Executive summary

Macquarie's remuneration system, which has progressively evolved over time, has been designed to balance risk and return. This is reflected in the remuneration system's overarching objective which seeks to align the interests of staff with those of shareholders so as to generate superior returns over time, while having due regard to risk.

During the past year, in relation to executive remuneration, governments, regulators and shareholders have increased their focus on whether risk and return is appropriately balanced. In the financial services sector, regulators and their governments seek to protect depositors' funds and ensure the stability of the financial system. Shareholders share this concern, but also expect a return on their capital appropriate to the risk involved. In other words, there is an elevated recognition among governments, regulators and shareholders of the need to balance risk and return.

Macquarie's Board of Directors (the Board) has actively assessed such issues and reached the conclusion that Macquarie's existing remuneration approach has the inbuilt resilience to respond to the issues that have been raised by governments, regulators and shareholders, although some further incremental changes are being made. They are:

— the vesting of Executive Committee Performance Share Units (PSUs) will be extended to vest in two equal tranches after years three and four. PSUs previously vested in three equal tranches after two, three and four years

— for a limited group of staff in the UK, defined as Code Staff under the Financial Services Authority (FSA) Remuneration Code (FSA Code), a greater proportion of remuneration is deferred, delivered in Macquarie shares and required to be held for a longer period. In addition, Malus[1] provisions have been expanded

— additional disclosure on past, present and future conditional remuneration has been provided for the Managing Director and Chief Executive Officer (Managing Director and CEO).

In addition, FY2012 has been a period of economic uncertainty which has seen some of Macquarie's businesses severely impacted by macroeconomic conditions, primarily the European debt crisis, the US debt downgrade and the overall risk-aversion in the market. As a result, there has been a high degree of disparity within each business' contribution to profit during the year. Macquarie's annuity style businesses have performed strongly, while some of the capital market-facing businesses have been impacted by challenging market conditions which have had an impact on client volumes and margins. Within the capital market-facing businesses, there has been a high degree of disparity in performance with some groups and teams performing well while others have operated at a loss.

Reflecting Macquarie's overall performance, total performance-based remuneration and in turn, total compensation expense, is down on the prior year, with profit share allocations being highly differentiated to reflect differences in individual and business performance.

Nonetheless, Macquarie remains committed to a **performance-based approach to remuneration**. The proportion and level of fixed remuneration for senior staff remains relatively low compared to comparable roles in other Australian corporations. The Board of Directors consider this is appropriate because it rewards performance. In 2012, fixed remuneration for Macquarie's 10 Executive Committee members comprised 13 per cent of current year awarded remuneration. The balance of their remuneration remains at risk.

Performance-based remuneration is aligned with shareholders' interests. 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. No ROE component of the profit share pool was created in FY2012. However, given the difficult market conditions experienced in FY2012 and the need to retain some key staff, the Non-Executive Directors of the Board have exercised their discretion and increased the quantum of the profit share pool. In prior years, this discretion has been exercised both upwards and downwards.

Profit share is allocated to Macquarie's businesses and, in turn, to individuals working in them, based predominantly 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, in the context of prudent risk-taking. In addition, other qualitative measures are used to assess individual performance. In some instances, retention of staff in difficult market conditions is also considered.

In the current year, for the Managing Director and CEO of Macquarie Group and the Managing Director and CEO of Macquarie Bank, the Non-Executive Directors considered financial performance measures, performance against peers, business performance and platform growth, cost management initiatives, other strategic initiatives, prudential and compliance matters, risk management, governance, staff and human resources indicators, reputation management and monitoring and community and social responsibility matters. The Board and Management also seek to ensure that remuneration for staff whose primary

[1] Malus is an ex-poste risk adjustment to deferred unvested remuneration (as explained on page 42).