,041	4,818
Sovereign	29,425	4,832	250	32	22	-	-
Bank	-	56,209	4,015	755	27	-	85
Total exposure (EaD)	**29,425**	**94,297**	**75,201**	**67,412**	**20,186**	**6,041**	**4,903**
Undrawn commitments							
Corporate	-	8,961	19,033	9,189	2,458	489	223
Sovereign	330	299	91	5	4	-	-
Bank	-	730	16	4	1	-	10
Total undrawn commitments	**330**	**9,990**	**19,140**	**9,198**	**2,463**	**489**	**233**

IRB approach							
Average EaD ($m)							
Corporate	-	1.10	0.59	0.36	0.22	0.22	0.50
Sovereign	20.48	1.85	0.82	0.10	0.07	-	-
Bank	-	1.83	1.41	1.81	0.30	-	4.07
Exposure weighted average LGD (%)							
Corporate	-	35.0 %	36.9 %	29.0 %	33.8 %	36.2 %	45.0 %
Sovereign	5.0 %	23.2 %	48.3 %	44.4 %	44.9 %	-	-
Bank	-	35.9 %	25.2 %	18.4 %	40.6 %	-	41.3 %
Exposure weighted average risk weight (%)							
Corporate	-	20.3 %	42.7 %	56.9 %	86.1 %	134.7 %	97.1 %
Sovereign	1.2 %	11.5 %	64.8 %	85.4 %	137.9 %	-	-
Bank	-	16.3 %	31.5 %	29.0 %	155.7 %	-	52.9 %

Table 5.3B: Retail Exposure by Risk Grade

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

	As at 30 Sep 13					
	PD risk grade mapping					
	0<0.1%	**0.1<0.5%**	**0.5<2.0%**	**2.0<5.0%**	**5.0<99.9%**	**100%**
IRB approach	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
Total exposure						
Residential mortgage	83,060	101,817	86,109	16,488	8,827	2,228
Qualifying revolving retail	3,998	3,157	1,928	1,004	919	89
Retail SME	1,531	4,468	6,717	2,680	1,017	463
Other retail	1,198	873	1,194	739	472	71
Total exposure (EaD)	**89,787**	**110,315**	**95,948**	**20,911**	**11,235**	**2,851**
Undrawn commitments						
Residential mortgage	21,775	12,716	6,038	482	73	6
Qualifying revolving retail	3,055	1,885	468	143	80	12
Retail SME	892	1,142	846	259	74	57
Other retail	733	260	189	80	34	1
Total undrawn commitments [(1)]	**26,455**	**16,003**	**7,541**	**964**	**261**	**76**

IRB approach						
Average EaD ($m) [(2)]						
Residential mortgage	0.07	0.27	0.25	0.29	0.37	0.17
Qualifying revolving retail	0.01	0.01	0.01	0.01	0.01	0.01
Retail SME	0.03	0.03	0.04	0.02	0.03	0.02
Other retail	-	0.01	0.01	0.01	-	0.01
Exposure weighted average LGD (%)						
Residential mortgage	20.0 %	20.0 %	20.7 %	20.1 %	20.0 %	20.5 %
Qualifying revolving retail	83.4 %	84.4 %	86.4 %	86.9 %	87.0 %	89.4 %
Retail SME	25.1 %	26.0 %	29.4 %	30.8 %	33.2 %	39.9 %
Other retail	82.9 %	81.0 %	79.4 %	78.4 %	77.6 %	76.3 %
Exposure weighted average risk weight (%)						
Residential mortgage	3.3 %	10.8 %	27.9 %	57.0 %	92.8 %	185.4 %
Qualifying revolving retail	4.2 %	12.0 %	37.3 %	81.9 %	164.7 %	141.7 %
Retail SME	6.2 %	15.4 %	35.2 %	60.0 %	104.0 %	197.6 %
Other retail	14.8 %	42.6 %	89.0 %	116.1 %	146.4 %	257.3 %

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

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

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	As at 31 Mar 13					
	PD risk grade mapping					
	0<0.1%	0.1<0.5%	0.5<2.0%	2.0<5.0%	5.0<99.9%	100%
IRB approach	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
Total exposure						
Residential mortgage	78,223	98,646	81,562	16,532	10,043	2,318
Qualifying revolving retail	4,100	2,980	2,019	1,049	980	71
Retail SME	1,710	4,478	6,607	2,716	1,035	537
Other retail	1,095	827	1,185	781	510	65
Total exposure (EaD)	**85,128**	**106,931**	**91,373**	**21,078**	**12,568**	**2,991**
Undrawn commitments						
Residential mortgage	20,806	12,427	5,618	451	69	7
Qualifying revolving retail	3,084	1,772	477	143	81	1
Retail SME	979	1,148	813	251	64	61
Other retail	664	237	182	79	35	1
Total undrawn commitments	**25,533**	**15,584**	**7,090**	**924**	**249**	**70**

IRB approach						
Average EaD ($m)						
Residential mortgage	0.07	0.27	0.24	0.28	0.37	0.18
Qualifying revolving retail	0.01	0.01	0.01	0.01	0.01	0.01
Retail SME	0.03	0.03	0.04	0.02	0.03	0.03
Other retail	-	0.01	0.01	0.01	-	0.01
Exposure weighted average LGD (%)						
Residential mortgage	20.0 %	20.0 %	20.5 %	20.1 %	20.0 %	20.7 %
Qualifying revolving retail	83.5 %	84.5 %	86.4 %	86.9 %	87.1 %	88.9 %
Retail SME	24.6 %	25.9 %	29.6 %	31.0 %	33.9 %	41.4 %
Other retail	82.6 %	81.0 %	79.0 %	78.8 %	77.2 %	77.4 %
Exposure weighted average risk weight (%)						
Residential mortgage	3.3 %	10.8 %	27.0 %	56.3 %	93.0 %	176.5 %
Qualifying revolving retail	4.1 %	12.1 %	37.5 %	83.4 %	170.1 %	270.8 %
Retail SME	6.1 %	15.4 %	35.7 %	61.2 %	107.0 %	176.4 %
Other retail	14.8 %	42.7 %	88.8 %	116.9 %	145.8 %	341.4 %

5.4 Credit Risk Mitigation

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

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

Collateral Management

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

Collateral commonly includes:

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

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

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

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

Credit Hedging

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

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

Credit Exposure Netting

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

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

Portfolio Management

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

Internal reporting systems are utilised to record all:

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

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

Table 5.4A: Mitigation by Eligible Collateral

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

	As at 30 Sep 13	
	Total exposure	of which is covered by eligible financial collateral [(1)]
	$m	$m
Specialised lending (SL)	65,211	235
Standardised approach		
Australian and foreign governments	4,071	218
Bank	10,458	-
Residential mortgage	38,023	66
Corporate	45,928	19,191
Other	3,744	64
Total standardised approach	102,224	19,539

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

	As at 31 Mar 13	
	Total exposure	of which is covered by eligible financial collateral
	$m	$m
Specialised lending (SL)	66,309	340
Standardised approach		
Australian and foreign governments	3,585	154
Bank	9,359	-
Residential mortgage	31,170	57
Corporate	49,023	25,433
Other	3,279	61
Total standardised approach	96,416	25,705

Table 5.4B: Mitigation by Guarantees and Credit Derivatives

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

	As at 30 Sep 13		
	Total exposure	of which is covered by guarantees	of which is covered by credit derivatives
	$m	$m	$m
IRB approach			
Corporate (including SME)	211,440	20,067	-
Sovereign	43,846	1	-
Bank	60,092	185	335
Residential mortgage	298,529	-	-
Qualifying revolving retail	11,095	-	-
Retail SME	16,876	-	-
Other retail	4,547	-	-
Total IRB approach	**646,425**	**20,253**	**335**
Specialised lending (SL)	**65,211**	**-**	**-**
Standardised approach			
Australian and foreign governments	4,071	436	-
Bank	10,458	191	-
Residential mortgage	38,023	-	-
Corporate	45,928	1	-
Other	3,744	-	-
Total standardised approach	**102,224**	**628**	**-**

	As at 31 Mar 13		
	Total exposure	of which is covered by guarantees	of which is covered by credit derivatives
	$m	$m	$m
IRB approach			
Corporate (including SME)	201,813	20,150	-
Sovereign	34,561	2	-
Bank	61,091	72	333
Residential mortgage	287,324	-	-
Qualifying revolving retail	11,199	-	-
Retail SME	17,083	-	-
Other retail	4,463	-	-
Total IRB approach	**617,534**	**20,224**	**333**
Specialised lending (SL)	**66,309**	**-**	**-**
Standardised approach			
Australian and foreign governments	3,585	354	-
Bank	9,359	169	-
Residential mortgage	31,170	-	-
Corporate	49,023	-	-
Other	3,279	-	-
Total standardised approach	**96,416**	**523**	**-**

5.5 Counterparty Credit Risk

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

Credit Limits

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

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

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

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

Collateral

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

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

Wrong Way Risk

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

Downgrade Impact

As at 30 September 2013, with respect to counterparty derivatives, the NAB Group would need to post $360 million of collateral in the event of a one notch downgrade to the NAB Group's credit rating, and $487 million in the event of a two notch downgrade.

