2010

BASEL II PILLAR 3

YEAR ENDED 30 SEPTEMBER 2010

APS 330: CAPITAL ADEQUACY & RISK MANAGEMENT IN ANZ

ANZ

Important Notice

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

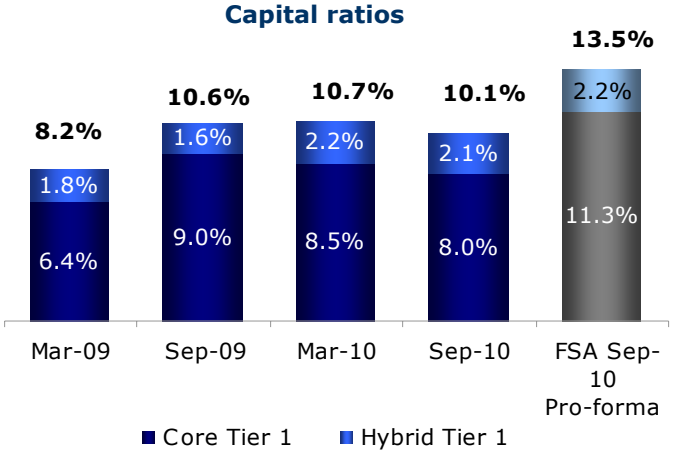
This disclosure was prepared as at 30 September 2010. ANZ has a continuous disclosure policy, under which ANZ will immediately notify the market of any material price sensitive information concerning the Group, in accordance with legislative and regulatory disclosure requirements.

TABLE OF CONTENTS[1]

[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]

Capital ratios

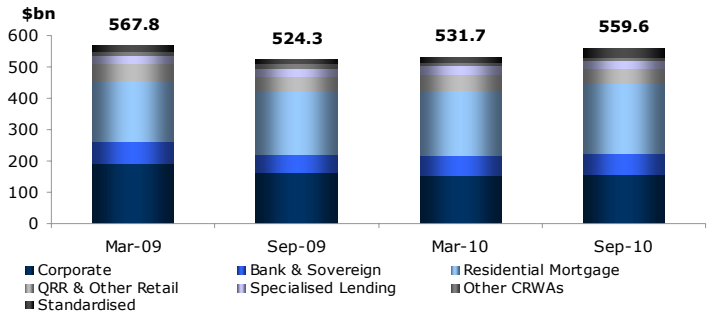


Strong capital position maintained

Tier 1 capital position has been impacted since Sep 09 mainly via:

- Acquisitions, reducing Tier 1 by 131bps (largest impact from ING of 79bps)
- Offset by underlying earnings net of dividends of 119bps.

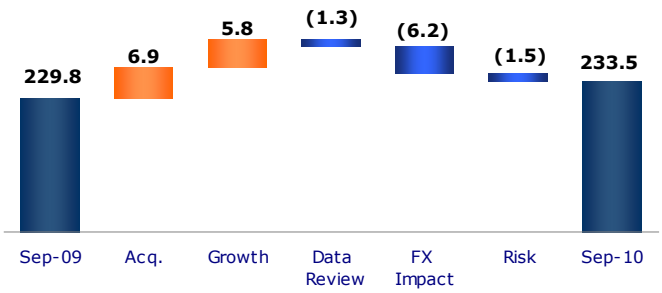
Exposure at Default ($bn)



Growth in EAD to $559.6bn driven by:

- Increases in Residential Mortgages in Australia and global Sovereign exposures, and Acquisitions of Landmark and RBS over 2010.

Movement in Credit Risk Weighted Assets ($bn)

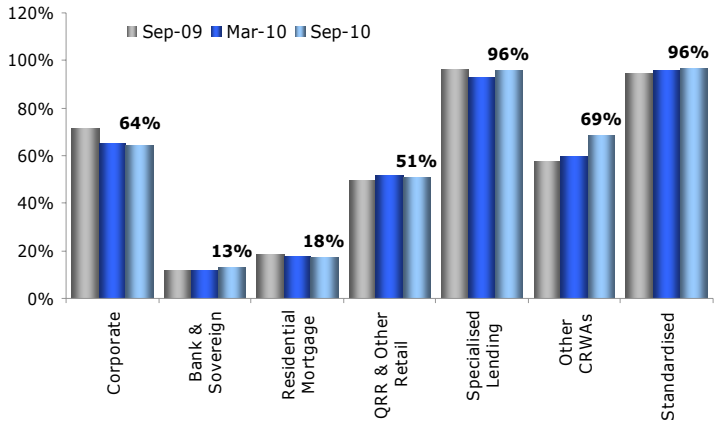


Similarly, increase in credit RWA driven by:

- Acquisitions relating to RBS and Landmark,
- Mortgages and Sovereign asset classes, (driving lower risk weights),
- This is partially offset by FX impacts and portfolio risk improvement, particularly from reduced tenors and upgrades.

[2] FSA Sep-10 Pro-forma represents estimated capital ratio using UK Financial Services Authority capital rules.

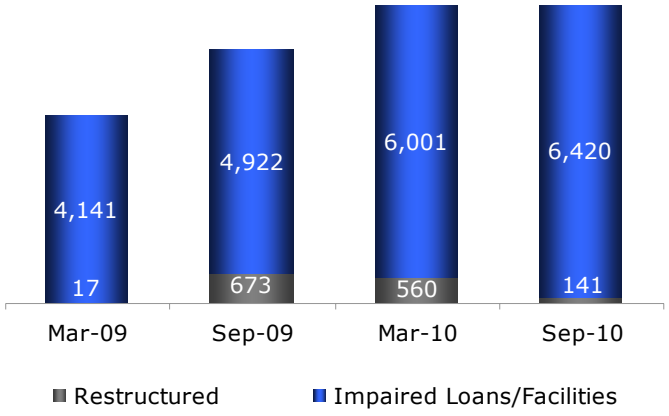
Average Risk Weights (CRWA/EAD)



Portfolio Average Risk Weight decreased 2.1% to 41.7% over the FY10

- Change in portfolio mix from contraction in Corporate EAD and growth in Sovereign and Residential Mortgages with lower average risk weights
- Risk weights remained stable since Mar 10

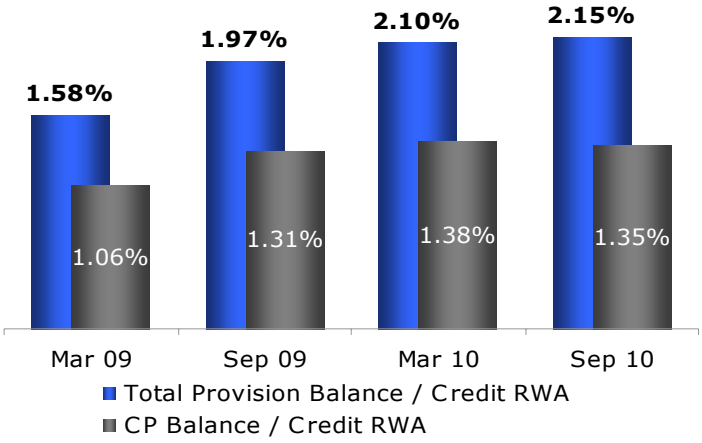
Impaired Assets ($m)



Impaired Assets remained stable since Mar 10

- With default rates in 2H10 lower than the first half, due to lower number of larger defaults
- Increases due to acquisitions were offset by upgrades to productive within the institutional portfolio
- Excluding acquisitions, impaired assets reduced ~5.5% since Mar 10

Provision ratios (Provisions/CRWA)



Provision coverage ratios remained solid

- High coverage of acquired portfolios in both RBS and Landmark

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).

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'[3]. 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

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

Basel II in ANZ

In December 2007, ANZ 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.

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 112: Capital Adequacy: Standardised Approach to Credit Risk
- APS 113: Capital Adequacy: Internal Ratings-based 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
- APS 220: Credit Quality
- APS 221: Large Exposures

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.

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

Verification of disclosures

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

Comparison to ANZ's Annual Report

These disclosures have been produced in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with 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 span 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 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[4]
- *Equity risk* – is the potential loss that may be incurred on equity investments in the banking book
- *Securitisation risk* – the risk of credit related losses greater than expected due to a securitisation failing to operate as anticipated, or of the values and risks accepted or transferred, not emerging as expected.

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

- *Strategic Risk* is defined to be the potential for loss arising from a failure in ANZ's strategies. These include strategies designed to address or anticipate changes in the competitive, client, political or regulatory environments.
- *Business Risk* is defined as the risk of financial loss due to unexpected movements in volume, profit margin, and operating expenses (excluding risks elsewhere defined) arising from unexpected changes in the business environment, customer preferences and/or competitor actions.
- *Liquidity risk* - the risk that ANZ has insufficient capacity to fund increases in assets, or is unable to meet its payment obligations as they fall due, including repaying depositors or maturing wholesale debt
- *Compliance risk* - 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.

[4] 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.

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

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

Risk management governance

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

Risk Committee	Assists the Board 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. This ensures they are aligned to adding shareholder value by managing and positioning the balance sheet consistent with ANZ's appetite for risk, maintaining ANZ's preferred AA rating, 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 shall normally meet six times a year.

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 non-traded market risk. Its responsibilities and duties include:

- Oversee the Risk Appetite Framework
- Approve credit and market risk policies
- Oversee credit and market risk model performance
- Ensure comprehensive credit and market risk control, including handling of emerging issues
- Approve business writing strategies
- Review credit provisions
- Oversee credit portfolio composition, including large exposures, risk grade migration, risk concentrations and changes to delinquency patterns
- Set and oversee market risk limits.

CMRC is chaired by ANZ's CRO and meets 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 shall normally meet six times a year It supports CMPC and CMRC, and in turn is supported by working groups.

Operational Risk Executive Committee (OREC)

OREC is the primary senior executive management forum responsible for the oversight of the control environment managing compliance and operational risk. Its main responsibilities and duties include:

- Endorse ANZ's Operational Risk Framework for approval by the Board Risk Committee
- Approve ANZ's Group Compliance Framework
- Approve Operational Risk policies and Compliance policies
- Monitor operational risk policies and compliance profiles, emerging risks, incidents, trends and remediation, including treatment plans for extreme risks.

OREC is chaired by ANZ's CRO and 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 shall normally meet six times a year.

Chapter 4 – Group structure and capital adequacy

Table 1 Scope of application

Top corporate entity

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

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

- Level 1 - being the ADI i.e. Australia and New Zealand Banking Group Limited, consolidated with APRA approved subsidiaries, to form the ADI's Extended Licensed Entity (ELE)
- Level 2 – being the consolidated group for financial reporting purposes adjusted to exclude associates activities and certain subsidiaries excluded under APS 110 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 consolidated group for financial reporting purposes.

