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

Executive summary

Through its remuneration approach, Macquarie's objective is to drive superior shareholder returns over the long term, while managing risk in a prudent fashion. Its aim is to do this by aligning the interests of staff and shareholders, while attracting, motivating and retaining high quality people. The consistency of this approach has served shareholders well over the longer term. The Board considers that, with incremental change, it continues to be the appropriate approach.

Nonetheless, over the past year, Macquarie has faced some remuneration challenges. Regulators in Australia and some overseas jurisdictions have focused on remuneration, causing adjustments to the structure of remuneration. At the same time, competition for staff has intensified. Some peers have sought to rebuild their business after the Global Financial Crisis. Other firms are not constrained by regulator pay guidelines and are able to offer attractive remuneration packages to target staff.

Macquarie has sought to address these twin and conflicting challenges by making further incremental changes to its remuneration structure within its broad overarching remuneration approach. In so doing, the focus continues to be on aligning the interests of shareholders and staff, while attracting and retaining our most valuable asset, namely our staff.

– For some staff, more profit share is being deferred and delivered in Macquarie equity, with less profit share being delivered as cash.
– 'Malus'[1] is to be introduced for some staff for FY2012 in line with regulatory requirements. Such an approach is consistent with Macquarie's existing ability to 'clawback' deferred profit share from those staff who leave and breach specific guidelines.
– For some staff, to meet regulatory guidance and market practice, a shift has occurred in the mix between fixed and variable remuneration. Such shifts are most notable in risk and finance staff, as well as in the structure of senior executive remuneration.

Notwithstanding these shifts to increased **fixed remuneration**, the proportion and level of fixed remuneration for senior staff remain relatively low compared to comparable roles in other Australian corporations. The Board of Directors considers this is appropriate because it encourages a performance orientation. In 2011, fixed remuneration for Macquarie's twelve Executive Committee members comprised, on average, 12 per cent of current year total remuneration. The balance of their remuneration remains at risk.

Macquarie remains committed to a **performance-based approach to remuneration** that is aligned with shareholders' interests. This is evidenced by the way the profit share pool is created using the twin measures of net profit after tax (NPAT) and return on equity (ROE), measures which are known to be drivers of returns to shareholders. For a given level of capital employed, total profit share rises or falls with NPAT. Macquarie's total profit share pool increases with performance and no maximum ceiling is imposed. This aligns shareholder and staff interests and provides the strongest incentive to staff to continuously strive to maximise long-term profitability.

Performance-based profit share is allocated to Macquarie's businesses and, in turn, to individuals based on performance. Performance is primarily assessed based on relative contribution to profits while taking into account capital usage and risk management. This results in businesses and individuals being motivated to increase earnings and to use shareholder funds efficiently, consistent with prudent risk-taking. In addition, other qualitative measures are used to assess individual performance. For the Managing Director and Chief Executive Officer (CEO) of Macquarie Group and the Managing Director and CEO of Macquarie Bank, the Non-Executive Directors annually and specifically assess each Managing Director's performance by considering a range of indicators, including risk management, governance and compliance, financial performance measures, strategic initiatives, staff and human resources indicators, reputation management and monitoring, community and social responsibility matters and efforts in respect of diversity. The approach adopted motivates staff to work co-operatively given that their profit share will reflect Macquarie's overall performance, the relative performance of their business and their individual contribution.

The Board and management also seek to ensure that remuneration for staff whose primary role is risk and financial control, including the Chief Risk Officer (CRO) and the Chief Financial Officer (CFO), preserves the independence of the function and maintains Macquarie's robust risk management framework.

Profit share is delivered in ways that encourage a longer-term perspective and ensures alignment with shareholders' longer-term interests and staff retention. In turn, this encourages staff to maximise profit without exposing Macquarie to risk or behaviours that jeopardise long-term profitability or reputation.

[1] Malus is an ex-post risk adjustment to deferred unvested remuneration.