Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations as they fall due, including repaying depositors or maturing wholesale debt, or that the Group has insufficient capacity to fund increases in assets. The timing mismatch of cash flows and the related liquidity risk is inherent in all banking operations and is closely monitored by the Group and managed in accordance with the risk appetite set by the Board.

The Group's approach to liquidity risk management incorporates two key components:

- **Scenario modelling of funding sources**

  ANZ's liquidity risk appetite is defined by the ability to meet a range of regulatory requirements and internal liquidity metrics mandated by the Board. The metrics cover a range of scenarios of varying duration and level of severity. The objective of this framework is to:

  - Provide protection against shorter-term extreme market dislocation and stress.
  - Maintain structural strength in the balance sheet by ensuring that an appropriate amount of longer-term assets are funded with longer-term funding.
  - Ensure that no undue timing concentrations exist in the Group's funding profile.

  A key component of this framework is the Liquidity Coverage Ratio (LCR), which is a severe short term liquidity stress scenario mandated by banking regulators including APRA. As part of meeting LCR requirements, ANZ has a Committed Liquidity Facility (CLF) with the Reserve Bank of Australia (RBA). The CLF has been established to offset the shortage of available High Quality Liquid Assets (HQLA) in Australia and provides an alternative form of contingent liquidity. The total amount of the CLF available to a qualifying ADI is set annually by APRA.

- **Liquid assets**

  The Group holds a portfolio of high quality unencumbered liquid assets in order to protect the Group's liquidity position in a severely stressed environment, as well as to meet regulatory requirements. High Quality Liquid Assets comprise three categories, with the definitions consistent with Basel 3 LCR:

  - Highest-quality liquid assets (HQLA1): Cash, highest credit quality government, central bank or public sector securities eligible for repurchase with central banks to provide same-day liquidity.
  - High-quality liquid assets (HQLA2): High credit quality government, central bank or public sector securities, high quality corporate debt securities and high quality covered bonds eligible for repurchase with central banks to provide same-day liquidity.
  - Alternative liquid assets (ALA): Assets qualifying as collateral for the CLF and other eligible securities listed by the Reserve Bank of New Zealand (RBNZ).

  The Group monitors and manages the size and composition of its liquid assets portfolio on an ongoing basis in line with regulatory requirements and the risk appetite set by the Board.

	Half Year Average			Movement	
	Mar 17 $B	**Sep 16 $B**	**Mar 16 $B**	**Mar 17 v. Sep 16**	**Mar 17 v. Mar 16**
Market Values Post Discount[1]					
HQLA1[2]	**127.1**	119.7	117.2	6%	8%
HQLA2	**4.3**	4.1	3.3	5%	30%
Internal Residential Mortgage Backed Securities (Australia)[2]	**33.7**	35.3	35.1	-5%	-4%
Internal Residential Mortgage Backed Securities (New Zealand)[3]	**0.6**	1.2	1.5	-50%	-60%
Other ALA[4]	**15.6**	17.7	18.6	-12%	-16%
Total Liquid Assets	**181.3**	178.0	175.7	2%	3%
Cash flows modelled under stress scenario					
Cash outflows	**172.7**	182.9	181.0	-6%	-5%
Cash inflows	**38.2**	40.2	42.1	-5%	-9%
Net cash outflows	**134.5**	142.7	138.9	-6%	-3%
Liquidity Coverage Ratio[5]	**135%**	125%	126%	10%	9%

1. *Half year average basis, calculated as prescribed per APRA Prudential Regulatory Standard (APS 210 Liquidity) and consistent with APS 330 requirements.*
2. *RBA open repo arrangement netted down from CLF, with a corresponding increase in HQLA.*
3. *New Zealand LCR surplus is excluded from NZ internal RMBS, consistent with APS 330 treatment.*
4. *Comprised of assets qualifying as collateral for the CLF, excluding internal RMBS, up to approved facility limit; and any liquid assets contained in the RBNZ's Liquidity Policy - Annex: Liquidity Assets - Prudential Supervision Department Document BS13A12.*
5. *All currency Level 2 LCR.*

Funding

ANZ targets a diversified funding base, avoiding undue concentrations by investor type, maturity, market source and currency.