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

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

Details of the capital treatment of ANZ's material subsidiaries are shown below:

Name	Included in Level 2?	Capital Treatment	Business
Amerika Samoa Bank	Yes	Assets Risk Weighted	Banking
ANZ Bank (Vietnam) Limited	Yes	Assets Risk Weighted	Banking
ANZ Capel Court Limited	Yes	Assets Risk Weighted	Investment Banking
ANZ Capital Hedging Pty Ltd	Yes	Assets Risk Weighted	Hedging
ANZ Commodity Trading Pty Ltd	Yes	Assets Risk Weighted	Finance
ANZ Cover Insurance Pty Ltd	No	Investment Deducted	Captive-Insurance
ANZ Trustees Limited	No	Investment Deducted	Trustee/Nominee
ANZ Funds Pty Ltd	Yes	Assets Risk Weighted	Holding Company
ANZ Bank (Europe) Limited	Yes	Assets Risk Weighted	Banking
ANZ Bank (Kiribati) Limited	Yes	Assets Risk Weighted	Banking
ANZ Bank (Samoa) Limited	Yes	Assets Risk Weighted	Banking
ANZ Holdings (New Zealand) Limited	Yes	Assets Risk Weighted	Holding Company
ANZ National Bank Limited	Yes	Assets Risk Weighted	Banking
ANZ Investment Services (New Zealand) Limited	Yes	Assets Risk Weighted	Fund Manager
ANZ National (Int'l) Limited	Yes	Assets Risk Weighted	Finance
Arawata Assets Limited	Yes	Assets Risk Weighted	Finance
ING (NZ) Holdings Limited	No	Investment Deducted	Holding Company
ING Insurance Holdings Limited	No	Investment Deducted	Holding Company
ING Life (NZ) Limited	No	Investment Deducted	Insurance
Private Nominees Limited	Yes	Assets Risk Weighted	Nominee
UDC Finance Limited	Yes	Assets Risk Weighted	Finance
ANZ International (Hong Kong) Limited	Yes	Assets Risk Weighted	Holding Company
ANZ Asia Limited	Yes	Assets Risk Weighted	Banking
ANZ Bank (Vanuatu) Limited	Yes	Assets Risk Weighted	Banking
ANZ International Private Limited	Yes	Assets Risk Weighted	Holding Company
ANZ Singapore Limited	Yes	Assets Risk Weighted	Merchant Banking
ANZ Royal Bank (Cambodia) Limited	Yes	Assets Risk Weighted	Banking
LFD Limited	Yes	Assets Risk Weighted	Holding Company
Minerva Holdings Limited	Yes	Assets Risk Weighted	Holding Company
Upspring Limited	Yes	Assets Risk Weighted	Investment
Votraint No.1103 Pty Ltd	Yes	Assets Risk Weighted	Investment
ANZ Lenders Mortgage Insurance Pty Limited	No	Investment Deducted	Mortgage Insurance
ANZ Nominees Limited	Yes	Assets Risk Weighted	Nominee
ANZ Orchard Investments Pty Ltd	Yes	Assets Risk Weighted	Holding Company
OnePath Australia Limited (formerly ING Australia Limited	No	Investment Deducted	Holding Company
OnePath Life Limited (formerly ING Life Limited)	No	Investment Deducted	Insurance
OnePath General Insurance Pty Limited (formerly ING General Insurance Pty Limited	No	Investment Deducted	Insurance
OnePath Funds Management Limited (foremerly ING funds Management Limited)	No	Investment Deducted	Funds Management
OnePath Custodians Limited (formerly ING Custodians Pty Ltd)	No	Investment Deducted	Custody
Australia and New Zealand Banking Group (PNG) Limited	Yes	Assets Risk Weighted	Banking
Chongqing Liangping ANZ Rural Bank Company Limited	Yes	Assets Risk Weighted	Banking
Citizens Bancorp Inc	Yes	Assets Risk Weighted	Holding Company
ANZ Guam Inc.	Yes	Assets Risk Weighted	Banking
Esanda Finance Corporation Limited	Yes	Assets Risk Weighted	General Finance
ETRADE Australia Limited	Yes	Assets Risk Weighted	Online Stockbroking
PT ANZ Panin Bank	Yes	Assets Risk Weighted	Banking
ANZ Vientiane Commercial Bank Limited	Yes	Assets Risk Weighted	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 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 approach for the calculation of credit and operational risk. 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 2010 and September 2009: Nil).

Table 2 Capital Structure

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

APRA determines PCRs for Tier 1 and Total Capital at both Level 1 and Level 2 under its prudential standards APS 110 – 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, 'Residual' capital, and 'Tier 1 deductions'. Fundamental capital comprises shareholders' equity adjusted for items which APRA does not allow as regulatory capital or classifies as lower forms of regulatory capital.

Fundamental capital includes the following significant adjustments:

- Residual Tier 1 capital instruments included within shareholders' equity are excluded.
- Reserves exclude the hedging reserve and available-for-sale revaluation reserve, and reserves of insurance, funds management and securitisation subsidiaries and associates excluded for Level 2 purposes.
- Retained earnings excludes retained earnings of insurance, funds management and securitisation subsidiaries and associates excluded for Level 2 purposes, but includes capitalised deferred fees forming part of loan yields that meet the criteria set out in the prudential standard.
- Current year (net of tax) earnings is net of any dividends paid during the current year and the expected dividend payments (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 three 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 (CPS1) and on 17 December 2009 ANZ issued AUD1,969 million of convertible preference shares (CPS2) that mandatorily convert into ordinary shares on 16 June 2014 and 15 December 2016 respectively, subject to certain conditions being satisfied. They may also convert earlier under certain circumstances. The distributions are preferred, non-cumulative, payable quarterly and based on the quarterly Australian Bank Bill Rate plus a margin of 250 and 300 basis points respectively and are subject to Directors resolving to payable quarterly in their absolute discretion and other payment tests being satisfied. In a winding-up of ANZ, the convertible preference shares will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.
- **UK Stapled Securities**. On 15 June 2007 ANZ raised GBP450 million of non-cumulative mandatory convertible stapled securities. On 15 June 2012, or an earlier date under certain circumstances, the UK Stapled Securities will mandatorily convert into ordinary shares, subject to certain conditions being satisfied. The distributions are non-cumulative at a fixed rate of 6.54% payable semi-annually. In a winding-up of ANZ, the ANZ preference shares forming part of the UK Stapled Securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.

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

- **US Trust Securities**. On 27 November 2003, ANZ issued USD1,100 million of non - cumulative trust securities 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 15 January 2010, ANZ redeemed for cash the USD350m tranche of the US Trust Securities. On 15 December 2013, ANZ has the right to redeem the USD750m tranche of the US Trust Securities for cash, subject to APRA approval. If ANZ does not exercise this right, holders are entitled to require ANZ to exchange the US Trust Securities into ordinary shares. The distributions are non-cumulative payable semi-annually. In a winding-up of ANZ, the ANZ preference shares forming part of the US Trust Securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.
- **Euro Trust Securities**. On 13 December 2004, ANZ issued EUR500 million of non - cumulative trust securities raising AUD871m, at the spot rate on the date of issue. Distributions are non-cumulative payable quarterly based upon the three month EURIBOR rate plus a margin of 66 basis points up until 15 December 2014, at which date ANZ has the right to redeem the Euro Trust Securities for cash (subject to APRA approval). After this date, the distribution rate is a rate based on the three month EURIBOR rate plus a margin of 166 basis points. In a winding-up of ANZ, the ANZ preference shares forming part of the Euro Trust securities will rank equal with other preference shares, but behind all depositors and creditors and ahead of ordinary shareholders.

For more information on these instruments, refer to the Loan Capital and Share Capital notes (Notes 27 and 28 respectively) in the 2010 ANZ Annual Report.

Tier 1 deductions include amounts deducted solely from Tier 1, mainly intangible assets i.e. goodwill, acquired portfolio of insurance/investment business 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 include the tangible component of investment in other subsidiaries and associates regulated by APRA, or their overseas equivalent, and the amount of Expected Losses (EL) in excess of Eligible Provisions for Loan Losses (net of tax).

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

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 6 month 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. At the first call date of 18 April 2013 the interest rate resets to the five year swap rate plus 200 basis points, and is callable on any interest payment date thereafter.

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 2010 ANZ Annual Report.

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

Table 2: Capital Structure [5] [6]

The following table summarises ANZ's Level 2 capital position as at 30 September 2010:

	Regulatory Capital		
	September 2010 $M	March 2010 $M	September 2009 $M
Tier 1 capital			
Paid-up ordinary share capital	20,140	19,563	19,064
Foreign currency translation reserve	(2,742)	(2,381)	(1,725)
Share and share option reserve	168	156	156
Reserves	(2,574)	(2,225)	(1,569)
Retained earnings including current year earnings	15,921	14,629	14,129
less : Accumulated retained profits and reserves of insurance, funds management and securitisation entities and associates	(1,312)	(955)	(1,010)
Dividend not provided for	(1,895)	(1,318)	(1,403)
add : Deferred fee revenue including fees deferred as part of loan yields	402	425	391
Accrual for Dividend Reinvestment Plans	569	395	421
Prudential retained earnings	13,685	13,176	12,528
Minority interests	64	66	65
Fundamental Tier 1 capital	**31,315**	**30,580**	**30,088**
Innovative Tier 1 capital	1,646	1,690	2,122
Non-innovative Tier 1 capital	3,787	3,791	1,901
Gross Tier 1 capital	**36,748**	**36,061**	**34,111**
Goodwill	(2,910)	(2,824)	(2,999)
Other deductions from Tier 1 capital only	(4,121)	(3,779)	(1,832)
50/50 deductions from Tier 1 capital	(3,026)	(2,830)	(2,661)
Deductions from Tier 1 capital	**(10,057)**	**(9,433)**	**(7,492)**
NET TIER 1 CAPITAL	**26,691**	**26,628**	**26,619**
Tier 2 capital			
Upper Tier 2 capital	1,226	1,060	1,392
Lower Tier 2 capital	6,644	7,430	9,108
Gross Tier 2 capital	**7,870**	**8,490**	**10,500**
Upper and lower Tier 2 capital deductions	(28)	(28)	(28)
50/50 deductions from Tier 2 capital	(3,026)	(2,830)	(2,661)
Deductions from Tier 2 capital	**(3,054)**	**(2,858)**	**(2,689)**
NET TIER 2 CAPITAL	**4,816**	**5,632**	**7,811**
TOTAL CAPITAL BASE	**31,507**	**32,260**	**34,430**
Other Deductions from Tier 1 capital			
Intangible component of investment in ING Australia and New Zealand (excluding prudential goodwill)	(2,043)	(1,961)	-
Capitalised software and other intangible assets	(1,169)	(1,008)	(897)
Capitalised expenses including loan and lease origination fees, capitalised securitisation establishment costs and costs associated with debt raisings	(655)	(617)	(602)
Applicable deferred tax assets (excluding the component relating to the general reserve for impairment of financial assets)	(235)	(215)	(325)
Mark-to-market impact of own credit spread	(19)	22	12
Negative Available-for-sale reserve		-	(20)
Total	**(4,121)**	**(3,779)**	**(1,832)**

Deductions taken 50% from Tier 1 and 50% from Tier 2 capital	Gross	50%	Gross	50%	Gross	50%
Investment in ANZ insurance subsidiaries	(396)	(198)	(378)	(189)	(321)	(161)
Investment in funds management entities	(72)	(36)	(66)	(33)	(67)	(33)
Investment in ING Australia and New Zealand	(1,690)	(845)	(1,268)	(634)	(1,474)	(737)
Investment in other Authorised Deposit Taking Institutions and overseas	(1,976)	(988)	(1,962)	(981)	(1,951)	(976)
Investment in other commercial operations	(42)	(21)	(72)	(36)	(72)	(36)
Expected loss in excess of eligible provisions	(1,119)	(560)	(1,035)	(518)	(1,012)	(506)
Other	(756)	(378)	(878)	(439)	(424)	(212)
Total	**(6,051)**	**(3,026)**	**(5,659)**	**(2,830)**	**(5,321)**	**(2,661)**

Details of Upper Tier 2 Capital			
Eligible component of post acquisition earnings and reserves in associates and joint ventures		-	269
Perpetual subordinated notes	946	975	1,026
General reserve for impairment of financial assets net of attributable	280	85	97
Total	**1,226**	**1,060**	**1,392**

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

[6] "Investment in OnePath (formerly ING Australia) and ING New Zealand" were joint venture investments until November 2009.