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

6. Securitisation

Introduction

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

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

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

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

Special Purpose Vehicle

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

Origination

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

The Level 2 Group's assessment and management of securitisation risk is governed by *Prudential Standard APS 120: Securitisation (APS 120).*

Affiliated Entities

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

6.1 Third Party Securitisation

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

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

(1) *Immaterial level of involvement.*

Structure and Organisation

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

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

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

Management

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

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

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

Initial structuring and assessment includes an analysis of matters such as portfolio composition and quality, the level and type of credit enhancement, due diligence on the quality of the servicer of the assets, and specific structural enhancements such as trigger events.

Measurement

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

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

The IAA methodology is applied to the following asset classes:

- residential mortgages
- equipment receivables
- auto loan receivables.

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

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

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

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

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

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

Monitoring and Reporting

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

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

Accounting Treatment

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

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

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

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

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

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

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

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

Securitisation Risks

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

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

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

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

Table 6.1A: Total Securitisation Exposures

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

	As at 30 Sep 13				
	Total outstanding exposures				
	Non-originating ADI exposures	Originating ADI			
		Directly originated assets	Indirectly originated assets	ABCP facilities provided	Other (manager services)
	$m	$m	$m	$m	$m
Underlying asset					
Residential mortgage	13,586	20	-	665	686
Credit cards and other personal loans	-	-	-	41	-
Auto and equipment finance	590	-	-	155	-
CDOs/CLOs [1]	-	-	-	-	1,281
Commercial mortgages	21	-	-	-	69
Corporate bonds	-	-	-	-	604
Other	570	-	-	-	402
Total underlying asset	**14,767**	**20**	**-**	**861**	**3,042**

(1) *As at 30 September 2013, all exposures are traditional securitisations, where the pool of assets is assigned to an SPV, usually by a sale.*

	As at 31 Mar 13				
	Total outstanding exposures				
	Non-originating ADI exposures	Originating ADI			
		Directly originated assets	Indirectly originated assets	ABCP facilities provided	Other (manager services)
	$m	$m	$m	$m	$m
Underlying asset					
Residential mortgage	10,884	25	-	806	700
Credit cards and other personal loans	-	-	-	42	-
Auto and equipment finance	562	-	-	140	-
CDOs/CLOs [1]	-	-	-	-	1,241
Commercial mortgages	21	-	-	-	333
Corporate bonds	-	-	-	-	572
Other	650	-	-	-	368
Total underlying asset	**12,117**	**25**	**-**	**988**	**3,214**

(1) *As at 31 March 2013, all exposures are traditional securitisations, where the pool of assets is assigned to an SPV, usually by a sale.*

Table 6.1B: Type of Exposure

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

	As at 30 Sep 13			As at 31 Mar 13		
	On-balance sheet $m	Off-balance sheet $m	Total $m	On-balance sheet $m	Off-balance sheet $m	Total $m
Securitisation exposure type						
Liquidity facilities	5	2,480	2,485	10	2,828	2,838
Warehouse facilities	7,877	1,990	9,867	6,950	2,063	9,013
Credit enhancements	255	608	863	5	17	22
Derivative transactions	178	-	178	204	-	204
Securities	17	-	17	63	-	63
Credit derivatives transactions	-	-	-	-	-	-
Other	5,297	-	5,297	4,239	-	4,239
Total securitisation exposures	**13,629**	**5,078**	**18,707**	**11,471**	**4,908**	**16,379**

Table 6.1C: Recent Third Party Securitisation Activity

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

	Notional amount of facilities provided	
	6 months ended 30 Sep 13 $m	6 months ended 31 Mar 13 $m
Securitisation exposure type		
Liquidity facilities	296	501
Warehouse facilities	2,043	-
Credit enhancements	850	-
Derivative transactions	22	15
Securities	-	5
Credit derivatives transactions	-	-
Other	2,004	927
Total new facilities provided	**5,215**	**1,448**

Table 6.1D: Exposures by Risk Weight

These tables show the risk weights for securitisation and resecuritisation exposures as calculated under Prudential Standard APS 120: Securitisation, split between the Ratings-Based Approach (RBA), the IAA, and Other.

Securitisation Exposures by Risk Weight

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

	As at 30 Sep 13		As at 31 Mar 13	
Risk weight bands	**Exposure $m**	**RWA $m**	**Exposure $m**	**RWA $m**
RBA				
≤10%	6,730	464	6,304	433
> 10% ≤ 25%	219	27	250	33
> 25% ≤ 35%	37	12	-	-
> 35% ≤ 50%	-	-	-	-
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	-	-	-	-
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
RBA sub-total	**6,986**	**503**	**6,554**	**466**
IAA				
≤10%	3,116	218	2,223	155
> 10% ≤ 25%	4,829	605	3,815	524
> 25% ≤ 35%	376	131	45	16
> 35% ≤ 50%	33	17	14	7
> 50% ≤ 75%	160	119	156	119
> 75% ≤ 100%	228	228	201	201
> 100% ≤ 650%	1	1	1	2
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	2
Deductions	19	-	18	-
IAA sub-total	**8,762**	**1,319**	**6,473**	**1,026**
Other				
≤10%	-	-	-	-
> 10% ≤ 25%	258	42	237	28
> 25% ≤ 35%	34	12	-	-
> 35% ≤ 50%	77	38	107	54
> 50% ≤ 75%	-	-	196	140
> 75% ≤ 100%	722	722	513	513
> 100% ≤ 650%	30	128	243	1,030
> 650% ≤ 850%	-	-	-	-
1250%	166	2,131	190	2,418
Deductions	-	-	-	-
Other sub-total	**1,287**	**3,073**	**1,486**	**4,183**
Total	**17,035**	**4,895**	**14,513**	**5,675**

Resecuritisation Exposures by Risk Weight

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

	As at 30 Sep 13		As at 31 Mar 13	
Risk weight bands	**Exposure $m**	**RWA $m**	**Exposure $m**	**RWA $m**
RBA				
≤10%	-	-	-	-
> 10% ≤ 25%	-	-	-	-
> 25% ≤ 35%	-	-	-	-
> 35% ≤ 50%	-	-	-	-
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	-	-	-	-
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
RBA sub-total	**-**	**-**	**-**	**-**
IAA				
≤10%	-	-	-	-
> 10% ≤ 25%	6	1	208	41
> 25% ≤ 35%	120	36	160	48
> 35% ≤ 50%	4	2	4	2
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	16	78	16	78
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
IAA sub-total	**146**	**117**	**388**	**169**
Other				
≤10%	81	5	74	3
> 10% ≤ 25%	4	1	10	1
> 25% ≤ 35%	7	2	-	-
> 35% ≤ 50%	1,021	409	1,020	408
> 50% ≤ 75%	82	53	-	-
> 75% ≤ 100%	180	180	222	222
> 100% ≤ 650%	21	98	24	121
> 650% ≤ 850%	5	45	-	-
1250%	97	1,213	84	1,034
Deductions	11	-	9	-
Other sub-total	**1,509**	**2,006**	**1,443**	**1,789**
Total	**1,655**	**2,123**	**1,831**	**1,958**

