09

BASEL II PILLAR 3

YEAR ENDED 30 SEPTEMBER 2009

APS 330: CAPITAL ADEQUACY & RISK MANAGEMENT IN ANZ

ANZ

Important Notice

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

This disclosure was prepared as at 30 September 2009. ANZ has a continuous disclosure policy, under which ANZ will immediately notify the market of any material price sensitive information concerning the Group, in accordance with legislative and regulatory disclosure requirements.

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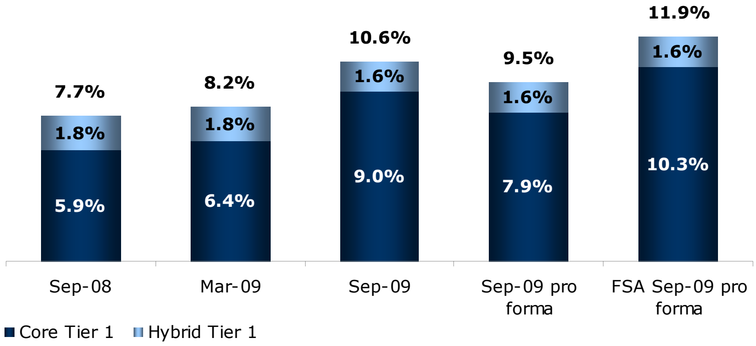
[1] Each Table reference adopted in this document aligns to those required by APS 330 to be disclosed at year end.

Chapter 1 – Highlights[2] [3]

Capital ratios

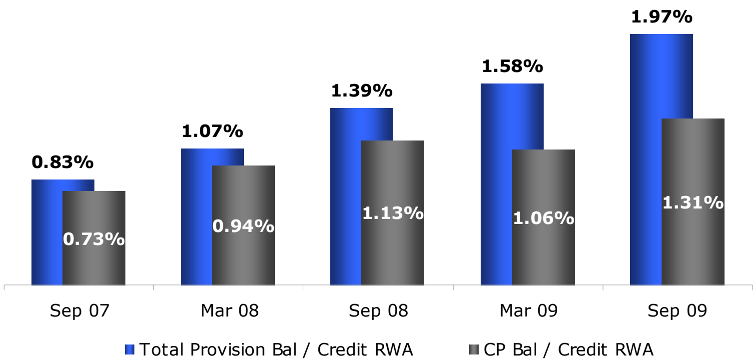


Strong capital position, even with capital committed to RBS assets and the ING JV

Capital position has been strengthened via:

- Three ordinary equity raisings totalling $5.7bn:
  - Institutional Share Placement $2.5bn
  - Share Purchase Plan $2.2bn
  - Final 2008 DRP underwrite $1.0bn
- Organic capital generation of $1.3bn
- RWA reduction
- Capital position further strengthened post Sep-09 results with offer of A$1.7bn hybrid Tier 1 more than offsetting redemption of US $350m hybrid

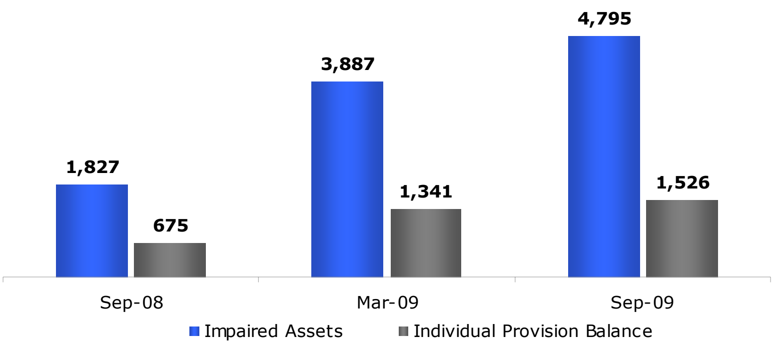
Provision ratios (Provisions/CRWA)



Higher provision balances relative to Credit Risk Weighted Assets (CRWA)

- Higher provisions for defaults and portfolio deterioration
- Lower CRWA from EAD contraction and portfolio data review

Impaired Assets and Individual Provisions



Growth in Impaired Assets slowed significantly during 2H09

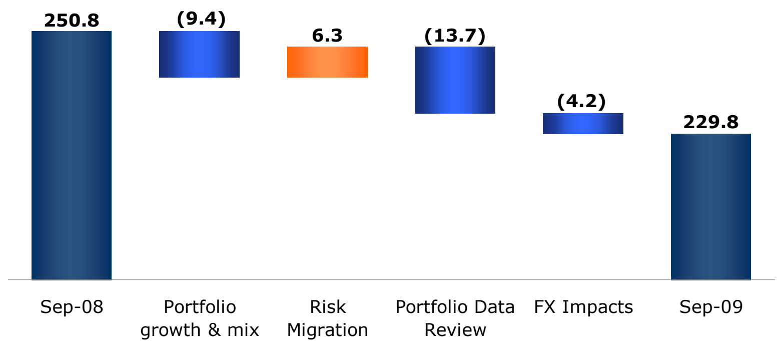
- Large Institutional defaults during 1H09
- Coverage (IP Balance / Impaired Assets) of 32% is negatively skewed by large Property Services exposures in Institutional division

[2] *Capital Ratios*: Sep-09 pro forma and FSA Sep-09 pro forma includes adjustment for acquisition of RBS assets and INGA & ING (NZ) Joint Venture in 2010 financial year.

[3] *Impaired Assets and Individual Provisions:* Impaired Assets excludes Restructured items of $673 million in September 2009 (March 09: $17 million; September 08: $846 million) and Impaired Derivatives of $127 million in September 09 (March 09: $254 million; September 08: Nil). By definition, Restructured items and Impaired Derivatives do not attract Individual Provision.

Chapter 1 – Highlights (continued)[4]

Movement in Credit Risk Weighted Assets ($bn)



Sep-08					Mar-09
250.8	2.2	6.2	(5.7)	4.3	257.8

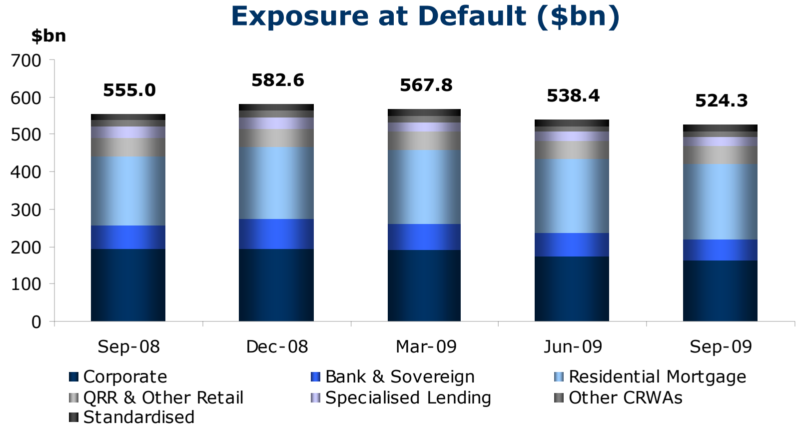
NB - HOH changes do not add to YOY due to changes in mix

Mar-09					Sep-09
257.8	(13.3)	1.0	(7.8)	(7.9)	229.8

Credit RWA down by $21bn to $229.8bn from Sep 08 driven by:

- 5.5% reduction in EAD
- Ongoing portfolio data review

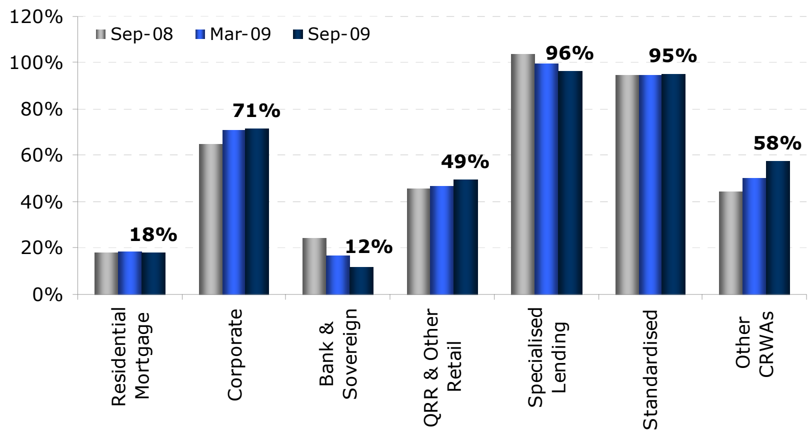
Exposure at Default ($bn)



EAD reduced $30.7bn to $524.3bn over the year

- Reduction in Corporate exposures, from customer portfolio amortisation and balance sheet restructuring, as well as portfolio data review
- Reclassifications from Specialised Lending to Corporate
- Reduction in Securitisation exposures

Average Risk Weights (CRWA/EAD)



Portfolio average Risk Weight decreased 1.4% to 43.8% over the year

- Change in portfolio mix from contraction in Corporate EAD (which has higher than average Risk Weight) and growth in Residential Mortgages
- Portfolio data review

[4] Other CRWAs comprise Securitisation, Equities, and Other Asset exposures.

Chapter 2 - Introduction

Purpose of this document

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

APS 330 mandates the release to the investment community and general public of information relating to capital adequacy and risk management practices. APS 330 has been established to implement Pillar 3 of the Basel Committee on Banking Supervision's framework for bank capital adequacy, known as 'Basel II'[5]. In simple terms, Basel II consists of three mutually reinforcing 'Pillars':

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

Basel II in ANZ

In December 2007, ANZ was one of the first banks in the world to receive accreditation for the most advanced approaches permitted under Basel II for credit and operational risk, complementing its existing accreditation for market risk.

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

In addition to releasing APS 330 for Pillar 3, APRA has a suite of 'Pillar 1' prudential standards - of which the following relate to ANZ:

- APS 110: Capital Adequacy
- APS 111: Capital Adequacy: Measurement of Capital
- APS 113: Capital Adequacy: Internal Ratings-based Approach to Credit Risk (and, to a limited extent, APS 112: Capital Adequacy: Standardised Approach to Credit Risk)
- APS 115: Capital Adequacy: Advanced Measurement Approaches to Operational Risk
- APS 116: Capital Adequacy: Market Risk
- APS 117: Capital Adequacy: Interest Rate Risk in the Banking Book
- APS 120: Securitisation
- APS 150: Basel II Transition

In contrast to most jurisdictions, Interest Rate Risk in the Banking Book is included in the Pillar 1 calculation of regulatory capital adequacy under APRA prudential standards, rather than being addressed as part of the Internal Capital Adequacy Assessment Process of Pillar 2.

Verification of disclosures

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

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

Comparison to ANZ's Annual Report

These disclosures have been produced in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards. As such, there are differences in some common areas of disclosures. These differences are most pronounced in the credit risk disclosures, for instance:

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

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

Chapter 3 - Risk appetite and governance

Risk types

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

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

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

- *Strategic risk* - external risks to the viability of a banking institution arising from unexpected adverse changes in business environment with respect to the economy, political landscape, regulation, technology, social mores, and the actions of competitors
- *Business risk* – risk of financial loss due to unexpected movements in volume, profit margin, and operating expenses (excluding risk elsewhere identified) arising from unexpected changes in the business environment, customer preferences and/or competitor actions
- *Liquidity risk* - the risk that ANZ has insufficient capacity to fund increases in assets, or is unable to meet its payment obligations as they fall due, including repaying depositors or maturing wholesale debt
- *Compliance risk* - the risk that ANZ does not conduct its business in accordance with the laws, regulations and adopted codes of the countries in which it operates

Risk Appetite Framework

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

The framework provides an unambiguous and enforceable risk statement, on the amount of risk ANZ is willing to accept which management operates within at all times. It supports strategic and core business activities and customer relationships ensuring that:

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

Risk management governance

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

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

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

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

Group Asset and Liability Committee (GALCO)

GALCO is responsible for the oversight and strategic management of ANZ's balance sheet, liquidity and funding positions and capital management activities to ensure they are aligned to adding shareholder value by managing and positioning the balance sheet consistent with ANZ's appetite for risk, maintaining ANZ's preferred AA rating and striving for best-practice corporate governance.

Specifically, GALCO co-ordinates, approves and, where necessary, directs:

- liquidity and funding activities, to ensure that these are managed in a way consistent with ANZ's strategy and within ANZ's appetite for liquidity risk
- the management of ANZ's capital management framework to ensure that ANZ is adequately capitalised to cover its material risks and exposures in an efficient and effective manner
- balance sheet management activities including management of non-traded market risk.

In all cases this is in accordance with the risk appetite and limits defined by the Board, regulatory requirements, and international best practice.

GALCO is chaired by ANZ's Chief Financial Officer (CFO) and meets at least six times per year. GALCO is supported by specialist committees that cover capital management and non-traded market risk, as well as regional asset and liability management committees.

Capital Management Policy Committee (CMPC)

CMPC is a sub-committee of GALCO, with responsibility for the oversight and control of ANZ's capital and portfolio measurement framework, addressing economic and regulatory capital requirements incorporating Economic Loss Provisioning methodology. CMPC is also responsible for making capital management and portfolio measurement related recommendations to GALCO.

The Committee's main objective is to ensure ANZ's regulatory and economic capital management activities are aligned with GALCO's objectives, with focus on:

- Internal Capital Adequacy Assessment Process, aligning capital levels and targets to risk appetite and policies and processes by which ANZ identifies, measures, monitors and manages risks
- Analysing economic capital in context of changes in material risks, emerging risks and/or methodology changes
- Stress testing reviews and updates

CMPC is chaired by ANZ's CFO (or in absence, ANZ's Chief Risk Officer) and meets six times annually

Credit and Market Risk Committee (CMRC)
CMRC is the senior executive management forum responsible for the oversight and control of credit and traded market risk and, as a delegation from GALCO, non-traded market risk. Its responsibilities and duties include: • Oversee the Risk Appetite Framework • Approve credit and market policy • Oversee credit and market risk model performance • Ensure comprehensive credit and market risk control, including handling of emerging issues • Approve business writing strategies • Approve credit transactions and provisions within its discretions • Oversee credit portfolio composition, including large exposures, risk grade migration, risk concentrations and changes to delinquency patterns • Set and oversee market risk limits. CMRC is chaired by ANZ's CRO and meets weekly, and is supported by a specialist committee that covers credit ratings systems
Credit Ratings System Oversight Committee (CRSOC)
CRSOC provides oversight and control of the internal ratings system for credit risk across ANZ. It provides governance over ratings models, as well as associated pricing and collections models or tools including: • Approving the content and design of the rating system, including models and methodology for Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD) • Prioritisation, monitoring and approval of model changes, enhancements and re-builds • Performance monitoring of internal rating system models • Monitor annual independent validation of use and performance of all models CRSOC is chaired by Chief Risk Officer (CRO) Australia and meets six times per year. It supports CMPC and CMRC, and in turn is supported by working groups
Operational Risk Executive Committee (OREC)
OREC is the primary senior executive management forum responsible for the oversight of the operational risk and the compliance risk control environment. Its main responsibilities and duties include: • Endorse ANZ's Operational Risk Framework for approval by Board Risk Committee • Approve ANZ's Group Compliance Framework • Approve Operational Risk policies and Compliance policies • Monitor operational risk policies and compliance profiles, emerging risks, incidents, trends and remediation, including treatment plans for extreme risks. OREC is chaired by ANZ's CRO and meets six times per year
Reputation Risk Committee (RRC)
The purpose of the RRC is to assist ANZ businesses, Risk, Compliance and Legal in partnership to effectively discharge their responsibility for managing reputation risk in relation to environmental, social, business and regulatory issues. RRC is chaired by ANZ's CRO and meets six times per year

Chapter 4 – Group structure and capital adequacy

Table 1 Scope of application

Consolidation, capital reporting and measurement

For financial reporting purposes, ANZ consolidates the financial statements of the Company and all its controlled entities where it is determined that there is a capacity to control. Control means the power to govern directly or indirectly the financial and operating policies of an entity so as to obtain benefits from its activities. In relation to special purpose entities, such control is deemed to exist where, in substance:

- the majority of the residual risks and rewards from the activities of the entity accrue to ANZ; or,
- ANZ controls the entity's decision making powers so as to obtain the majority of the risks and rewards from the entity's activities.

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

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

ANZ is a Level 1 and Level 2 reporter and measures capital adequacy monthly on a Level 1 and Level 2 basis. ANZ is not required to report on a Level 3 basis.