Table 3 Capital adequacy

Capital Management Approach

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

- Regulatory compliance such that capital levels exceed APRA's PCRs both at Level 1 and Level 2[7] 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 to meet 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" credit rating category bank. Economic Capital is an internal estimate of capital levels required to support risk and unexpected losses above a desired target solvency level
- Capital levels are commensurate with ANZ maintaining its preferred "AA" credit rating category for senior long-term unsecured debt given its risk appetite outlined in its strategic plan
- An appropriate balance between maximising shareholder returns and prudent capital management principles

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

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

- A review of capital ratios, targets, and levels of different classes of capital against ANZ's risk profile and risk appetite outlined in the Strategic Plan. ANZ's capital targets reflect the key policy objectives above, and the desire to ensure that under specific stressed economic scenarios that 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, asset 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 APRA's PCRs and the US Federal Reserve's minimum Tier 1 and Total Capital requirements; 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 the capital issuance and maturity profile, options around capital products, timing and markets and strategies under differing market and economic conditions.

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

[7] 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.

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

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

Regulatory change

The Basel Committee on Banking Supervision has released a series of consultation papers (Basel III) containing a number of proposals to strengthen the global capital and liquidity framework to improve the banking sector's ability to absorb shocks arising from financial and economic stress.

The consultation papers aim to increase the quality, quantity, consistency and transparency of the capital base, whilst strengthening the risk coverage of the capital framework by:

- Increasing the minimum level of capital, with new minimum capital targets for Core Tier 1 (4.5%), Tier 1 (6.0%) and Total Capital (8.0%) to be phased in between 2013 and 2015;
- Increasing the capital buffers that banks are required to hold for stress scenarios and to dampen the impact of pro-cyclical elements of the prudential regulators. A capital conservation buffer of 2.5% and a counter-cyclical buffer of 0.0% to 2.5% will be phased in between 2016 and 2019. Failure to maintain the full capital buffers will result in limitations on the amount of current year earnings that can be paid as discretionary bonuses and to Tier 1 and Tier 2 investors as coupons and capital returns;
- Increasing Tier 1 deductions, although a number of the proposals are consistent with the current APRA prudential standards;
- Increasing the focus on Fundamental Tier 1 capital and tightening the regulations for Residual Tier 1 and Tier 2 capital instruments including a proposal that at the time of 'non-viability', these instruments will be written off, with any potential compensation for investors limited to an issuance of ordinary shares. Existing Tier 1 and Tier 2 instruments that do not have these requirements will be phased out between 2013 and 2022. these proposals are to be supplemented, by yet to be released details around 'contingent capital' and 'bail in' instruments, which may not initially be prudential capital, but are converted in part or in full into Fundamental Tier 1 capital at predetermined trigger points;
- Supplementing the risk adjusted capital ratio targets with the introduction of a minimum leverage ratio (Tier 1 capital divided by adjusted total assets including off balance sheet exposures) of 3.0% between 2013 and 2018.
- Introducing measures (yet to be released) to address the impact of system risk and inter connectedness risk;
- Improving transparency of reporting capital ratio calculations in the financial statements; and
- Increasing the capital requirements for traded market risk, credit risk and securitisation transactions.

The Basel Committee is expected to finalise the majority of the reforms by the end of 2010, for implementation between 2012 and 2019. Following the release of the final reforms by the Basel Committee, ANZ expects APRA to engage the Australian banking and insurance industry ahead of the development and implementation of revised Australian prudential standards. It is not possible to accurately determine the impacts associated with these reforms on ANZ, including revised operating capital targets, until APRA's position is finalised.

Table 3: Capital Ratios and Risk Weighted Assets[8] [9] [10]

	Risk Weighted Assets		
	September 2010 $M	March 2010 $M	September 2009 $M
Subject to Advanced IRB approach			
Corporate	101,940	100,945	116,153
Sovereign	2,720	2,470	1,408
Bank	6,135	5,108	5,592
Residential Mortgage	38,708	37,423	36,725
Qualifying revolving retail	7,205	7,238	6,852
Other retail	17,899	17,942	17,108
Credit risk weighted assets subject to Advanced IRB approach	**174,607**	**171,126**	**183,838**
Credit Risk Specialised Lending exposures subject to slotting criteria	**26,605**	**24,965**	**24,272**
Subject to Standardised approach			
Corporate	21,281	16,330	13,163
Sovereign	-	-	-
Bank	-	-	-
Residential Mortgage	567	399	411
Qualifying revolving retail	1,841	4	-
Other retail	1,113	560	382
Credit risk weighted assets subject to standardised approach	**24,802**	**17,293**	**13,956**
Credit risk weighted assets relating to securitisation exposures	2,091	1,975	2,658
Credit risk weighted assets relating to equity exposures	1,577	1,639	1,914
Other assets	3,835	3,377	3,174
Total credit risk weighted assets	**233,517**	**220,375**	**229,811**
Market risk weighted assets	5,652	3,969	3,553
Operational risk weighted assets	17,383	16,481	16,240
Interest rate risk in the banking book weighted assets	7,690	8,136	2,465
TOTAL RISK WEIGHTED ASSETS	**264,242**	**248,961**	**252,069**
Capital ratios (%)			
Level 2 Total capital ratio	**11.9%**	**13.0%**	**13.7%**
Level 2 Tier 1 capital ratio	**10.1%**	**10.7%**	**10.6%**
Level 1: Australia and New Zealand Banking Group Limited extended licensed entity Total capital ratio	**12.3%**	**13.7%**	**14.2%**
Level 1: Australia and New Zealand Banking Group Limited extended licensed entity Tier 1 capital ratio	**11.0%**	**11.9%**	**11.6%**
Other significant ADI or overseas bank subsidiary: ANZ National Bank Limited Group Total capital ratio	**13.1%**	**13.2%**	**12.7%**
Other significant ADI or overseas bank subsidiary: ANZ National Bank Limited Group Tier 1 capital ratio	**9.7%**	**9.5%**	**9.0%**

Risk Weighted Assets (RWA)

Total RWA increased by $12.2 billion (4.8%) in Full Year September 2010, mainly due to an increase in Interest Rate Risk in the Banking Book of $5.2 billion (212.0%).

Credit Risk Weighted Assets

The key drivers of the increase in Credit RWA were (i) an increase in Standardised RWA of $10.8 billion (77.7%) due to the acquisition of certain Royal Bank of Scotland (RBS) assets in Asia as well as growth in our existing Asian businesses, (ii) an increase in IRB Specialised Lending Slotting of $2.3 billion (9.6%) mainly due to growth in exposures, (iii) an increase in IRB Retail Mortgages of $2.0 billion (5.4%) driven by a combination of growth and risk in the portfolio, and offset by (iv) a decrease in AIRB Corporate RWA of $14.2 billion (12.2%) due to a reduction in risk in the asset class and on-going data review.

Market Risk, Operating Risk and IRRBB Risk Weighted Assets

Interest Rate Risk in the Banking Book and Market Risk RWA grew significantly over the year. IRRBB grew by $5.2 billion (212.0%) as a result of a reduction in embedded gains and increased repricing and yield curve risk. Market Risk grew $2.1 billion (+59.1%) due to growth in the global rates trading business.

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[8] Specialised Lending subject to supervisory 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.

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

[10] Certain September 2009 and March 2010 comparatives throughout this disclosure have been restated to reflect minor reclassifications of exposure between asset classes.

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 Supervisory 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

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):

Capital ratio	ANZ under APRA rules			ANZ under FSA rules
	Sep-09	Mar-10	Sep-10	Sep-10 pro forma*
Core Tier-1*	9.0%	8.5%	8.0%	11.3%
Tier-1	10.6%	10.7%	10.1%	13.5%
Total Capital	13.7%	13.0%	11.9%	15.2%

** 'Core Tier 1' = Tier 1 excluding Residual Tier 1 instruments*

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

- Does not require a deduction for accrued dividends (although APRA does give credit for expected shares to be issued under a dividend reinvestment plan);
- Does not require a Tier 1 deduction for certain capitalised expenses and net deferred tax assets;
- Allows 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 50% Tier-1 deduction and a 50% Tier 2 deduction; and
- Has a more favourable treatment for investments in associates and insurance and funds management subsidiaries.

For RWA, the major reasons for the differences are:

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

The Australian Bankers' Association (ABA) has released a detailed fact sheet[11] documenting the differences between the Australian and UK rules and the implications for prudential capital ratios.

[11] bankers.asn.au

Chapter 5 – Credit risk

Summary of Credit risk disclosures[12] [13]

	September 2010			
	Risk Weighted Assets $M	Regulatory Credit Exposure $M	Individual provision charge for the twelve months ended $M	Write-offs for the twelve months ended $M
Corporate (incl. Specialised Lending)	128,545	186,059	1,007	916
Sovereign	2,720	35,099	-	-
Bank	6,135	32,681	(23)	8
Residential Mortgage	38,708	220,055	162	117
Qualifying Revolving Retail	7,205	20,764	216	262
Other Retail	17,899	28,282	302	330
Standardised	24,802	25,714	106	60
Total	**226,014**	**548,654**	**1,770**	**1,693**

	March 2010			
	Risk Weighted Assets $M	Regulatory Credit Exposure $M	Individual provision charge for the six months ended $M	Write-offs for the six months ended $M
Corporate (incl. Specialised Lending)	125,910	181,978	625	575
Sovereign	2,470	34,786	-	-
Bank	5,108	27,952	(18)	8
Residential Mortgage	37,423	208,508	97	52
Qualifying Revolving Retail	7,238	20,396	107	128
Other Retail	17,942	28,250	162	174
Standardised	17,293	18,030	53	25
Total	**213,384**	**519,900**	**1,026**	**963**

	September 2009			
	Risk Weighted Assets $M	Regulatory Credit Exposure $M	Individual provision charge for the twelve months ended $M	Write-offs for the twelve months ended $M
Corporate (incl. Specialised Lending)	140,425	188,067	1,766	1,100
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	228	262
Other Retail	17,108	28,651	459	415
Standardised	13,956	14,696	90	39
Total	**222,066**	**510,877**	**2,750**	**1,889**

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: Internal Ratings-Based Approach to Credit Risk. There are however several small portfolios (mainly retail and local corporates in Asia Pacific) where ANZ applies

[12] 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. Regulatory Credit Exposure in Tables 4 and 6 is net of credit risk mitigation such as guarantees, credit derivatives, netting and financial collateral.