$15.5 billion of term wholesale debt with a remaining term greater than one year as at 31 March 2017 was issued during the half year ended 31 March 2017. The weighted average tenor of new term debt was 5.1 years.

The following tables show the Group's total funding composition:

	As at			Movement	
	Mar 17 $M	Sep 16 $M	Mar 16 $M	Mar 17 v. Sep 16	Mar 17 v. Mar 16
Customer deposits and other liabilities[1]					
Australia	**197,632**	187,667	184,226	5%	7%
Institutional	**179,326**	171,155	176,157	5%	2%
New Zealand	**74,266**	72,818	67,951	2%	9%
Wealth Australia	**326**	343	362	-5%	-10%
Asia Retail & Pacific	**21,867**	22,782	23,496	-4%	-7%
TSO and Group Centre[1]	**(5,202)**	(5,142)	(5,414)	1%	-4%
Customer deposits	**468,215**	449,623	446,778	4%	5%
Other funding liabilities[2]	**15,362**	14,531	16,127	6%	-5%
Total customer liabilities (funding)	**483,577**	464,154	462,905	4%	4%
Wholesale funding[3]					
Debt issuances	**88,778**	91,080	81,947	-3%	8%
Subordinated debt	**20,297**	21,964	17,557	-8%	16%
Certificates of deposit	**57,428**	61,429	65,077	-7%	-12%
Commercial paper	**9,482**	19,349	21,065	-51%	-55%
Other wholesale borrowings[4,5]	**66,433**	65,442	56,391	2%	18%
Total wholesale funding	**242,418**	259,264	242,037	-6%	0%
Shareholders' equity	**57,908**	57,927	56,464	0%	3%
Total funding	**783,903**	781,345	761,406	0%	3%

	As at			Movement	
	Mar 17 $M	Sep 16 $M	Mar 16 $M	Mar 17 v. Sep 16	Mar 17 v. Mar 16
Funded assets					
Other short term assets & trade finance assets[6]	**60,008**	65,800	68,015	-9%	-12%
Liquids[5]	**168,030**	161,302	147,419	4%	14%
Short term funded assets	**228,038**	227,102	215,434	0%	6%
Lending & fixed assets[7]	**555,865**	554,243	545,972	0%	2%
Total funded assets	**783,903**	781,345	761,406	0%	3%
Funding liabilities[3,5]					
Other short term liabilities	**48,022**	48,806	40,360	-2%	19%
Short term funding	**53,495**	69,028	73,559	-23%	-27%
Term funding < 12 months	**20,968**	23,668	22,224	-11%	-6%
Other customer and central bank deposits[1,8]	**84,880**	79,597	87,632	7%	-3%
Total short term funding liabilities	**207,365**	221,099	223,775	-6%	-7%
Stable customer deposits[1,9]	**416,775**	402,146	392,151	4%	6%
Term funding > 12 months	**93,556**	90,708	81,589	3%	15%
Shareholders' equity and hybrid debt	**66,207**	67,392	63,891	-2%	4%
Total stable funding	**576,538**	560,246	537,631	3%	7%
Total funding	**783,903**	781,345	761,406	0%	3%