Total Exposures by Risk Weight

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

	As at 30 Sep 13		As at 31 Mar 13	
Risk weight bands	**Exposure $m**	**RWA $m**	**Exposure $m**	**RWA $m**
RBA				
≤10%	6,730	464	6,304	433
> 10% ≤ 25%	219	27	250	33
> 25% ≤ 35%	37	12	-	-
> 35% ≤ 50%	-	-	-	-
> 50% ≤ 75%	-	-	-	-
> 75% ≤ 100%	-	-	-	-
> 100% ≤ 650%	-	-	-	-
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	-
Deductions	-	-	-	-
RBA sub-total	**6,986**	**503**	**6,554**	**466**
IAA				
≤10%	3,116	218	2,223	155
> 10% ≤ 25%	4,835	606	4,023	565
> 25% ≤ 35%	496	167	205	64
> 35% ≤ 50%	37	19	18	9
> 50% ≤ 75%	160	119	156	119
> 75% ≤ 100%	228	228	201	201
> 100% ≤ 650%	17	79	17	80
> 650% ≤ 850%	-	-	-	-
1250%	-	-	-	2
Deductions	19	-	18	-
IAA sub-total	**8,908**	**1,436**	**6,861**	**1,195**
Other				
≤10%	81	5	74	3
> 10% ≤ 25%	262	43	247	29
> 25% ≤ 35%	41	14	-	-
> 35% ≤ 50%	1,098	447	1,127	462
> 50% ≤ 75%	82	53	196	140
> 75% ≤ 100%	902	902	735	735
> 100% ≤ 650%	51	226	267	1,151
> 650% ≤ 850%	5	45	-	-
1250%	263	3,344	274	3,452
Deductions	11	-	9	-
Other sub-total	**2,796**	**5,079**	**2,929**	**5,972**
Total	**18,690**	**7,018**	**16,344**	**7,633**

Table 6.1E: Exposures Deducted from Capital

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

	As at 30 Sep 13					
	Deductions relating to ADI-originated assets securitised				Deductions relating to other securitisation exposures	Total
	Residential mortgage	Credit cards and other personal loans	Commercial loans	Other		
	$m	$m	$m	$m	$m	$m
Securitisation exposures deducted from capital [(1)]						
Deductions from Common Equity Tier 1 Capital	-	-	-	-	30	**30**
Total securitisation exposures deducted from capital	**-**	**-**	**-**	**-**	**30**	**30**

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

	As at 31 Mar 13					
	Deductions relating to ADI-originated assets securitised				Deductions relating to other securitisation exposures	Total
	Residential mortgage	Credit cards and other personal loans	Commercial loans	Other		
	$m	$m	$m	$m	$m	$m
Securitisation exposures deducted from capital						
Deductions from Common Equity Tier 1 Capital	-	-	-	-	27	**27**
Total securitisation exposures deducted from capital	**-**	**-**	**-**	**-**	**27**	**27**

6.2 Level 2 Group Owned Securitised Assets

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

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

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

Structure and Organisation

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

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

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

Management

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

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

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

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

At the Level 2 Group level, Group Treasury is also responsible for the oversight of secured funding plans and strategies, and for ensuring that activities across the Level 2 Group are coordinated and Level 2 Group objectives are achieved.

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

Measurement

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

Monitoring and Reporting

Reporting is conducted periodically including:

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

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

Accounting Treatment

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

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

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

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

Table 6.2A: Assets Securitised by the Level 2 Group

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

	As at 30 Sep 13				
	Total outstanding exposures securitised assets originated by ADI		Impaired assets relating to exposures securitised	Total past due assets from exposures securitised	ADI recognised loss from exposures securitised
	Traditional	Synthetic			
	$m	$m	$m	$m	$m
Underlying asset (1)					
Residential mortgage (2)	47,728	-	116	151	-
Credit cards	-	-	-	-	-
Auto and equipment finance	212	-	3	1	-
Commercial loans	-	-	-	-	-
Other	-	-	-	-	-
Total underlying asset	**47,940**	**-**	**119**	**152**	**-**

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

(2) *Includes internal securitisation pools of residential mortgage-backed securities (RMBS) that have been developed as a source of contingent liquidity to support the Level 2 Group's liquid asset holdings. The amount of these securitised assets is $36,296 million (March 2013: $29,115 million).*

	As at 31 Mar 13				
	Total outstanding exposures securitised assets originated by ADI		Impaired assets relating to exposures securitised	Total past due assets from exposures securitised	ADI recognised loss from exposures securitised
	Traditional	Synthetic			
	$m	$m	$m	$m	$m
Underlying asset					
Residential mortgage	39,574	-	59	81	-
Credit cards	-	-	-	-	-
Auto and equipment finance	294	-	3	1	-
Commercial loans	-	-	-	-	-
Other	-	-	-	-	-
Total underlying asset	**39,868**	**-**	**62**	**82**	**-**

Table 6.2B: Recent Securitisation Activity

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

	6 months ended 30 Sep 13			6 months ended 31 Mar 13		
	Amount securitised during period directly originated	Amount securitised during period indirectly originated	Recognised gain or loss on sale	Amount securitised during period directly originated	Amount securitised during period indirectly originated	Recognised gain or loss on sale
	$m	$m	$m	$m	$m	$m
Underlying asset [(1)]						
Residential mortgage	9,350	-	-	9,323	-	-
Credit cards	-	-	-	-	-	-
Auto and equipment finance	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total underlying asset	**9,350**	**-**	**-**	**9,323**	**-**	**-**

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

Disclosure 6.2C: Securitisation Subject to Early Amortisation

Attachment G of *APS 120* provides for specific regulatory treatment for securitisations of certain types of assets. As at 30 September 2013 and 31 March 2013, none of these securitisations have been undertaken by the Level 2 Group.

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

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

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

There have been no exposures identified for specific external securitisation deals between 30 September 2013 and the disclosure date of this report.

Disclosure 6.2E: Credit Risk Mitigation and Guarantors

APS 330 Table 12n requires disclosure of resecuritisation exposures retained or purchased, broken down according to the application of credit risk mitigation and exposures to guarantors. As at 30 September 2013, the Level 2 Group did not have any resecuritisation exposures to which credit risk mitigation is applied or exposures to guarantors.

7. Market Risk

Introduction

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

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

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

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

Structure and Organisation

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

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

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

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

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

Management

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

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

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

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

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

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

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

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

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

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

Measurement

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

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

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

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

Table 7.1A: Standard Method Risk-Weighted Assets

	As at 30 Sep 13 $m	31 Mar 13 $m
Risk-Weighted Assets		
Interest rate risk	964	989
Equity position risk	1	3
Foreign exchange risk	-	139
Commodity risk	10	9
Total risk-weighted assets - standard method	**975**	**1,140**

Table 7.1B: Total Risk-Weighted Assets

	As at 30 Sep 13 $m	31 Mar 13 $m
Market risk (1)		
Standard method	975	1,140
Internal model approach	4,216	4,759
Total market risk RWA	**5,191**	**5,899**

(1) *Market Risk risk-weighted assets are calculated on a Basel 2.5 basis for each period presented.*

Table 7.1C: Internal Model Approach VaR

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

	6 months ended 30 Sep 13			As at
	Mean value $m	Minimum value $m	Maximum value $m	30 Sep 13 $m
VaR at a 99% confidence level (1)				
Foreign exchange risk	4	1	8	1
Interest rate risk	6	4	12	6
Volatility risk	1	1	2	1
Commodities risk	1	-	2	-
Credit risk	7	5	10	6
Inflation risk	-	-	1	-
Diversification benefit	(8)	n/a	n/a	(6)
Total diversified VaR at a 99% confidence level	**11**	**7**	**14**	**8**
Other market risks (2)	1	-	2	-
Total VaR for physical and derivative positions	**12**	**7**	**16**	**8**

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

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

	6 months ended 31 Mar 13 Mean value $m	Minimum value $m	Maximum value $m	As at 31 Mar 13 $m
VaR at a 99% confidence level				
Foreign exchange risk	3	1	6	2
Interest rate risk	6	2	13	5
Volatility risk	1	-	1	1
Commodities risk	-	-	1	1
Credit risk	8	6	10	6
Inflation risk	1	-	1	-
Diversification benefit	(8)	n/a	n/a	(8)
Total diversified VaR at a 99% confidence level	**11**	**7**	**14**	**7**
Other market risks	1	1	2	2
Total VaR for physical and derivative positions	**12**	**8**	**16**	**9**