[13] The Individual Provision charge relates to loans and advances, and does not include impairment on Available-For-Sale assets of $1 million in September 2009 (March 2010: $20 million; September 2009: Nil).

the Standardised Approach to credit risk, under APS 112 Capital Adequacy: Standardised Approach to Credit Risk.

Credit risk management framework and policies

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

Organisation

As described in Chapter 3, the Credit and Market Risk Committee (CMRC) is ANZ's most senior executive level credit risk committee. The Credit Ratings System Oversight Committee supports the CMRC, by providing group-wide scrutiny of ANZ's rating system.

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

The authority to make credit decisions is delegated by the Board to the CEO who in turn delegates authority to the CRO. The CRO in turn delegates some of his credit discretion to individuals as part of a 'cascade' of authority from senior to the most junior credit officers. Within ANZ, credit approval for almost all judgemental lending is made on a 'dual approval' basis, jointly by the business writer in the business unit and the respective independent credit risk officer. 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 ongoing accreditation training in order to be granted and retain a credit discretion. Credit discretions are reviewed on an annual basis, and may be varied based on the holder's performance.

Portfolio direction and performance

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

- Business writing strategies that are prepared by the businesses and set out appetite, planned portfolio growth, capital usage and risk/return profile, and also identify areas that may require attention to mitigate and improve risk management;
- Regular portfolio reviews; and
- 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; and
- Ongoing review and refinement of ANZ's credit risk measurement and policy framework.

Reporting – Overview and Definitions

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

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

Examples of reports include 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 facilities

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

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[14] its credit obligations to ANZ in full, without recourse by ANZ to actions such as realising available security; and
- The obligor is at least 90 days past due on a credit obligation to ANZ.

Restructured items

Restructured items are facilities in which (1) 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 (2) are not considered impaired. Restructured items may include 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 on a case-by-case basis for all individually managed impaired assets taking into consideration factors such as the realisable value of security (or other credit mitigants), the likely return available upon liquidation or bankruptcy, legal uncertainties, estimated costs involved in recovery, the market price of the exposure in secondary markets and the amount and timing of expected receipts and recoveries.

Write-offs

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

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

[14] 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.

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

The methodology underpinning calculation of collective provision from historical experience is predominantly based around the product of an exposure's Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD)[15]. 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; and
- 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[16].

Specific Provision and General Reserve for Credit Losses

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

Table 4(b) part (i): Period end and average regulatory credit exposure [17] [18]

	Regulatory Credit Exposure			
Portfolio Type	**September 2010 $M**	**March 2010 $M**	**September 2009 $M**	**Average for year $M**
Corporate	179,506	171,447	176,039	177,773
Sovereign	35,099	34,786	28,618	31,859
Bank	32,681	27,952	29,444	31,063
Residential Mortgage	221,534	209,643	202,731	212,133
Qualifying Revolving Retail	22,605	20,400	19,820	21,213
Other Retail	29,394	28,810	29,033	29,214
Specialised Lending	27,835	26,862	25,192	26,514
Total Exposure	**548,654**	**519,900**	**510,877**	**529,766**

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

[16] 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.

[17] 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.

[18] Average for the year represents simple average of this year and prior year exposures.

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

Facility Type	Regulatory Credit Exposure			
	September 2010 $M	March 2010 $M	September 2009 $M	Average for year $M
Acceptance	11,495	12,510	13,762	12,628
Cash and Liquid Assets	11,353	13,521	18,402	14,878
Contingents, Commitments, Other off B/S	110,437	103,868	103,557	106,997
Creditors & Other Liabilities	96	41	378	237
Derivatives	21,929	14,151	13,912	17,921
Due from Other Financial Institutions	4,806	6,353	3,207	4,007
Investment Securities	19,501	16,381	14,758	17,130
Loans & Advances	346,177	330,963	326,272	336,225
Other Assets	1,485	582	432	959
Total Deposits & Other Borrowings	55	234	240	148
Trading Securities	21,320	21,296	15,957	18,639
Total Exposures	**548,654**	**519,900**	**510,877**	**529,766**

Table 4(c): Geographic distribution of regulatory credit exposure [19]

Portfolio Type	September 2010			
	Australia $M	New Zealand $M	Other $M	Total $M
Corporate	105,484	37,698	36,324	**179,506**
Sovereign	13,565	7,373	14,161	**35,099**
Bank	17,077	2,958	12,646	**32,681**
Residential Mortgage	178,566	41,565	1,403	**221,534**
Qualifying Revolving Retail	20,764	-	1,841	**22,605**
Other Retail	21,374	6,908	1,112	**29,394**
Specialised Lending	22,015	5,320	500	**27,835**
Total exposures	**378,845**	**101,822**	**67,987**	**548,654**

Portfolio Type	March 2010			
	Australia $M	New Zealand $M	Other $M	Total $M
Corporate	103,519	38,761	29,167	**171,447**
Sovereign	12,542	6,879	15,365	**34,786**
Bank	12,031	2,630	13,291	**27,952**
Residential Mortgage	166,496	42,069	1,078	**209,643**
Qualifying Revolving Retail	20,396	-	4	**20,400**
Other Retail	21,325	6,908	577	**28,810**
Specialised Lending	21,014	5,381	467	**26,862**
Total exposures	**357,323**	**102,628**	**59,949**	**519,900**

Portfolio Type	September 2009			
	Australia $M	New Zealand $M	Other $M	Total $M
Corporate	105,615	41,975	28,449	**176,039**
Sovereign	8,445	6,086	14,087	**28,618**
Bank	13,379	3,087	12,978	**29,444**
Residential Mortgage	157,118	44,521	1,092	**202,731**
Qualifying Revolving Retail	19,820	-	-	**19,820**
Other Retail	21,188	7,421	424	**29,033**
Specialised Lending	18,790	5,980	422	**25,192**
Total exposures	**344,355**	**109,070**	**57,452**	**510,877**

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

Table 4(d): Industry distribution of regulatory credit exposure [20] [21]

September 2010

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

March 2010

Portfolio Type	Agriculture, Forestry, Fishing & Mining $M	Business Services $M	Construction $M	Entertainment, Leisure & Tourism $M	Financial, Investment & Insurance $M	Government and Official Institutions $M	Manufacturing $M	Personal $M	Property Services $M	Wholesale Trade $M	Retail Trade $M	Transport & Storage $M	Other $M	Total $M
Corporate	33,148	7,782	5,629	8,937	14,801	1,368	26,998	2,101	13,699	15,663	11,614	7,575	22,132	**171,447**
Sovereign	33	-	21	-	17,929	15,854	201	73	43	-	-	-	632	**34,786**
Bank	-	-	-	-	27,648	-	62	-	-	72	-	64	106	**27,952**
Residential Mortgage	-	-	-	-	-	-	-	209,643	-	-	-	-	-	**209,643**
Qualifying Revolving Retail	-	-	-	-	-	-	-	20,400	-	-	-	-	-	**20,400**
Other retail	2,319	1,691	2,380	753	304	8	821	13,922	891	595	1,868	1,072	2,186	**28,810**
Specialised Lending	288	-	60	155	407	-	250	-	21,141	-	-	2,086	2,475	**26,862**
Total exposures	**35,788**	**9,473**	**8,090**	**9,845**	**61,089**	**17,230**	**28,332**	**246,139**	**35,774**	**16,330**	**13,482**	**10,797**	**27,531**	**519,900**
% of Total	6.9%	1.8%	1.6%	1.9%	11.8%	3.3%	5.4%	47.3%	6.9%	3.1%	2.6%	2.1%	5.3%	100.0%

September 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	32,234	8,383	5,243	9,223	15,368	1,509	28,283	2,232	17,406	15,773	12,352	8,112	19,921	**176,039**
Sovereign	34	-	22	-	18,285	9,889	173	-	23	13	-	-	179	**28,618**
Bank	-	-	58	98	29,039	-	56	-	-	1	-	105	87	**29,444**
Residential Mortgage	-	-	-	-	-	-	-	202,731	-	-	-	-	-	**202,731**
Qualifying Revolving Retail	-	-	-	-	-	-	-	19,820	-	-	-	-	-	**19,820**
Other Retail	2,380	1,661	2,329	773	312	13	851	13,838	887	610	1,867	1,102	2,410	**29,033**
Specialised Lending	246	-	401	152	412	33	298	-	20,120	-	-	1,196	2,334	**25,192**
Total exposures	**34,894**	**10,044**	**8,053**	**10,246**	**63,416**	**11,444**	**29,661**	**238,621**	**38,436**	**16,397**	**14,219**	**10,515**	**24,931**	**510,877**
% of Total	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%

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

[21] Other Industry 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 [22]

September 2010

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

March 2010

Portfolio Type	<= 12 mths $M	1 ~ 5 years $M	>5 years $M	No Maturity Specified $M	Total $M
Corporate	78,241	73,191	19,650	365	**171,447**
Sovereign	13,043	18,675	3,068	-	**34,786**
Bank	18,688	9,124	140	-	**27,952**
Residential Mortgage	1,793	4,347	176,859	26,644	**209,643**
Qualifying Revolving Retail	-	-	-	20,400	**20,400**
Other Retail	9,808	13,014	5,414	574	**28,810**
Specialised Lending	9,942	13,360	3,536	24	**26,862**
Total exposures	**131,515**	**131,711**	**208,667**	**48,007**	**519,900**

September 2009

Portfolio Type	<= 12 mths $M	1 ~ 5 years $M	>5 years $M	No Maturity Specified $M	Total $M
Corporate	76,855	79,198	19,581	405	**176,039**
Sovereign	9,443	17,488	1,687	-	**28,618**
Bank	19,767	9,528	149	-	**29,444**
Residential Mortgage	1,897	4,682	170,337	25,815	**202,731**
Qualifying Revolving Retail	-	-	-	19,820	**19,820**
Other Retail	10,354	13,053	5,117	509	**29,033**
Specialised Lending	10,990	10,983	3,219	-	**25,192**
Total exposures	**129,306**	**134,932**	**200,090**	**46,549**	**510,877**

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

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

September 2010

Industry Sector	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for the six months ended $M	Write-offs for the six months ended $M
Agriculture, forestry, fishing & mining	2	1,197	165	217	72	35
Business Services	-	218	50	102	14	21
Construction	-	98	35	44	23	47
Entertainment Leisure & Tourism	-	49	9	21	5	5
Financial, Investment & Insurance	-	448	11	96	15	80
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	2	402	22	197	2	31
Personal	-	1,084	1,057	611	311	341
Property Services	41	1,831	88	257	140	72
Retail Trade	-	171	37	79	23	12
Transport & Storage	-	80	23	38	10	9
Wholesale Trade	-	353	18	101	11	14
Other	6	578	40	112	118	63
Total	**51**	**6,510**	**1,555**	**1,875**	**744**	**730**

March 2010

Industry Sector	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for the six months ended $M	Write-offs for the six months ended $M
Agriculture, forestry, fishing & mining	4	934	164	170	89	3
Business Services	-	268	66	103	22	35
Construction	-	119	42	62	37	14
Entertainment Leisure & Tourism	-	38	11	23	9	2
Financial, Investment & Insurance	-	864	14	173	(1)	107
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	3	559	28	185	94	128
Personal	-	780	996	373	334	306
Property Services	48	1,755	102	207	201	190
Retail Trade	-	148	37	63	27	16
Transport & Storage	-	85	19	41	22	7
Wholesale Trade	-	255	18	84	60	67
Other	12	689	26	109	132	88
Total	**67**	**6,494**	**1,523**	**1,593**	**1,026**	**963**

September 2009

Industry Sector	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Individual provision charge for the six months ended $M	Write-offs for the six months ended $M
Agriculture, forestry, fishing & mining	-	458	77	55	19	18
Business Services	-	215	41	114	77	60
Construction	-	122	43	43	31	29
Entertainment Leisure & Tourism	-	57	42	27	5	7
Financial, Investment & Insurance	1	958	10	261	222	197
Government & Official Institutions	-	-	-	-	-	-
Manufacturing	6	627	34	230	178	133
Personal	-	802	950	357	461	373
Property Services	118	1,580	159	194	120	102
Retail Trade	-	114	53	53	33	34
Transport & Storage	-	85	31	32	24	5
Wholesale Trade	-	127	139	69	31	11
Other	2	323	18	91	100	137
Total	**127**	**5,468**	**1,597**	**1,526**	**1,301**	**1,106**

[23] Past due loans ≥ 90 days includes $1,416 million well secured loans (March 2010: $1,370 million; September 2009: $1,462 million).