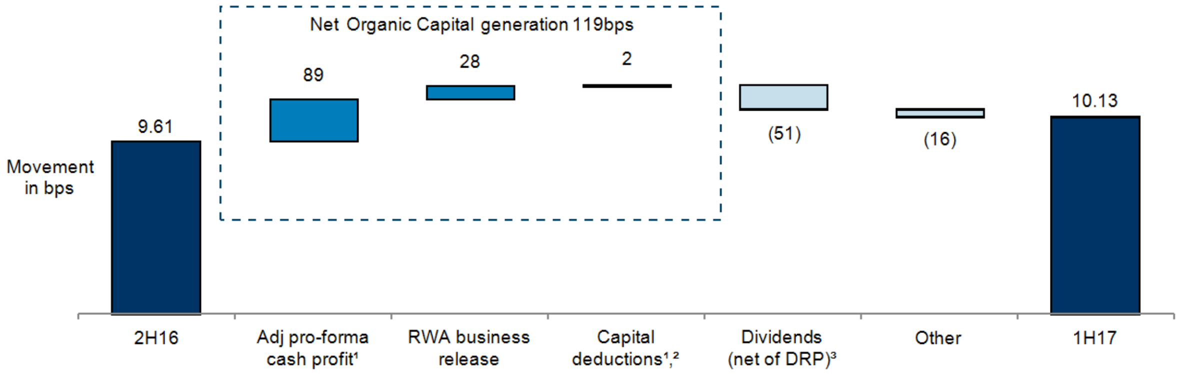
1. *Includes term deposits, other deposits and an adjustment recognised in Group Centre to eliminate Wealth Australia investments in ANZ deposit products.*
2. *Includes interest accruals, payables and other liabilities, provisions and net tax provisions, excluding other liabilities in Wealth Australia.*
3. *Excludes liability for acceptances as they do not provide net funding.*
4. *Includes borrowings from banks, net derivative balances, special purpose vehicles and other borrowings.*
5. *Includes RBA open-repo arrangement netted down by the exchange settlement account cash balance.*
6. *Includes short-dated assets such as trading securities, available for sale securities, trade dated assets and trade finance loans.*
7. *Excludes trade finance loans.*
8. *Total customer liabilities (funding) plus Central Bank deposits less stable customer deposits.*
9. *Stable customer deposits represent operational type deposits or those sourced from retail / business / corporate customers and the stable component of other funding liabilities.*

Capital Management

	As at					
	APRA Basel 3			Internationally Comparable Basel 3[1]		
	Mar 17	Sep 16	Mar 16	Mar 17	Sep 16	Mar 16
Capital Ratios						
Common Equity Tier 1	**10.1%**	9.6%	9.8%	**15.2%**	14.5%	14.0%
Tier 1	**12.1%**	11.8%	11.6%	**18.2%**	17.4%	16.2%
Total capital	**14.5%**	14.3%	13.7%	**21.3%**	20.7%	18.7%
Risk weighted assets ($B)	**397.0**	408.6	388.3	**309.4**	316.4	317.8

1. *Internationally Comparable methodology aligns with APRA's information paper entitled "International Capital Comparison Study" (13 July 2015).*

APRA Basel 3 Common Equity Tier 1 (CET1) – March 2017 v September 2016



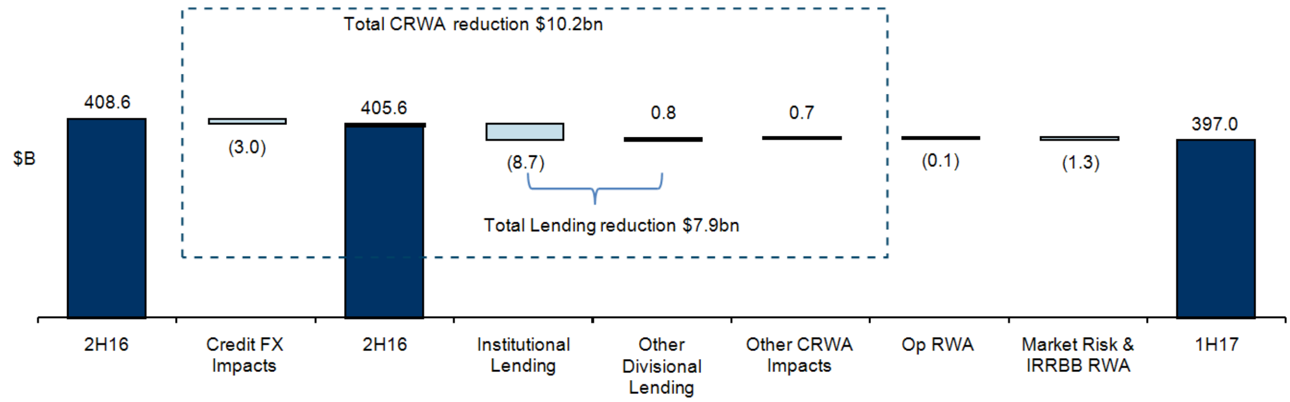
1. *Excludes specified items. Refer to page 12 for further details.*
2. *Capital deductions represent the movement in retained earnings in deconsolidated entities, capitalised software (excluding accounting changes relating to the capitalisation of internally generated software assets), EL versus EP shortfall and other intangibles in the period.*
3. *8.6 million ordinary shares were issued under the Dividend Reinvestment Plan and Bonus Option Plan for the 2016 final dividend.*

- **March 2017 v September 2016**

  ANZ's CET1 ratio increased 52 bps to 10.1% during the March 2017 half. Key drivers of the movement in the CET1 ratio were:

  - Net organic capital generation was 119 bps or $4.8 billion. This was primarily driven by cash profit (excluding specified items) and a net reduction in underlying RWA (excluding foreign exchange impacts, regulatory changes and other one-offs). The RWA reduction was mainly driven by a $8.7 billion decrease in Institutional Credit RWAs from lower lending, due to portfolio rebalancing.
  - Payment of the September 2016 Final Dividend (net of shares issued under the DRP) reduced the CET1 ratio by 51 bps.
  - Other items decreased CET1 by 16 bps reflecting net impacts from other RWA measurement changes, movement in non-cash earnings and net foreign currency translation.

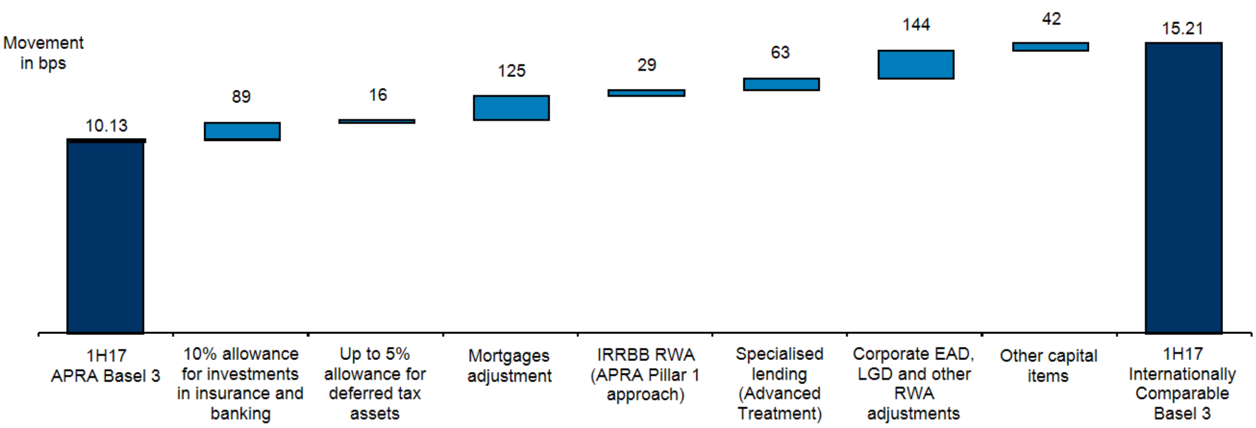
Total Risk Weighted Assets (RWA) – March 2017 v September 2016



- **March 2017 v September 2016**

  - ANZ's total RWA decreased by $11.6 billion. Excluding the impact of foreign currency translation, Credit RWAs decreased by $7.2 billion primarily driven by a decline in Institutional lending. Non-credit RWA decreased by $1.4 billion mainly driven by lower risk profile in IRRBB RWA.

APRA to Internationally Comparable[1] Common Equity Tier 1 (CET1) as at 31 March 2017



1. *ANZ's interpretation of the regulations documented in the Basel Committee publications; "Basel 3: A global regulatory framework for more resilient banks and banking systems" (June 2011) and "International Convergence of Capital Measurement and Capital Standards" (June 2006). Also includes differences identified in APRA's information paper entitled "International Capital Comparison Study" (13 July 2015).*

The above provides a reconciliation of the CET1 ratio under APRA's Basel 3 prudential capital standards to Internationally Comparable Basel 3 standards. APRA views the Basel 3 reforms as a minimum requirement and hence has not incorporated some of the concessions proposed in the Basel 3 rules and has also set higher requirements in other areas. As a result, Australian banks' Basel 3 reported capital ratios will not be directly comparable with international peers. The International Comparable Basel 3 CET1 ratio incorporates differences between APRA and both the Basel Committee Basel 3 framework (including differences identified in the March 2014 Basel Committee's Regulatory Consistency Assessment Programme (RCAP) on Basel 3 implementation in Australia) and its application in major offshore jurisdictions.

The material differences between APRA's Basel 3 and Internationally Comparable Basel 3 ratios include:

Deductions

- Investments in insurance and banking associates – APRA requires full deduction against CET1. On an Internationally Comparable basis, these investments are subject to a concessional threshold before a deduction is required.
- Deferred tax assets – A full deduction is required from CET1 for deferred tax assets (DTA) relating to temporary differences. On an Internationally Comparable basis, this is first subject to a concessional threshold before the deduction is required.

Risk Weighted Assets (RWA)

- IRRBB RWA – APRA requires inclusion of Interest Rate Risk in the Banking Book (IRRBB) within the RWA base for the CET1 ratio calculation. This is not required on an Internationally Comparable basis.
- Mortgages RWA – APRA imposes a floor of 20% on the downturn Loss Given Default (LGD) used in credit RWA calculations for residential mortgages. Additionally, from July 2016, APRA also requires a higher correlation factor above the Basel framework 15% requirement in order to raise the average risk weighting of Australian residential mortgages to at least 25%. The Internationally Comparable Basel 3 framework only requires a downturn LGD floor of 10% and a correlation factor of 15%.
- Specialised lending - APRA requires the supervisory slotting approach to be used in determining credit RWA for specialised lending exposures. The Internationally Comparable basis allows for the advanced internal ratings based approach to be used when calculating RWA for these exposures.
- Unsecured Corporate Lending LGD – Adjustment to align ANZ's unsecured corporate lending LGD to 45% to be consistent with banks in other jurisdictions. The 45% LGD rate is also used in the Foundation Internal Ratings-Based approach (FIRB).
- Undrawn Corporate Lending Exposure at Default (EAD) – To adjust ANZ's credit conversion factors (CCF) for undrawn corporate loan commitments to 75% (used in FIRB approach) to align with banks in other jurisdictions.

Leverage Ratio

At 31 March 2017, the Group's APRA Leverage Ratio was 5.3% which is above the 3% minimum currently proposed by the Basel Committee on Banking Supervision (BCBS). APRA has not finalised a minimum leverage ratio requirement for Australian ADIs. The following table summarises the Group's Leverage Ratio calculation:

	As at			Movement	
	Mar 17 $M	Sep 16 $M	Mar 16 $M	Mar 17 v. Sep 16	Mar 17 v. Mar 16
Tier 1 Capital (net of capital deductions)	**48,091**	**48,285**	**45,062**	0%	7%
On-balance sheet exposures (excluding derivatives and securities financing transaction exposures)	**747,708**	744,359	733,935	0%	2%
Derivative exposures	**30,968**	30,600	30,542	1%	1%
Securities financing transaction (SFT) exposures	**30,286**	31,417	21,420	-4%	41%
Other off-balance sheet exposures	**97,492**	98,460	102,953	-1%	-5%
Total exposure measure	**906,454**	904,836	888,850	0%	2%
APRA Leverage Ratio[1]	**5.3%**	5.3%	5.1%	0 bps	20 bps
Internationally Comparable Leverage Ratio[1]	**6.0%**	6.0%	5.7%	0 bps	30 bps