Table 7.1D: Internal Model Approach Stressed VaR

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

	6 months ended 30 Sep 13 Mean value $m	Minimum value $m	Maximum value $m	As at 30 Sep 13 $m
Stressed VaR at a 99% confidence level (1)				
Foreign exchange risk	7	1	23	1
Interest rate risk	11	6	17	10
Volatility risk	2	1	4	2
Commodities risk	1	-	3	-
Credit risk	18	11	22	18
Inflation risk	1	1	4	1
Diversification benefit	(18)	n/a	n/a	(12)
Total diversified VaR at a 99% confidence level	**22**	**14**	**30**	**20**
Other market risks (2)	1	-	3	-
Total VaR for physical and derivative positions	**23**	**14**	**33**	**20**

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

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

	6 months ended 31 Mar 13 Mean value $m	Minimum value $m	Maximum value $m	As at 31 Mar 13 $m
Stressed VaR at a 99% confidence level				
Foreign exchange risk	5	1	12	3
Interest rate risk	11	4	21	10
Volatility risk	2	1	3	3
Commodities risk	-	-	1	1
Credit risk	17	12	21	12
Inflation risk	1	1	4	2
Diversification benefit	(15)	n/a	n/a	(12)
Total diversified VaR at a 99% confidence level	**21**	**12**	**31**	**19**
Other market risks	2	1	3	2
Total VaR for physical and derivative positions	**23**	**13**	**34**	**21**

Monitoring and Reporting

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

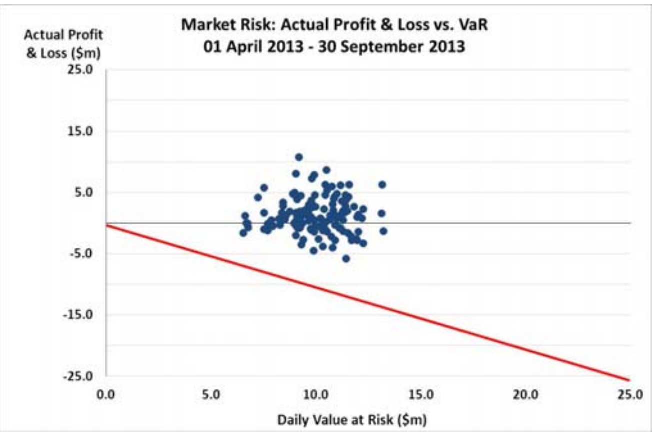
The results of back-testing are reported to senior management, risk committees and the regulators. In addition to back-testing, the risk measurement model and all pricing models are subject to periodical reviews and independent validation at frequencies specified by the Group Model Risk Policy.

Table 7.1E: Back-testing Results

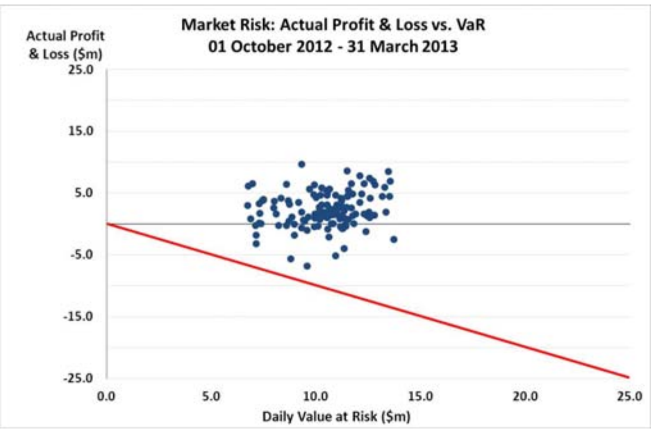
Comparison of VaR estimates to actual gains/losses	6 months ended 30 Sep 13	6 months ended 31 Mar 13
Number of "outliers" incurred for the trading portfolio	-	-

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

6 months ended 30 Sep 13



6 months ended 31 Mar 13



Back-testing Outliers

Back-testing, carried out by comparing the Level 2 Group's daily VaR estimate against actual P&L numbers, identified no exceptions during the six month period to 30 September 2013 and no exceptions during the previous six month period to 31 March 2013. This remains within the model parameters and indicates acceptable operation of the VaR model within APRA's guidelines.

8. Operational Risk

Introduction

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

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

Structure and Organisation

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

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

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

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

Management

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

Implementation of the GORF leads to:

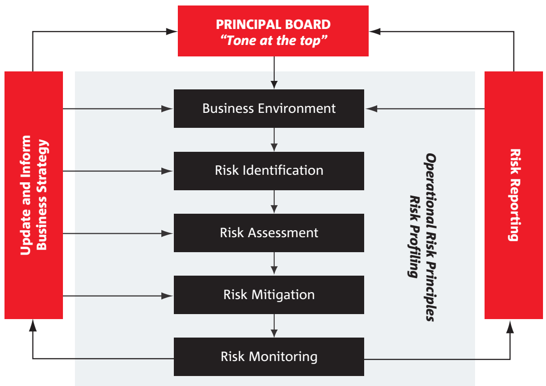
- all staff taking responsibility and ownership for managing the operational risk inherent in their day-to-day activities
- promoting and embedding a risk conscious culture and behaviour throughout the NAB Group
- consistency in the identification, assessment, management, monitoring, measurement and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

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

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

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

The NAB Group's Operational Risk Framework



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

- Business Continuity Management
- Change Risk
- Event Management
- Information Security
- Model Risk
- Operational Risk Profiling
- Outsourcing
- Physical Security
- Travel Security
- Executive protection

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

Measurement

The NAB Group has been accredited to use its internal operational risk models and processes to determine regulatory capital for its Australian, New Zealand and Wholesale Banking operations. The NAB Group uses APRA's standardised approach for Clydesdale and GWB.

The NAB Group's AMA calculation of regulatory capital for operational risk uses data captured from:

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

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

Calculation of Operational Risk Capital

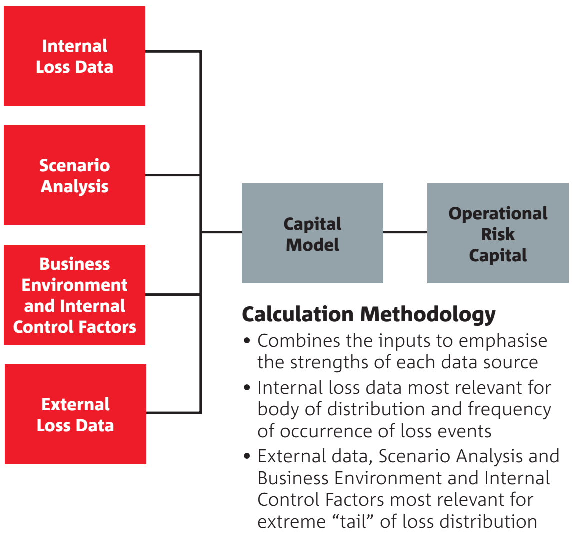


Table 8A: Total Risk-Weighted Assets

	As at 30 Sep 13 $m	As at 31 Mar 13 $m
Operational risk		
Standardised approach	3,738	3,829
Advanced measurement approach	31,011	29,503
Total operational risk RWA	34,749	33,332

Monitoring and Reporting

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

GOR&C provides the following reporting:

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

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

Risk Mitigation through Insurance

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

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

Regulatory and Compliance Management

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

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

9. Non-Traded Market Risk

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

Structure and Organisation

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

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

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

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

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

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

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

9.1 Funding and Liquidity Risk

Introduction

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

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

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

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

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

Management

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

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

The GNTMR Policy, Liquidity and Funding Standards and Group Limits Schedule detail the Board's risk appetite and guiding principles regarding liquidity and funding. In addition, they define the framework to ensure that the Level 2 Group can meet its current and future payment obligations as they become due under diverse operating scenarios and the framework to ensure that Level 2 Group and subsidiary balance sheet management practices do not introduce unacceptable levels of funding risk.

