Credit Opinion: Macquarie Bank Limited

Macquarie Bank Limited

Sydney, New South Wales, Australia

Ratings

Category	**Moody's Rating**
Outlook	Positive
Bank Deposits	A1/P-1
Bank Financial Strength	C+
Issuer Rating	A1
Senior Unsecured	A1
Subordinate	A2
Commercial Paper	P-1
Other Short Term	P-1
Ult Parent: Macquarie Group Limited	
Outlook	Stable
Issuer Rating	A2
ST Issuer Rating	P-1
Macquarie International Finance Limited	
Outlook	Stable
Issuer Rating	A2
Senior Unsecured -Dom Curr	A2
Subordinate MTN	A3
ST Issuer Rating	P-1
Other Short Term	P-1

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Key Indicators

Macquarie Bank Limited

	[1]**2007**	**2006**	**2005**	**2004**	**2003**	**Avg.**
Total Assets (USD Millions)	**110,284**	**76,090**	**38,114**	**33,559**	**19,653**	[2]**46.92**
Total Assets (AUD Millions)	**136,389**	**106,211**	**49,313**	**43,771**	**32,517**	[2]**35.16**
Shareholders' Equity (AUD Millions)	**7,519**	**5,337**	**4,432**	**2,833**	**2,735**	[2]**23.98**
NPL/Shareholders' Equity & Loan Loss Reserves(%)	**2.16**	**2.65**	**1.90**	**3.16**	**1.09**	[2]**-0.02**
Overhead Ratio (%)	**71.11**	**70.30**	**68.84**	**70.99**	**78.46**	[2]**-0.07**
Shareholders' Equity/Total Assets (%)	**5.51**	**5.02**	**8.99**	**6.47**	**8.41**	[2]**-8.27**
Pre-provision Profit/Avg Total Assets (%)	**1.62**	**1.53**	**2.53**	**1.90**	**1.27**	[2]**-1.49**
Liquid Assets/Total Assets (%)	**41.63**	**38.62**	**44.13**	**46.77**	**46.35**	[2]**-2.23**
Total Risk-Weighted Ratio (CAR) (%)	**15.50**	**14.10**	**21.20**	**19.90**	**21.40**	[2]**-4.39**
"Non-Performing" Loans/Gross Loans (%)	**0.32**	**0.37**	**0.52**	**0.85**	**0.30**	[2]**-11.82**

[1] As of March 31. [2] Compound annual growth rate.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of C+ to Macquarie Bank (MBL), which translates into a baseline credit assessment of A2. Following a restructure of the Macquarie group, MBL is now a subsidiary of Macquarie Group Limited (MGL).

MBL has an entrenched franchise position in Australia and is rapidly growing offshore in targeted business lines. As an investment bank, we tend to view MBL as naturally oriented towards a slightly higher risk/return profile than a major commercial bank. It will also act more opportunistically, leading to greater swings in its financial profile. However risk management is viewed as a strength, as demonstrated by the bank's low exposure to troubled asset classes during recent credit market turmoil.

MBL has demonstrated particularly stable earnings over time relative to the global investment banking peer group, as a result of good diversification of business lines that are frequently, in themselves, relatively volatile. Inter-group coordination is a strength: the bank has a strong track record of extracting value from opportunities via multiple business lines. As such, MBL is likely to continue to benefit from the capabilities of its affiliates post-restructure.

MBL's ratings carry a positive outlook as a result of the restructure, which indirectly improves the bank's funding profile and should decrease its exposure to some large credit concentrations and volatile business lines over time.

The bank's long-term global-scle local currency (GLC) deposit rating of A1 is based on the very high probability of systemic support, in case of need - which results in a 1 notch lift from the A2 baseline credit assessment. The short-term GLC deposit rating is Prime-1. Australia is considered a high support country and MBL is viewed as having high systemic importance, being an important player in Australia's financial market.

The bank's long- and short-term GLC issuer ratings - which address the risk of senior non-deposit obligations - and its senior debt ratings are also A1 / Prime-1, reflecting the same support considerations as the deposit ratings.

Thus the GLC deposit and debt ratings of MBL incorporate three main elements: (1) the bank's BFSR of C+, (2) Moody's assessment of a high probability of systemic support (a component of joint default analysis, referred to as JDA) and (3) the seniority of its deposits and debt.

The bank's foreign currency obligations are rated the same as its local currency obligations. Australia's sovereign ceilings for deposits and debt are at Aaa, and therefore do not constrain the bank's foreign currency ratings.