Investments in entities deconsolidated for prudential purposes are deducted from regulatory capital and the assets of those entities are excluded from aggregate Risk Weighted Assets (RWA). For Level 2 reporting, all investments in subsidiaries are either eliminated on consolidation or deducted from the capital base where deconsolidation for prudential purposes is required.

The capital treatment of each material controlled entity of ANZ is as follows:

Name	Deducted from capital?	Business
Amerika Samoa Bank	No	Banking
ANZ Bank (Vietnam) Limited	No	Banking
ANZ Capel Court Limited	No	Investment Banking
ANZ Capital Hedging Pty Ltd	No	Hedging
ANZ Commodity Trading Pty Ltd	No	Finance
ANZcover Insurance Pty Ltd	Yes	Captive-Insurance
ANZ Trustees Limited	Yes	Trustee/Nominee
ANZ Funds Pty Ltd	No	Investment
ANZ Bank (Europe) Limited	No	Banking
ANZ Bank (Kiribati) Limited	No	Banking
ANZ Bank (Samoa) Limited	No	Banking
ANZ Holdings (New Zealand) Limited	No	Holding Company
ANZ National Bank Limited	No	Banking
ANZ Investment Services (New Zealand) Limited	No	Fund Manager
ANZ National (Int'l) Limited	No	Finance
Awarata Finance Limited	No	Finance
Arawata Trust	No	Finance
Arawata Holdings Limited	No	Holding Company
Harcourt Corporation Limited	No	Investment
Arawata Trust Company	No	Finance
Endeavour Finance Limited	No	Finance
Tui Endeavour Limited	No	Finance
Private Nominees Limited	No	Nominee
UDC Finance Limited	No	Finance
ANZ International (Hong Kong) Limited	No	Holding Company

Name	Deducted from capital?	Business
ANZ Asia Limited	No	Banking
ANZ Bank (Vanuatu) Limited	No	Banking
ANZ International Private Limited	No	Holding Company
ANZ Singapore Limited	No	Merchant Banking
ANZ Royal Bank (Cambodia) Limited	No	Banking
LFD Limited	No	Holding Company
Minerva Holdings Limited	No	Holding Company
Upspring Limited	No	Finance
Votraint No. 1103 Pty. Ltd	No	Investment
ANZ Lenders Mortgage Insurance Pty Limited	Yes	Mortgage Insurance
ANZ Nominees Limited	No	Nominee
ANZ Orchard Investments Pty Ltd	No	Holding Company
Australia and New Zealand Banking Group (PNG) Limited	No	Banking
Chongqing Liangping ANZ Rural Bank Company Limited	No	Banking
Citizens Bancorp Inc	No	Holding Company
Citizens Security Bank (Guam) Inc	No	Banking
Esanda Finance Corporation Limited	No	General Finance
ETRADE Australia Limited	No	Online Stockbroking
Omeros II Trust	Yes	Securitisation
PT ANZ Panin Bank	No	Banking
ANZ Vientiane Commercial Bank Limited	No	Banking

Restrictions on Transfers of Capital within ANZ

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

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

ANZ established a licensed banking branch in New Zealand in January 2009. The branch structure expands the range of funding options available to ANZ's New Zealand business, but does not impact the capital requirements of ANZ National.

Capital deficiencies in non-consolidated subsidiaries

The aggregate amount of any under-capitalisation of any non-consolidated subsidiary (or subsidiaries) that is required to be deducted from capital is nil (March 2009 and September 2008: Nil).

Table 2 Capital Structure

APRA's prudential standards adopt a risk-based capital assessment framework, based on the Basel II capital measurement standards, in assessing capital adequacy for an ADI. This risk based approach requires eligible capital to be divided by total RWA, with the resultant ratio being used as a measure of an ADI's capital adequacy.

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

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

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

Fundamental capital includes the following significant adjustments:

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

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

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

- **ANZ Convertible Preference Shares**. On 30 September 2008 ANZ issued AUD1,081 million of convertible preference shares that mandatorily convert into ordinary shares on 16 June 2014, subject to certain conditions being satisfied. They may convert earlier under certain circumstances. The distributions are preferred, non-cumulative, based on the quarterly Australian Bank Bill Rate subject to Directors resolving to pay in their absolute discretion and other payment tests being satisfied. In a winding-up of ANZ, the instrument will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.
- **UK Stapled Securities**. On 15 June 2007 ANZ raised GBP450 million of non-cumulative mandatory convertible stapled securities. On 15 June 2012, or an earlier date under certain circumstances, the UK Stapled Securities will mandatorily convert into ordinary shares. The distributions are non-cumulative at a fixed rate of 6.54% payable semi-annually. In a winding-up of ANZ, the ANZ preference shares forming part of the ANZ Stapled Securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.

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

- **US Trust Securities**. On 27 November 2003, ANZ issued USD1,100 million of loan capital in two tranches of USD350m with an initial call date of 15 January 2010 at a coupon rate of 4.484%, and USD750m with an initial call date of 15 December 2013 and a coupon rate of 5.36%. On these dates ANZ has the discretion to redeem the respective tranche of the US Trust Securities for cash, subject to APRA approval. If ANZ does not exercise this discretion, the investor is entitled to require ANZ to exchange the US Trust Securities into ordinary shares. The distributions are non-cumulative payable half yearly in arrears. In a winding-up of ANZ, the ANZ preference shares forming part of the US Trust Securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders. On the 6 November 2009, ANZ issued a notice of redemption for cash on the 15 January 2010 as to the USD350m tranche of the US Trust Securities.
- **Euro Trust Securities**. On 24 September 2004, ANZ issued EUR500 million of preference shares raising AUD871m, at the spot rate on the date of issue. Distributions are non-cumulative payable quarterly in arrears based upon the three month EURIBOR rate plus a margin of 66 basis points up until 15 December 2014, at which date ANZ has a call right for cash (subject to APRA approval). After this date, the distribution rate is a rate based on the three month EURIBOR rate plus a margin of 166 basis points. In a winding-up of ANZ, the ANZ preference shares forming part of the Euro Trust securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.

For more information on these instruments, refer to the Loan Capital and Share Capital notes (Notes 27 and 28 respectively) in the 2009 ANZ Annual Report.

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

Tier 2 capital is comprised of Upper and Lower Tier 2 capital, less capital deductions taken 50% from Tier 1 and 50% from Tier 2 capital. Upper Tier 2 capital mainly comprises perpetual subordinated debt instruments, whilst Lower Tier 2 comprises dated subordinated debt instruments which meet the requirements of the prudential standard.

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

- USD300m note issued by ANZ on 30 October 1986 which pays a rate of LIBOR plus 15 basis points
- NZD835m note issued by ANZ National Bank Limited on 17 April 2008 which pays a fixed rate of 9.66% for five years payable semi-annually in arrears. At the first call date of 18 April 2013 the interest rate resets to the five year swap rate plus 200 basis points.

To qualify as Lower Tier 2 capital, the instrument must have a minimum term of five years and the amount eligible for inclusion in capital is amortised on a straight line basis at a rate of 20% per annum over the last four years to maturity. For more details on these Lower Tier 2 capital instruments, refer to the Subordinated Notes section of the Loan Capital note (Note 27) in the 2009 ANZ Annual Report.

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

The following table summarises ANZ's Level 2 capital position as at 30 September 2009:

Table 2: Capital Structure[6]

	Regulatory Capital					
	September 2009 $M		March 2009 $M		September 2008 $M	
Fundamental Tier 1 capital						
Paid-up ordinary share capital		19,064		14,103		12,566
Foreign currency translation reserve	(1,725)		(373)		(816)	
Share and share option reserve	156		105		107	
Reserves		(1,569)		(268)		(709)
Retained earnings including current year earnings	14,129		13,620		13,772	
less : Accumulated retained profits and reserves of insurance, funds management and securitisation entities and associates	(1,010)		(1,336)		(841)	
Dividend not provided for	(1,403)		(993)		(1,511)	
add : Deferred fee revenue including fees deferred as part of loan yields	391		403		351	
Accrual for Dividend Reinvestment Plans	421		298		453	
Prudential retained earnings		12,528		11,992		12,224
Minority interests		65		72		62
Fundamental Tier 1 capital		**30,088**		**25,899**		**24,143**
Innovative Tier 1 capital		2,122		3,076		2,847
Non-innovative Tier 1 capital		1,901		2,019		2,095
Gross Tier 1 capital		**34,111**		**30,994**		**29,085**
Deductions from Tier 1 capital						
Goodwill		(2,999)		(3,033)		(3,064)
Intangible component of investments in non-consolidated subsidiaries and other non-Level 2 entities		-		-		(1,773)
Other deductions from Tier 1 capital only		(1,832)		(2,414)		(1,813)
50/50 deductions from Tier 1 capital		(2,661)		(2,604)		(1,206)
Total Tier 1 capital deductions		**(7,492)**		**(8,051)**		**(7,856)**
NET TIER 1 CAPITAL		**26,619**		**22,943**		**21,229**
Tier 2 capital						
Upper Tier 2 capital		1,392		1,464		1,377
Lower Tier 2 capital		9,108		9,217		9,195
Gross Tier 2 capital		**10,500**		**10,681**		**10,572**
Deductions from Tier 2 capital						
Upper and lower Tier 2 capital deductions		(28)		(28)		(28)
50/50 deductions from Tier 2 capital		(2,661)		(2,604)		(1,206)
Total Tier 2 capital deductions		**(2,689)**		**(2,632)**		**(1,234)**
NET TIER 2 CAPITAL		**7,811**		**8,049**		**9,338**
TOTAL CAPITAL BASE		**34,430**		**30,992**		**30,567**

[6] Refer following page for breakdown of Other deductions from Tier 1 capital only, 50/50 deductions from Tier 1 capital and Upper Tier 2 capital.

Table 2: Capital Structure (continued)[7]

	September 2009	March 2009	September 2008
Other Deductions from Tier 1 capital	**$m**	**$m**	**$m**
Capitalised software and other intangible assets	(897)	(783)	(677)
Capitalised expenses including loan and lease origination fees, capitalised securitisation establishment costs and costs associated with debt raisings	(602)	(643)	(642)
Applicable deferred tax assets (excluding the component relating to the general reserve for impairment of financial assets)	(325)	(524)	(92)
Earnings not recognised for prudential purposes	-	-	(117)
Mark-to-market impact of own credit spread	12	(358)	(149)
Negative Available-for-sale reserve	(20)	(106)	(136)
Total	**(1,832)**	**(2,414)**	**(1,813)**

Deductions taken 50% from Tier 1 and 50% from Tier 2	September 2009 Gross	September 2009 50%	March 2009 Gross	March 2009 50%	September 2008 Gross	September 2008 50%
Investment in ANZ insurance subsidiaries	(321)	(161)	(281)	(141)	(131)	(65)
Investment in funds management entities	(67)	(33)	(66)	(33)	(68)	(34)
Investment in joint ventures with ING in Australia and New Zealand	(1,474)	(737)	(1,456)	(728)	(524)	(262)
Investment in other Authorised Deposit Taking Institutions and overseas equivalents	(1,951)	(976)	(1,851)	(925)	(1,219)	(610)
Investment in other commercial operations	(72)	(36)	(72)	(36)	(72)	(36)
Expected loss in excess of eligible provsions	(1,012)	(506)	(1,017)	(508)	(334)	(167)
Other	(424)	(212)	(465)	(233)	(64)	(32)
Total	**(5,321)**	**(2,661)**	**(5,208)**	**(2,604)**	**(2,412)**	**(1,206)**

Details of Upper Tier 2 Capital	September 2009	March 2009	September 2008
Eligible component of post acquisition earnings and reserves in associates and joint ventures	269	271	248
Perpetual subordinated notes	1,026	1,129	1,075
General reserve for impairment of financial assets net of attributable deferred tax asset	97	64	54
Total	**1,392**	**1,464**	**1,377**

Table 3 Capital adequacy

Capital Management Approach

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

- Regulatory compliance, incorporating compliance with APRA's PCRs at both Level 1 and Level 2[8] for Tier 1 and Total Capital, and the US Federal Reserve's minimum Tier 1 and Total Capital adequacy requirements via ANZ's Foreign Holding Company licence in the United States of America
- Capital levels are aligned with the risks in the business and strategic and business development plans through ensuring that available capital (i.e. shareholders' equity including preference shares and Residual Tier 1 capital) exceeds the level of Economic Capital required to support the Ratings Agency default frequency confidence level for a AA long term credit rating category bank. Economic Capital is an internal estimate of capital levels required to support unexpected losses above a desired target solvency level
- Capital levels are commensurate with ANZ maintaining its preferred AA long term credit rating category for senior long term unsecured debt given its risk appetite outlined in its strategic plan
- An appropriate balance between maximising shareholder returns and prudent capital management principles.

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

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

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

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

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

From these processes, a Capital Plan is developed and approved by the Board which identifies organic capital generations and usages, planned capital issuances and expected capital maturity profiles, and options around capital strategies including products, timing and markets under differing market and economic conditions.

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

Capital Targets

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

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

ANZ has adopted the Tier 1 capital ratio as its principal capital management target. Since September 2008 ANZ has set a minimum operating Tier 1 target in excess of 7.5%. Given recent difficult economic and financial market conditions, ANZ has maintained its Tier 1 ratio well above this minimum target.

Table 3: Capital Ratios and Risk Weighted Assets [9] [10] [11]

	Risk Weighted Assets		
	September 2009 $M	March 2009 $M	September 2008 $M
Subject to Advanced IRB approach			
Corporate	116,153	136,559	127,365
Sovereign	1,408	1,402	2,079
Bank	5,592	10,374	12,624
Residential Mortgage	36,725	35,932	33,727
Qualifying revolving retail	6,852	8,900	8,703
Other retail	17,108	14,905	14,218
Credit risk weighted assets subject to Advanced IRB approach	**183,838**	**208,072**	**198,716**
Credit Risk Specialised Lending exposures subject to slotting criteria	**24,272**	**25,362**	**30,250**
Subject to Standardised approach			
Corporate	13,531	15,594	12,980
Sovereign	-	-	-
Bank	13	21	21
Residential Mortgage	411	467	344
Credit risk weighted assets subject to standardised approach	**13,955**	**16,082**	**13,345**
Credit risk weighted assets relating to securitisation exposures	2,658	3,364	4,271
Credit risk weighted assets relating to equity exposures	1,914	1,707	1,146
Other assets	3,174	3,183	3,022
Total credit risk weighted assets	**229,811**	**257,770**	**250,750**
Market risk weighted assets	3,553	5,632	2,609
Operational risk weighted assets	16,240	17,480	18,017
Interest rate risk in the banking book weighted assets	2,465	-	4,058
TOTAL RISK WEIGHTED ASSETS	**252,069**	**280,882**	**275,434**
Capital ratios (%)			
Level 2 Total capital ratio	**13.7%**	**11.0%**	**11.1%**
Level 2 Tier 1 capital ratio	**10.6%**	**8.2%**	**7.7%**
Level 1: Australia and New Zealand Banking Group Limited extended licensed entity Total capital ratio	**14.2%**	**11.5%**	**11.6%**
Level 1: Australia and New Zealand Banking Group Limited extended licensed entity Tier 1 capital ratio	**11.6%**	**9.0%**	**8.4%**
Other significant ADI or overseas bank subsidiary: ANZ National Bank Limited Group Total capital ratio	**12.7%**	**12.3%**	**11.6%**
Other significant ADI or overseas bank subsidiary: ANZ National Bank Limited Group Tier 1 capital ratio	**9.0%**	**8.7%**	**8.1%**

Total Risk Weighted Assets increased by $5.4 billion in the March 2009 half and reduced by $28.8 billion in the second half, for a net full-year reduction of $23.4 billion.

Exposure volume grew slightly in the first half to March 2009 but reduced significantly in the second half due to a combination of exchange rate impact, reduced lending asset volumes and large reductions in exposure to off-balance sheet instruments.

Credit quality deterioration was a key driver of credit Risk Weighted Asset increase in the first half, however had a limited impact in the second half and was offset by other portfolio changes including a slightly shortened maturity profile and a relative improvement in the portfolio mix of non-loan assets. Ongoing portfolio data review reduced risk weighted assets in both halves.

Corporate Risk Weighted Assets reduced over the full year as reduced volumes of exposure, due to portfolio amortisation and reduced off-balance sheet volumes mainly in the second half, offset deterioration in credit quality that occurred mainly in the first half.

Bank Risk Weighted Assets dropped across both halves (mainly in the second) on reduced volumes of exposure, particularly in off-balance sheet instruments, and continued relative improvement in the quality of the portfolio with an increased proportion of higher-rated counterparties and shortening maturity profile.