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

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

Measurement

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

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

Monitoring and Reporting

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

Regulatory Change

The revised Prudential Standard for Liquidity Risk (*Prudential Standard APS 210: Liquidity*) will be effective from January 2014. This will include a new regulatory Liquidity Coverage Ratio (LCR) with compliance required from January 2015. The LCR measures the liquidity required in a severe stress scenario over a 30-day period. As part of the NAB Group's funding plan, a key focus is on achieving compliance with the new LCR measure through holding increased liquid assets and ensuring sufficient collateral is available for accessing the Reserve Bank of Australia's Committed Liquidity Facility (CLF).

9.2 Interest Rate Risk in the Banking Book

Introduction

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

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

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

Management

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

The key elements of the management framework for IRRBB include:

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

Measurement

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

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

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

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

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

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

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

Monitoring and Reporting

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

Table 9.2A: Interest Rate Risk in the Banking Book

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

	As at 30 Sep 13		As at 31 Mar 13	
	200 bp parallel increase	200 bp parallel decrease	200 bp parallel increase	200 bp parallel decrease
	$m	$m	$m	$m
Change in economic value (1)				
AUD	(162)	189	(154)	171
CHF	(1)	2	(1)	2
EUR	(17)	18	(21)	21
GBP	(123)	132	(6)	9
HKD	2	(2)	4	(4)
JPY	(1)	1	(1)	1
NZD	(28)	29	7	(7)
USD	84	(48)	57	(15)
Other	12	(12)	7	(7)
Total change in economic value	**(234)**	**309**	**(108)**	**171**

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

Table 9.2B: Total Risk-Weighted Assets

	As at	
	30 Sep 13	31 Mar 13
	$m	$m
IRRBB risk-weighted assets	7,464	4,643

9.3 Equities Banking Book Position

Introduction

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

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

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

Management

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

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

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

Measurement

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

Monitoring and Reporting

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

Monitoring and Reporting Framework

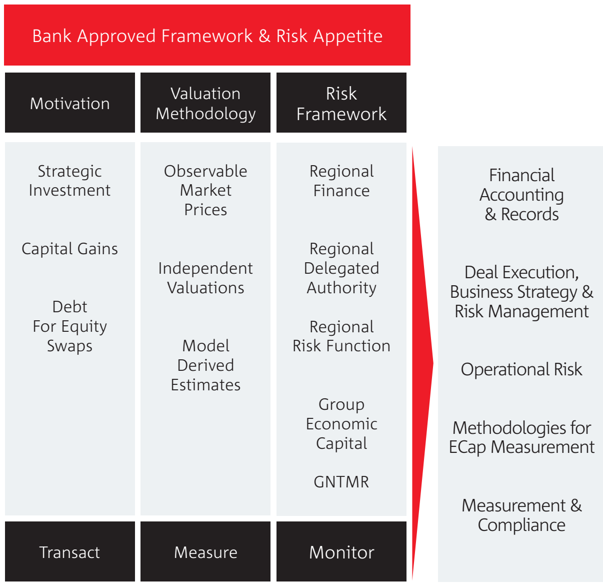


Table 9.3A: Equities Banking Book Position

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

	As at 30 Sep 13		As at 31 Mar 13	
	Carrying value [1]	Fair value [2]	Carrying value	Fair value
	$m	$m	$m	$m
Total listed equities (publicly traded)	89	89	88	84
Total unlisted equities	416	416	469	418

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

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

Table 9.3B: Gains and Losses on Equity Investments

This table provides the realised (actual) gains/losses arising from sales and liquidations in the six months to 30 September 2013 recognised through the profit and loss account. Unrealised (expected) gains/losses which were previously included in Tier 1 and Tier 2 capital represent gains/losses recognised in the balance sheet but not through the profit and loss account.

	6 months ended	
	30 Sep 13	31 Mar 13
	$m	$m
Gains (losses) on equity investments		
Cumulative realised gains (losses) in reporting period	7	(5)
Total unrealised gains (losses)	89	65
Total unrealised gains (losses) included in Common Equity Tier 1, Tier 1 and/or Tier 2 capital	60	67

Disclosure 9.3C: Equity Investments Subject to Grandfathering Provision

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

9.4 Foreign Exchange Risk in the Banking Book

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

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

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

The key elements of the management framework for FXRBB include:

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

10. Detailed Capital Disclosures

10.1 Common Disclosure Template – Regulatory Capital

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

		As at 30 Sep 13 $m
Common Equity Tier 1 Capital: instruments and reserves		
1	Directly issued qualifying ordinary shares (and equivalent for mutually-owned entities) capital	24,964
2	Retained earnings	19,561
3	Accumulated other comprehensive income (and other reserves)	(1,930)
4	Directly issued capital subject to phase out from CET1 (only applicable to mutually-owned companies)	-
5	Ordinary share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-
6	**Common Equity Tier 1 Capital before regulatory adjustments**	**42,595**
Common Equity Tier 1 Capital: regulatory adjustments		
7	Prudential valuation adjustments	1
8	Goodwill (net of related tax liability)	5,132
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	2,293
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	-
11	Cash-flow hedge reserve	120
12	Shortfall of provisions to expected losses	668
13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	-
14	Gains and losses due to changes in own credit risk on fair valued liabilities	(188)
15	Defined benefit superannuation fund net assets	19
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	-
17	Reciprocal cross-holdings in common equity	-
18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the ADI does not own more than 10% of the issued share capital (amount above 10% threshold)	-
19	Significant investments in the ordinary shares of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	-
20	Mortgage service rights (amount above 10% threshold)	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	-
22	Amount exceeding the 15% threshold	-
23	of which: significant investments in the ordinary shares of financial entities	-
24	of which: mortgage servicing rights	-
25	of which: deferred tax assets arising from temporary differences	-
APRA specific regulatory adjustments		
26	National specific regulatory adjustments (sum of rows 26a, 26b, 26c, 26d, 26e, 26f, 26g, 26h, 26i and 26j)	4,019
26a	of which: treasury shares	(9)
26b	of which: offset to dividends declared under a dividend reinvestment plan (DRP), to the extent that the dividends are used to purchase new ordinary shares issued by the ADI	-
26c	of which: deferred fee income	(93)
26d	of which: equity investments in financial institutions not reported in rows 18, 19 and 23	2,241
26e	of which: deferred tax assets not reported in rows 10, 21 and 25	1,637
26f	of which: capitalised expenses	117
26g	of which: investments in commercial (non-financial) entities that are deducted under APRA prudential requirements	96
26h	of which: covered bonds in excess of asset cover in pools	-
26i	of which: undercapitalisation of a non-consolidated subsidiary	-
26j	of which: other national specific regulatory adjustments not reported in rows 26a to 26i	30
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	-
28	**Total regulatory adjustments to Common Equity Tier 1**	**12,064**
29	**Common Equity Tier 1 Capital (CET1)**	**30,531**

