

Notes to the consolidated financial statements

for the half-year ended 30 September 2014

continued

Note 20

Fair values of financial assets and liabilities continued

Correlation

Correlation is a measure of the relationship between the movements of two variables (i.e. how the change in one variable influences a change in the other variable). Correlation is a key input of derivatives with more than one underlying and is generally used to value hybrid and exotic instruments.

Volatility and skew

Volatility is a measure of the variability or uncertainty in returns for a given derivative underlying. It represents an estimate of the amount a particular underlying instrument, parameter or index will change in value over time. Volatility is an input in the valuation of derivatives containing optionality. Volatility and skew are impacted by the underlying risk, term and strike price of a derivative.

Forward prices

Forward prices are a price or rate that is applicable to a financial transaction that will take place in the future. It is generally based on the spot price or rate, adjusted for the cost of carry, and defines the price or rate that will be used to deliver a currency, bond, commodity or some other underlying instrument in the future. A forward may also refer to the rate fixed for a future financial obligation, such as the interest rate on a loan payment.

Inputs for unlisted equity securities

Unlisted equity instruments are generally valued based on earnings multiples of comparable companies. Significant unobservable inputs may include earnings before interest, taxes, depreciation and amortisation (EBITDA) multiples, discount rates, and forecast earnings of the investee companies.

Note 21

Events after the reporting period

On 8 October 2014, MBL issued 4.3 million Macquarie Bank Capital Notes ("BCN") at face value of \$100 each. These instruments are non-cumulative and unsecured and may be redeemed at face value on 24 March 2020, 24 September 2020 and 24 March 2021 (subject to certain conditions being satisfied) or earlier in specified circumstances.

BCN may also be converted into a variable number of MGL's ordinary shares (subject to certain conditions being satisfied) on these redemption dates or mandatorily exchanged on 24 March 2023. They can also be exchanged earlier on an acquisition event (where a person acquires control of MGL or MBL) or where APRA determines MBL would be non-viable without an exchange or a public sector injection of capital (or equivalent support).

The BCN pay discretionary, semi-annual floating rate cash distributions equal to 6 month BBSW plus 330bps margin, adjusting for franking credits, paid semi annually.