Residential Mortgage Risk Weighted Assets increased over the year mostly through increased exposure volume, mainly in the first half in Australia, and deterioration in credit quality in New Zealand.

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

[10] Standardised exposures to all private sector counterparties other than banks and residential mortgages have been classified in the Corporate category as they do not meet the requirement for other AIRB asset classes. The main types of standardised exposures are business lending and other personal lending.

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

Qualifying Revolving Retail and Other Retail Risk Weighted Assets and volumes were stable in the first half and mainly impacted by methodology changes in the second half. Regulatory changes and regular modelling reviews resulted in a reclassification of exposures from Qualifying Revolving Retail to Other Retail and from Other Retail to Corporate. These reclassifications resulted in a moderate net increase in Risk Weighted Assets overall.

Specialised Lending Risk Weighted Assets decreased in both halves, mainly in the first. The reduction is due partly to reclassifications of exposures to the Corporate asset class and partly to the downgrade to default of a small number of large exposures.

Securitisation exposure Risk Weighted Assets reduced over both halves, mainly due to volume reduction from portfolio amortisation and some reclassification of exposures to the Corporate asset class - partially offset by declines in credit quality.

Market Risk Risk Weighted Assets increased from September 2008 to September 2009 due to increased VaR from Rates businesses, partially offset by a reduction in Specific Risk Risk Weighted Assets driven by reduced short and long positions in qualifying bonds with greater than two years to maturity. Interest Rate Risk in the Banking Book risk weighted assets reduced between September 2008 and September 2009 due to the increase in embedded gains on Investment Term of Capital offsetting the increased volatility in repricing and yield curve risk as measured by Value at Risk (VaR).

Operational Risk Risk Weighted Assets reduced by $1.8 billion over the period due to the application of an updated capital methodology.

APRA has established a regulatory capital floor for AIRB and AMA (Advanced Measurement Approach) banks[12] during a transition period starting from the commencement of the AIRB and AMA on 1 January 2008. The regulatory capital floor calculation involves the calculation of RWA and gross capital under both Basel I and Basel II rules. Reductions in capital may be available, provided that a bank maintains its prudential capital ratio, subject to a floor of 90% of the transitional regulatory floor calculation. Since implementation of Basel II, ANZ has operated in excess of the capital floor. APRA has not announced an end date for the transition period.

Types of exposures in each Basel asset class

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

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

[12] Refer to Chapter 5 for an explanation of AIRB and Chapter 8 for an explanation of AMA.

International Capital Ratio Comparisons

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

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

Capital ratio	Target operating range	ANZ under APRA rules				ANZ under FSA rules	ANZ under OSFI rules
		Sep-08	Mar-09	Sep-09	Sep-09 pro forma*	Sep-09 pro forma*	Sep-09 pro forma*
Core Tier-1**	6% - 6.5%	5.9%	6.4%	9.0%	7.9%	10.3%	10.1%
Tier-1	7.5% - 8.0%	7.7%	8.2%	10.6%	9.5%	11.9%	11.8%
Total Capital	10.5%+	11.1%	11.0%	13.7%	12.4%	14.6%	14.8%

** Includes acquisition of RBS assets and INGJV in 2010 financial year as described in Chapter 9*
*** 'Core Tier 1' = Tier 1 excluding Residual Tier 1 instruments*

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

- Do not require a deduction for accrued dividends (although APRA does give credit for expected shares to be issued under a dividend reinvestment plan)
- Do not require a Tier 1 deduction for certain capitalised expenses and net deferred tax assets
- Allow the comparison of Expected Loss to Eligible Provisions for Loan Loss to be made on a gross basis and any excess is then tax effected, whereas APRA require Expected Losses to be compared to Eligible Provisions for Loan Losses net of tax, and any excess to be taken as a Tier-1 deduction
- Have a more favourable treatment for investments in associates and insurance and funds management subsidiaries which would include INGJV entities post obtaining full ownership as presented in the ANZ pro forma and associated FSA and OSFI comparisons.

For RWA, the major reasons for the differences are:

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

The Australian Bankers' Association (ABA) has released a detailed fact sheet[13] documenting the differences between the Australian and UK rules and the implications for prudential capital ratios.

[13] www.bankers.asn.au

Chapter 5 – Credit risk

Summary of Credit risk disclosures[14] [15]

September 2009

	Risk Weighted Assets $M	Regulatory Credit Exposure $M	Individual Provisions Charge for the year ended $M	Write-offs for the year ended $M
Corporate	140,425	188,067	1,723	1,118
Sovereign	1,408	28,618	-	-
Bank	5,592	29,444	45	27
Residential Mortgage	36,725	201,581	162	46
Qualifying Revolving Retail	6,852	19,820	229	264
Other Retail	17,108	28,651	477	395
Standardised	13,955	14,696	114	39
Total	**222,065**	**510,877**	**2,750**	**1,889**

March 2009

	Risk Weighted Assets $M	Regulatory Credit Exposure $M	Individual Provisions Charge for the 6 month period ended $M	Write-offs for the 6 month period ended $M
Corporate	161,921	217,873	1,030	451
Sovereign	1,402	21,553	-	-
Bank	10,374	48,847	4	30
Residential Mortgage	35,932	195,432	48	14
Qualifying Revolving Retail	8,900	23,604	108	124
Other Retail	14,905	27,073	218	148
Standardised	16,082	16,948	41	16
Total	**249,516**	**551,330**	**1,449**	**783**

September 2008

	Risk Weighted Assets $M	Regulatory Credit Exposure $M	Individual Provisions Charge for the year ended $M	Write-offs for the year ended $M
Corporate	157,615	225,169	480	160
Sovereign	2,079	9,350	-	-
Bank	12,624	50,799	45	6
Residential Mortgage	33,727	186,287	40	45
Qualifying Revolving Retail	8,703	23,458	219	270
Other Retail	14,218	26,708	214	189
Standardised	13,345	13,989	34	29
Total	**242,311**	**535,760**	**1,032**	**699**

Table 4 Credit risk – General disclosures

Definition of credit risk

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

Regulatory approval to use the Advanced Internal Ratings-Based approach

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

[14] Regulatory credit exposure in this table includes Advanced IRB, Specialised Lending and Standardised exposures, however does not include Securitisation, Equities or Other Assets exposures. Specialised Lending is included in the Corporate asset class.

[15] The Individual Provision charge relates to loans and advances, and does not include impairment on Available-For-Sale assets of $20 million in September 2009 (March 2009: $20 million; September 2008: $98 million).

Credit risk management framework and policies

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

Organisation

As described in Chapter 3, the Credit Risk and Market Risk Committee (CMRC) is ANZ's most senior executive level credit risk committee. It oversees the Risk Appetite Framework, approves business writing strategies and large transactions within its discretion, reviews portfolio metrics, ensures current and emerging risks are being managed effectively and oversees certain risk controls such as portfolio caps, risk triggers, high level credit policies and single customer concentration tolerance.

An independent risk management function is staffed by risk specialists. The primary responsibility for prudent and profitable management of credit risk assets and customer relationships rests with the business units. Risk provides independent credit assessment on lending decisions, and also performs key roles in portfolio management such as development and validation of credit risk measurement systems, loan asset quality reporting, and development of credit standards and policies.

The authority to make credit decisions is delegated by the Board to the CEO who in turn delegates authority to the CRO and CMRC. The CRO in turn delegates some of his credit discretion to individuals as part of a 'cascade' of authority from senior to the most junior credit officers. Within ANZ, credit approval for almost all non-retail lending is made on a 'dual approval' basis, jointly by the business writer in the Business Unit and the respective independent credit risk officer. For retail lending, highly automated risk assessment processes mean that sole credit discretions are the norm, with assessors reviewing the output of decision tools. Individuals must complete appropriate upfront and ongoing accreditation training in order to be granted and retain a credit discretion, and such discretions are reviewed on an annual basis.

Portfolio direction and performance

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

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

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

- Monitoring, analysing and reporting ANZ's credit risk profile and progress in meeting portfolio objectives
- Calculating and reporting ANZ's Collective Provision, Economic Capital, Expected Loss, regulatory RWA and regulatory Expected Loss
- Assessing impact of emerging issues, and conducting ad hoc investigations and analysis
- Validating rating/scoring tools and credit estimates
- Ongoing review and refinement of ANZ's credit risk measurement and policy framework

Reporting

Credit risk Management Information Systems, reporting and analysis are managed centrally and at the divisional and business unit level.

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

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

Past due loans

Exposures where a contractual payment has not been met or the customer is outside of contractual arrangements are deemed past due. Typically, past due facilities include those operating in excess of approved arrangements or where scheduled repayments are outstanding.

Basel II definition of default

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

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

Restructured items

Restructured items are facilities in which the original terms have been modified to provide for concessions of interest, or principal, or other payments due, or for an extension in maturity for a non-commercial period for reasons related to the financial difficulties of a customer, and are not considered impaired. Includes both on and off balance sheet exposures.

Impaired assets

Irrespective of whether a facility is 90 days past due, individually managed facilities are classified as impaired when there is doubt as to whether the contractual amounts due, including interest and other payments, will be met in a timely manner. Impaired assets include a credit valuation adjustment (CVA), which is a market assessment of the credit risk of the relevant counterparties.

Individual Provisions

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

Write offs

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

Collective Provisions

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

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

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

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

The methodology underpinning calculation of collective provision from historical experience is predominantly based around the product of an exposure's Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD) [17]. ANZ uses slightly different PD, LGD and EAD factors in the calculation of regulatory capital and expected loss (EL), due to the different requirements of APRA and accounting standards. The key differences are:

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

Essentially these differences reflect the effects of the credit cycle on credit losses. Point in time refers to losses at any given point in the credit cycle, cycle adjusted refers to adjusting estimates to reflect a full credit cycle and downturn refers to losses at the worst of the cycle and is the most conservative estimate to use. Regardless of the adjustments, the starting point for all estimates is the output of the rating/scoring models and tools to satisfy the in use test[18].

Specific Provision and General Reserve for Credit Losses

There is a difference in the split between ANZ's Individual Provision and Collective Provision for accounting purposes and the Specific Provision and General Reserve for Credit Losses (GRCL) for regulatory purposes, due to definitional differences. This difference does not impact total provisions, and essentially relates to the classification of $186 million collectively assessed provisions on defaulted accounts, as illustrated below:

	Specific Provision Balance $m	General Reserve for Credit Losses $m	Total $m
Collective Provision	186	2,814	3,000
Individual Provision	1,526	-	1,526
Total Provision for credit impairment			**4,526**

The disclosures in this document are based on Individual Provision and Collective Provision, for ease of comparison with other published results.

[17] PD, LGD and EAD are explained in the following section.

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

Table 4(b) part (i): Period end and average regulatory credit exposure[19] [20]

Credit Exposure by Portfolio Type	Regulatory Credit Exposure September 2009 $M	March 2009 $M	September 2008 $M	Average for year $M
Corporate	201,598	233,467	238,154	219,876
Sovereign	28,618	21,553	9,350	18,984
Bank	29,459	48,876	50,827	40,143
Residential Mortgage	202,731	196,757	187,263	194,997
Qualifying Revolving Retail	19,820	23,604	23,458	21,639
Other Retail	28,651	27,073	26,708	27,680
Total Exposure	**510,877**	**551,330**	**535,760**	**523,319**

Table 4(b) part (ii): Regulatory credit exposure by facility type

Credit Exposure by Facility Type	Regulatory Credit Exposure September 2009 $M	March 2009 $M	September 2008 $M	Average for year $M
Acceptance	17,850	19,161	18,599	18,225
Cash and liquid assets	18,402	19,039	18,051	18,227
Contingents liabilities, commitments, and other off-balance sheet	103,557	119,835	125,630	114,594
Creditors & Other Liabilities	378	130	871	625
Derivatives	13,912	29,653	19,186	16,549
Due from other financial Institutions	3,207	3,776	9,546	6,377
Investment Securities	14,758	14,127	14,927	14,843
Loans & Advances	326,272	333,093	321,539	323,906
Other assets	432	1,581	315	374
Total deposits & other borrowings	240	199	184	212
Trading Securities	11,869	10,736	6,912	9,391
Total Exposures	**510,877**	**551,330**	**535,760**	**523,319**

Table 4(c): Geographic distribution of regulatory credit exposure[21]

Portfolio Type	September 2009 Geographic Distribution Australia $M	New Zealand $M	Other $M	Total $M
Corporate	124,405	47,940	29,253	**201,598**
Sovereign	8,445	6,086	14,087	**28,618**
Bank	13,379	3,102	12,978	**29,459**
Residential Mortgage	157,118	44,521	1,092	**202,731**
Qualifying Revolving Retail	19,820	-	-	**19,820**
Other Retail	21,188	7,421	42	**28,651**
Total exposures	**344,355**	**109,070**	**57,452**	**510,877**

Portfolio Type	March 2009 Geographic Distribution Australia $M	New Zealand $M	Other $M	Total $M
Corporate	144,689	52,077	36,701	**233,467**
Sovereign	9,126	4,073	8,354	**21,553**
Bank	26,017	6,893	15,966	**48,876**
Residential Mortgage	150,352	45,145	1,260	**196,757**
Qualifying Revolving Retail	19,401	4,203	-	**23,604**
Other Retail	22,311	4,740	22	**27,073**
Total exposures	**371,896**	**117,131**	**62,303**	**551,330**

Portfolio Type	September 2008 Geographic Distribution Australia $M	New Zealand $M	Other $M	Total $M
Corporate	147,647	53,498	37,009	**238,154**
Sovereign	2,440	3,678	3,232	**9,350**
Bank	20,425	5,091	25,311	**50,827**
Residential Mortgage	140,769	45,569	925	**187,263**
Qualifying Revolving Retail	19,106	4,352	-	**23,458**
Other Retail	21,844	4,864	-	**26,708**
Total exposures	**352,231**	**117,052**	**66,477**	**535,760**

[19] In accordance with APS 330, regulatory credit exposure throughout Table 4 includes Advanced IRB, Specialised Lending and Standardised exposures, however does not include Securitisation, Equities or Other Assets exposures. Specialised Lending is included within Corporate asset class.

[20] Margin Lending exposures of $1,553 million were reclassified during the period from Standardised to Other Assets, and are therefore excluded from Tables 4(b), 4(c), 4(d), 4(e), 4(i), 5(b), 7(b) and 7(c). Prior period comparatives have also been restated to reflect this reclassification (March 2009: $1,407 million; September 2008: $1,842 million).

[21] Other geography comprises ANZ's operations in Asia Pacific, Europe and America.