[24] Impaired derivatives include a credit valuation adjustment (CVA) of $77 million, being a market value based assessment of the credit risk of the relevant counterparties (March 2010: $61 million; September 2009: $64 million).

[25] Impaired loans / facilities include restructured items of $141 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 2010: $560 million; September 2009: $673 million).

Table 4(f) part (ii): Impaired asset, Past due loans, Provisions and Write-offs [26]

	Impaired Derivatives $M			Impaired Loans / Facilities $M			Past due loans ≥ 90 days $M			Individual provision balance $M			Individual provision charge $M				Write-offs $M			
Portfolios subject to IRB approach	Sep-10	Mar-10	Sep-09	Sep-10	Mar-10	Sep-09	Sep-10	Mar-10	Sep-09	Sep-10	Mar-10	Sep-09	Six months ended Sep-10	Six months ended Mar-10	Twelve months ended Sep-10	Twelve months ended Sep-09	Six months ended Sep-10	Six months ended Mar-10	Twelve months ended Sep-10	Twelve months ended Sep-09
Corporate	51	67	127	4,840	5,325	4,499	298	338	398	965	1,016	1,022	382	625	1,007	1,766	341	575	916	1,100
Sovereign	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank	-	-	-	97	123	98	-	-	-	28	33	44	(5)	(18)	(23)	45	-	8	8	27
Residential Mortgage	-	-	-	574	511	425	881	849	806	215	234	170	65	97	162	162	65	52	117	46
Qualifying revolving retail	-	-	-	-	-	-	84	78	70	-	-	2	109	107	216	228	134	128	262	262
Other retail	-	-	-	362	344	316	139	141	159	225	202	230	140	162	302	459	156	174	330	415
Total IRB approach	**51**	**67**	**127**	**5,873**	**6,303**	**5,338**	**1,402**	**1,406**	**1,433**	**1,433**	**1,485**	**1,468**	**691**	**973**	**1,664**	**2,660**	**695**	**938**	**1,633**	**1,850**
Portfolios subject to Standardised approach																				
Corporate	-	-	-	298	144	81	97	94	144	156	77	29	14	28	42	86	1	1	2	38
Sovereign	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Residential Mortgage	-	-	-	21	17	15	3	4	-	6	5	3	4	2	6	4	-	-	-	1
Qualifying Revolving Retail	-	-	-	106	-	-	13	-	20	106	-	-	(3)	-	(3)	-	7	-	7	-
Other Retail	-	-	-	212	30	34	40	19	-	174	26	26	38	23	61	-	27	24	50	-
Total Standardised approach	**-**	**-**	**-**	**637**	**191**	**130**	**153**	**117**	**164**	**442**	**108**	**58**	**53**	**53**	**106**	**90**	**35**	**25**	**60**	**39**
Total	**51**	**67**	**127**	**6,510**	**6,494**	**5,468**	**1,555**	**1,523**	**1,597**	**1,875**	**1,593**	**1,526**	**744**	**1,026**	**1,770**	**2,750**	**730**	**963**	**1,693**	**1,889**

[26] Certain September 2009 and March 2010 comparatives in this table have been restated to reflect minor reclassifications of exposure between asset classes.

Table 4(g): Impaired assets, Past due loans[27], Provisions and Write-offs by Geography [28] [29]

	September 2010				
Geographic Region	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	51	4,232	1,234	977	2,021
New Zealand	-	1,582	238	469	612
Other	-	696	83	429	520
Total	**51**	**6,510**	**1,555**	**1,875**	**3,153**

	March 2010				
Geographic Region	Impaired derivatives $M	Impaired loans/facilities $M	Past due loans ≥ 90 days $M	Individual provision balance $M	Collective provision balance $M
Australia	67	4,441	1,162	1,009	2,013
New Zealand	-	1,424	286	471	672
Other	-	629	75	113	352
Total	**67**	**6,494**	**1,523**	**1,593**	**3,037**

	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**

Table 4(h): Reconciliation of changes in Provisions

Collective Provision	**Twelve months ended September 2010 $M**	**Six months ended March 2010 $M**	**Twelve months ended September 2009 $M**
Balance at start of period	3,000	3,000	2,821
Charge to income statement	(4)	36	235
Provisions acquired	240	49	-
Adjustments for exchange rate fluctuations	(83)	(48)	(56)
Total Collective Provision	**3,153**	**3,037**	**3,000**
Individual Provisions			
Balance at start of period	1,526	1,526	675
Charge to income statement for loans and advances	1,770	1,026	2,750
Provisions acquired	394	39	-
Adjustments for exchange rate fluctuations	(100)	(32)	(22)
Discount unwind	(165)	(61)	(73)
Bad debts written-off	(1,693)	(963)	(1,889)
Recoveries of amounts previously written off	143	58	85
Total Individual Provision	**1,875**	**1,593**	**1,526**
Total Provisions	**5,028**	**4,630**	**4,526**

[27] Past due loans ≥ 90 days includes $1,416 million well secured loans (March 2010: $1,370 million; September 2009: $1,462 million).

[28] Refer to Page 25 for explanation and reconciliation of accounting Individual and Collective provisions and regulatory Specific provision and General Reserve for Credit Losses.

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

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

	September 2010 $M	March 2010 $M	September 2009 $M
Advanced IRB			
Corporate	158,224	155,116	162,875
Sovereign	35,099	34,786	28,618
Bank	32,681	27,952	29,444
Residential Mortgage	220,055	208,508	201,581
Qualifying Revolving Retail	20,764	20,396	19,820
Other Retail	28,282	28,250	28,651
Total Advanced IRB	**495,105**	**475,008**	**470,989**
Specialised Lending (subject to slotting criteria)	**27,835**	**26,862**	**25,192**
Standardised			
Corporate	21,282	16,331	13,164
Sovereign	-	-	-
Bank	-	-	-
Residential Mortgage	1,479	1,135	1,150
Qualifying revolving retail	1,841	4	-
Other retail	1,112	560	382
Total Standardised	**25,714**	**18,030**	**14,696**
Total Exposure	**548,654**	**519,900**	**510,877**

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

	September 2010 $M			March 2010 $M			September 2009 $M		
	Specific Provision Balance	General Reserve for Credit Losses	Total	Specific Provision Balance	General Reserve for Credit Losses	Total	Specific Provision Balance	General Reserve for Credit Losses	Total
Collective Provision	233	2,920	3,153	260	2,777	3,037	186	2,814	3,000
Individual Provision	1,875	-	1,875	1,593	-	1,593	1,526	-	1,526
Total Provision for Credit Impairment			**5,028**			**4,630**			**4,526**

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

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]

Risk weight	September 2010 $M	March 2010 $M	September 2009 $M
Standardised approach exposures			
0%	-	-	-
20%	3	3	3
35%	1,177	1,125	1,130
50%	292	10	9
75%	1	-	1
100%	24,239	16,892	13,553
150%	2	-	-
>150%	-	-	-
Capital deductions	-	-	-
Total	**25,714**	**18,030**	**14,696**
Other assets			
0%	-	-	-
20%	1,625	1,746	1,553
35%	-	-	-
50%	-	-	-
75%	-	-	-
100%	3,510	3,028	2,863
150%	-	-	-
>150%	-	-	-
Capital deductions	-	-	-
Total	**5,135**	**4,774**	**4,416**
Specialised Lending exposures subject to supervisory slotting			
0%	1,660	1,817	1,298
70%	6,993	6,531	6,560
90%	12,026	11,296	9,770
115%	5,189	5,791	5,943
250%	1,968	1,427	1,621
Total	**27,836**	**26,862**	**25,192**
Equity exposures			
Risk weight			
300%	-	-	1
400%	394	410	478
Total	**394**	**410**	**479**

[31] 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 types of borrowers and the rating approach adopted within each of of ANZ's AIRB portfolios:

IRB Asset Class	Borrower type	Rating Approach
Sovereign	Central governments Central banks Certain multilateral development banks	AIRB
Bank	Banks[32] 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[33] 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. Under the Standardised approach, exposures are mapped to several regulatory risk weights, mainly based on the type of counterparty and its external rating.

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

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

The ANZ rating system

As an AIRB bank, ANZ's internal models generate the inputs into regulatory capital adequacy to determine the risk weighted exposure calculations for both on and off-balance sheet exposures, including undrawn portions of credit facilities, committed and contingent exposures and 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; and

[32] The IRB asset class "Bank" excludes investment banks.

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

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

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

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

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

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

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

ANZ CCR	Moody's	Standard & Poor's	PD Range
0+ to 1-	Aaa to <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); and

- 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 and several executive management committees, and are 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 review by Internal Audit.

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

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

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

Rating process by asset class

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

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

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

Regardless of what credit risk rating tool is used, lending staff rating a customer are required to review the model-generated PD (or CCR) and take into account any out-of-model factors or policy overlays to decide whether or not to override the model rating. Overrides of a rating model to a better rating require 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 development banks	External rating and expert judgement
Bank	Banks In Australia only, other ADIs incorporated in Australia	Statistically-based models Review of all relevant and material information including external ratings
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. The scores are calibrated to PD, so the PD master scale gives ANZ a common language to understand and discuss credit risk. LGD is recognised through the process of pooling retail exposures into homogenous groups.