Credit Strengths

Credit strengths are:

[1] Strong brand value in home market, founded on management strength and advisory capabilities

[2] Nimbleness & expertise allows the firm to avail itself of niche business opportunities

[3] Diverse revenue streams and historically restrained appetite for credit/market risk have contributed to very stable earnings relative to securities industry peers

[4] Strong risk management framework - please refer to Moody's Risk Management Assessment (separate report)

[5] Considered approach to liquidity management

Credit Challenges

Credit challenges re:

[1] Ongoing exposure to the Macquarie Group's investment banking operations

[2] Increasingly complex and diversified operations will require ongoing risk-management vigilance

[3] Earnings exposure to global equity markets slowdown

Rating Outlook

The rating outlook is Positive. The group restructuring has put in place several elements that may be expected to improve MBL's credit profile over time. Firstly, the transaction improves the group's asset-liability position by substantially increasing the proportion of the group's funding derived from long-term sources. Secondly, it transfers some exposure concentrations in large assets that have less consistent liquidity characteristics to its affiliate Macquarie Financial Holdings Limited (MFHL). Thirdly, by transferring many of its investment banking activities to MFHL, the Bank is also trimming exposure to some cyclical business lines, without substantially reducing its overall diversity of income.

A transitional bridge facility exists from MBL to MGL, which is the funding vehicle for MFHL. Consequently MBL retains an indirect exposure to MFHL. However, as the facility is refinanced over time, this exposure will fall away. Furthermore, the new structure creates a regulatory ring-fencing of MBL, imposing strict constraints on inter-company transactions and limiting MBL's future exposure to its affiliates.

While Moody's believes that instability in credit markets is likely to persist for some time to come, the Bank has demonstrated its strong access to funding in recent months. Therefore, the rating agency believes that there is a good possibility that the Bank will be able to refinance a meaningful portion of the bridge facility within the 18 month timeframe addressed by a rating outlook.

What Could Change the Rating - Up

An eventual rating upgrade of Macquarie Bank's financial strength rating, and possibly its deposit and debt ratings, would require:

[1] Substantial refinancing of the bridge facility

[2] Demonstrated earnings stability

[3] Evidence that that bank is indeed effectively ring-fenced from the risks and financing requirements of MFHL.

What Could Change the Rating - Down

As the positive outlook indicates, a rating downgrade is currently considered a low probability event as the MBL's financial metrics are strong for its rating level. This provides a buffer against the turbulent outlook for financial markets.

Recent Results and Developments

On 16 November 2007, MBL because the banking subsidiary of Macquarie Group Limited. MBL's investment banking and specialist funds businesses were transferred to a newly created affiliate Macquarie Financial Holdings Limited.

Stand-alone financial statements for MBL have not been published.

DETAILED RATING CONSIDERATIONS

Detailed rating considerations for MBL's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a C+ BFSR to MBL with a positive outlook. As a point of reference, this is in line with the qualitative factors on Moody's BFSR scorecard. The quantitative factor analysis score is not disclosed at this stage, because the bank has not yet published financial statements.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Improving

MBL is still a relatively small player relative to Moody's rated wholesale bank peergroup, however it has a strong position in its home market, despite strong competition from global wholesale banks, and has achieved strong targeted growth in certain business lines.

MBL holds the following business lines of the Macquarie group:

o Corporate banking

o Mortgage lending / RMBS

o Margin lending

o Equity derivatives

o Traditional funds management

o Australian & New Zealand wrap & superannuation platforms

o Wealth management

o Domestic equity brokerage

o Real estate packaging & funds management

o Treasury & commodities

While growth in mortgage lending is likely to be negatively affected by the ongoing dislocations in credit markets, MBL's other activities are performing well as the Australian economy continues to . In particular, the bank's superannuation business is growing very strongly as the bank (i) gains market share and (ii) on the back of Australia's mandatory pension savings scheme.

With reference to the scorecard, the franchise score of C (baseline risk assessment of A2) somewhat understates the strength of the bank's position. The market share and sustainability subscore of C is driven by market share definitions. We would see the bank at the upper end of the category, recognising its strong position in Australia's financial market and growing presence internationally. The earnings stability sub-score of D is driven by the scorecard definitions and overstates the firm's historical earnings volatility, although we do believe there is some potential for sporadic correlations of business line performances to occur that could lead to a significant overall earnings impact in a given year. The geographic diversification score of B reflects the fact that MBL has the most geographically diversified revenue stream of all the rated banks in Australia, with offshore income accounting for over half of the total.