Table 4(d): Industry distribution of regulatory credit exposure[22] [23]

September 2009

Portfolio Type	Agriculture, Forestry, Fishing & Mining	Business Services	Construction	Entertainment, Leisure & Tourism	Financial, Investment & Insurance	Government and Official Institutions	Manufacturing	Personal	Property Services	Wholesale Trade	Retail Trade	Transport & Storage	Other	Total $M
Corporate	32,481	8,383	5,644	9,375	15,765	1,579	28,552	2,626	37,527	15,773	12,352	9,307	22,234	**201,598**
Sovereign	34	-	22	-	18,284	9,890	173	-	23	13	-	-	179	**28,618**
Bank	-	-	58	98	29,054	-	56	-	-	1	-	105	87	**29,459**
Residential Mortgage	-	-	-	-	-	-	-	202,731	-	-	-	-	-	**202,731**
Qualifying Revolving Retail	-	-	-	-	-	-	-	19,820	-	-	-	-	-	**19,820**
Other retail	2,380	1,661	2,329	772	312	13	851	13,458	887	611	1,864	1,102	2,411	**28,651**
Total exposures	**34,895**	**10,044**	**8,053**	**10,245**	**63,415**	**11,482**	**29,632**	**238,635**	**38,437**	**16,398**	**14,216**	**10,514**	**24,911**	**510,877**
	6.8%	2.0%	1.6%	2.0%	12.4%	2.2%	5.8%	46.7%	7.5%	3.2%	2.8%	2.1%	4.9%	100.0%

March 2009

Portfolio Type	Agriculture, Forestry, Fishing & Mining $M	Business Services $M	Construction $M	Entertainment, Leisure & Tourism $M	Financial, Investment & Insurance $M	Government and Official Institutions $M	Manufacturing $M	Personal $M	Property Services $M	Wholesale Trade $M	Retail Trade $M	Transport & Storage $M	Other $M	Total $M
Corporate	37,070	9,086	6,363	10,628	23,591	1,896	34,183	2,412	41,987	20,232	13,357	10,501	22,161	**233,467**
Sovereign	-	-	28	-	13,541	7,360	166	-	36	54	-	-	368	**21,553**
Bank	2	-	22	121	47,811	-	121	1	89	69	57	86	497	**48,876**
Residential Mortgage	-	-	-	-	-	-	-	196,757	-	-	-	-	-	**196,757**
Qualifying Revolving Retail	-	-	-	-	-	-	-	23,604	-	-	-	-	-	**23,604**
Other Retail	2,621	1,821	2,584	964	339	13	1,045	9,576	1,120	707	2,453	1,228	2,602	**27,073**
Total exposures	**39,693**	**10,907**	**8,997**	**11,713**	**85,282**	**9,269**	**35,515**	**232,350**	**43,232**	**21,062**	**15,867**	**11,815**	**25,628**	**551,330**
	7.2%	2.0%	1.6%	2.1%	15.5%	1.7%	6.4%	42.1%	7.8%	3.8%	2.9%	2.1%	4.6%	100.0%

September 2008

Portfolio Type	Agriculture, Forestry, Fishing & Mining $M	Business Services $M	Construction $M	Entertainment, Leisure & Tourism $M	Financial, Investment & Insurance $M	Government and Official Institutions $M	Manufacturing $M	Personal $M	Property Services $M	Wholesale Trade $M	Retail Trade $M	Transport & Storage $M	Other $M	Total $M
Corporate	37,939	9,392	5,879	9,978	28,894	5,563	29,621	6,610	41,805	19,604	13,336	9,739	19,794	**238,154**
Sovereign	-	-	-	-	6,101	2,819	161	-	10	46	-	-	213	**9,350**
Bank	-	4	-	99	50,082	-	11	22	6	44	-	41	518	**50,827**
Residential Mortgage	-	-	-	-	-	-	-	187,263	-	-	-	-	-	**187,263**
Qualifying Revolving Retail	-	-	-	-	-	-	-	23,458	-	-	-	-	-	**23,458**
Other Retail	2,257	1,548	2,268	758	277	14	832	12,250	923	622	2,029	1,007	1,923	**26,708**
Total exposures	**40,196**	**10,944**	**8,147**	**10,835**	**85,354**	**8,396**	**30,625**	**229,603**	**42,744**	**20,316**	**15,365**	**10,787**	**22,448**	**535,760**
	7.5%	2.0%	1.5%	2.0%	15.9%	1.6%	5.7%	42.9%	8.0%	3.8%	2.9%	2.0%	4.2%	100.0%

[22] Property Services Industry bucket includes commercial property operators and developers, real estate agents, non-financial asset investors and machinery and equipment hiring and leasing.

[23] Other Industry bucket includes Health & Community Services, Education, Communication Services, Electricity, Gas & Water Supply, and Personal & Other Services.

Table 4(e): Residual contractual maturity of regulatory credit exposure[24]

September 2009

Portfolio Type	<= 12 mths $M	1 ~ 5 years $M	>5 years $M	No Maturity Specified $M	Total $M
Corporate	87,846	90,547	22,800	405	**201,598**
Sovereign	9,443	17,488	1,687	-	**28,618**
Bank	19,767	9,543	149	-	**29,459**
Residential Mortgage	1,897	4,682	170,337	25,815	**202,731**
Qualifying Revolving Retail	-	-	-	19,820	**19,820**
Other Retail	10,354	12,671	5,117	509	**28,651**
Total exposures	**129,307**	**134,931**	**200,090**	**46,549**	**510,877**

March 2009

Portfolio Type	<= 12 mths $M	1 ~ 5 years $M	>5 years $M	No Maturity Specified $M	Total $M
Corporate	97,724	107,140	26,771	1,832	**233,467**
Sovereign	9,623	10,853	1,077	-	**21,553**
Bank	32,898	15,199	779	-	**48,876**
Residential Mortgage	2,314	4,785	164,238	25,420	**196,757**
Qualifying Revolving Retail	-	-	-	23,604	**23,604**
Other Retail	7,033	12,890	6,624	526	**27,073**
Total exposures	**149,592**	**150,867**	**199,489**	**51,382**	**551,330**

September 2008

Portfolio Type	<= 12 mths $M	1 ~ 5 years $M	>5 years $M	No Maturity Specified $M	Total $M
Corporate	105,989	102,874	26,517	2,774	**238,154**
Sovereign	6,968	1,557	825	-	**9,350**
Bank	37,230	11,650	1,929	18	**50,827**
Residential Mortgage	2,103	4,655	155,795	24,710	**187,263**
Qualifying Revolving Retail	-	-	-	23,458	**23,458**
Other Retail	6,830	13,498	6,232	148	**26,708**
Total exposures	**159,120**	**134,234**	**191,298**	**51,108**	**535,760**

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

Table 4(f) part (i): Impaired assets, Past due loans[25], Provisions and Write-offs by Industry sector[26 27]

September 2009

Industry Sector	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Charges for individual provision for the year ended $M	Write-offs for the year ended $M
Agriculture, forestry, fishing & mining	-	458	77	55	42	51
Business Services	-	215	41	114	118	66
Construction	-	122	43	43	76	44
Entertainment Leisure & Tourism	-	57	42	27	20	15
Financial, Investment & Insurance	1	958	10	261	544	425
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	6	627	34	230	301	139
Personal	-	802	950	357	809	649
Property Services	118	1,580	159	194	437	263
Retail Trade	-	114	53	53	78	49
Transport & Storage	-	85	31	32	36	24
Wholesale Trade	-	127	139	69	66	16
Other	2	323	18	91	223	148
Total	**127**	**5,468**	**1,597**	**1,526**	**2,750**	**1,889**

March 2009

Industry Sector	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Charges for individual provision for the 6 month period ended $M	Write-offs for the 6 month period ended $M
Agriculture, forestry, fishing & mining	-	114	55	41	23	33
Business Services	-	113	43	82	41	7
Construction	-	114	40	45	45	15
Entertainment Leisure & Tourism	-	50	28	25	15	8
Financial, Investment & Insurance	8	741	133	245	322	228
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	1	345	35	186	123	6
Personal	-	477	1,036	247	350	278
Property Services	244	1,280	81	173	317	161
Retail Trade	-	130	43	60	45	14
Transport & Storage	-	38	20	15	11	18
Wholesale Trade	-	128	22	60	34	5
Other	1	374	50	162	123	10
Total	**254**	**3,904**	**1,586**	**1,341**	**1,449**	**783**

September 2008

Industry Sector	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Charges for individual provision for the year ended $M	Write-offs for the year ended $M
Agriculture, forestry, fishing & mining	-	121	39	50	55	20
Business Services	-	56	23	42	71	36
Construction	-	32	13	12	12	6
Entertainment Leisure & Tourism	-	30	20	18	15	6
Financial, Investment & Insurance	-	601	104	146	189	53
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	-	161	19	67	44	44
Personal	-	230	458	127	349	367
Property Services	-	887	73	15	18	4
Retail Trade	-	37	30	20	7	9
Transport & Storage	-	54	7	24	33	19
Wholesale Trade	-	181	231	64	124	92
Other	-	283	43	90	115	43
Total	**-**	**2,673**	**1,060**	**675**	**1,032**	**699**

Impaired loans / facilities at $5.5 billion represents a $2.8 billion increase over 30 September 2008, driven mainly by increases in Australia and New Zealand. The increase in Australia was predominately across entities within Institutional Relationships, Corporate Banking and Financial Institution portfolios. There was an increase in the Australia Division across most businesses, as the deteriorating economic environment resulted in higher levels of default, particularly within Esanda, Business Banking, and Investment and Insurance Products. The New Zealand increase was driven primarily by customer downgrades in the small business, commercial, agribusiness segments and mortgage portfolios. Overseas increased slightly, mainly in Europe and America.

Past due loans at $1.6 billion represents an increase of $0.5 billion from 30 September 2008. The increase is principally in Australia and New Zealand due primarily to reduced exit options in Australia caused by a tightened refinance market, a soft property market and the continued deterioration of the New Zealand economy.

[25] Past due loans ≥ 90 days includes $1,462 million well secured loans (March 2009: $1,440 million; September 2008: $945 million).

[26] Impaired derivatives include a credit valuation adjustment (CVA) of $64 million, being a market assessment of the credit risk of the relevant counterparties (March 2009: $70 million; September 2008: $56 million).

[27] Impaired loans / facilities include restructured items of $673 million for customer facilities in which the original terms have been modified to provide for concessions of interest, or principal, or other payments due, or for an extension in maturity for a non-commercial period for reasons related to the financial difficulties of a customer, and are not considered impaired. Includes both on and off balance sheet exposures (March 2009: $17 million; September 2008: $846 million).

Individual provision balance at $1.5 billion represents an increase of $0.9 billion since 30 September 2008. The increase is principally in Australia following a large number of downgrades across the portfolio, partially offset by write-offs in personal lending, financial and commercial property portfolios.

The charge for individual provisions for half year ending 31 March 2009 was $1.4 billion, compared to charge of $1.0 billion for full year ending 30 September 2008 (first half 2008: $333 million; second half 2008: $699 million). The charge for the current half was principally in Institutional and Australia reflecting the current downward global economic cycle and its overall adverse effect on credit quality and includes two large provisions totalling $330 million within the Institutional division. Retail portfolios are experiencing rising levels of bankruptcies, liquidations/administrations and customers falling under hardship policies. This is coupled with lower recovery rates in a tightened debt sales market and lower resale values impacting Esanda recoveries. The increases in New Zealand occurred across all segments with higher provisions in the second half, as weaker local economic conditions impacted exports, household income and spending.

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

	Impaired Derivatives $M			Impaired Loans / Facilities $M			Past due loans ≥ 90 days $M			Individual provision balance $M			Charges for individual provision $M				Write-offs $M			
Portfolios subject to IRB approach	Sep-09	Mar-09	Sep-08	Sep-09	Mar-09	Sep-08	Sep-09	Mar-09	Sep-08	Sep-09	Mar-09	Sep-08	6 months ending Sep-09	6 months ending Mar-09	12 months ending Sep-09	12 months ending Sep-08	6 months ending Sep-09	6 months ending Mar-09	12 months ending Sep-09	12 months ending Sep-08
Corporate	127	254	-	4,199	3,164	2,218	496	410	285	932	931	427	693	1,030	1,723	480	667	451	1,118	160
Sovereign	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank	-	-	-	98	7	31	-	-	-	44	4	25	41	4	45	45	(3)	30	27	6
Residential Mortgage	-	-	-	425	279	145	805	879	545	189	91	52	114	48	162	40	32	14	46	45
Qualifying revolving retail	-	-	-	-	-	-	70	77	67	-	-	-	121	108	229	219	140	124	264	270
Other retail	-	-	-	472	348	212	174	181	140	293	269	152	251	226	477	214	247	148	395	189
Total IRB approach	**127**	**254**	**-**	**5,194**	**3,798**	**2,606**	**1,545**	**1,547**	**1,037**	**1,458**	**1,295**	**656**	**1,220**	**1,416**	**2,636**	**998**	**1,083**	**767**	**1,850**	**670**
Portfolios subject to Standardised approach																				
Corporate	-	-	-	254	101	67	43	39	23	61	45	19	77	33	110	34	22	16	38	29
Sovereign	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Residential Mortgage	-	-	-	20	5	-	9	-	-	7	1	-	4	-	4	-	1	-	1	-
Total Standardised approach	**-**	**-**	**-**	**274**	**106**	**67**	**52**	**39**	**23**	**68**	**46**	**19**	**81**	**33**	**114**	**34**	**23**	**16**	**39**	**29**
Total	**127**	**254**	**-**	**5,468**	**3,904**	**2,673**	**1,597**	**1,586**	**1,060**	**1,526**	**1,341**	**675**	**1,301**	**1,449**	**2,750**	**1,032**	**1,106**	**783**	**1,889**	**699**

Table 4(g): Impaired assets, Past due loans[28], Provisions and Write-offs by Geography[29] [30]

	September 2009				
Geographic Region	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	127	3,907	1,068	1,060	2,001
New Zealand	-	1,001	365	391	660
Other	-	560	164	75	339
Total	**127**	**5,468**	**1,597**	**1,526**	**3,000**

	March 2009				
Geographic Region	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	254	3,157	968	1,072	1,931
New Zealand	-	530	453	224	506
Other	-	217	165	45	305
Total	**254**	**3,904**	**1,586**	**1,341**	**2,742**

	September 2008				
Geographic Region	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	-	2,224	776	516	2,149
New Zealand	-	279	259	111	447
Other	-	170	25	48	225
Total	**-**	**2,673**	**1,060**	**675**	**2,821**

Table 4(h): Reconciliation of changes in Provisions

Collective Provision	For the year ended 30 September 2009 $M	For the year ended 30 September 2008 $M
Balance at start of period	2,821	1,992
Charge to income statement	235	818
Adjustments for exchange rate fluctuations and other	(56)	11
Total Collective Provision	**3,000**	**2,821**
Individual Provisions		
Balance at start of period	675	270
Charge to income statement for loans and advances	2,750	1,032
Write-offs	(1,889)	(699)
Recoveries of amounts previously written off	85	100
Adjustments for exchange rate fluctuations	(22)	-
Discount Unwind	(73)	(28)
Total Individual Provision	**1,526**	**675**
Total Provisions	**4,526**	**3,496**

The Collective Provision balance at $3.0 billion represents a increase of $0.2 billion from 30 September 2008 arising from an increase in charges within New Zealand and Overseas partially offset by decreases in Australia. The New Zealand charge reflected a rise in unsecured consumer delinquencies and a weakening risk profile across the portfolio particularly in the Rural business unit. Unfavourable risk movements were also experienced across the Overseas region. The decrease in Australia was mainly due to lower Institutional lending and concentration provision releases following defaults by a number of large customers within Institutional crystallising losses which were provided for in 2008.

[28] Past due loans ≥ 90 days includes $1,462 million well secured loans (March 2009: $1,440 million; September 2008: $945 million).

[29] Refer to Page 23 for explanation and reconciliation of accounting Individual and Collective provisions and regulatory Specific provision and General Reserve for Credit Losses.

[30] Other geography comprises ANZ's operations in Asia Pacific, Europe and America.

Table 4(i): Regulatory credit exposures by measurement approach

Advanced IRB	September 2009 $M	March 2009 $M	September 2008 $M
Corporate	188,067	217,873	225,169
Sovereign	28,618	21,553	9,350
Bank	29,444	48,847	50,799
Residential Mortgage	201,581	195,432	186,287
Qualifying Revolving Retail	19,820	23,604	23,458
Other Retail	28,651	27,073	26,708
Total Advanced IRB	**496,181**	**534,382**	**521,771**

Standardised	September 2009 $M	March 2009 $M	September 2008 $M
Corporate	13,531	15,594	12,985
Sovereign	-	-	-
Bank	15	29	28
Residential Mortgage	1,150	1,325	976
Other Retail	-	-	-
Total Standardised	**14,696**	**16,948**	**13,989**

Total Exposure	**510,877**	**551,330**	**535,760**

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

Use of external rating agencies (External Credit Assessment Institutions)

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

Table 5(b): Regulatory credit exposure by risk bucket [31] [32]

Risk weight	September 2009 $M	March 2009 $M	September 2008 $M
Standardised approach exposures			
0%	-	-	-
20%	3	3	3
35%	1,130	1,313	971
50%	9	22	23
75%	1	-	-
100%	13,553	15,609	12,992
150%	-	1	-
>150%	-	-	-
Capital deductions	-	-	-
Total	**14,696**	**16,948**	**13,989**
Other assets			
0%	-	-	-
20%	1,553	1,407	1,842
35%	-	-	-
50%	-	-	-
75%	-	-	-
100%	2,863	2,902	2,654
150%	-	-	-
>150%	-	-	-
Capital deductions	-	-	-
Total	**4,416**	**4,309**	**4,496**
Specialised Lending exposures subject to supervisory slotting			
0%	1,298	852	125
70%	6,560	7,136	9,794
90%	9,770	9,613	9,667
115%	5,943	5,782	6,866
250%	1,621	2,026	2,719
Total	**25,192**	**25,409**	**29,171**
Equity exposures			
Risk weight			
300%	1	64	-
400%	478	379	286
Total	**479**	**443**	**286**

[31] Margin Lending exposures of $1,553 million were reclassified during the period from Standardised to Other Assets, and are therefore excluded from Tables 4(b), 4(c), 4(d), 4(e), 4(i), 5(b), 7(b) and 7(c). Prior period comparatives have also been restated to reflect this reclassification (March 2009: $1,407 million; September 2008: $1,842 million).