Estimation of LGD and EAD

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

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

[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] [38]

	September 2010							
	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	6,423	30,304	48,335	59,584	6,611	2,951	4,015	**158,223**
Sovereign	30,545	2,271	40	1,981	260	-	2	**35,099**
Bank	28,084	2,365	1,505	610	10	13	94	**32,681**
Total	**65,052**	**34,940**	**49,880**	**62,175**	**6,881**	**2,964**	**4,111**	**226,003**
% of Total	**28.8%**	**15.5%**	**22.1%**	**27.5%**	**3.0%**	**1.3%**	**1.8%**	**100.0%**
Undrawn commitments (included in above)								
Corporate	1,455	15,973	15,872	10,690	666	339	159	**45,154**
Sovereign	952	167	4	39	1	-	-	**1,163**
Bank	76	17	35	51	-	-	-	**179**
Total	**2,483**	**16,157**	**15,911**	**10,780**	**667**	**339**	**159**	**46,496**
Average Exposure At Default								
Corporate	0.675	1.003	0.300	0.253	0.415	0.323	0.772	
Sovereign	11.458	6.774	0.882	4.371	29.044	-	0.153	
Bank	0.621	0.950	1.913	0.511	0.143	38.725	7.831	
Exposure-weighted average Loss Given Default (%)								
Corporate	59.2%	59.6%	46.4%	37.3%	40.5%	44.5%	39.5%	
Sovereign	2.6%	4.9%	38.2%	54.9%	42.3%	-	59.0%	
Bank	62.7%	64.0%	63.7%	54.9%	61.4%	66.5%	64.2%	
Exposure-weighted average risk weight (%)								
Corporate	18.4%	34.4%	50.4%	75.1%	129.2%	208.1%	162.3%	
Sovereign	0.4%	2.0%	60.8%	110.4%	126.3%	-	781.7%	
Bank	13.8%	21.9%	58.9%	105.7%	205.6%	324.5%	160.5%	

	March 2010							
	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	6,403	28,468	45,854	61,453	6,095	2,602	4,241	**155,116**
Sovereign	30,821	1,919	145	1,589	310	-	2	**34,786**
Bank	24,928	1,557	865	472	12	13	105	**27,952**
Total	**62,152**	**31,944**	**46,864**	**63,514**	**6,417**	**2,615**	**4,348**	**217,854**
% of Total	**28.5%**	**14.7%**	**21.5%**	**29.2%**	**2.9%**	**1.2%**	**2.0%**	**100.0%**
Undrawn commitments (included in above)								
Corporate	1,697	12,834	15,717	11,330	572	186	270	**42,606**
Sovereign	977	91	2	13	2	-	-	**1,085**
Bank	223	10	6	41	-	-	-	**280**
Total	**2,897**	**12,935**	**15,725**	**11,384**	**574**	**186**	**270**	**43,971**
Average Exposure At Default								
Corporate	0.712	1.077	0.354	0.256	0.424	0.223	0.655	
Sovereign	14.608	6.280	5.625	7.736	20.796	0.000	0.162	
Bank	0.947	0.923	0.696	0.410	0.219	0.362	7.012	
Exposure-weighted average Loss Given Default (%)								
Corporate	59.9%	58.9%	45.3%	38.2%	40.0%	39.3%	41.8%	
Sovereign	2.5%	4.9%	58.7%	55.3%	41.7%	85.0%	59.0%	
Bank	62.7%	63.2%	65.3%	67.0%	62.7%	74.7%	63.0%	
Exposure-weighted average risk weight (%)								
Corporate	16.9%	33.5%	49.1%	78.3%	128.7%	180.9%	167.3%	
Sovereign	0.5%	2.2%	68.9%	112.1%	124.8%	397.4%	781.7%	
Bank	13.7%	22.3%	64.2%	117.7%	208.0%	349.0%	157.5%	

[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.

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

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

	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								
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 (%)								
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%	

Table 6(d): Retail regulatory credit exposure subject to Internal Ratings Based (IRB) approach by risk grade[39]

	September 2010							
	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	4,152	143,452	16,817	43,586	6,174	4,294	1,581	**220,056**
Qualifying Revolving Retail	10,596	290	1,925	4,901	1,953	958	141	**20,764**
Other Retail	37	3,439	1,377	16,781	5,133	877	639	**28,282**
Total	**14,785**	**147,180**	**20,118**	**65,268**	**13,260**	**6,129**	**2,361**	**269,101**
% of Total	**5%**	**55%**	**7%**	**24%**	**5%**	**2%**	**1%**	**100%**
Undrawn commitments (included in above)								
Residential Mortgage	523	16,527	1,705	2,859	249	219	9	**22,090**
Qualifying Revolving Retail	8,248	289	1,265	2,243	600	112	14	**12,772**
Other Retail	34	2,430	880	2,328	255	62	2	**5,990**
Total	**8,805**	**19,246**	**3,850**	**7,430**	**1,104**	**393**	**26**	**40,852**
Average Exposure At Default								
Residential Mortgage	0.100	0.206	0.155	0.182	0.180	0.166	0.255	
Qualifying Revolving Retail	0.011	0.006	0.010	0.009	0.008	0.007	0.008	
Other Retail	0.006	0.010	0.011	0.014	0.009	0.007	0.035	
Exposure-weighted average Loss Given Default (%)								
Residential Mortgage	22.7%	20.2%	20.4%	20.8%	20.3%	20.6%	21.6%	
Qualifying Revolving Retail	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	
Other Retail	72.2%	62.0%	56.6%	44.7%	48.4%	65.5%	56.5%	
Exposure-weighted average risk weight (%)								
Residential Mortgage	4.9%	7.1%	15.1%	28.7%	74.6%	113.6%	239.8%	
Qualifying Revolving Retail	4.8%	11.3%	14.0%	38.7%	106.5%	205.7%	316.7%	
Other Retail	18.4%	28.6%	38.2%	58.3%	76.4%	159.4%	199.4%	

[39] 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 2010							
	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	2,990	124,525	32,335	37,732	5,783	3,649	1,494	**208,508**
Qualifying Revolving Retail	10,390	274	1,824	4,688	2,044	1,019	157	**20,396**
Other Retail	30	3,440	1,772	16,577	4,932	876	623	**28,250**
Total	**13,410**	**128,239**	**35,931**	**58,997**	**12,759**	**5,544**	**2,274**	**257,154**
% of Total	**5.2%**	**49.9%**	**14.0%**	**22.9%**	**5.0%**	**2.2%**	**0.9%**	**100.0%**
Undrawn commitments (included in above)								
Residential Mortgage	381	14,107	2,816	2,482	235	91	10	**20,122**
Qualifying Revolving Retail	8,068	274	1,194	2,151	628	128	25	**12,468**
Other Retail	26	2,283	1,174	2,121	262	55	7	**5,928**
Total	**8,475**	**16,664**	**5,184**	**6,754**	**1,125**	**274**	**42**	**38,518**
Average Exposure At Default								
Residential Mortgage	0.037	0.202	0.220	0.177	0.172	0.172	0.258	
Qualifying Revolving Retail	0.011	0.006	0.010	0.008	0.008	0.007	0.008	
Other Retail	0.001	0.011	0.007	0.015	0.010	0.007	0.028	
Exposure-weighted average Loss Given Default (%)								
Residential Mortgage	20.8%	20.0%	21.8%	20.6%	20.3%	20.5%	21.6%	
Qualifying Revolving Retail	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	73.2%	
Other Retail	71.2%	61.4%	60.3%	44.4%	48.6%	65.1%	58.5%	
Exposure-weighted average risk weight (%)								
Residential Mortgage	5.1%	6.8%	16.1%	30.3%	76.5%	113.5%	237.9%	
Qualifying Revolving Retail	4.7%	11.0%	13.6%	38.1%	106.0%	205.2%	271.7%	
Other Retail	18.1%	29.0%	41.7%	58.7%	76.5%	158.6%	209.7%	

	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								
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 Loss Given Default (%)								
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%	

Table 6(e): Actual Losses by portfolio type [40]

Basel Asset Class	Six months ended September 2010 Individual provision charge $M	Write-offs $M
Corporate	382	341
Sovereign	-	-
Bank	(5)	-
Residential Mortgage	65	65
Qualifying Revolving Retail	109	134
Other Retail	140	156
Total Advanced IRB	**691**	**695**
Standardised	53	35
Total	**744**	**730**

Basel Asset Class	Six months ended March 2010 Individual provision charge $M	Write-offs $M
Corporate	625	575
Sovereign	-	-
Bank	(18)	8
Residential Mortgage	97	52
Qualifying revolving retail	107	128
Other retail	162	174
Total Advanced IRB	**973**	**938**
Standardised	53	25
Total	**1,026**	**963**

Basel Asset Class	Six months ended September 2009 Individual provision charge $M	Write-offs $M
Corporate	731	671
Sovereign	-	-
Bank	41	(3)
Residential Mortgage	114	32
Qualifying revolving retail	120	138
Other retail	238	245
Total Advanced IRB	**1,244**	**1,083**
Standardised	57	23
Total	**1,301**	**1,106**

[40] Charges for Individual Provision relate to loans and advances, and do not include impairment on available-for-sale of $1 million in September 2010 (March 2010: $20 million; September 2009: Nil)

Table 6(f): Analysis of actual versus Expected Losses by portfolio type (Advanced AIRB) [41]

	September 2009	September 2010	
	One year expected loss (EL) estimates	Actual losses for 12 months ending September 2010	
	Regulatory EL estimate $M	Write-offs $M	Individual provision charge $M
Corporate	2,694	916	1,007
Sovereign	7	-	-
Bank	58	8	(23)
Residential Mortgage	561	117	162
Qualifying Revolving Retail	396	262	216
Other Retail	813	330	302
Total Advanced IRB	**4,529**	**1,633**	**1,664**

	September 2008	September 2009	
	One year expected loss (EL) estimates	Actual losses for 12 months ending September 2009	
	Regulatory EL estimate $M	Write-offs $M	Individual provision charge $M
Corporate	1,686	1,100	1,766
Sovereign	10	-	-
Bank	91	27	45
Residential Mortgage	391	46	162
Qualifying Revolving Retail	363	262	228
Other Retail	510	415	459
Total Advanced IRB	**3,051**	**1,850**	**2,660**

Regulatory EL shown above represents estimated credit loss from defaults over a one year period (computed as the product of PD, LGD and EAD) plus Individual Provision as at 30 September 2009. The actual loss measures are Charges for Individual Provision and Write-offs for the year ended 30 September 2010. While these metrics provide some insight into the predictive power of ANZ's estimations, any comparison has limitations due to definitional differences - eg:

- The parameters PD, LGD and EAD underlying the Regulatory EL calculation represent through the cycle estimates based on APRA methodologies which include the use of the LGD floor for Mortgages, slotting approach for project finance, object finance and non diversified real estate. Regulatory EL also includes the Individual Provision balance on defaulted exposures

- Regulatory EL is a measure of expected credit losses at the start of the year, whereas the Individual Provision Charge and Write-Offs relate to a fluctuating portfolio and are recorded throughout the year

- 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 during the year because many of the defaults that emerged during the year are still in the workout period where recovery options are being identified and pursued.

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

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[42]. 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; and
- Guarantees and pledges.

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

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

Policies and processes for collateral valuation and management

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

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

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

Guarantee support

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

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

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

Use of credit derivatives for risk mitigation

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

Only certain credit derivatives such as credit default swaps (CDS) are recognised for risk mitigation purposes in the determination of regulatory capital. A CDS entails the payment by one party in

[42] 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.

exchange for credit default protection payment if a credit default event on a reference asset occurs. Standard, legally enforceable documentation applies.

