

# Risk Management Report

## continued

### Funds transfer pricing

An internal funds transfer pricing framework is in place that has been designed to produce appropriate incentives for business decision-making by reflecting the true funding costs arising from business actions. Under this framework, each business is allocated the full cost of the funding required to support its products and business lines, recognising the actual and contingent funding-related exposures their activities create for the group as a whole. Businesses that raise funding are compensated at a level that is appropriate for the liquidity benefit provided by the funding.

### Regulatory and compliance risk

The Compliance Division is an independent function responsible for ensuring that all Compliance Risks are appropriately assessed and managed across Macquarie.

In line with the core risk management principle of risk ownership, business heads are responsible for identifying risks within their businesses and ensuring that they are managed appropriately. The Compliance Division enables business management to fulfil these supervisory responsibilities by establishing a robust and effective compliance framework, and by performing an advisory, training and monitoring role in respect of the compliance risks arising from Macquarie's business activities.

The Compliance Division communicates and delivers on its priorities by defining and implementing a risk-based compliance program that sets out planned activities, such as the implementation and review of specific policies and procedures, compliance testing and staff training. The compliance program is overseen by the Global Head of Compliance to ensure appropriate coverage across businesses and co-ordination among other risk management functions.

The Head of Compliance reports directly to the CRO.

The Head of Compliance has free access to the BGCC at any time and meets privately with the BGCC at least once a year.

The RMG Compliance role is closely supported by RMG Prudential, Capital & Markets (PCM) to ensure compliance with prudential standards and consistency of Macquarie's approach to prudential regulation globally.

### Legal risk

Legal risk includes the risk that:

- transactions are not capable of being enforced as expected
- business does not adequately understand the legal and regulatory framework in which it operates
- the organisation may be found to be responsible for a claim based on a breach of contract, law or regulation.

Legal risk is managed through identification and assessment of legal risk, and by minimising or mitigating legal risk as far as reasonably practical. Responsibility for legal risk lies with Macquarie's businesses in conjunction with Legal and Governance. The Head of Legal and Governance, the General Counsel, is a member of Macquarie's Operations Review Committee and reports directly to the CEO. The General Counsel has access to the Board and any Board committees. Each Macquarie Operating Group has

a business General Counsel who reports to the General Counsel and to the relevant Operating Group Head.

### Reputation risk

All activities have embedded elements of reputation risk. Managing reputation risk is an essential role of senior management as it has the potential to impact both earnings and access to capital. Macquarie seeks to manage and minimise reputation risk through its corporate governance structure and risk management framework.

Macquarie operates under a strong corporate governance structure consistent with the regulatory requirements of various regulators including the Australian Securities & Investments Commission (ASIC), the Australian Securities Exchange (ASX) and Australian Prudential Regulation Authority (APRA). *Goals and Values* incorporating a clear code of ethics are communicated to all staff and regional Integrity Officers deal with potential issues of integrity.

Operating Groups take ownership of risk, including reputation risk. In addition, a robust, independent risk management framework incorporates active management and monitoring of risks arising within Macquarie. The operation of this framework and oversight by RMG are major mitigants to reputation risk.

The various policies, procedures and practices in place aim to minimise reputation risk. Regular reporting to the Operations Review Committee and Boards includes detail on reputation risk issues as appropriate.

The direct financial losses arising from reputation risk (such as breach of mandates and regulatory fines) as well as legal costs are taken into account in the operational risk capital model.

### Internal Audit

Internal Audit provides independent assurance to Management and the Board on the quality and effectiveness of Macquarie's internal control, risk management and governance systems and processes. Internal Audit provides an independent and objective assessment as to whether risks have been adequately identified; adequate internal controls are in place to manage those risks; and whether those controls are working effectively. Internal Audit is independent of both business management and the activities it reviews.

The Head of Internal Audit is jointly accountable to the BAC and the CRO. The BAC approves the appointment and removal of the Head of Internal Audit who has unlimited access to the BAC.

### Basel III

Macquarie Bank is accredited under the Foundation Internal Ratings Based Approach (FIRB) for credit risk, the Advanced Measurement Approach (AMA) for operational risk, the internal model approach for market risk<sup>(1)</sup> and the internal model approach for interest rate risk in the banking book.

These advanced approaches place a higher reliance on a bank's internal capital measures and therefore require a more sophisticated level of risk management and risk measurement practices.

<sup>(1)</sup> Standard approach applied for specific risk on debt securities.