Factor 2: Risk Positioning

Trend: Neutral

Strong risk management framework

MBL has a strong risk management culture, with a dedicated risk-management group in place for over two decades. The bank's incentive structures reward behaviours geared towards long-term sustainability, with performance pay linked to risk-adjusted measures and deferred out as much as ten years. The firm's risk appetite is measured against both earnings and capital, using economic scenarios for stress-testing purposes and a comprehensive economic capital model. Overall, we see MBL as comparing well to international best practice in many regards.

How to maintain the "freedom within boundaries" balance as international operations grow

An important component of MBL's success has been its ability to maintain a highly entrepreneurial culture, in which individual business units are able to function with great autonomy, while maintaining tight, central risk control. Maintaining this balance will become increasingly challenging - and at the same time important - as the bank becomes ever more diverse and international in its operations. MBL's staff numbers have increased rapidly, approximately doubling since 2004, with over one third now located outside Australia. Rapid growth in a variety of locations will inevitably test the cohesiveness of the MBL culture, which the bank is seeking to manage by a rollout of guidelines covering business practices and integrity.

Low overall credit risk appetite

MBL's business model has, in the past, focused on generating fee income while maintaining comparatively lower on balance sheet risk. For example the bank has historically favoured equity brokerage over underwriting. As one would expect, given the bank's wholesale profile, MBL's largest credit exposures are counterparty exposures to highly-rated, global financial institutions.

Relative to commercial banks, loans constitute a relatively low proportion of MBL's assets. The majority of the loan portfolio is retail focused (principally leases and residential mortgages) and granular. The performance of this asset class has historically been quite strong as it is largely secured, although the bank's approach to credit management of these exposures is less sophisticated than large retail banks. Probably the greatest credit risk is posed by MBL's financing of selective real estate projects, but the bank has an excellent track record of managing its asset quality in this sector, even through the sharp market correction of the early 1990's.

Moody's Risk Management Assessment

The separate report published by Moody's considers the bank's risk framework, but not its risk appetite. MBL was one of only three firms in the global securities peergroup whose risk management was judged to be a "significant credit strength", the highest ranking assessment outcome.

BFSR Scorecard

The overall scorecard risk position score is C+ (baseline risk assessment of A1), which considers both risk management and risk appetite. The overall score is constrained only by the bank's continuing exposures to large single asset concentrations at MFHL via the bridge facility (borrower concentration of D) and disclosures which lack detailed line of business data, risk analyses and stress testing results (transparency score of C). For a wholesale bank, it runs a notably low level of market risk, scoring an A at the consolidated group level for this subfactor.

Factor 3: Regulatory Environment

Trend: Neutral

All Australian banks are subject to the same score on regulatory environment. This factor does not address bank specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Moody's views the Australian regulatory environment as a positive factor that provides a strong underpinning to Australian bank ratings. Please refer to Moody's Banking System Outlook for Australia to obtain a detailed discussion on the Regulatory Environment.

Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all Australian banks. Moody's assigns a B+ for the overall operating environment. Economic volatility is low - although not the lowest amongst developed countries - and the country has a strong legal system with good enforceability of creditor claims. We see these factors as supporting average bank asset quality and profitability over economic cycles. Please refer to Moody's Banking System Outlook for Australia to obtain a detailed discussion on the Operating Environment.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Neutral

In the absence of published data, Moody's pro-forma estimates suggest that MBL will have a lower level of profitability than the consolidated group. Nevertheless, profitability is likely to remain comfortably within the range for its BFSR.

MBL has grown profits rapidly off the back of its geographic and business line expansion. As discussed, individual business lines are potentially quite volatile, but diversification has delivered a stable overall earnings pattern. The most significant risk to profits would likely come from a global equity markets slowdown.

Factor 6: Liquidity

Trend: Positive

The restructure is likely to have a positive impact on the bank's liquidity and funding profile. In effect, the group is removing large asset concentrations from the Bank's balance sheet and funding them with long-term debt at the MGL level. Consequently, the short-term asset to short-term liability position of the Bank is likely to improve over time, and this is the most important driver of the Positive outlook for the BFSR.

Factor 7: Capital Adequacy

Trend: Negative

MBL has indicated that it is likely to maintain a capital ratio in the high single digit range. This is in line with the global peer group, and would suggest a capital subfactor score in the B range. The capital level is well down from the pre-restructure range, but is matched by a similar decrease in concentration risks.

Factor 8: Efficiency

Trend: Neutral

Efficiency is likely to remain in the D range, by Moody's estimates - but strong relative to a typical securities company. The high discretionary bonus component of total costs will continue to mean that the Bank has a fair degree of short-term flexibility to cope with earnings shocks. Mid-term flexibility is likely to be limited however, since if bonus levels are persistently below market, considerable talent loss will result.