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

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

The use of netting

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

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

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

Transaction structuring to mitigate credit risk

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

Concentrations of credit risk mitigation

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

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

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

	September 2010				
	Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Standardised					
Corporate	22,050	768	-	21,282	3.5%
Sovereign	-	-	-	-	0.0%
Bank	-	-	-	-	0.0%
Residential Mortgage	1,479	-	-	1,479	0.0%
Qualifying revolving retail	1,841	-	-	1,841	0.0%
Other retail	1,112	-	-	1,112	0.0%
Total	**26,482**	**768**	**-**	**25,714**	**2.9%**

	March 2010				
	Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Standardised					
Corporate	16,831	500	-	16,331	3.0%
Sovereign	-	-	-	-	0.0%
Bank	-	-	-	-	0.0%
Residential Mortgage	1,135	-	-	1,135	0.0%
Qualifying revolving retail	4	-	-	4	0.0%
Other retail	560	-	-	560	0.0%
Total	**18,530**	**500**	**-**	**18,030**	**2.7%**

	September 2009				
	Exposure $M	Eligible Financial Collateral $M	Other Eligible Collateral $M	Total Exposure post Credit Risk Mitigation $M	% Coverage
Standardised					
Corporate	13,514	350	-	13,164	2.6%
Sovereign	-	-	-	-	0.0%
Bank	-	-	-	-	0.0%
Residential Mortgage	1,150	-	-	1,150	0.0%
Qualifying revolving retail	-	-	-	-	0.0%
Other retail	401	19	-	382	0.0%
Total	**15,065**	**369**	**-**	**14,696**	**2.4%**

[43] In order to show the cover provided by the disclosed mitigants, the exposure amount reported above is prior to the application of eligible risk mitigation. Excluding these mitigants, the Standardised exposure amount is $25,714 million (March 2010: $18,030; September 2009: $14,696 million).

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

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

	September 2010			
	Exposure $M	Exposures Covered by Guarantees $M	Exposures Covered by Credit Derivatives $M	% Coverage
Advanced IRB				
Corporate	192,037	16,497	229	8.7%
Sovereign	25,365	30	-	0.1%
Bank	36,666	4,236	-	11.6%
Residential Mortgage	220,055	-	-	0.0%
Qualifying Revolving Retail	20,764	-	-	0.0%
Other Retail	28,281	-	-	0.0%
Total	**523,168**	**20,763**	**229**	**4.0%**
Standardised				
Corporate	21,282	-	-	0.0%
Sovereign	-	-	-	0.0%
Bank	-	-	-	0.0%
Residential Mortgage	1,479	-	-	0.0%
Qualifying Revolving Retail	1,841	-	-	0.0%
Other Retail	1,112	-	-	0.0%
Total	**25,714**	**-**	**-**	**0.0%**

	March 2010			
	Exposure $M	Exposures Covered by Guarantees $M	Exposures Covered by Credit Derivatives $M	% Coverage
Advanced IRB				
Corporate	185,540	13,500	378	7.5%
Sovereign	26,937	30	-	0.1%
Bank	32,617	4,970	-	15.2%
Residential Mortgage	208,508	-	-	-
Qualifying Revolving Retail	20,396	-	-	-
Other Retail	28,250	-	-	-
Total	**502,248**	**18,500**	**378**	**3.8%**
Standardised				
Corporate	16,331	-	-	-
Sovereign	-	-	-	-
Bank	-	-	-	-
Residential Mortgage	1,135	-	-	-
Qualifying Revolving Retail	4	-	-	-
Other Retail	560	-	-	-
Total	**18,030**	**-**	**-**	**-**

	September 2009			
	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	201,582	-	-	-
Qualifying Revolving Retail	19,820	-	-	-
Other Retail	28,651	-	-	-
Total	**496,960**	**14,766**	**779**	**3.1%**
Standardised				
Corporate	13,164	-	-	-
Sovereign	-	-	-	-
Bank	-	-	-	-
Residential Mortgage	1,150	-	-	-
Qualifying Revolving Retail	-	-	-	-
Other Retail	382	-	-	-
Total	**14,696**	**-**	**-**	**-**

[45] Table 7(c) shows the exposure amount by asset class prior to the impact of guarantees and credit derivatives. Guarantee coverage for Corporate exposures can originate from Corporate, Sovereign or Bank counterparties. 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 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).

- Settlement risk arises where one party makes payment or delivers value in the expectation but without certainty that the counterparty will perform the corresponding obligation in a bilateral contract or due to timing differences when one counterparty performs its obligations at settlement date but the other counterparty party fails to perform its payment obligation
- Market replacement risk (pre-settlement risk) exposure is the risk that a counterparty will default before expiry and final settlement of a derivative contract.

ANZ transacts market instruments with end user and professional counterparties. End users are typically customers who require access to over the counter derivative market instruments to hedge specific business risks to protect against price movement risk associated with their core business activity. ANZ provides end user counterparties with hedging instruments to manage price movement risk. In turn, ANZ may seek to hedge out price movement risk including those arising from end user related transactions by entering into transactions with professional counterparties that conduct two way (buy and sell) business.

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

Market related counterparty credit risk governance

ANZ's derivative and counterparty credit risk management is governed by credit principles, policies and procedures. A Counterparty Credit Risk function is responsible for determining the counterparty credit risk exposure methodology applied to derivatives, day-to-day capture of relevant transactions in the counterparty credit limit management system and the calculation of counterparty credit risk. Counterparty credit limits are approved by the Credit Approval Discretion (CAD) holder following the same principles as on balance sheet credit limit approval process.

Market related counterparty credit risk measurement and reporting

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

- The mark-to-market value is the current replacement cost of the contract, and can be positive or negative. ANZ measures counterparty credit risk exposure for positive mark to market positions. If it is negative i.e. out of the money, ANZ will apply a factor (amount) to the negative value and if it still remains negative, the value used in the calculation is zero. Positive mark-to-market to ANZ represents the cost of replacing an outstanding contract with a counterparty based on the current market value of the contract if a counterparty defaulted on its obligations
- The PCRE factors recognise that prices may change over the remaining period to maturity, and that risk decreases as the contract's remaining term to maturity decreases. In general terms PCRE is calculated by applying a risk weighting or volatility factor to the face value of the notional principal of individual trades
- The PCRE factors are also used by credit officers when establishing credit limits, to ensure that credit assessment recognises the potential volatility of the transactions' values. 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.

Credit Valuation Adjustment

ANZ uses a credit valuation adjustment (CVA) model to adjust the fair value of derivative instruments over the life of the financial instrument to take into account the impact of counterparty credit quality. This is undertaken by a present value of losses (PVL) methodology which calculates the present value of expected losses over the life of the financial instrument as a function of probability of default, loss given default, expected credit risk exposure and an asset correlation factor.

Impaired derivatives are subject to a CVA which is based on an individual assessment of the expected losses on the transaction.

Wrong way risk

ANZ's management of counterparty credit risk also takes into consideration the possibility of wrong way risk arising. Wrong way risk emerges when a counterparty's probability of default is adversely correlated with market risk factors. ANZ's credit policies and transaction evaluation by credit risk are central in managing wrong way risk arising from derivative transactions, including credit derivatives. These considerations are made as part of the independent transaction approval processes.

Counterparty credit risk mitigation

ANZ's primary tools to mitigate counterparty credit risk are netting, collateral, structuring derivatives with enhanced credit protection in master agreements and a rigorous control and reporting system.

Credit risk mitigation techniques:

- A bilateral netting master agreement in the form of an ISDA or other ANZ approved netting agreement allows close-out netting of in the money and out of the money exposures in a portfolio with offsetting contracts, with a single net payment with the same legal counterparty.
- In some transactions, ANZ or the counterparty may be required to lodge collateral. Standard market documentation in the form of ISDA Master Agreement with Credit Support Annex governs the amount of collateral required to be posted or received by ANZ and counterparty and the re-margining frequency between counterparties. In some agreements the amount of collateral required and other terms may be linked to external credit ratings. 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
- Use of right to break clauses in master agreement or trade confirmation to reduce term of long dated derivative trades
- Credit exposure control, monitoring and reporting of excesses against approved credit limits
- Additional termination triggers such as credit rating downgrade clauses and change in ownership clauses being including in documentation, resulting in close out of exposure if triggered
- Linking covenants and events of default in existing loan facility agreement to master agreement.
- Use of credit derivatives to hedge counterparty credit risk exposure
- Settlement through Continuous Linked Settlement (CLS) to eliminate settlement risk for foreign exchange transactions with CLS members.

In the event of a downgrading of ANZ's rating by one notch from AA to AA- at 30 September 2010, 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 580 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[47], 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[48], ANZ applies an Internal Ratings-Based approach (as outlined in APS 120: 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. 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 derivatives and/or 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

[47] APRA has extended the definition of securitisation in certain cases where only one tranche or class of creditors is serviced by the cash flow from the pool of assets.

[48] 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.

joint risk and business approval. The securitisation team must be involved in all non-trading securitisation transactions, which ensures consistent expert treatment.

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

Risk measurement and reporting of securitisation exposures

In accordance with APS 120: Securitisation, 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. ANZ undertakes its own internal risk assessments for securitisation exposures and supplements this assessment with external rating agency ratings and/or methodology.

The type and frequency of reporting 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 [49] [50]

Traditional securitisations	September 2010			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure Facilities provided $M
Residential mortgage	211	-	-	1,908
Credit cards and other personal loans	-	-	-	18
Auto and equipment finance	-	-	-	542
Commercial loans	-	-	-	22
Other	-	-	-	2,887
Total	**211**	**-**	**-**	**5,377**

Synthetic securitisations	September 2010			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**-**	**-**	**-**	**-**

Aggregate of traditional and synthetic securitisations	September 2010			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure Facilities provided $M
Residential mortgage	211	-	-	1,908
Credit cards and other personal loans	-	-	-	18
Auto and equipment finance	-	-	-	542
Commercial loans	-	-	-	22
Other	-	-	-	2,887
Total	**211**	**-**	**-**	**5,377**

Traditional securitisations	March 2010			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure Facilities provided $M
Residential mortgage	242	-	-	1,626
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	870
Commercial loans	-	-	-	161
Other	-	-	-	3,626
Total	**242**	**-**	**-**	**6,283**

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

[50] 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 (cont.)

