
Note 41

Financial risk management

Risk Management Group

Risk is an integral part of the Consolidated Entity's businesses. The main risks faced by the Consolidated Entity are market risk, equity risk, credit risk, liquidity risk, operational risk, legal risk and compliance risk. Responsibility for management of these risks lies with the individual businesses giving rise to them. It is the responsibility of the Risk Management Group (RMG) to ensure appropriate assessment and management of these risks.

RMG is independent of all other areas of the Consolidated Entity. The Head of RMG, as Macquarie's Chief Risk Officer, is a member of the Executive Committee of MGL and MBL and reports directly to the Managing Director and Chief Executive Officer with a secondary reporting line to the Board Risk Committee. RMG authority is required for all material risk acceptance decisions. RMG identifies, quantifies and assesses all material risks and sets prudential limits. Where appropriate, these limits are approved by the Executive Committee and the Board.

Note 41.1

Credit risk

Credit risk is defined as the risk of a counterparty failing to complete its contractual obligations when they fall due. The consequent loss is either the amount of the loan not repaid, or the loss incurred in replicating a trading contract with a new counterparty.

The responsibility for approval of credit exposures is delegated to specific individuals by the Board of MGL. While Operating Groups are assigned modest levels of Credit discretions, all credit exposures above these levels are independently assessed by RMG. Credit risk analysis is focused on ensuring that risks have been fully identified and that the downside risk is properly understood so that a balanced assessment can be made of the worst outcome against the expected rewards. After this analysis is undertaken, limits are set for an acceptable level of potential exposure. All limits and ratings are reviewed at least once a year, or more frequently if necessary, to ensure that the most current information available on counterparties is taken into account.

Credit exposures for loans are evaluated as the full face value whereas exposures for derivatives are a function of potential market movements. When trading gives rise to settlement risk, this exposure is assessed as the full face value of the settlement amount. Credit exposures which fluctuate through the duration of the transaction are monitored daily. These include exposures such as swaps, forward contracts and options, which are assessed using sophisticated valuation techniques.

To mitigate credit risk, the Consolidated Entity makes use of margining and other forms of collateral or credit enhancement techniques (including guarantees, letters of credit, the purchase of credit default swaps and mortgage insurance) where appropriate.

All customers' counterparty limits and exposures are allocated an MGL rating on a 1 – 13 scale which broadly corresponds with Standard & Poor's and Moody's Investor Services credit ratings. Each MGL rating is assigned a Probability of Default estimate. Credit limits and exposures are also allocated a Loss Given Default ratio reflecting the estimated economic loss in the event of default occurring.

All loan assets are subject to recurring review and assessment for possible impairment. Where there is a deteriorating credit risk profile, the exposures are monitored on a monthly basis through the CreditWatch report and FICC CreditWatch report. The business remains responsible for the management of the counterparty and of the risk position, but RMG oversight is increased to ensure that positions are managed for optimal outcomes. When counterparties default, RMG and the business work together to resolve the issues and to manage the facilities through the impairment and provisioning process.

The Consolidated Entity's policies to control credit risk include avoidance of unacceptable concentrations of risk either to any economic sector or to an individual counterparty. Policies are in place to regulate large exposures to single counterparties or groups of counterparties.

The Consolidated Entity has a country risk framework which covers the assessment of country risk and the approval of country risk limits. Where appropriate the country risk is covered by political risk insurance.

The balances disclosed in the credit risk tables below exclude financial assets that are subject to risks other than credit risk, such as equity investments, interests in associates and joint ventures or bank notes and coins.