Factor 9: Asset Quality

Trend: Weakening

Lending is not a core activity for MBL in the way that it is for a commercial bank. MBL does originate residential mortgages in a number of global markets, but borrower credit quality is typically at the higher end. Asset quality post-restructure is likely to remain excellent and within the A range on the scorecard.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global-scale local currency (GLC) deposit rating of A1 to MBL.

The GLC deposit rating is supported by the bank's Baseline Credit Assessment of A2 as well as by Australia's local-currency deposit ceiling (LCDC) of Aaa. The bank receives a 1 notch uplift from its Baseline Credit Assessment, bringing the GLC deposit rating to A1.

We view Australia as a high support country. The Australian regulator has a proactive approach to system management, favouring an open resolution approach to prevent problems arising at individual institutions, so as to safeguard financial system stability and safeguard depositor interests (and by extension, creditor interests). The Australian authorities have also demonstrated a pronounced willingness to provide liquidity support - directly from the central bank, or indirectly through supporting the liquidity of the country's major banks - on numerous occasions in recent decades. Australia does not have a deposit insurance scheme that would provide for a clear exit mechanism for troubled institutions - which may in practice restrict the set of options available to the authorities, and increase the likelihood of support being provided.

A financial claims scheme has been proposed that would effectively provide retail depositors with an advance payout on expected recoveries from a bank liquidation. However, we expect that the authorities' propensity to provide liquidity in an emergency may decrease only gradually as public expectations adapt. In any case, we would continue to expect support for the country's largest institutions, which play an important role in the payments system, to remain strong.

The probability of systemic support for MBL in the event of a stress situation is judged to be very high. This is based on MBL's significant position in the Australian financial market.

Additionally, under the regulator's own Probability And Impact Rating System - which measures the systemic impact of the failure of an individual institution - MBL falls well within the "Entity Impact Rating" of Extreme, as measured by its total assets size (http://www.apra.gov.au/PAIRS/Ratings.cfm), even if some allowance is made for the fact that it is a wholesale institution that does not have a big presence in the retail deposit market at % of household deposits.

Foreign Currency Deposit Rating

The Foreign Currency Deposit ratings of MBL are unconstrained given that Australia has a country ceiling of Aaa.

Foreign Currency Debt Rating

The Foreign Currency Debt ratings of MBL are unconstrained given that Australia has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the GLC rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of government support for the bank in case a stress situation occurs and the degree of dependence between the issuer rating and the LCDC.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to a high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be reminded that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt obligations may also be constrained by the country ceiling for foreign currency bonds and notes, however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Macquarie Bank Limited

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**B-**	
Factor 1: Franchise Value (20%)						**C+**	**Neutral**
Market Share and Sustainability			**x**				

Geographical Diversification		**x**					
Earnings Stability			**x**				
Earnings Diversification [2]							
Factor 2: Risk Positioning (20%)						**C+**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		**x**					
- Risk Management		x					
- Controls	x						
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness			x				
- Quality of Financial Information			x				
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		**x**					
Market Risk Appetite	**x**						
Factor 3: Regulatory Environment (5%)						**A**	**Neutral**
Factor 4: Operating Environment (5%)						**B+**	**Neutral**
Economic Stability		**x**					
Integrity and Corruption		**x**					
Legal System	**x**						
Financial Factors (50%)						**B**	
Factor 5: Profitability (7.9%)						**B+**	**Weakening**
PPP % Avg RWA	--	--	--	--	--		
Net Income % Avg RWA	--	--	--	--	--		
Factor 6: Liquidity (7.9%)						**B-**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets	--	--	--	--	--		
Liquidity Management	--	--	--	--	--		
Factor 7: Capital Adequacy (7.9%)						**B+**	**Neutral**
Tier 1 ratio (%)	--	--	--	--	--		
Tangible Common Equity % RWA	--	--	--	--	--		
Factor 8: Efficiency (3.5%)						**D**	**Neutral**
Cost/income ratio	--	--	--	--	--		
Factor 9: Asset Quality (7.9%)						**A**	**Weakening**
Problem Loans % Gross Loans	--	--	--	--	--		
Problem Loans % (Equity + LLR)	--	--	--	--	--		
Lowest Combined Score (15%)						**B-**	
Economic Insolvency Override						**Neutral**	
Total Scorecard Implied BFSR						**B-**	
Assigned BFSR						**C+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information
[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral