Directors' Report
for the financial year ended 31 March 2011
continued

Review of financial position

The Consolidated Entity's liquidity risk management framework operated effectively throughout the year ensuring funding requirements were met and sufficient liquidity was maintained. Cash and liquid assets increased from $A22 billion at 31 March 2010 to $A26 billion at 31 March 2011. Cash and liquid asset holdings represent approximately 30 per cent of the Consolidated Entity's net funded assets.

As an Australian Prudential Regulation Authority (APRA) authorised and regulated NOHC, MGL is required to hold adequate regulatory capital to cover the risks for the whole Macquarie Group, including the Non-Banking Group. Macquarie and APRA have agreed a capital adequacy framework for MGL, based on Macquarie's Board-approved Economic Capital Adequacy Model (ECAM) and APRA's capital standards for ADIs.

MGL's capital adequacy framework requires it to maintain minimum regulatory capital requirements calculated as the sum of the dollar value of:

- The Banking Group's minimum Tier 1 capital requirement, based on a percentage of risk-weighted assets plus Tier 1 deductions (using prevailing APRA ADI Prudential Standards); and
- The Non-Banking Group capital requirement, calculated using Macquarie's ECAM.

The Consolidated Entity has satisfied its externally imposed capital requirements throughout the year. At 31 March 2011, the Macquarie Banking Group had a Tier 1 Capital Ratio of 10.7 per cent and a Total Capital Ratio of 12.4 per cent. The Consolidated Entity remains well capitalised with $A3.0 billion of eligible capital in excess of the minimum regulatory capital requirements.

Events subsequent to balance date

At the date of this report, the Directors are not aware of any matter or circumstance which has arisen that has significantly affected or may significantly affect the operations of the Consolidated Entity, the results of those operations or the state of affairs of the Consolidated Entity in the financial years subsequent to 31 March 2011 not otherwise disclosed in this report.

Likely developments in operations and expected outcomes

Continuing market uncertainty makes forecasting difficult.

The net profit contributions for Macquarie Securities, Macquarie Capital, Fixed Income, Currencies and Commodities and Corporate and Asset Finance for the year ending 31 March 2012 are currently expected to be up on the prior year. The net profit contributions for Macquarie Funds and Banking and Financial Services for the year ending 31 March 2012 are currently expected to be broadly in line with the prior year.

The full year 2012 result for each operating group will vary with market conditions, in particular for Macquarie Capital and Macquarie Securities which are assuming better market conditions. Movements in foreign exchange rates will impact the contribution of each group.

The Group's compensation ratio and effective tax rate are expected to be consistent with historical levels. The continued higher cost of funding is likely to reflect market conditions and high liquidity levels.

Consequently, it is currently expected that the result for the Macquarie Group for the year ending 31 March 2012 will be an improvement on the prior year. However, the final result will be dependent upon market conditions, particularly for Macquarie Capital and Macquarie Securities which are assuming better market conditions. The full year 2012 result also remains subject to a range of other challenges including increased competition across all markets, the cost of a continued conservative approach to funding and capital, and regulation, including the potential for regulatory change.

Over the medium term, Macquarie's businesses are increasingly well positioned to benefit from future growth due to its deep expertise in major markets, growing global market share, strength in diversity, a balance sheet positioned for growth and an effective risk management culture.