		As at 30 Sep 13 $m
Additional Tier 1 Capital: instruments		
30	Directly issued qualifying Additional Tier 1 instruments	1,496
31	of which: classified as equity under applicable accounting standards	-
32	of which: classified as liabilities under applicable accounting standards	1,496
33	Directly issued capital instruments subject to phase out from Additional Tier 1	5,450
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	3
35	of which: instruments issued by subsidiaries subject to phase out	-
36	**Additional Tier 1 Capital before regulatory adjustments**	**6,949**
Additional Tier 1 Capital: regulatory adjustments		
37	Investments in own Additional Tier 1 instruments	-
38	Reciprocal cross-holdings in Additional Tier 1 instruments	-
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the ADI does not own more than 10% of the issued share capital (amount above 10% threshold)	-
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
41	National specific regulatory adjustments (sum of rows 41a, 41b and 41c)	-
41a	of which: holdings of capital instruments in group members by other group members on behalf of third parties	-
41b	of which: investments in the capital of financial institutions that are outside the scope of regulatory consolidations not reported in rows 39 and 40	-
41c	of which: other national specific regulatory adjustments not reported in rows 41a and 41b	-
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	-
43	**Total regulatory adjustments to Additional Tier 1 Capital**	**-**
44	**Additional Tier 1 Capital (AT1)**	**6,949**
45	**Tier 1 Capital (T1 = CET1 + AT1)**	**37,480**
Tier 2 Capital: instruments and provisions		
46	Directly issued qualifying Tier 2 instruments	-
47	Directly issued capital instruments subject to phase out from Tier 2	4,776
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group T2)	1
49	of which: instruments issued by subsidiaries subject to phase out	-
50	Provisions	694
51	**Tier 2 Capital before regulatory adjustments**	**5,471**
Tier 2 Capital: regulatory adjustments		
52	Investments in own Tier 2 instruments	75
53	Reciprocal cross-holdings in Tier 2 instruments	-
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the ADI does not own more than 10% of the issued share capital (amount above 10% threshold)	-
55	Significant investments in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
56	National specific regulatory adjustments (sum of rows 56a, 56b and 56c)	143
56a	of which: holdings of capital instruments in group members by other group members on behalf of third parties	-
56b	of which: investments in the capital of financial institutions that are outside the scope of regulatory consolidation not reported in rows 54 and 55	143
56c	of which: other national specific regulatory adjustments not reported in rows 56a and 56b	-
57	**Total regulatory adjustments to Tier 2 Capital**	**218**
58	**Tier 2 Capital (T2)**	**5,253**
59	**Total Capital (TC = T1 + T2)**	**42,733**
60	**Total risk weighted assets based on APRA standards**	**362,078**

		As at 30 Sep 13 $m
Capital ratios and buffers		
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	8.43%
62	Tier 1 (as a percentage of risk weighted assets)	10.35%
63	Total capital (as a percentage of risk weighted assets)	11.80%
64	Buffer requirement (minimum CET1 requirement of 4.5% plus capital conservation buffer of 2.5% plus any countercyclical buffer requirements expressed as a percentage of risk-weighted assets)	7.00%
65	of which: capital conservation buffer requirement	2.50%
66	of which: ADI-specific countercyclical buffer requirements	n/a
67	of which: G-SIB buffer requirement	n/a
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	n/a
National minima (if different from Basel III)		
69	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum)	n/a
70	National Tier 1 minimum ratio (if different from Basel III minimum)	n/a
71	National total capital minimum ratio (if different from Basel III minimum)	n/a
Amounts below the thresholds for deduction (not risk-weighted)		
72	Non-significant investments in the capital of other financial entities	414
73	Significant investments in the ordinary shares of financial entities	1,826
74	Mortgage servicing rights (net of related tax liability)	-
75	Deferred tax assets arising from temporary differences (net of related tax liability)	1,637
Applicable caps on the inclusion of provisions in Tier 2		
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	565
77	Cap on inclusion of provisions in Tier 2 under standardised approach	715
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	129
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	1,545
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)		
80	Current cap on CET1 instruments subject to phase out arrangements	-
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-
82	Current cap on AT1 instruments subject to phase out arrangements	5,450
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	(226)
84	Current cap on T2 instruments subject to phase out arrangements	5,060
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-

10.2 Level 2 Regulatory Balance Sheet

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

	NAB Group Balance Sheet As at 30 Sep 13 $m	Adjustments $m	Level 2 Regulatory Balance Sheet As at 30 Sep 13 $m	Template Reference / Reconciliation Table
Assets				
Cash and liquid assets	35,666	(2,806)	32,860	
Due from other banks	43,193	-	43,193	
Trading derivatives	39,214	697	39,911	
Trading securities	32,996	-	32,996	
Investments - available for sale	34,886	(7)	34,879	
Investments - held to maturity	5,629	(2,418)	3,211	
Investments relating to life insurance business	75,599	(75,599)	-	
Other financial assets at fair value	75,756	(3)	75,753	
Hedging derivatives	3,926	-	3,926	
Loans and advances	411,979	(63)	411,916	
Due from customers on acceptances	29,319	-	29,319	
Current tax assets	63	(1)	62	
Property, plant and equipment	1,993	(7)	1,986	
Goodwill and other intangible assets	7,641	(4,332)	3,309	Table A
Deferred tax assets	1,616	(435)	1,181	
Investment in non-consolidated entities	-	5,945	5,945	Table A
Due from controlled entities	-	2,470	2,470	
Other assets	8,951	(930)	8,021	
Total assets	**808,427**	**(77,489)**	**730,938**	
Liabilities				
Due to other banks	34,623	(548)	34,075	
Trading derivatives	41,749	(42)	41,707	
Other financial liabilities at fair value	26,431	-	26,431	
of which:				
Change in own credit worthiness	188	-	188	Row 14
Hedging derivatives	3,431	(21)	3,410	
Deposits and other borrowings	445,572	(523)	445,049	
Liability on acceptances	3,228	-	3,228	
Life policy liabilities	64,509	(64,509)	-	
Current tax liabilities	922	(11)	911	
Provisions	1,636	(173)	1,463	
Bonds, notes and subordinated debt	110,722	(2,442)	108,280	
Other debt issues	2,944	-	2,944	
of which:				
Convertible preference share	1,496	-	1,496	Row 32
Defined benefit superannuation plan liabilities	354	-	354	
External unitholders' liability	11,837	(11,837)	-	
Deferred tax liabilities	-	(935)	(935)	
Due to controlled entities	-	625	625	
Other liabilities	13,849	1,837	15,686	
Total liabilities	**761,807**	**(78,579)**	**683,228**	
Net assets	**46,620**	**1,090**	**47,710**	

	NAB Group Balance Sheet As at 30 Sep 13 $m	Adjustments $m	Level 2 Regulatory Balance Sheet As at 30 Sep 13 $m	Template Reference / Reconciliation Table
Equity				
Issues and paid-up ordinary share capital	23,605	1,359	24,964	Row 1
Other contributed equity	4,534	-	4,534	
Contributed equity	**28,139**	**1,359**	**29,498**	
General reserve for credit losses	539	-	539	
Asset revaluation reserve	79	-	79	
Foreign currency translation reserve	(2,501)	16	(2,485)	
Cash flow hedge reserve	105	15	120	Row 11
Equity-based compensation reserve	296	-	296	
Available for sale investments reserve	62	(2)	60	
Other reserves	(1,959)	29	(1,930)	Row 3
Reserves	**(1,420)**	**29**	**(1,391)**	
Retained profits	19,842	(281)	19,561	Row 2
Total equity (parent entity interest)	**46,561**	**1,107**	**47,668**	
Non-controlling interest in controlled entities	59	(17)	42	
Total equity	**46,620**	**1,090**	**47,710**	

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

Table A	**As at 30 Sep 13 $m**	**Template Reference**
Goodwill and other intangible assets	3,309	
Investment in non-consolidated entities	5,945	
Total	**9,254**	
Less		
DTL for other intangible assets	3	
Goodwill (net of related tax liability)	5,132	Row 8
Other intangibles other than mortgage-servicing rights (net of related tax liability)	2,293	Row 9
Net tangible assets of investment in non-consolidated entities	**1,826**	
Add		
Insignificant equity investment in financial institutions	415	
Total equity investment in financial institutions	**2,241**	Row 26d

10.4 Material Entities Excluded from Level 2 Regulatory Balance Sheet

Table 10.4A: Insurance and Fund Management Entities

	As at 30 Sep 13	
	Total Assets $m	Total Liabilities $m
National Wealth Management Holdings Limited	9,192	2,064
National Australia Financial Management Limited	6,620	5
MLC Holdings Limited	3,824	-
MLC Lifetime Company Limited	2	-
MLC Investments Limited	82	16
MLC Limited	68,622	65,771
National Australia Trustees Limited	10	1

Table 10.4B: Securitisation Entities

	As at 30 Sep 13	
	Total Assets $m	Total Liabilities $m
Titan NZ Funding Trust	763	762
TSL (USA)	577	577
Titan Securitisation Ltd	546	545
National RMBS Trust 2006-3 [(1)]	380	385
Quasar No. 14 Trust	301	301
National ABS Trust 2012-1M	227	227
Titan NZ (Vector Series 1 Bonds) MTN Trust	223	223
Titan NZ (MRP Bonds) Trust	223	223

