

Directors' Report – Remuneration Report

for the financial year ended 31 March 2011

continued

3.2 Remuneration is linked to the drivers of shareholder returns

For most Executive Directors, the largest component of their remuneration is delivered as an annual profit share allocation, based on their performance over the year. Macquarie's approach to measuring performance for the purpose of determining annual profit share is to utilise financial performance measures which are known to be drivers of long-term shareholder returns. They are NPAT and ROE.

NPAT and ROE were selected as the most appropriate performance measures for the following reasons:

- they are correlated over time with total shareholder returns
- they provide an appropriate incentive because they are elements of performance over which the executives can exercise considerable control. TSR, on the other hand, is influenced by many external factors over which executives have limited control. Moreover, regulators do not support the use of that measure
- both measures can be substantiated using information that is disclosed in audited financial accounts, providing confidence in the integrity of the remuneration system from the perspective of both shareholders and staff.

These two drivers motivate staff to expand existing businesses and establish promising new activities. The use of ROE to measure excess returns – ROE relative to the cost of equity capital – creates a particularly strong incentive for staff to ensure that capital is used efficiently, while having regard to risk. Therefore, the use of these two measures, in combination, results in appropriate outcomes for shareholders.

Both measures are also enshrined in the performance hurdles applicable on PSUs for Executive Committee members (refer section 3.3.11.3).

Notwithstanding these factors, other qualitative measures are used in assessing performance.

Overview of profit share arrangements

The profit share arrangements are designed to encourage superior performance by motivating executives to focus on maximising earnings and ROE, while having appropriate regard for risk, thereby driving long-term shareholder returns. A Macquarie-wide profit sharing pool is created at the corporate level which is the basis of creating substantial incentives for superior profitability but low or no participation for less satisfactory performance.

Determination of the profit share pool

The size of the pool is determined annually by reference to Macquarie's after-tax profit and its earnings over and above the estimated cost of capital. A portion of Macquarie's profit earned accrues to the staff profit share pool. Once the cost of equity capital is met, an additional portion of excess profit is accrued to the profit share pool. The methodology used to calculate the profit share pool is reviewed at least annually by the BRC and the Non-Executive Directors of the Board, including:

- the proportion of after-tax profit and the proportion of earnings in excess of Macquarie's cost of equity capital used to calculate the pool
- the cost of equity capital and the tax rate.

As part of this review, the CRO and the CFO advise the BRC on the risk input into the calculation of the profit share pool.

The Non-Executive Directors of the Board have discretions:

- to change the quantum of the pool to reflect internal and external factors if deemed in the interests of Macquarie and shareholders. In doing this, the Board considers shareholders' interests, the employment environment and staff retention requirements. It is critical that Macquarie has the flexibility to remain competitive in the global markets in which it operates while having due regard to shareholder interests over the short and medium term
- to defer the payment of profit share amounts to a subsequent year at a Macquarie business or individual level where it is in the interests of Macquarie and shareholders to do so.

This year, the Non-Executive Directors of the Board have exercised their discretion in relation to changing the quantum of the pool. They have also done so in prior years.