[32] Standardised exposures to all private sector counterparties (other than banks and residential mortgages) have been classified in the Corporate category as they do not meet the requirements for other AIRB asset classes. The main types of the exposures are Business Lending and Other Personal Lending.

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

Portfolios subject to the AIRB approach

The following table summarises the coverage of ANZ's AIRB portfolios:

IRB Asset Class	Borrower type	Rating Approach
Sovereign	Central governments Central banks Certain multilateral banks	AIRB
Bank	Banks[33] In Australia only, other authorised deposit taking institutions (ADI) incorporated in Australia	AIRB
Corporate	Corporations, partnerships or proprietorships that do not fit into any other asset class	AIRB
Specialised Lending	Income Producing Real Estate Project Finance Object Finance	AIRB – Supervisory Slotting[34]
Residential Mortgages	Exposures secured by residential property	AIRB
Qualifying Revolving Retail	Consumer credit cards <$100k limit	AIRB
Other Retail	Small business lending Other lending to consumers	AIRB
Equity		AIRB – fixed risk weights
Other assets	All other assets not falling into the above classes e.g. margin lending, fixed assets	AIRB – fixed risk weights

In addition, ANZ has applied the Standardised Approach to some portfolio segments (mainly retail and local corporates in Asia Pacific) where currently available data does not enable development of advanced internal models for PD, LGD and EAD estimates.

ANZ applies its full normal risk measurement and management framework to these segments, however the credit rating tools may not have received AIRB approval. Standardised segments will be migrated to AIRB if they reach a volume that generates sufficient data for development of advanced internal models.

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

The ANZ rating system

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

- PD is an estimate of the level of the risk of borrower default. Borrower ratings are derived by way of rating models used both at loan origination and for ongoing monitoring
- EAD is defined as the expected facility exposure at the date of default
- LGD is an estimate of the potential economic loss on a credit exposure, incurred as a consequence of obligor default and expressed as a percentage of the facility's EAD. When measuring economic loss, all relevant factors are taken into account, including material effects of the timing of cash flows and material direct and indirect costs associated with collecting on the exposure, including realisation of collateral.

[33] The Bank Basel asset class excludes investment banks.

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

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

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

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

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

ANZ CCR	Moody's	Standard & Poor's	PD Range
0+ to 1-	Aaa to <Aa3	AAA to <A+	0.00-0.03%
2+ to 3+	A1 to <Baa2	A+ to <BBB	0.03-0.16%
3= to 4=	Baa2 to < Ba1	BBB to <BB+	0.16-0.51%
4- to 6-	Ba1 to <B1	BB+ to <B+	0.51-3.49%
7+ to 8+	B1 to <Caa	B+ to <CCC	3.49-10.09%
8=	Caa	CCC	10.09-99.99%
8-, 9 and 10	Default	Default	100%

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

ANZ also uses two specialised PD master scales for the mapping of sovereign and bank PDs to external rating agency ratings.

Use of internal estimates other than for regulatory capital purposes

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

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

PD, LGD and EAD are used in the calculation of economic capital and in the collective provisioning process. Regulatory and economic capital are calculated from the same data sources and starting from the same basis, however there are some differences between the factors used because several aspects of ANZ's rating system are adjusted in accordance with APRA requirements for regulatory capital purposes. The most significant of these adjustments are the use for regulatory capital purposes of downturn LGDs; the imposition of a 20% LGD floor for exposures secured by Australian residential real estate and the mandatory use of the supervisory slotting approach for project finance and most commercial real estate exposures.

Controls surrounding the ratings system

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

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

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

Rating process by asset class

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

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

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

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

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

IRB Asset Class	Borrower type	Rating Approach
Sovereign	Central governments Central banks Certain multilateral banks	External rating and expert judgement
Bank	Banks In Australia only, other ADIs incorporated in Australia	Statistically-based models Review of all relevant and material information including external ratings
Corporate	Corporations, partnerships or proprietorships that do not fit into any other asset class	Mainly statistical models Some use of expert models and policy processes
Specialised Lending	Income Producing Real Estate Project Finance Object Finance	Supervisory Slotting[35]
Residential Mortgages	Exposures secured by residential property	Statistical models
Qualifying Revolving Retail	Consumer credit cards <$100k limit	Statistical models
Other Retail	Small business lending Other lending to consumers	Statistical models

For the Retail Basel asset class (Residential Mortgages, Qualifying Revolving Retail and Other Retail exposures) the large number of relatively homogenous exposures enable the development of statistically robust application scoring models for use at origination and behavioural scoring for ongoing management. LGD is recognised through the process of pooling retail exposures into homogenous groups.

Estimation of LGD and EAD

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

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

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

Table 6(d): Non Retail regulatory credit exposure subject to Internal Ratings Based (IRB) approach[36][37]

September 2009	AAA < A+ $M	A+ < BBB $M	BBB < BB+ $M	BB+ < B+ $M	B+ < CCC $M	CCC $M	Default $M	Total $M
Regulatory credit exposure								
Corporate	6,543	28,634	48,005	65,423	6,622	3,720	3,928	162,875
Sovereign	25,610	1,691	94	1,218	1	1	3	28,618
Bank	26,441	1,290	1,026	507	15	26	139	29,444
Total	**58,594**	**31,615**	**49,125**	**67,148**	**6,638**	**3,747**	**4,070**	**220,937**
% of Total	**26.5%**	**14.3%**	**22.2%**	**30.4%**	**3.0%**	**1.7%**	**1.8%**	**100.0%**
Undrawn commitments (included in above)								
Corporate	1,769	12,735	15,382	12,580	611	546	201	43,824
Sovereign	437	63	1	20	-	-	-	521
Bank	256	6	8	5	-	-	-	275
Total	**2,462**	**12,804**	**15,391**	**12,605**	**611**	**546**	**201**	**44,620**
Average Exposure At Default (EAD)								
Corporate	0.790	1.467	0.577	0.336	0.514	0.329	0.651	
Sovereign	38.223	13.421	8.502	10.884	0.072	0.344	0.179	
Bank	9.955	1.101	1.362	0.509	0.374	13.889	2.278	
Exposure-weighted average Loss Given Default (LGD) (%)								
Corporate	59.6%	55.6%	47.8%	38.5%	43.6%	43.5%	47.0%	
Sovereign	2.5%	4.8%	58.5%	56.7%	39.0%	2.0%	59.0%	
Bank	62.0%	64.1%	60.7%	66.0%	58.8%	64.3%	42.0%	
Exposure-weighted average risk weight (%)								
Corporate	17.9%	34.0%	55.0%	78.9%	142.7%	203.6%	259.0%	
Sovereign	0.4%	1.9%	68.2%	98.4%	154.1%	11.5%	0.0%	
Bank	13.4%	19.1%	57.8%	124.9%	195.9%	311.1%	340.9%	

March 2009	AAA < A+ $M	A+ < BBB $M	BBB < BB+ $M	BB+ < B+ $M	B+ < CCC $M	CCC $M	Default $M	Total $M
Regulatory credit exposure								
Corporate	9,773	37,424	56,437	74,769	7,186	3,560	3,315	192,464
Sovereign	18,895	1,278	28	1,291	9	49	3	21,553
Bank	42,172	2,190	3,644	673	25	74	69	48,847
Total	**70,840**	**40,892**	**60,109**	**76,733**	**7,220**	**3,683**	**3,387**	**262,864**
% of Total	**26.9%**	**15.6%**	**22.9%**	**29.2%**	**2.7%**	**1.4%**	**1.3%**	**100.0%**
Undrawn commitments (included in above)								
Corporate	3,395	14,508	16,690	16,029	789	537	338	52,286
Sovereign	1,088	101	-	95	1	1	-	1,286
Bank	1,943	85	165	20	-	2	32	2,247
Total	**6,426**	**14,694**	**16,855**	**16,144**	**790**	**540**	**370**	**55,819**
Average Exposure At Default (EAD)								
Corporate	0.887	1.692	0.674	0.364	0.557	0.305	0.909	
Sovereign	45.530	9.909	1.500	8.842	1.311	48.502	0.257	
Bank	17.276	1.639	1.610	0.588	0.450	1.943	11.540	
Exposure-weighted average Loss Given Default (LGD) (%)								
Corporate	60.6%	57.1%	48.6%	39.8%	46.7%	48.3%	45.7%	
Sovereign	2.7%	4.8%	5.0%	58.3%	5.1%	2.0%	59.0%	
Bank	62.7%	63.4%	64.9%	58.5%	68.1%	65.7%	63.5%	
Exposure-weighted average risk weight (%)								
Corporate	21.1%	34.8%	57.9%	82.7%	167.0%	229.1%	204.2%	
Sovereign	0.5%	1.7%	8.4%	98.1%	19.9%	11.0%	0.0%	
Bank	16.0%	25.6%	53.6%	108.2%	221.5%	320.3%	162.0%	

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

[37] Average Exposure at Default (EAD) is calculated as total EAD divided by the total number of credit risk generating exposures.

Table 6(d): Non Retail regulatory credit exposure subject to Internal Ratings Based (IRB) approach (continued)

	September 2008							
	AAA < A+ $M	A+ < BBB $M	BBB < BB+ $M	BB+ < B+ $M	B+ < CCC $M	CCC $M	Default $M	Total $M
Regulatory credit exposure								
Corporate	17,321	39,769	58,273	73,003	3,706	2,097	1,829	195,998
Sovereign	6,892	658	2	1,768	26	-	4	9,350
Bank	43,064	3,313	2,083	1,959	244	35	101	50,799
Total	**67,277**	**43,740**	**60,358**	**76,730**	**3,976**	**2,132**	**1,934**	**256,147**
% of Total	**26.3%**	**17.1%**	**23.6%**	**30.0%**	**1.6%**	**0.8%**	**0.8%**	**100.0%**
Undrawn commitments (included in above)								
Corporate	4,738	16,277	15,664	15,415	529	462	217	53,302
Sovereign	651	125	2	105	-	-	1	884
Bank	3,342	251	42	61	6	1	85	3,788
Total	**8,731**	**16,653**	**15,708**	**15,581**	**535**	**463**	**303**	**57,974**
Average Exposure At Default (EAD)								
Corporate	1.436	2.081	0.689	0.315	0.321	0.178	0.701	
Sovereign	16.890	14.008	0.666	41.118	0.494	-	0.185	
Bank	13.896	2.152	2.902	1.555	1.296	0.262	20.125	
Exposure-weighted average Loss Given Default (LGD) (%)								
Corporate	62.1%	58.5%	49.4%	39.5%	40.5%	48.0%	47.7%	
Sovereign	3.3%	4.3%	2.0%	58.5%	58.8%	0.0%	59.0%	
Bank	62.8%	64.4%	64.8%	56.9%	55.1%	67.6%	64.2%	
Exposure-weighted average risk weight (%)								
Corporate	19.6%	37.1%	57.0%	84.3%	135.2%	227.3%	258.1%	
Sovereign	0.6%	2.2%	1.6%	110.3%	168.0%	0.0%	710.9%	
Bank	17.1%	27.1%	62.4%	119.7%	180.4%	328.6%	160.5%	

Table 6(d): Retail regulatory credit exposure subject to Internal Ratings Based (IRB) approach by risk grade[38]

ANZ rating system of Retail exposures

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

	September 2009							
	0.00% < 0.11% $M	0.11% < 0.30% $M	0.30% < 0.51% $M	0.51% < 3.49% $M	3.49% < 10.09% $M	10.09% < 100.00 % $M	Default $M	Total $M
Regulatory Credit Exposure								
Residential Mortgage	3,587	120,570	11,016	56,097	5,327	3,574	1,410	201,581
Qualifying Revolving Retail	10,196	249	1,843	4,598	1,860	921	153	19,820
Other Retail	1,086	3,415	1,757	16,048	5,025	746	574	28,651
Total	**14,869**	**124,234**	**14,616**	**76,743**	**12,212**	**5,241**	**2,137**	**250,052**
% of Total	**5.9%**	**49.7%**	**5.8%**	**30.7%**	**4.9%**	**2.1%**	**0.9%**	**100.0%**
Undrawn commitments (included in above)								
Residential Mortgage	402	12,690	1,191	4,037	235	96	13	18,664
Qualifying Revolving Retail	7,983	249	1,233	2,155	604	121	23	12,368
Other Retail	452	2,117	1,169	2,388	276	50	5	6,457
Total	**8,837**	**15,056**	**3,593**	**8,580**	**1,115**	**267**	**41**	**37,489**
Average Exposure At Default (EAD)								
Residential Mortgage	0.041	0.191	0.158	0.213	0.168	0.178	0.286	
Qualifying Revolving Retail	0.011	0.006	0.010	0.008	0.008	0.007	0.008	
Other Retail	0.086	0.010	0.006	0.014	0.011	0.007	0.027	
Exposure-weighted average LGD (%)								
Residential Mortgage	20.8%	20.1%	20.2%	21.4%	20.3%	20.6%	21.8%	
Qualifying Revolving Retail	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	
Other Retail	24.8%	56.5%	65.0%	45.5%	44.6%	61.4%	57.1%	
Exposure-weighted average risk weight (%)								
Residential Mortgage	4.6%	6.9%	14.4%	26.9%	77.9%	113.8%	241.5%	
Qualifying Revolving Retail	4.8%	11.3%	13.9%	38.5%	106.9%	206.3%	275.0%	
Other Retail	5.8%	26.3%	43.1%	60.2%	70.1%	147.1%	192.3%	

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

Table 6(d): Retail regulatory credit exposure subject to Internal Ratings Based (IRB) approach by risk grade (continued)

March 2009

	0.00% < 0.11% $M	0.11% < 0.30% $M	0.30% < 0.51% $M	0.51% < 3.49% $M	3.49% < 10.09% $M	10.09% < 100.00 % $M	Default $M	Total $M
Regulatory Credit Exposure								
Residential Mortgage	3,800	113,959	27,277	39,008	6,161	3,936	1,291	195,432
Qualifying Revolving Retail	10,874	2,141	1,790	5,454	2,073	1,103	169	23,604
Other Retail	1,348	2,642	879	16,493	4,479	702	530	27,073
Total	**16,022**	**118,742**	**29,946**	**60,955**	**12,713**	**5,741**	**1,990**	**246,109**
% of Total	**6.5%**	**48.2%**	**12.2%**	**24.8%**	**5.2%**	**2.3%**	**0.8%**	**100.0%**
Undrawn commitments (included in above)								
Residential Mortgage	361	12,454	2,721	2,383	220	101	14	18,254
Qualifying Revolving Retail	8,680	1,785	1,214	2,712	704	145	21	15,261
Other Retail	467	651	699	2,025	107	49	9	4,007
Total	**9,508**	**14,890**	**4,634**	**7,120**	**1,031**	**295**	**44**	**37,522**
Average Exposure At Default (EAD)								
Residential Mortgage	0.046	0.185	0.123	0.160	0.167	0.161	0.201	
Qualifying Revolving Retail	0.010	0.009	0.009	0.007	0.007	0.006	0.006	
Other Retail	0.032	0.023	0.003	0.018	0.011	0.007	0.018	
Exposure-weighted average LGD (%)								
Residential Mortgage	20.9%	20.1%	21.8%	20.8%	20.4%	20.5%	21.4%	
Qualifying Revolving Retail	73.9%	80.0%	73.3%	74.5%	73.7%	73.7%	73.9%	
Other Retail	22.2%	18.6%	37.6%	39.6%	43.1%	53.4%	51.7%	
Exposure-weighted average risk weight (%)								
Residential Mortgage	5.5%	6.7%	14.7%	30.0%	73.2%	111.4%	267.6%	
Qualifying Revolving Retail	4.7%	8.5%	13.5%	37.9%	105.4%	205.3%	857.5%	
Other Retail	5.2%	9.4%	24.5%	52.7%	67.5%	127.9%	330.5%	