[(1)] *This entity has negative assets due to accounting measurement differences where the hedging derivatives are measured at marked to market but the financial instruments being hedged are measured at amortised cost.*

11. Glossary

Term	Description
ABCP	Asset-Backed Commercial Paper being a form of commercial paper that is collateralised by other financial assets. It is a short-term debt instrument created by an issuing party (typically a bank or other financial institution).
ADI	Authorised Deposit-taking Institution.
Advanced IRB approach	The Advanced Internal Ratings Based (IRB) approach refers to the processes employed by the NAB Group to estimate credit risk. This is achieved through the use of internally developed models to assess potential credit losses using the outputs from the PD, LGD and EaD models.
AMA	Advanced Measurement Approach (AMA) is the risk estimation process used for the NAB Group's operational risk. It combines internally developed risk estimation processes with an integrated risk management process, embedded within the business with loss event management.
APRA	Australian Prudential Regulation Authority.
APS	Prudential Standards issued by APRA applicable to ADIs.
Back-testing	Back-testing refers to the process undertaken to monitor performance of the NAB Group's risk models. Historical data is used to compare the actual outcomes to the expected outcomes. Theoretical (or hypothetical) back-testing refers to the process whereby the trading positions at the end of the preceding day are revalued using the end-of-day rates for that day and then again at the succeeding day's closing rates. The difference between the two mark-to-market values of the portfolio which represents the profit and loss that would have occurred had there been no transactions on the day, is compared with the VaR. VaR is also compared with the actual daily traded profit and loss as a cross-check of the reasonableness of the theoretical portfolio movement.
Basel Accord	The Basel regulatory framework (which includes Basel II, Basel 2.5 and Basel III) is the global benchmark for assessing banks' capital adequacy. The guidelines are aimed at promoting a more resilient banking system through the development of capital adequacy standards that are more accurately aligned with the individual risk profile of institutions, by offering greater flexibility for supervisors to recognise and encourage the use of more sophisticated risk management techniques.
BIPRU	BIPRU refers to the UK PRA's requirements and guidance for accreditation under the Basel Accord. It refers to the Prudential Sourcebook for Banks, Building Societies and Investment Firms.
Board	Principal Board of Directors of NAB.
Capital adequacy	Capital adequacy is the outcome of identifying and quantifying the major risks the NAB Group is exposed to, and the capital that the NAB Group determines as an appropriate level to hold for these risks, as well as its strategic and operational objectives, including its target credit rating.
CDO	Collateralised Debt Obligation.
Central Counterparty (CCP)	A clearing house which interposes itself, directly or indirectly, between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer.
CLO	Collateralised Loan Obligation.
Committed Liquidity Facility (CLF)	The Reserve Bank of Australia will establish a committed liquidity facility (CLF) as part of Australia's implementation of the Basel III liquidity reform, which will provide high-quality liquidity to commercial banks to assist them in meeting the Basel III liquidity requirements.
Common Equity Tier 1	Common equity is recognised as the highest quality component of capital. It is subordinated to all other elements of funding, absorbs losses as and when they occur, has full flexibility of dividend payments and has no maturity date. It is predominately comprised of common shares; share premium; retained earnings; undistributed current year earnings; as well as other elements as defined under *APS 111 Capital Adequacy: Measurement of Capital.*
Credit derivatives	Credit derivatives include single-name credit default and certain total rate of return swaps, cash funded credit linked notes and first-to-default and second-to-default credit derivative basket products. ADIs may also recognise many more complex credit derivatives that do not fall into the list above, that have been approved by APRA.
Credit derivative transactions	In relation to securitisation exposures, credit derivative transactions are those in which the credit risk of a pool of assets is transferred to the NAB Group, usually through the use of credit default swaps.
Credit enhancements	Credit enhancements are arrangements in which the NAB Group holds a securitisation exposure that is able to absorb losses in the pool, providing credit protection to investors or other parties to the securitisation. A first loss credit enhancement is available to absorb losses in the first instance. A second loss credit enhancement is available to absorb losses after first loss credit enhancements have been exhausted.
Credit Value Adjustment (CVA)	A capital charge to reflect potential mark-to-market losses due to counterparty migration risk on bilateral OTC derivative contracts.
The Credit Risk function	All areas reporting directly to the Chief Credit Officer including Credit Insight & Appetite, Credit Frameworks, Credit Oversight, Counterparty Credit and Strategic Business Services.
Default Fund	Clearing members' funded or unfunded contributions towards, or underwriting of, a CCP's mutualised loss sharing arrangements.
Derivative transactions	In relation to securitisation exposures, derivative transactions include interest rate and currency derivatives provided to securitisation SPVs, but do not include credit derivative transactions.
EaD	Exposure at Default (EaD) is an estimate of the total committed credit exposure expected to be drawn at the time of default for a customer or facility that the NAB Group would incur in the event of a default. It is used in the calculation of RWA.
Economic capital	Economic capital represents the NAB Group's internal assessment of the amount of capital required to protect against potential unexpected future losses arising from its business activities, in line with its target credit rating.
ELE	The Extended Licensed Entity (ELE) comprises the ADI itself and any APRA approved subsidiary entities assessed as effectively part of a single 'stand-alone' entity, as defined in *APS 222 Associations with Related Entities.*
Eligible financial collateral	Eligible financial collateral, under the standardised approach, will be the amount of cash collateral, netting and eligible bonds and equities. Eligible financial collateral, under the IRB approach, for corporate, sovereign and bank portfolios, is limited to the collateral items detailed in paragraphs 4 and 23 of Attachment G of *APS 112*. Recognition of eligible financial collateral is subject to the minimum conditions detailed in that same Attachment, paragraph 6.
Fair value	Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.