Synthetic securitisations	March 2010			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure Facilities provided $M
Residential mortgage	-	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	246
Total	**-**	**-**	**-**	**246**

Aggregate of traditional and synthetic securitisations	March 2010			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure Facilities provided $M
Residential mortgage	242	-	-	1,626
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	870
Commercial loans	-	-	-	161
Other	-	-	-	3,872
Total	**242**	**-**	**-**	**6,529**

Traditional securitisations	September 2009			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure 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			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure 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			
Underlying asset	ANZ originated $M	Third party originated $M	Other Services $M	Regulatory credit exposure 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**

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

Underlying asset	Value as at 30 September 2010 ANZ originated $M	Impaired $M	Past due $M	Half Year Losses recognised $M
Residential Mortgage	211	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**211**	**-**	**-**	**-**

Underlying asset	Value as at 31 March 2010 ANZ originated $M	Impaired $M	Past due $M	Half Year Losses recognised $M
Residential Mortgage	242	-	-	-
Credit cards and other personal loans	-	-	-	-
Auto and equipment finance	-	-	-	-
Commercial loans	-	-	-	-
Other	-	-	-	-
Total	**242**	**-**	**-**	**-**

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

Table 9(f): Securitisation – Regulatory credit exposures by exposure type [51]

Securitisation exposure type	Regulatory credit exposure September 2010 $M	March 2010 $M	September 2009 $M
Liquidity facilities	2,529	2,888	3,915
Funding facilities	2,549	3,034	3,006
Underwriting facilities	-	-	-
Lending facilities	-	-	-
Credit enhancements	25	26	59
Holdings of securities (excluding trading book)	319	626	1,561
Other	-	-	-
Total	**5,422**	**6,574**	**8,541**

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

Securitisation risk weights	September 2010 Regulatory credit exposure $M	September 2010 Risk weighted assets $M	March 2010 Regulatory credit exposure $M	March 2010 Risk weighted assets $M	September 2009 Regulatory credit exposure $M	September 2009 Risk weighted assets $M
≤ 25%	3,230	369	4,772	517	6,206	627
>25 ≤ 35%	146	51	-	-	225	79
>35 ≤ 50%	20	10	20	10	26	13
>50 ≤ 75%	186	98	14	10	412	309
>75 ≤ 100%	1,482	1,482	1,388	1,388	1,630	1,630
>100 ≤ 650%	54	81	20	50	-	-
1250% (Deduction)	304	-	360	-	42	-
Total	**5,422**	**2,091**	**6,574**	**1,975**	**8,541**	**2,658**

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

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

Securitisation exposures deducted from Capital	September 2010			March 2010			September 2009		
	Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	Total $M	Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	Total $M	Deductions from Tier 1 Capital $M	Deductions from Tier 2 Capital $M	Total $M
Residential Mortgage	-	-	-	-	-	-	-	-	-
Credit cards and other personal loans	-	-	-	-	-	-	-	-	-
Auto and equipment finance	-	-	-	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-	-	-	-
Other	152	152	305	180	180	360	21	21	42
Total	**152**	**152**	**305**	**180**	**180**	**360**	**21**	**21**	**42**

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[52]

	For the six months to 30 September 2010		
	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	-	971	-
Credit cards and other personal loans	-	139	-
Auto and equipment finance	-	830	-
Commercial loans	-	-	-
Other	-	152	-
Total	-	**2,092**	-

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

[52] "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

	For the six months to 31 March 2010		
	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	-	505	-
Credit cards and other personal loans	-		-
Auto and equipment finance	-		-
Commercial loans	-		-
Other	-	164	-
Total	-	**669**	-

Securitisation activity by facility provided	Notional amount $M
Liquidity facilities	-
Funding facilities	229
Underwriting facilities	-
Lending facilities	-
Credit enhancements	-
Holdings of securities (excluding trading book)	-
Other	-
Total	**229**

	For the six 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**

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 all traded positions including foreign exchange and commodity risks in the trading book and banking book. 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 (CMRC) 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.

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 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 a historical simulation with a 500 day observation period. Traded VaR is calculated at 97.5% confidence interval, one-day holding period for trading activities (for internal purposes) and 99% confidence interval, ten-day holding period for the calculation of regulatory 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.

VaR estimates and sensitivities alone is not a sufficiently reliable measure to estimate the maximum loss ANZ could suffer in an extreme market event as it is driven by historical observations. To complement VaR analysis, ANZ 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 as well as possible future events. 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 and 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 outcomes. 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 [53] [54]

	VaR over six months ended 30 September 2010			
Value at Risk (VaR)	Mean $M	Maximum $M	Minimum $M	Period end $M
Equities	-	-	-	-
Interest Rate	18.7	24.9	11.1	11.2
Foreign exchange	1.6	3.2	1.1	2.6
Commodity	2.3	3.7	1.6	2.1
Credit	3.2	4.9	2.2	3.0

	VaR over six months ended 31 March 2010			
Value at Risk (VaR)	Mean $M	Maximum $M	Minimum $M	Period end $M
Equities	-	-	-	-
Interest Rate	15.7	23.8	9.2	23.8
Foreign exchange	2.5	7.8	0.8	1.9
Commodity	2.1	3.2	0.9	2.1
Credit	3.0	4.9	1.7	4.4

	VaR over six months ended 30 September 2009			
Value at Risk (VaR)	Mean $M	Maximum $M	Minimum $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

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

[54] 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 31 September 2010, based on the prior 250 business days, there were zero hypothetical and zero actual genuine negative outliers, compared to zero hypothetical and 1 actual genuine negative outliers as at 31 March 2010. This decrease in the number of hypothetical and actual genuine negative outliers is in line with expectations as the high market volatility experienced from early 2008 has been rolled out of the current historical VaR model while a reduction in market volatility throughout 2009-2010 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.

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[55], equity trading and electricity trading risk factors. For internal purposes only ANZ also uses an internal model for electricity and equities.

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 [56]

	Capital requirements		
Market Risk under standardised approach	September 2010 $M	March 2010 $M	September 2009 $M
Interest rate risk	126	121	112
Equity position risk	8	2	3
Foreign exchange risk	-	-	-
Commodity risk	8	5	6
Total	142	128	121
RWA equivalent	1,775	1,597	1,514

[55] 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.

[56] 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[57], 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, operational risk measurement and capital allocation 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..

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 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.

[57] 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
- Maintaining risk registers and recording operational risk events and compliance incidents on the ANZ loss event database.
- 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 divisions and 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 process includes the following activities: risk identification and evaluation; control self assessment, testing and remediation; risk mitigation tracking; internal loss event capture, event case management and monitoring. Material risks and events (including actual losses, near misses and breaches) are recorded and required to be escalated and reported to the appropriate level (either within the business, to Divisional Risk committee, CRO or the OREC) in accordance with established risk appetite and reporting thresholds for risk acceptance, remediation approval or tracking. In addition, Division Committees and OREC receive regular reporting on: trends, change in risk profiles, results from reviews or specific test results, remediation tracking and monitoring.

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

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

Capital outcomes include:

- Operational Risk Regulatory Capital to meet the regulatory capital soundness standard based on a 99.9% confidence interval in accordance with 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 and partnership arrangements with financial institutions in Asia. 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 any investments over delegated authorities, and all regulatory notification requirements are met. Performance of these investments is monitored by both the owning business unit and Group 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.

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

Equity investments	Balance sheet value			Fair value		
	September 2010 $M	March 2010 $M	September 2009 $M	September 2010 $M	March 2010 $M	September 2009 $M
Value of listed (publicly traded) equities	1,903	1,851	1,697	2,831	2,547	2,199
Value of unlisted (privately held) equities	1,514	1,531	3,337	1,566	1,558	3,713
Total	**3,417**	**3,382**	**5,034**	**4,397**	**4,105**	**5,912**

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

Gains (losses) on equity investments	Half Year 31 September 2010 $M	Half Year 31 March 2010 $M	Full Year 30 September 2010 $M	Full Year 30 September 2009 $M
Cumulative realised gains (losses) from disposals and liquidations in the reporting period	23	2	25	(6)
Total unrealised gains (losses)	(80)	46	(34)	21
Total unrealised gains (losses) included in Gross Tier 1/Tier 2 capital	-	-		-

Table 13(f): Equities – Capital requirement

Risk Weighted Assets	September 2010 $M	March 2010 $M	September 2009 $M
Equity investments subject to a 300% risk weight	1	1	2
Equity investments subject to a 400% risk weight	1,576	1,638	1,912
Total minimum capital requirement by equity asset class	**1,577**	**1,639**	**1,914**
Aggregate amount of equity investments subject to:			
Supervisory provisions	n/a	n/a	n/a
Grandfathering provisions	n/a	n/a	n/a

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

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

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 the following principal techniques to quantify and monitor IRRBB:

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

The calculations used to quantify IRRBB require assumptions to be made about the repricing term of exposures that do not have a contractually defined repricing date, such as deposits with no set maturity dates, and prepayments. Changes to these assumptions require GALCO approval.
Where relevant, IRRBB techniques recognise foreign currency effects as all measures are expressed in Australian dollars.

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

Reporting of 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. Compliance with the risk appetite and limit framework is reported to CMRC, GALCO and the Risk Committee of the Board.

IRRBB regulatory capital is calculated monthly.

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) [58]

	Change in Economic Value		
Standard Shock Scenario Stress Testing: Interest rate shock applied	**September 2010 $M**	**March 2010 $M**	**September 2009 $M**
AUD			
200 basis point parallel increase	128	32	(9)
200 basis point parallel decrease	(135)	(31)	16
NZD			
200 basis point parallel increase	(1)	(20)	(76)
200 basis point parallel decrease	(0)	17	75
USD			
200 basis point parallel increase	(18)	(7)	(17)
200 basis point parallel decrease	11	7	10
GBP			
200 basis point parallel increase	(8)	(4)	(5)
200 basis point parallel decrease	3	1	2
Other			
200 basis point parallel increase	(25)	8	(17)
200 basis point parallel decrease	16	3	11

IRRBB regulatory capital	**615**	**651**	**197**
IRRBB regulatory RWA	**7,690**	**8,136**	**2,465**

Stress testing methodology

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

[58] 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 manages its funding profile using a range of funding metrics and balance sheet disciplines. This approach is designed to ensure that an appropriate proportion of the Group's assets are funded by stable funding sources including core customer deposits, longer-dated wholesale funding (with a remaining term exceeding one year) and equity. ANZ's funding profile strengthened further during 2010 as a result of solid growth in customer deposits and the continued focus on avoiding short-term wholesale funding maturity concentrations.

Customer deposits and other funding liabilities increased by 10% to $267.1 billion at 30 September 2010 (58% of total funding) from $242.4 billion (55% of total funding) at 30 September 2009.

The proportion of total funding from term wholesale source has been maintained.

As a result, the Group's proportional reliance on short-term wholesale funding decreased from 17% to 12% in the year to 30 September 2010. Proportionate short-term wholesale funding has approximately halved over the last two years (22% as at 30 September 2008).

Wholesale funding

ANZ maintained access to all major wholesale funding markets. Benchmark term debt issues were executed in AUD, USD, EUR, JPY, CAD, CHF and NZD. Short-term wholesale funding markets continue to function effectively, both locally and offshore. $26.4 billion of term wholesale funding (with a remaining term greater than one year at the end of the financial year) was issued during 2010 largely to replace maturing term debt and also to commence pre-funding the 2011 term funding issuance requirement:

- The weighted average tenor of new term debt issuance lengthened to 4.7 years (from 3.9 years in 2009)
- The weighted average cost of new term debt issuance decreased approximately 42 basis points during 2010 as a result of more stable market conditions relative to the prior year. Average portfolio costs remain substantially above pre-crisis levels and continue to increase as maturing term wholesale funding is replaced at higher spreads
- In Feb 2010 the Australian Government announced that the Guarantee Scheme for Large Deposits and Wholesale Funding would close to new liabilities on 31 March 2010. The withdrawal of the Australian Government Guarantee did not have any adverse impact on ANZ's funding activities. The withdrawal of the Australian Government Guarantee did not

adversely impact ANZ's funding activities. ANZ has not used the Australian Government Guarantee for a benchmark debt issue since June 2009

- Guaranteed wholesale funding comprises only 4.6% of ANZ's total funding.

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 2010 the volume of eligible securities available, post any repurchase (i.e. "repo") discounts applied by the applicable central bank, was $66.7 billion. In addition, the liquidity portfolio provided cover against over one year of offshore wholesale debt maturities.

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

Supplementing the prime liquid asset portfolio, ANZ holds additional cash and liquid asset balances. The 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: 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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