September 2008

	0.00% < 0.11% $M	0.11% < 0.30% $M	0.30% < 0.51% $M	0.51% < 3.49% $M	3.49% < 10.09% $M	10.09% < 100.00 % $M	Default $M	Total $M
Regulatory Credit Exposure								
Residential Mortgage	1,524	110,113	25,807	38,639	5,772	3,633	799	186,287
Qualifying Revolving Retail	10,556	2,155	2,018	5,439	2,203	947	140	23,458
Other Retail	1,259	2,714	1,425	15,420	4,865	634	391	26,708
Total	**13,339**	**114,982**	**29,250**	**59,498**	**12,840**	**5,214**	**1,330**	**236,453**
% of Total	**6%**	**49%**	**12%**	**25%**	**5%**	**2%**	**1%**	**100%**
Undrawn commitments (included in above)								
Residential Mortgage	244	11,218	2,608	2,390	206	93	10	16,769
Qualifying Revolving Retail	8,368	1,837	1,392	2,789	766	126	19	15,297
Other Retail	409	701	805	1,537	452	48	8	3,960
Total	**9,021**	**13,756**	**4,805**	**6,716**	**1,424**	**267**	**37**	**36,026**
Average Exposure At Default (EAD)								
Residential Mortgage	0.025	0.177	0.115	0.157	0.163	0.158	0.196	
Qualifying Revolving Retail	0.010	0.010	0.008	0.007	0.007	0.006	0.006	
Other Retail	0.030	0.023	0.005	0.019	0.010	0.006	0.018	
Exposure-weighted average LGD (%)								
Residential Mortgage	20.0%	20.1%	21.9%	20.9%	20.6%	20.6%	21.3%	
Qualifying Revolving Retail	73.9%	79.4%	74.1%	74.3%	73.7%	73.7%	73.9%	
Other Retail	22.4%	19.9%	35.1%	38.0%	46.1%	54.4%	51.6%	
Exposure-weighted average risk weight (%)								
Residential Mortgage	5.1%	6.9%	14.6%	30.5%	74.6%	112.0%	267.6%	
Qualifying Revolving Retail	4.9%	8.4%	13.9%	39.0%	111.4%	207.1%	846.3%	
Other Retail	4.2%	9.1%	23.6%	51.2%	72.1%	129.3%	348.8%	

Table 6(e): Actual Losses by portfolio type[39]

	Full Year September 2009	
Basel Asset Class	Charges for individual provision $M	Write-offs $M
Corporate	1,723	1,118
Sovereign	-	-
Bank	45	27
Residential Mortgage	162	46
Qualifying revolving retail	229	264
Other retail	477	395
Total Advanced IRB	**2,636**	**1,850**
Standardised	114	39
Total Exposure	**2,750**	**1,889**

	Half Year March 2009	
Basel Asset Class	Charges for individual provision $M	Write-offs $M
Corporate	1,030	451
Sovereign	-	-
Bank	4	30
Residential Mortgage	48	14
Qualifying revolving retail	108	124
Other retail	218	148
Total Advanced IRB	**1,408**	**767**
Standardised	41	16
Total Exposure	**1,449**	**783**

	Full Year September 2008	
Basel Asset Class	Charges for individual provision $M	Write-offs $M
Corporate	480	160
Sovereign	-	-
Bank	45	6
Residential Mortgage	40	45
Qualifying Revolving Retail	219	270
Other Retail	214	189
Total Advanced IRB	**998**	**670**
Standardised	34	29
Total Exposure	**1,032**	**699**

Refer to Table 4(f) part (i) for commentary on provisions. Write-offs increased to $1,889 million in 2009 compared to $699 million for full year 2008 (first half 2008: $376 million; second half 2008: $323 million). Write-offs in Australia were driven by unsecured portfolios, Commercial Property and Finance and Insurance. Increases in New Zealand were driven by retail and commercial.

[39] Charges for Individual Provision relate to loans and advances, and do not include impairment on available-for-sale of $20 million in September 2009 (March 2009: $20 million; September 2008: $98 million).

Table 6(f): Analysis of actual versus Expected Losses by portfolio type (Advanced AIRB) [40]

	30 September 2009 Actual losses		30 September 2008 One year Expected Loss (EL) estimates	
	Write Offs	Charges for Individual Provision	Internal model EL estimate	Regulatory EL estimate
	$m	$m	$m	$m
Corporate	1,118	1,723	687	1,686
Sovereign	-	-	10	10
Bank	27	45	68	91
Residential Mortgage	46	162	58	391
Qualifying Revolving Retail	264	229	330	363
Other Retail	395	477	332	510
Total Advanced IRB	**1,850**	**2,636**	**1,485**	**3,051**

Regulatory EL and Internal EL shown above represent estimated credit loss from defaults over a one year period and are computed as the product of PD, LGD and EAD as at 30 September 30 2008. The actual loss measures are Charges for Individual Provision and Write-offs recorded in ANZ's financial statements through during 2009. While these metrics provide some insight into the predictive power of ANZ's estimations, any comparison has limitations due to definitional differences - eg:

- Both Regulatory and Internal EL are a measure of expected credit losses for a snapshot of ANZ's credit exposure at a certain balance sheet date while the Charges for Individual Provisions and Write-Offs are recorded for a fluctuating credit portfolio over the course of a financial year – and Write Offs may relate to prior period defaults
- The parameters PD, LGD and EAD underlying the Regulatory EL calculation represent through the cycle estimates based on APRA methodology which includes the use of the LGD floor for Mortgages, slotting approach for project finance, object finance and non diversified real estate
- Internal EL is calculated on non-impaired exposures only and uses long run LGD's rather than downturn LGD. Regulatory EL includes the Individual Provision balance on defaulted exposures
- Charges for Individual Provisions represent an accounting estimate of likely losses on defaulted exposures, whereas Write-offs are taken when defaulted exposures are assessed as partially or fully uncollectable after the proceeds from any realisation of collateral have been taken into account. There is typically a time lag between Charges for Individual Provisions and Write-offs.

Charges for Individual Provision exceeded write-offs in 2009 because many of the defaults that emerged during the year are still in the workout period where recovery options are being identified and pursued.

Table 7 Credit risk mitigation disclosures

Main types of collateral taken by ANZ

Collateral is used to mitigate credit risk, as the secondary source of repayment in case the counterparty cannot meet its contractual repayment obligations[41]. Types of collateral typically taken by ANZ include:

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

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

[40] Table 6(f) relates only to Advanced IRB and not Standardised, Equities, Securitisation or Other Assets.

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

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

Policies and processes for collateral valuation and management

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

In order to achieve legal enforceability and certainty, ANZ has standard collateral instruments, and where applicable, security interests are registered. The use of collateral management systems also provides certainty that the collateral has been properly taken, registered and stored.

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

Guarantee support

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

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

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

Use of credit derivatives for risk mitigation

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

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

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

A CDS may only be transacted with banks, ANZ-related conduits and non-bank financial institutions that have been credit assessed and approved by a specific specialist credit point. All parties must meet minimum credit standards and be allocated a related credit limit.

The use of netting

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

In order to apply on-balance sheet netting, the arrangement must be specifically documented with the customer and meet a number of legally enforceable requirements. Reliance on ANZ's common law right of set off is not sufficient to be recognised for regulatory capital purposes.

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

Transaction structuring to mitigate credit risk

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

Concentrations of credit risk mitigation

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

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

Table 7(b): Credit risk mitigation - collateral[42 43 44]

	September 2009			
	Total Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	% Coverage
Standardised				
Corporate	13,881	350	-	2.5%
Sovereign	-	-	-	0.0%
Bank	15	-	-	0.0%
Residential Mortgage	1,169	19	-	1.6%
Other Retail	-	-	-	0.0%
Total	**15,065**	**369**	**-**	**2.4%**

	March 2009			
	Total Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	% Coverage
Standardised				
Corporate	16,072	478	-	3.0%
Sovereign	-	-	-	0.0%
Bank	29	-	-	0.0%
Residential Mortgage	1,347	22	-	1.6%
Other Retail	-	-	-	0.0%
Total	**17,448**	**500**	**-**	**2.9%**

	September 2008			
	Total Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	% Coverage
Standardised				
Corporate	13,466	481	-	3.6%
Sovereign	-	-	-	0.0%
Bank	28	-	-	0.0%
Residential Mortgage	994	18	-	1.8%
Other Retail	-	-	-	0.0%
Total	**14,488**	**499**	**-**	**3.4%**

[42] In order to show the cover provided by the disclosed mitigants, the exposure amount is prior to the application of the eligible risk mitigation. Excluding mitigants, the Standardised exposure amount is $14,696 million as of September 2009 (March 2009: $18,355 million; September 2008: $15,831 million).

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

[44] Margin Lending exposures of $1,553 million were reclassified during the period from Standardised to Other Assets, and are therefore excluded from Tables 4(b), 4(c), 4(d), 4(e), 4(i), 5(b), 7(b) and 7(c). Prior period comparatives have also been restated to reflect this reclassification (March 2009: $1,407 million; September 2008: $1,842 million).

Table 7(c): Credit risk mitigation – guarantees and credit derivatives[45] [46]

September 2009	Total Exposure $M	Exposures Covered by Guarantees $M	Exposures Covered by Credit Derivatives $M	% Coverage
Advanced IRB				
Corporate	190,898	10,809	779	6.1%
Sovereign	23,052	24	-	0.1%
Bank	32,959	3,933	-	11.9%
Residential Mortgage	201,581	-	-	-
Qualifying Revolving Retail	19,820	-	-	-
Other Retail	28,651	-	-	-
Total	**496,960**	**14,766**	**779**	**3.1%**
Standardised				
Corporate	13,531	-	-	-
Sovereign	-	-	-	-
Bank	15	-	-	-
Residential Mortgage	1,150	-	-	-
Other Retail	-	-	-	-
Total	**14,696**	**-**	**-**	**-**

March 2009	Total Exposure $M	Exposures Covered by Guarantees $M	Exposures Covered by Credit Derivatives $M	% Coverage
Advanced IRB				
Corporate	221,174	12,053	1,023	5.9%
Sovereign	18,121	35	-	0.2%
Bank	50,001	1,898	-	3.8%
Residential Mortgage	195,432	-	-	-
Qualifying Revolving Retail	23,604	-	-	-
Other Retail	27,073	-	-	-
Total	**535,405**	**13,986**	**1,023**	**2.8%**
Standardised				
Corporate	15,594	-	-	-
Sovereign	-	-	-	-
Bank	29	-	-	-
Residential Mortgage	1,325	-	-	-
Other Retail	-	-	-	-
Total	**16,948**	**-**	**-**	**-**

[45] Guarantee coverage for Corporate exposures can originate from Corporate, Sovereign or Bank counterparties. Table 7(c) shows the original exposure amount by asset class prior to the impact of the guarantee. For example, a Corporate exposure guaranteed by a Bank is shown above as a Corporate, however it will appear in other tables in this Pillar 3 disclosure as a Bank exposure i.e. post the effect of the guarantee.

[46] The total exposure amount in Table 7(c) has been grossed up for the mitigant value of Credit Derivatives.

Table 7(c): Credit risk mitigation – guarantees and credit derivatives (continued)

	September 2008			
	Total Exposure $M	Exposures Covered by Guarantees $M	Exposures Covered by Credit Derivatives $M	% Coverage
Advanced IRB				
Corporate	227,266	7,720	821	3.8%
Sovereign	8,912	58	-	0.7%
Bank	49,961	-	-	-
Residential Mortgage	186,287	-	-	-
Qualifying Revolving Retail	23,458	-	-	-
Other Retail	26,708	-	-	-
Total	**522,592**	**7,778**	**821**	**1.6%**
Standardised				
Corporate	12,985	-	-	-
Sovereign	-	-	-	-
Bank	28	-	-	-
Residential Mortgage	976	-	-	-
Other Retail	-	-	-	-
Total	**13,989**	**-**	**-**	**-**

Table 8 General disclosures for derivatives and counterparty credit risk

Definition of market-related counterparty credit risk

Market-related credit risk is present in market instruments (derivatives and forward contracts), and comprises settlement risk (default at the end of the contract) and market replacement risk (default at any time during the life of the contract). Market-related credit risk requires a different method to calculate EAD because actual and potential market movements impact ANZ’s exposure or replacement rate. The markets covered by this treatment include interest rates, foreign exchange, credit default swaps, equities and commodities.

Market related counterparty credit risk governance

The Market Risk function is responsible for methodology and Credit Risk function is responsible for day-to-day capture of relevant transactions in the counterparty credit risk management system and the calculation of counterparty credit risk. As described in Chapter 7, Market Risk provides regular reporting to the CMRC, ANZ’s most senior executive credit and trading risk committee.

Market related counterparty credit risk measurement and reporting

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

- The mark-to-market is essentially the current replacement cost of the contract, and can be positive or negative. Where it is positive, i.e. in the money, ANZ has a credit exposure against the counterparty; if it is negative i.e. out of the money, the value used in the calculation is zero
- The PCRE factors recognise that prices change over the remaining period to maturity, and that risk increases with time. The PCRE factors are mandated for regulatory capital purposes. For internal economic capital purposes, more granular PCRE factors, based on observed historic volatilities are used. The economic capital treatment also takes concentrations into account.

For certain non-standard products where regular PCRE factors do not apply, ANZ uses a specialist credit system to apply a Monte Carlo simulation to calculate the potential credit exposure. The PCRE factors are also used by lending officers when establishing customer limits, to ensure that credit assessment recognises the potential volatility of the transactions. In terms of reporting, counterparty credit risk is calculated daily and excesses above approved limits are reported to account controllers and risk officers for action.

Impaired derivatives are subject to a Credit Valuation Adjustment (market assessment of credit risk of relevant counterparties, as stated in Chapter 5) which obviates the need for an Individual Provision.

Wrong way risk

ANZ's management of counterparty credit risk also recognises the possibility of wrong way risk arising. Wrong way risk emerges when a counterparty's Probability of Default is positively correlated with market risk factors. ANZ's credit policies require consideration of wrong way risk arising on all transactions, including credit derivatives. These assessments are reviewed as part of independent credit approval processes.

Counterparty credit risk mitigation

ANZ's primary tools to mitigate counterparty credit risk are netting, collateral and a rigorous control system.

Close-out netting agreements reduce the risk of loss by reducing all eligible transactions with a single counterparty to a single net figure i.e. both in and out of the money positions.

In some transactions, ANZ or the counterparty may be required to lodge collateral. Standard market documentation governs the amount of collateral required and the re-margining frequency between counterparties. There is a link between the amount of collateral required and external ratings, as well as minimum transfer amounts. This means that in the event that ANZ's or a counterparty's external rating was downgraded, ANZ or the counterparty would likely be required to lodge additional collateral. The amount required to be lodged would depend upon the underlying instruments and the state of the markets, so would be different at each re-margining interval.

In the event of a downgrading of ANZ's rating by one notch from AA to AA- at 30 September 2009, ANZ would not have been required to lodge additional collateral with its counterparties. A downgrade of two notches from AA to A+ would have required lodging of an additional USD 400 million.

The control system, with the system of counterparty limits and independent calculation and reporting of excesses, has been described above.

Chapter 6 – Securitisation

Table 9 Securitisation disclosures

Definition of securitisation

A securitisation is a financial structure where the cash flow from a pool of assets is used to service obligations to at least two different tranches or classes of creditors, typically holders of debt securities, with each class or tranche reflecting a different degree of credit risk. This stratification of credit risk means that one class of creditors is entitled to receive payments from the pool before another class. Securitisations take many forms, and may be categorised as traditional or synthetic, depending on legal ownership of the pool of assets:

- Traditional securitisations involve the legal transfer of ownership of the underlying asset pool into a Special Purpose Vehicle (SPV), which finances the purchase by issuing debt instruments (notes) to investors. The assets in the SPV are insulated from the bankruptcy of the seller or servicer of those assets, and principal and interest are paid to the investors from realisation of or regular cash flows from those assets. The notes are commonly referred to as asset backed securities (ABS), and may take the form of residential mortgage backed securities (RMBS)
- Synthetic securitisations also transfer the credit risk of the pool of assets to third parties, however legal ownership of the assets remains with the originator. This transfer of credit risk may be achieved via funded structures (eg: credit-linked notes) or may be unfunded (eg: credit default swaps, credit derivatives or guarantees).

Regulatory capital approaches used in ANZ's securitisation activities

For securitisation exposures held in ANZ's banking book[47], ANZ applies an Internal Ratings-Based approach (as outlined in APS 120 Capital Adequacy: Securitisation) to determine the regulatory capital charge related to banking book securitisation exposures.

For securitisation exposures held in ANZ's trading book, regulatory capital is calculated under market risk approaches described in Chapter 7.

Securitisation activities

ANZ is involved in four main types of securitisation activities:

- Securitisation of ANZ-originated assets - The securitisation of ANZ-originated assets provides diversity in the funding base of ANZ and may be traditional or synthetic. Such securitisations may or may not involve the transfer of credit risk and as such, may or may not provide regulatory capital relief
- Securitisation of third-party originated assets
- Facilities and services provided to securitisations - ANZ provides various facilities to securitisations, including: liquidity, funding and credit support as well as services such as structuring and arranging, conduit management and (via ANZ Capel Court Limited) trust management
- Investment in securities - ANZ purchases notes issued from securitisation programs for trading or liquidity purposes.

Governance of securitisation activities

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

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

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

When ANZ is investing in securitisations, the global Markets business manages them as they do any other part of the trading or liquidity portfolios.

Risk measurement and reporting of securitisation exposures

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

The rating derived from the above process is used with a conservative LGD and EAD for economic capital.

All facilities for securitisation vehicles are reviewed at least annually, including the risk grade. The reliance on external rating agency ratings and/or methodology means that ANZ must periodically review the methodology to ensure that it remains appropriate.

The type and frequency of reporting for ANZ's securitisation exposures is a function of the nature of those exposures:

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

Accounting policies

Many securitisation structures will involve the creation of a securitisation SPV. Any SPV in which ANZ has involvement is assessed for control under the requirements of AASB Interpretation 112 Consolidation – Special Purpose Entities, which is based on the concepts of risk and rewards. Where control is determined to exist, the SPV is consolidated into ANZ's financial statements. This assessment is performed regardless of whether the assets are ANZ or third-party originated. Financial instruments held and issued either from SPVs which are consolidated by ANZ or those held or issued to a non-consolidated SPV are recognised and valued using the principles of AASB 139 Financial Instruments: Recognition and Measurement, depending on their nature.

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

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

Use of external rating agencies

ANZ typically uses Standard & Poor's, Moody's Investor Services and/or Fitch Ratings for securitisations. These rating agencies are all used across a variety of asset classes and securitisation activities.

Table 9(d): Traditional and synthetic securitisation exposures[48] [49]

Traditional securitisations	September 2009			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	284	-	-	1,782
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	1,057
Commercial loans	-	-	-	181
Other	-	-	-	4,410
Total	**284**	**-**	**-**	**7,430**

Synthetic securitisations	September 2009			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	1,065
Total	**-**	**-**	**-**	**1,065**

Aggregate of traditional and synthetic securitisations	September 2009			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	284	-	-	1,782
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	1,057
Commercial loans	-	-	-	181
Other	-	-	-	5,475
Total	**284**	**-**	**-**	**8,495**

Traditional securitisations	March 2009			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	326	-	-	3,077
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	1,371
Commercial loans	-	-	-	554
Other	-	-	-	5,300
Total	**326**	**-**	**-**	**10,302**

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

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

Table 9(d): Traditional and synthetic securitisation exposures (continued)

Synthetic securitisations	**March 2009**			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	2,200	-	-	-
Other	-	-	-	1,409
Total	**2,200**	**-**	**-**	**1,409**

Aggregate of traditional and synthetic securitisations	**March 2009**			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	326	-	-	3,077
Credit cards and other personal loans	0	-	-	-
Auto and equipment finance	0	-	-	1,371
Commercial loans	2,200	-	-	554
Other	0	-	-	6,709
Total	**2,526**	**-**	**-**	**11,711**

Traditional securitisations	**September 2008**			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	371	-	-	3,467
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	1,480
Commercial loans	-	-	-	807
Other	-	-	-	6,819
Total	**371**	**-**	**-**	**12,573**

Synthetic securitisations	**September 2008**			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	2,200	-	-	-
Other	-	-	-	1,667
Total	**2,200**	**-**	**-**	**1,667**

Aggregate of traditional and synthetic securitisations	**September 2008**			Regulatory credit exposure
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Facilities provided $M
Residential mortgage	371	-	-	3,467
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	1,480
Commercial loans	2,200	-	-	807
Other	-	-	-	8,486
Total	**2,571**	**-**	**-**	**14,240**

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

Underlying asset	Value as at 30 September 2009 ANZ originated $M	Impaired $M	Past due $M	Half Year Losses recognised $M
Residential Mortgage	284	-	0	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**284**	**-**	**-**	**-**

Underlying asset	Value as at 31 March 2009 ANZ originated $M	Impaired $M	Past due $M	Half Year Losses recognised $M
Residential Mortgage	326	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	2,200	-	-	-
Other	-	-	-	-
Total	**2,526**	**-**	**-**	**-**

Underlying asset	Value as at 30 September 2008 ANZ originated $M	Impaired $M	Past due $M	Half Year Losses recognised $M
Residential Mortgage	371	-	-	-
Credit cards and other personal loans	0	-	-	-
Auto and equipment finance	0	-	-	-
Commercial loans	2,200	-	-	-
Other	0	-	-	-
Total	**2,571**	**-**	**-**	**-**

Table 9(f): Securitisation – Regulatory credit exposures by exposure type[50]

Securitisation exposure type	Regulatory credit exposure September 2009 $M	March 2009 $M	September 2008 $M
Liquidity facilities	3,915	5,239	5,732
Funding facilities	3,006	4,327	5,792
Underwriting facilities	-	-	-
Lending facilities	-	-	-
Credit enhancements	59	117	122
Holdings of securities (excluding trading book)	1,561	2,073	2,639
Other	-	-	-
Total	**8,541**	**11,756**	**14,285**

Table 9(g): Securitisation – Regulatory credit exposures by risk weight band

Securitisation risk weights	September 2009 Regulatory credit exposure $M	Risk weighted assets $M	March 2009 Regulatory credit exposure $M	Risk weighted assets $M	September 2008 Regulatory credit exposure $M	Risk weighted assets $M
≤ 25%	6,206	627	8,938	1,264	11,569	1,528
>25 ≤ 35%	225	79	1,009	353	736	257
>35 ≤ 50%	26	13	-	-	137	64
>50 ≤ 75%	412	309	1	1	1	1
>75 ≤ 100%	1,630	1,630	1,746	1,746	1,644	1,643
>100 ≤ 650%	-	-	-	-	183	778
1250% (Deduction)	42	-	62	-	15	-
Total	**8,541**	**2,658**	**11,756**	**3,364**	**14,285**	**4,271**

Securitisation exposures deducted from Capital	September 2009 Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	Total $M	March 2009 Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	Total $M	September 2008 Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	Total $M
Residential Mortgage	-	-	-	-	-	-	-	-	-
Credit cards and other personal loans	-	-	-	-	-	-	-	-	-
Auto and equipment finance	-	-	-	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-	-	-	-
Other	21	21	42	31	31	62	8	8	15
Total	**21**	**21**	**42**	**31**	**31**	**62**	**8**	**8**	**15**

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

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

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

Table 9(j): Securitisation – Summary of current year's activity by underlying asset type and facility[51]

	For the 6 months to 30 September 2009		
	Original value securitised		
Securitisation activity by underlying asset type	ANZ originated $M	Third party originated $M	Recognised gain or loss on sale $M
Residential mortgage	-	1,773	-
Credit cards and other personal loans	-	-	-
Auto and equipment finance	-	400	-
Commercial loans	-	-	-
Other	-	-	-
Total	**-**	**2,173**	**-**

Securitisation activity by facility provided	Notional amount $M
Liquidity facilities	-
Funding facilities	-
Underwriting facilities	-
Lending facilities	59
Credit enhancements	-
Holdings of securities (excluding trading book)	-
Other	-
Total	**59**

	For the 6 months to 31 March 2009		
	Original value securitised		
Securitisation activity by underlying asset type	ANZ originated $M	Third party originated $M	Recognised gain or loss on sale $M
Residential mortgage	-	772	-
Credit cards and other personal loans	-	-	-
Auto and equipment finance	-	-	-
Commercial loans	-	-	-
Other	-	-	-
Total	**-**	**772**	**-**

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

[51] "Third party originated" represents the total original assets of the securitisation, and is not representative of ANZ's exposure.

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

	For the 6 months to 30 September 2008		
	Original value securitised		
Securitisation activity by underlying asset type	ANZ originated $M	Third party originated $M	Recognised gain or loss on sale $M
Residential mortgage	-	-	-
Credit cards and other personal loans	-	-	-
Auto and equipment finance	-	2,041	-
Commercial loans	-	-	-
Other	-	4,833	-
Total	**-**	**6,874**	**-**

Securitisation activity by facility provided	Notional amount $M
Liquidity facilities	335
Funding facilities	2,902
Underwriting facilities	-
Lending facilities	-
Credit enhancements	-
Holdings of securities (excluding trading book)	-
Other	-
Total	**3,237**

Chapter 7 – Market Risk

Table 11 Market risk – Internal Models Approach (IMA)

Definition and scope of market risk

Market risk is defined as the risk to ANZ's earnings arising from changes in interest rates, foreign exchange rates and credit spreads, or from fluctuations in bond, commodity or equity prices.

Market risk arises through ANZ's trading and balance sheet activities. This chapter focuses on market risk arising from the traded book positions as well as from trading book and banking book positions that give rise to foreign exchange or commodity risks. Chapter 10 deals with market risk management of interest rate in the banking book.

Regulatory approval to use the Internal Models Approach

ANZ has been given approval by APRA to use the Internal Models Approach (IMA) under APS 116 Capital Adequacy: Market Risk for all trading portfolios except for specific interest rate risk, equity trading and electricity trading. ANZ uses the Standardised Approach to market risk capital for these three subsets of market risk.

Governance of market risk

The Board's Risk Committee oversight of market risk is supported by the Credit and Market Risk Committee as described in Chapter 3.

The Market Risk function is a specialist risk management unit independent of the business that is responsible for measuring and monitoring market risk, and has designed and implemented policies and procedures to ensure that market risk exposures are managed within the appetite and limit framework set by the Board.

The management of market risk arising from the traded book positions as well as from trading book and banking book positions that give rise to foreign exchange or commodity risks is described below.

Traded market risk

Management of traded market risk is governed by the Traded Market Risk Management Framework. Key aspects of this framework include:

- A clear definition of the trading book
- A comprehensive set of market risk policies that promote the proactive identification and communication of risk
- A robust Value at Risk (VaR) quantification approach that captures all sources of material market risk, supplemented by comprehensive stress testing
- A comprehensive market risk limit framework that controls all material market risks
- An independent Market Risk function which actively monitors market risk exposure, compliance with limits and risk policies, as well as the ongoing effectiveness and appropriateness of the risk management framework
- Regular and effective reporting of market risk to executive management and the Board.

Measurement of market risk

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

ANZ's key tools to measure and manage traded market risk on a daily basis are VaR estimates and sensitivities measures. VaR is calculated using historical changes in market rates and prices over the previous 500 business days. Traded VaR is calculated at 97.5% confidence interval, one-day holding period for trading activities and 99% confidence interval, ten-day holding period for the calculation of regulatory market risk capital. A 97.5% confidence level, one-day holding period VaR means that there is 97.5% chance that a loss will not exceed the VaR estimate on any given day. A 99% confidence level, ten-day holding period VaR means that there is 99% chance that a loss will not exceed the VaR estimate over a period of 10 days, assuming no rebalancing of risk positions. All material market risk factors and all trading portfolios (with the exception of interest rate risk – specific risk, equities and electricity trading, for which capital is calculated using under the Standardised Approach described in Table 10 below) are captured within the VaR model.

As VaR is driven by historical observations, it alone is not sufficiently reliable to estimate the maximum loss ANZ could suffer in an extreme market event. To complement VaR analysis, ANZ therefore also undertakes a wide range of stress tests to the trading portfolio, both on individual portfolios and at the Group level. Standard stress tests are applied on a daily basis and measure the potential loss impact arising from applying the largest market movements during the previous seven years over specific holding periods. Holding periods used to calculate stress parameters differ and reflect the relative liquidity of each product type.

Plausible severe scenarios are developed with reference to past events impacting traded markets such as the oil shock in the 1970's, stock market crash in 1987 and the emergence of global financial crisis in 2008, as well as possible future events such as a flu pandemic. Potential losses arising as a result of these scenarios are calculated monthly and reported to the CMRC.

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

All VaR models used within ANZ for the purposes of measuring exposure against limits are evaluated against actual and hypothetical profit and loss outcome. Back testing is conducted daily, and outliers are analysed to understand if the issues are the result of trading decisions, systemic changes in market conditions or issues related to the VaR model i.e. historical data or model calibration.

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

Table 11(d): VaR Values over the reporting period[52] [53]

	VaR values over six months ended 30 September 2009			
Value at Risk (VaR)	Mean value $M	Maximum value $M	Minimum value $M	Period end $M
Equities	-	-	-	-
Interest Rate	6.6	10.8	2.4	9.6
Foreign exchange	2.1	4.6	0.9	3.5
Commodity	1.4	4.3	0.6	1.2
Credit	1.8	3.2	1.2	2.4

	VaR values over six months ended 31 March 2009			
Value at Risk (VaR)	Mean value $M	Maximum value $M	Minimum value $M	Period end $M
Equities	-	-	-	-
Interest Rate	5.5	10.3	2.4	6.6
Foreign exchange	1.7	3.0	0.9	1.5
Commodity	1.0	2.5	0.6	0.9
Credit	1.9	3.2	1.2	2.2

	VaR values over six months ended 30 September 2008			
Value at Risk (VaR)	Mean value $M	Maximum value $M	Minimum value $M	Period end $M
Equities	-	-	-	-
Interest Rate	1.9	3.6	1.2	2.8
Foreign exchange	0.9	2.5	0.4	2.5
Commodity	1.0	1.5	0.4	1.3
Credit	1.0	2.6	0.6	1.2

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

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

Comparison of VaR estimates to actual gains/losses

Back testing involves the comparison of calculated VaR exposures with profit and loss data to identify the frequency of incidents when trading losses exceed the calculated VaR. As a probabilistic measure of potential future gains or losses, it is expected that results exceed VaR a proportion of the time. For APRA backtesting purposes, VaR is calculated at the 99% confidence interval with a one day holding period. Therefore, over the long-run we would expect one back testing outlier every 100 days.

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

As at 30 September 2009, based on the prior 250 business days, there were 6 hypothetical and 1 actual genuine negative outliers compared to 20 hypothetical and 4 actual genuine negative outliers as at 30 September 2008. This decrease in the number of hypothetical and actual genuine negative outliers is in line with expectations as the historical VaR model now incorporates the market volatility experienced from August 2007 onwards, while a reduction in market volatility throughout 2009 has decreased the magnitude of daily actual and hypothetical profit and loss results. Considering this the VaR model continues to be an appropriate model to use for Market Risk calculations.

Reporting of market risk

Market Risk conducts daily VaR and stress testing and reports the results to Market Risk management, senior executives and trading management. In the event of breaches, Market Risk will escalate details of the breach to the appropriate discretion holder within Market Risk and Group Risk. All breaches are reported to CMRC on a monthly basis.

Market Risk monitors and analyses back testing results on a daily basis and reports quarterly results to CMRC.

Mitigation of market risk

ANZ's system of market risk quantification is fundamental to how market risk is mitigated. The results are compared to established limits and breaches are reported immediately to management who instruct on the appropriate action in accordance with authorised delegations. All breaches are subsequently reported to senior executive Risk committees, i.e. CMRC.

ANZ also uses standard market documentation in order to reduce potential exposures by techniques such as netting. In the event of a default, netting agreements are designed to reduce amounts owed to and from counterparties to a single net figure.

The Market Risk group is also an important factor in how ANZ mitigates its market risk. It is a unit independent of the dealing, processing/settlements operations and manages the day-to-day risk management function. Market Risk group has presence in all the major dealing operations centres in Australia, New Zealand, Asia, Europe and America.

Commodities risk

Commodity price risk arises as a result of movement in prices for various commodities. All exposures to commodity prices are transferred to the trading book and centrally managed by the business and monitored by the Market Risk function in accordance with the Traded Market Risk Management Framework.

Foreign exchange risk

Foreign exchange risk arises as a result of movements in relative values of various currencies. It arises from ANZ's operating business activities, trading activities and structural foreign exchange exposures from foreign investments and capital management activities.

Foreign exchange exposures from ANZ's normal operating business and trading activities are recorded in core multi-currency systems and managed within the trading book in accordance with the Traded Market Risk Management Framework.

ANZ's structural foreign exchange exposures are managed in accordance with the policies approved by the Risk Committee of the Board, with the main objective of ensuring that ANZ's capital ratio is largely protected from the changes in foreign exchange. ANZ's investment in ANZ National Bank in New Zealand is the main source of the structural foreign exchange exposure.

Table 10 Market risk – Standardised Approach

ANZ uses the standard model approach to measure market risk capital for interest rate risk – specific risk[54], equity trading and electricity trading risk factors.