Term	Description
Foundation IRB (FIRB)	Foundation Internal Ratings Based (FIRB) approach refers to an alternative approach to advanced IRB defined under the Basel Accord where a Group develops its own PD models and seeks approval from its regulator to use these in the calculation of regulatory capital, and the regulator provides a supervisory estimate for LGD and EaD.
General Reserve for Credit Losses (GRCL)	The general reserve for credit losses (GRCL) is an estimate of the reasonable and prudent expected credit losses over the remaining life of the portfolio and on non-defaulted assets. The reserve is a compliance requirement under APRA's *Prudential Standard 220 – Credit Quality*.
GRCL calculation methodology	The GRCL is calculated as a collective provision for doubtful debts, excluding securitisation and provision on default no-loss assets. The difference between the GRCL and accounting collective provision is covered with an additional top-up, created through a transfer from retained earnings to reflect losses expected as a result of future events that are not recognised in the NAB Group's collective provision for accounting purposes. All collective provisions on defaulted or otherwise non-performing assets, regardless of expected loss, are reported as additional regulatory specific provisions.
Guarantees	Guarantors under the standardised approach are recognised according to *APS 112 Attachment F* paragraph 3. The secured portion of an exposure is weighted according to the risk weight appropriate to the guarantor and the unsecured portion is weighted according to the risk weight applicable to the original counterparty (Refer to Attachment A for the appropriate risk weights). Under the IRB approach, for corporate, sovereign and bank portfolios, the ADI may recognise credit risk mitigation in the form of guarantees and credit derivatives according to the FIRB substitution approach where an ADI uses supervisory estimates of LGD (refer to *APS 113 Attachment B* paragraph 49), an AIRB substitution approach where the ADI has approval from APRA to use its own estimates of LGD (refer to *APS 113 Attachment B* paragraph 60) and, for certain exposures, a double default approach (refer to *APS 113 Attachment B* paragraph 67). An ADI may decide, separately for each eligible exposure, to apply either the relevant substitution approach or the double default approach. For retail portfolios there are two approaches for the recognition of credit risk mitigation in the form of guarantees and credit derivatives under the retail IRB approach, a substitution approach (refer to *APS 113 Attachment C* paragraph 19) and, for certain exposures, a double default approach (refer to *APS 113 Attachment C* paragraph 28). An ADI may decide separately for each eligible exposure to apply either the substitution approach or the double default approach.
IAA	Internal Assessment Approach.
ICAAP	Internal Capital Adequacy Assessment Process (ICAAP) is the mechanism developed and used by the NAB Group to determine capital requirements as outlined under Basel III. It results in the NAB Group identifying and assessing all risks to which it is exposed and allocating an appropriate level of capital to each.
IFRS	International Financial Reporting Standards.
IMA	Internal Model Approach (IMA) describes the approach used in the assessment of traded market risk. The NAB Group uses, under approval from APRA, the IMA to calculate general market risk for all transactions in the trading book other than those covered by the Standard Method.
Impaired facilities	Impaired facilities consist of Retail loans (excluding unsecured portfolio-managed facilities) which are contractually 90 days or more past due with security insufficient to cover principal and arrears of interest revenue. Unsecured portfolio managed facilities are classified as impaired assets when they become 180 days past due (if not written off) as per ARF 220 instructions; Non-retail loans that are contractually 90 days or more past due and/or sufficient doubt exists about the ultimate ability to collect principal and interest; and Impaired off-balance sheet credit exposures, where current circumstances indicate that losses may be incurred.
IRB approach	The internal ratings based (IRB) approach refers to the processes employed by the NAB Group to estimate credit risk. This is achieved through the use of internally developed models to assess the potential credit losses using the outputs from the probability of default, loss given default and exposure at default models.
IRRBB	Interest rate risk in the banking book.
Level 2 Group	The Level 2 Group, being NAB and the entities it controls subject to certain exceptions set out in *Section 2 Scope of Application* of this report.
Level 3 conglomerate Group	Contains APRA-regulated entities with material operations across more than one APRA-regulated industry and/or unregulated entities.
LGD	Loss Given Default (LGD) is an estimate of the expected severity of loss for a credit exposure following a default event. Regulatory LGDs reflect a stressed economic condition at the time of default. It is used in the calculation of RWA.
Liquidity Coverage Ratio (LCR)	LCR is a new measure announced as part of the Basel III liquidity reforms that will apply from January 2015. The ratio measures the amount of high quality liquid assets held that can be converted to cash easily and immediately in private markets, to total net cash flows required to meet its liquidity needs for a 30 day calendar liquidity stress scenario.
Liquidity facilities	Liquidity facilities are provided by the NAB Group to an SPV for the primary purpose of funding any timing mismatches between receipts of funds on underlying exposures and payments on securities issued by the SPV (asset liquidity facilities), or to cover the inability of the SPV to roll over ABCP (standby liquidity facilities).
Loan to value ratio	Loan to Value Ratio (LVR) is the ratio between the loan and value of the security provided.
Masterscale	Masterscale is a consistent series of grades applied to credit exposures that allows the NAB Group to place every credit exposure into a specific grade or range that represents the likelihood of a credit default. This allows comparison of customers and portfolios.
NAB	National Australia Bank Limited ABN 12 004 044 937.
NAB Group	NAB and its controlled entities.
Net Stable Funding Ratio (NSFR)	NSFR is a new measure announced as part of the Basel III liquidity reforms that will apply from January 2018. The ratio establishes a minimum acceptable amount of stable funding (the portion of those types and amounts of equity and liability financing expected to be reliable sources of funds over a one-year time horizon under conditions of extended stress) based on the liquidity characteristics of an ADI's assets and activities over a one-year horizon.
Net write-offs	Write-offs on loans at amortised cost net of recoveries.
Non-retail credit	Non-retail credit broadly refers to credit exposure to business customers. It excludes retail credit defined below.
Non-traded book	Non-traded book refers to the investment in securities held by the NAB Group through to maturity.
The Operational Risk function	All areas reporting directly to the General Manager, Operational Risk and Compliance.
Past due facilities ≥ 90 days	Past due facilities ≥ 90 days consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
PD	Probability of Default (PD) is an estimate of the likelihood of a customer defaulting or not repaying their borrowings and other obligations to the NAB Group in the next 12 months.
Point in Time	Point in Time (PiT) within this document refers to risk models that estimate the likelihood of default and resulting loss over a 12-month period having regard to the current economic conditions.

Term	Description
Qualifying revolving retail exposures	For the purposes of regulatory reporting, credit cards are referred to as qualifying revolving retail.
RBA	Ratings-Based Approach.
Regulatory capital	Regulatory capital is the total capital held by the NAB Group as a buffer against potential losses arising from the business the NAB Group operates in. Unlike economic capital, it is calculated based on guidance and standards provided by the NAB Group's regulators, including APRA. It is designed to support stability in the banking system and protect depositors.
Regulatory expected loss	Regulatory Expected Loss (EL) is a calculation of the estimated loss that may be experienced by the NAB Group over the next 12 months. Regulatory EL calculations are based on the PD, LGD and EaD values of the portfolio at the time of the estimate which include stressed LGDs for economic conditions. As such, regulatory EL is not an estimate of long-run average expected loss.
Resecuritisation	Resecuritisation exposures are securitisation exposures in which the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation exposure. In addition, an exposure to one or more resecuritisation exposures is a resecuritisation exposure.
Retail credit	For the purposes of managing credit, two broad categories are used: retail credit and non-retail credit. This reflects the different approaches to the sales and ongoing management of credit and is consistent with the approach required under the Basel Accord. Retail credit refers to the credit provided to retail or personal customers. For the purposes of regulatory capital, retail credit is categorised into four groups: residential mortgages, credit cards (or qualifying revolving credit), retail SME and other.
Risk appetite	Risk appetite defines the level of risk the NAB Group is prepared to accept as part of its business. The resulting level of risk is a direct input into the NAB Group's capital requirements.
Risk-Weighted Assets (RWA)	A quantitative measure of the NAB Group's risk, required by the APRA risk-based capital adequacy framework, covering credit risk for on- and off-balance sheet exposures, market risk, operational risk and interest rate risk in the banking book.
Securities	Securities include the purchase of securitisation debt securities for either trading or banking book purposes.
Securitisation	Structured finance technique which involves pooling and packaging cash-flow converting financial assets into securities that can be sold to investors.
SME	Small and medium sized enterprises.
SGA	Specialised Group Assets.
Specific provisions	Specific provisions for prudential purposes include all provisions for impairment assessed on an individual basis in accordance with IFRS excluding securitisation.
Sponsor	The entity that establishes the securitisation SPVs including ABCP conduits and often provides other services.
Standardised approach	Standardised refers to an alternative approach to the assessment of risk (notably credit and operational) whereby the institution uses external rating agencies to assist in assessing credit risk and/or the application of specific values provided by regulators to determine RWA.
Stress testing	Stress testing refers to a technique whereby the NAB Group's capital position is assessed against a number of different scenarios used to determine the movement on expected losses and subsequent impact on capital.
Through the cycle	Through the Cycle (TtC) within this document refers to risk models that estimate the likelihood of default and resulting loss over a 12-month period having regard to the impact of an economic downturn.
Tier 1 Capital	Tier 1 Capital comprises the highest quality components of capital that fully satisfy all of the characteristics outlined under APRA's prudential framework. It provides a permanent and unrestricted commitment of funds, are freely available to absorb losses, do not impose any unavoidable servicing charge against earnings, and rank behind the claims of depositors and other creditors in the event of winding-up.
Tier 1 Capital ratio	Tier 1 capital as defined by APRA divided by risk-weighted assets.
Tier 2 Capital	Tier 2 capital includes other components of capital that, to varying degrees, fall short of the quality of Tier 1 capital but nonetheless contribute to the overall strength of an entity as a going concern. It is divided into: Upper Tier 2 capital comprising components of capital that are essentially permanent in nature, including some forms of hybrid capital instrument; and Lower Tier 2 capital comprising components of capital that are not permanent.
Tier 2 Capital ratio	Tier 2 capital as defined by APRA divided by risk-weighted assets.
Traded book	Traded book refers to the NAB Group's investment portfolio that is traded or exchanged in the market from time to time that reflects market opportunities.
Value at Risk (VaR)	Value at Risk (VaR) is a mathematical technique that uses statistical analysis of historical data to estimate the likelihood that a given portfolio's losses will exceed a certain amount.
Warehouse facilities	Warehouse facilities are lending facilities provided by the NAB Group to an SPV for the financing of exposures in a pool. These may be on a temporary basis pending the issue of securities or on an on-going basis.
Write-offs	Write-offs represent credit losses in accordance with accounting rules.

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