1. *Leverage ratio includes Additional Tier 1 securities subject to Basel 3 transitional relief, net of any transitional adjustments.*

- **March 2017 v September 2016**

  ANZ's leverage ratio is broadly flat relative to September 2016 due to capital generation from cash earnings (net of dividend payments) being offset by the buyback and cancellation of remaining CPS2 Additional Tier 1 Capital instruments of $1.1 billion not reinvested in CN4, and increased holdings of High Quality Liquid Assets.

Other regulatory developments

- **Financial System Inquiry (FSI)**

  The Australian Government completed a comprehensive inquiry into Australia's financial system and the FSI final report was released on 7 December 2014. The contents of the report are wide-ranging and key recommendations that may have an impact on regulatory capital levels include:

  - Setting capital standards such that Australian Authorised Deposit-taking Institutions' (ADIs) capital ratios are unquestionably strong;
  - Raising the average internal ratings-based (IRB) mortgage risk weight to narrow the difference between average mortgage risk-weight for ADIs using IRB models and those using standardised risk weights;
  - Implementing a framework for minimum loss absorbing and recapitalisation capacity in line with emerging international practice;
  - Developing a common reporting template that improves the transparency and comparability of capital ratios of Australian ADIs; and
  - Introducing a leverage ratio that acts as a backstop to ADIs risk-based capital requirements, in line with the Basel framework.

  APRA supported the FSI's recommendation that the capital ratios of ADIs should be unquestionably strong and, with effect from July 2016, APRA increased the capital requirements for Australian residential mortgage exposures for ADIs accredited to use the IRB approach to credit risk (including ANZ). APRA has also announced that further guidance regarding unquestionably strong capital requirements will be released in the middle of 2017. Further changes to the unquestionably strong framework may result in higher capital requirements for ADIs. Apart from the above, APRA has not made any announcements regarding the other key FSI recommendations. Therefore, the final outcomes from the FSI, including any impacts and the timing of these impacts on ANZ, remain uncertain.

- **Net Stable Funding Ratio (NSFR)**

  APRA has finalised its NSFR requirements for Australian ADIs and confirmed that the NSFR will become a minimum requirement on 1 January 2018. As part of managing future liquidity requirements, ANZ monitors the NSFR in its internal reporting and believe the Group is well placed to meet this requirement by the implementation date.

- **Level 3 Conglomerates (Level 3)**

  APRA is extending its prudential supervision framework to Conglomerate Groups via the Level 3 framework which will regulate a bancassurance group such as ANZ as a single economic entity with minimum capital requirements and additional monitoring of risk exposure levels.

  In August 2016, APRA confirmed the deferral of capital requirements for Conglomerate Groups until 2019 at the earliest, to allow for the final capital requirements arising from FSI recommendations as well as from international initiatives that are in progress.

  The non-capital components of the Level 3 framework relating to group governance, risk exposures, intragroup transactions and other risk management and compliance requirements will become effective on 1 July 2017. ANZ is not expecting any material impact on its operations based upon the current version of these standards.

- **Current Proposals from the Basel Committee on Banking Supervision (BCBS) on RWA**

  As part of the BCBS agenda to simplify RWA measurement and reduce their variability amongst banks, the BCBS has issued a number of consultation documents associated with:

  - Standardised approach to RWA for credit risk;
  - Revisions to Standardised Measurement Approach to Operational Risk;

- Fundamental Review of the Trading Book;
- Interest Rate Risk in the Banking Book;
- Framework on the imposition of capital floors based on standardised RWA approaches; and
- Additional constraints on the use of internal models for credit RWA.

Apart from the review of the Trading Book standard which has been finalised, BCBS is still currently consulting on the other proposals. The impacts of these changes on ANZ are subject to the final form of these BCBS proposals that APRA will implement for Australian ADIs.