Directors' Report
for the financial year ended 31 March 2013
continued

Review of financial position

The Consolidated Entity's liquidity risk management framework operated effectively throughout the year ensuring funding requirements were met and sufficient liquidity was maintained. Cash and liquid assets were $A20 billion at 31 March 2013 representing approximately 13 per cent of the Consolidated Entity's total assets, or 23 per cent of the Consolidated Entity's net funded assets.

Retail deposits increased by 7 per cent from 31 March 2012 to $A31 billion at 31 March 2013, while total deposits increased from $A33.9 billion at 31 March 2012 to $A36.2 billion at 31 March 2013. During the year ended 31 March 2013, $A9.7 billion of new term funding was raised and $A2.8 billion of government guaranteed debt was repurchased with a plan to launch a public tender to repurchase additional outstanding government guaranteed debt.

As an Australian Prudential Regulation Authority (APRA) authorised and regulated NOHC, MGL is required to hold adequate regulatory capital to cover the risks for the whole Macquarie Group, including the Non-Bank Group. Macquarie and APRA have agreed a capital adequacy framework for MGL, based on Macquarie's Board-approved Economic Capital Adequacy Model (ECAM) and APRA's capital standards for ADIs.

MGL's capital adequacy framework requires it to maintain minimum regulatory capital requirements calculated as the sum of:

- the Bank Group's minimum Tier 1 capital requirement, based on a percentage of risk-weighted assets plus Tier 1 deductions using prevailing APRA ADI Prudential Standards; and
- the Non-Bank Group's capital requirement, calculated using Macquarie's ECAM. Transactions internal to the Macquarie Group are eliminated.

The Consolidated Entity has satisfied its regulatory capital requirements throughout the year. At 31 March 2013, the Macquarie Bank Group had a Common Equity Tier 1 Capital Ratio of 9.7 per cent and a Tier 1 Capital Ratio of 10.8 per cent. The Consolidated Entity remains well capitalised with $A3.1 billion of eligible capital in excess of the minimum regulatory capital requirements(1).

During the year, $A251 million of shares were purchased under the buyback at an average price of $A25.58 per share. Macquarie intends(2) to purchase approximately $A250 million of shares on-market to satisfy the requirements of the Macquarie Group Employee Retained Equity Plan. The buying period for the MEREP will commence on 13 May and is expected to be completed in early July(3). The shares for the Dividend Reinvestment Plan are to be acquired on-market(2).

Macquarie intends to replace the 2008 Convertible Preference Securities (CPS) with a new security. There will be a reinvestment offer for existing CPS holders and a priority offer for Macquarie Group Limited shareholders. The final terms are subject to regulatory approval.

(1) Macquarie Group Regulatory Capital surplus under APRA Basel III (at 7% Bank Group RWAs). 7% is the internal minimum Tier 1 ratio of the Bank Group.
(2) Shares will be issued if purchasing becomes impractical or inadvisable
(3) Actual buying may be completed sooner or later. Buying for the MEREP will be suspended during the DRP and hybrid pricing periods.

Events subsequent to balance date

At the date of this report, the Directors are not aware of any matter or circumstance which has arisen that has significantly affected or may significantly affect the operations of the Consolidated Entity, the results of those operations or the state of affairs of the Consolidated Entity in the financial years subsequent to 31 March 2013 not otherwise disclosed in this report.

Likely developments in operations and expected outcomes

While market volatility makes forecasting difficult, subject to market conditions it is currently expected that net profit contribution from operating groups for the financial year ending 31 March 2014 will be up on the prior year.

The tax rate is currently expected to be in the mid 30 per cent range based on the present mix of income.

Accordingly, the Group's result for the financial year ending 31 March 2014 is expected to be an improvement on the prior year provided market conditions for the financial year ending 31 March 2014 are not worse than those experienced over the past 12 months.

The result for the financial year ending 31 March 2014 also remains subject to a range of other challenges, including: the cost of our continued conservative approach to funding and capital; regulation, including the potential for regulatory changes; increased competition in some markets; and the overall cost of funding.

Macquarie remains well positioned to deliver superior performance in the medium term, due to its deep expertise in major markets, strength in diversity, ability to adapt its portfolio mix to changing market conditions, the ongoing benefits of continued cost initiatives, a strong and conservative balance sheet, and a proven risk management framework and culture.