ANZ is in dialogue with APRA concerning approval of an internal model for electricity trading, and is building a history of results using an internal equity model in preparation for an application to APRA for internal model recognition. For interest rate risk – specific risk, ANZ's internal VaR model captures general interest rate and credit spread risk for all products, but not the credit spread risk associated with individual issuers of interest rate products.

Table 10(b): Market Risk – Standardised Approach[55]

	Capital requirements		
Market Risk under standardised approach	September 2009 $M	March 2009 $M	September 2008 $M
Interest rate risk	112	147	167
Equity position risk	3	3	2
Foreign exchange risk	-	-	-
Commodity risk	6	7	6
Total	121	157	175
RWA equivalent	1,514	1,961	2,187

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

[55] RWA equivalent is the capital requirement multiplied by 12.5 in accordance with APRA Prudential Standard APS 110.32.

Chapter 8 – Operational Risk

Table 12 Operational Risk

Definition of operational risk

Within ANZ, operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal risk, and the risk of reputational loss[56], however excludes strategic risk.

Regulatory approval to use the Advanced Measurement Approach

ANZ has been granted approval by APRA to use the Advanced Measurement Approach (AMA) under APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk. The approved AMA applies across all of ANZ, and does not comprise partial use.

Operational risk governance and structure

The roles of ANZ Board Risk Committee and the Operational Risk Executive Committee (OREC) are described in Chapter 3.

Group Operational Risk are responsible for exercising governance over operational risk through the management of the operational risk framework, policy development, framework assurance, operational risk measurement and capital allocation, fraud strategy and reporting of operational risk issues to executive committees.

Divisional Risk Committees and Business Unit Risk Forums manage and maintain oversight of operational risks supported by thresholds for escalation and monitoring.

Business units are responsible for implementation of the operational risk framework, including the identification, analysis, assessment and treatment of operational risks on a day-to-day basis. Divisional Risk personnel provide oversight of operational risk management undertaken in the business units, and are involved in decision making processes concerning all material operational risk matters.

Operational risk principles

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

- Operational risk is recognised as a primary risk within ANZ and has a governance structure responsible for maintaining oversight
- ANZ will create a culture that recognises operational risk as everyone’s responsibility with roles and responsibilities clearly articulated at all levels in the organisation
- ANZ will create an environment for sound, transparent decision-making that includes a framework to identify, assess, control and monitor ANZ’s operational risks
- Key decisions within ANZ will be informed by balancing operational risk with reward
- ANZ will continuously monitor the effectiveness and relevance of its framework for managing operational risk
- ANZ will monitor its exposure to operational risk and changes to its operational risk profile
- ANZ will learn from losses arising from operational risk by identifying and improving the underlying root cause.

The framework is supported by a comprehensive set of policies and guidelines.

Operational risk management

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

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

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

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

Dedicated Divisional and Group Corporate Centre Risk Governance teams provide a support monitoring and oversight function for business units, with Internal Audit providing independent assurance and review.

Operational risk mitigation

In line with industry practice, ANZ obtains insurance cover from third party and captive providers for those operational risks where cost-effective premiums can be obtained. ANZ's AMA operational risk regulatory capital does not utilise insurance mitigation under APS115.

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

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

Operational risk reporting

ANZ's operational risk management includes internal loss capture, case management and reporting. Operational risk and compliance events (including actual losses, near misses and breaches) are recorded and managed to ensure timely, complete and accurate reporting. Such events are required to be escalated to the appropriate level (either within the business, to Divisional Risk committee, CRO or the OREC) in accordance with established reporting thresholds for risk acceptance, remediation approval or tracking.

ANZ's Advanced Measurement Approach

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

ANZ uses a scenario based methodology to determine its operational risk regulatory capital. This methodology incorporates the use of business risk profiles which consider the current business environment and internal control factors over a twelve month time horizon.

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

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

Capital outcomes include:

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

Compliance

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

Chapter 9 – Equities

Table 13 Equities – disclosures for banking book positions

Definition and categorisation of equity investments held in the banking book

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

- *Equity investments that are taken for strategic reasons* - These transactions represent strategic business initiatives and include ANZ's investments in wealth management joint ventures with ING in Australia and New Zealand[57] and partnership arrangements with financial institutions in Asia[58]. These investments are undertaken only after extensive analysis and due diligence by Group Strategic Development, internal specialists and external advisors, where appropriate. Board approval is required prior to committing to such investments and all regulatory notification requirements are met. Performance of these investments is monitored by both the owning business unit and Group Strategic Development to ensure that it is within expectations and the values of the investments are tested at least annually for impairment
- *Equity investments on which capital gains are expected* - These transactions are originated and managed by dedicated equity finance teams. These transactions represent funding solutions for known customers of ANZ and are governed by specific policies. ANZ ensures that the investment in these entities does not constitute a controlling interest in the relevant business
- *Equity investments made as the result of a work out of a problem exposure* - From time to time, ANZ will take an equity stake in a customer as part of a work out arrangement for problem exposures. These investments are made only where there is no other viable option available and form an immaterial part of ANZ's equity exposures.

Valuation of and accounting for equity investments in the banking book

The accounting treatment of equity investments, other than for joint ventures, depends on whether ANZ has significant influence over the investee, as described in AASB 128 Investment in Associates. Where significant influence is assessed, the investment is classified as an Investment in Associates in the financial statements. ANZ adopts the equity method of accounting for associates and the Group's interest in joint venture entities. ANZ's share of results of associates and joint venture entities is included in the consolidated income statement. Shares in associates and joint venture entities are stated in the consolidated balance sheet at cost plus ANZ's share of post acquisition net assets. Interests in associates and joint ventures are reviewed annually for impairment, using either market value, or a discounted cash flow methodology to assess value in-use.

In accordance with APS 111 Capital Adequacy: Measurement of Capital, equity accounted earnings from strategic investments in joint ventures and partnerships are excluded from regulatory capital until received in the form of a dividend.

Where ANZ does not have significant influence over the investee, the investment is classified as Available For Sale. The investment is initially recognised at fair value plus transaction costs. Subsequent gains or losses arising from changes in fair value are included as a separate component of equity in the available for sale revaluation reserve, with any impairment recognised in the income statement. When the asset is sold the cumulative gain or loss relating to the asset held in the available for sale revaluation reserve is transferred to the income statement.

[57] On 25 September 2009 ANZ announced it had reached agreement with ING Groep to acquire ING Groep's 51% shareholdings in the ANZ-ING wealth management and life insurance joint ventures in Australia and New Zealand, taking its ownership interest to 100%. Completion is subject to various conditions and is expected to occur during the fourth quarter of calendar 2009.

[58] In addition to existing partnership arrangements with financial institutions in Asia, ANZ announced on 4 August 2009 it had reached agreement with Royal Bank of Scotland Group plc to acquire selected businesses in Taiwan, Singapore, Indonesia, Hong Kong, Philippines and Vietnam. Completion in each country is subject to regulatory approval in each jurisdiction and is expected to occur from late 2009 through 2010.

Table 13(b) and 13(c): Equities – Types and nature of Banking Book investments[59]

Equity investments	Balance sheet value			Fair value		
	September 2009 $M	March 2009 $M	September 2008 $M	September 2009 $M	March 2009 $M	September 2008 $M
Value of listed (publicly traded) equities	1,697	2,042	1,993	2,199	1,708	2,059
Value of unlisted (privately held) equities	3,337	3,140	2,935	3,713	3,628	3,757
Total	**5,034**	**5,182**	**4,928**	**5,912**	**5,336**	**5,816**

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

Gains (losses) on equity investments	Half Year 30 September 2009 $M	Half Year 31 March 2009 $M	Full Year 30 September 2009 $M	Full Year 30 September 2008 $M
Cumulative realised gains (losses) from disposals and liquidations in the reporting	(3)	(3)	(6)	159
Total unrealised gains (losses)	18	3	21	(56)
Total unrealised gains (losses) included in Gross Tier 1/Tier 2 capital	-	-	-	-

Table 13(f): Equities – Capital requirement

Risk Weighted Assets	September 2009 $M	March 2009 $M	September 2008 $M
Equity investments subject to a 300% risk weight	2	193	-
Equity investments subject to a 400% risk weight	1,912	1,514	1,146
Total minimum capital requirement by equity asset class	**1,914**	**1,707**	**1,146**
Aggregate amount of equity investments subject to:			
Supervisory provisions	n/a	n/a	n/a
Grandfathering provisions	n/a	n/a	n/a

[59] At 31 March 2009 and 30 September 2009, the market value of listed equities equals the fair value of these instruments. At 30 September 2008, one listed security had a market value materially different to its fair value. The intrinsic value of this instrument was considered best represented by the fair value. The market value of this instrument at 30 September 2008 was $65 million and the fair value was $56 million.

Chapter 10 - Interest rate risk in the banking book (IRRBB)

Table 14 Interest rate risk in the banking book

Definition of IRRBB

Interest Rate Risk in the Banking Book (IRRBB) relates to the potential adverse impact of changes in market interest rates on ANZ's future net interest income. The risk arises from the following principal sources:

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

Regulatory capital approach

ANZ has received approval to use the Internal Model Approach for the calculation of regulatory capital for IRRBB, under APS 117 Capital Adequacy: Interest Rate Risk in the Banking Book (Advanced ADIs).

Governance

As described in Chapter 3, the Board's oversight of IRRBB is supported by ANZ Asset & Liability Committee (GALCO) to manage the strategic position and oversee the interest rate risk arising from the discretionary position. The Global Markets business manages non-traded interest rate risk within earnings and market value limits consistent with ANZ's risk appetite. Market Risk is the independent unit responsible for monitoring and measuring IRRBB and has designed and implemented policies and procedures to ensure that IRRBB exposure is managed within the limit framework set by the Board. GALCO has delegated responsibility for monthly monitoring of IRRBB to the CMRC.

Management framework

As with other key risks within ANZ, IRRBB is managed under a comprehensive framework. Key aspects of the measurement and reporting framework which provides the basis for monitoring IRRBB include:

- A comprehensive set of policies that promote the proactive identification and communication of risk
- Funds Transfer Pricing (FTP) framework to transfer interest rate risk from business units so it can be managed by the Global Markets business and monitored by Market Risk
- Quantifying the magnitude of risks and controlling the potential impact that changes in market interest rates can have on the net interest income and balance sheet fair value of ANZ
- An independent Market Risk function which actively monitors market risk exposure, compliance with limits and risk policies, as well as the ongoing effectiveness and appropriateness of the risk management framework
- Regular and effective reporting of IRRBB to Executive Management and the Board.

Measurement of IRRBB

ANZ uses four principal techniques to quantify IRRBB:

- *Interest Rate Sensitivity* – this is an estimate of the change in economic value of the banking book due to a 1 basis point move in a specific part of the yield curve
- *Earnings-at-Risk (EaR)* – this is an estimate of the amount of income that is at risk from interest rate movements over a given holding period, expressed to a 97.5% or 99% level of statistical confidence
- *Value-at-Risk (VaR)* – this is an estimate of the impact of interest rate changes on the banking book's market value, expressed to a 97.5% or 99% level of statistical confidence for a given holding period
- *Stress testing* – Standard and extraordinary tests are used to highlight potential risk which may not be captured by VaR, and how the portfolio might behave under extraordinary circumstances.

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

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

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

Embedded losses and gains in the banking book are also calculated. This is calculated as the economic value of the banking book using wholesale market rates (typically the Interest Rate Swap curve).

Reporting of IRRBB

The output of ANZ's VaR and EaR calculations are analysed by Global Market Risk on a daily basis. Stress tests are calculated monthly and reported to CMRC, GALCO and the Risk Committee of the Board.

IRRBB regulatory capital is calculated monthly and reported to Group executives.

Details of ANZ's risk exposures, stress tests and compliance with limits are reported to CMRC on a monthly basis. Reports are also provided to the Board's Risk Committee at least quarterly.

ANZ's IRRBB capital requirement

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

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

Results of standard shock scenario

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

The table below shows the results of this test by currency of the exposures outside the trading book.

Table 14(b): Interest rate risk in the banking book (IRRBB)[60] [61]

	Change in Economic Value		
Standard Shock Scenario Stress Testing: Interest rate shock applied	**30 September 2009 $M**	**31 March 2009 $M**	**30 September 2008 $M**
AUD			
200 basis point parallel increase	(9)	(134)	(66)
200 basis point parallel decrease	16	141	71
NZD			
200 basis point parallel increase	(76)	(79)	(69)
200 basis point parallel decrease	75	79	67
USD			
200 basis point parallel increase	(17)	(22)	(23)
200 basis point parallel decrease	10	20	25
GBP			
200 basis point parallel increase	(5)	(6)	(5)
200 basis point parallel decrease	2	5	5
Other			
200 basis point parallel increase	(17)	(38)	(14)
200 basis point parallel decrease	11	35	15

IRRBB regulatory capital	**197**	**-**	**325**
IRRBB regulatory RWA	**2,465**	**-**	**4,058**

Stress testing methodology

The information provided for ANZ's IRRBB capital requirement, as determined by its internal model. The capital requirement includes a value for Repricing & Yield Curve risk based on historical simulation with a 99% confidence interval, 1 year holding period and a 6 year historical data set. Values for Optionality and Basis risk are also included and have been determined using Monte Carlo simulation. Embedded losses also make up the capital requirement and are calculated as the difference between the book value of banking book items and the current economic value.

[60] IRRBB risk weighted assets reduced from September 2008 to September 2009 due to the increase in embedded gains on Investment Term of Capital offsetting the increased volatility in repricing and yield curve risk as measured by Value at Risk VaR. The reduction in IRRBB RWA to nil at March 2009 was due to both realisation of prior gains and an increase in global term yields.

[61] Risk Weighted Assets are derived by multiplying total regulatory capital by 12.5

Chapter 11 – Liquidity risk

Overview

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

Governance

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

Scenario modelling

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

Funding metrics

ANZ actively uses balance sheet disciplines to prudently manage funding requirements. ANZ also employs funding metrics to ensure that an appropriate proportion of ANZ's assets are funded by stable funding sources including core customer deposits, longer-dated wholesale debt (with a remaining term exceeding one year) and equity. ANZ's funding profile strengthened further during the financial year as a result of solid growth in customer deposits and issuance of $25.8 billion of term wholesale debt.

Customer deposits and other funding liabilities increased by 12% to $242.4 billion at 30 September 2009 (55% of total funding) from $215.6 billion (50% of total funding) at 30 September 2008. As a result, the ANZ's proportional reliance on short term wholesale funding decreased to 17% from 22%

Wholesale funding

ANZ maintained access to all major wholesale funding markets to meet its borrowing requirement in full. Benchmark term debt issues were executed in AUD, USD, JPY, EUR and CHF. Short-term wholesale funding markets continue to function effectively, both locally and offshore:

- In aggregate during the 2009 Financial Year the ANZ raised $25.8 billion of new term funding (greater than one year at the end of the financial year).
- The weighted average tenor of new term debt issuance was 3.9 years.

The marginal cost of term funding has declined from the peaks established in early calendar 2009, however funding costs remain high by historical standards. The weighted average cost of term debt issuance increased by 69 basis points in 2009 (including the cost of the Government Guarantee) as a result of market conditions.

ANZ continues to build and maintain strong, long-term relationships with wholesale debt investors. The ANZ's wholesale debt issuance program was supported by debt investor meetings held in Australia, New Zealand, the United States, the United Kingdom, Europe, Asia and the Middle East.

ANZ also undertook the following actions to improve its funding capabilities, specifically:

- Established a licensed banking branch in New Zealand in January 2009. The branch structure expands the range of funding options available to our New Zealand business; and
- Transitioned Esanda Finance Corporation Limited (Esanda) from a wholly owned subsidiary towards a division of ANZ, including the launch of Esanda Term Deposits.

Liquidity portfolio

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

At 30 September 2009 the volume of eligible securities available, post any repurchase (i.e. "repo") discounts applied by the applicable central bank, was $60.2 billion. In addition, the liquidity portfolio provided cover against over one year of offshore wholesale debt maturities.

The Liquidity portfolio is well diversified by counterparty, currency, and tenor. Under the liquidity policy framework securities purchased must be of a similar or better credit quality to ANZ's external long-term or short-term credit ratings and continue to be repo eligible. Currently securities issued by approximately 84 separate counterparties - comprising bank, government and agency issuers - are held in the portfolio.

Supplementing the prime liquid asset portfolio the ANZ holds additional cash and liquid asset balances. Our Markets business also holds secondary sources of liquidity in the form of highly liquid instruments in its trading portfolios.

Appendix - ANZ Bank (Europe) Limited

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

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

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

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Australia and New Zealand Banking Group Limited

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