

# Macquarie Bank Limited

24 May 2022

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## Issuer Outline

Macquarie Bank Limited (MBL, Macquarie) is an APRA regulated Authorised Deposit-taking Institution (ADI) headquartered in Sydney, Australia. MBL is a wholly owned subsidiary of the ASX-listed Macquarie Group Limited (MGL).

MBL provides funding to the Bank Group comprising two main operating groups, Banking and Financial Services (BFS, ~20% of net operating profit), and Commodities and Global Markets (CGM, ~80% of net operating profit).

MBL operates across a diverse set of business lines across different locations and service offerings: asset finance, lending, banking, risk and capital solutions across debt, equity and commodities.

MBL acts primarily as an investment intermediary for institutional, corporate, government and retail clients and counterparties around the world, generating income by providing a diversified range of products and services to clients.

Sector: Financials  
Sub-sector: Banks  
Country: Australia  
Ownership: Public

## Key Financials (AUDm)

LTM (31 March)	2022
Net interest income	2,453
Non-interest income	7,141
NPAT	2,717
Gross loans	123,765
Total assets	349,628
Customer deposits	101,614
Other borrowings	185,854
Credit losses (new provisions) (%)	0.01
CET 1 ratio (%)	16.5

Source: FIIG Securities, Company Reports and S&P IQ Capital

## Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call <sup>1</sup>	Maturity Date
AU3FN0054284	AUD 750m	Subordinated Unsecured Tier 2	BBSW +2.90%	Quarterly	28 May 2025	28 May 2030
AU3FN0061065	AUD 750m	Subordinated Unsecured Tier 2	BBSW +1.55%	Quarterly	17 Jun 2026	17 Jun 2031
USQ568A9SP31	USD 750m	Subordinated Unsecured AT1	6.125%	Semi-annual	8 March 2027	Perpetual

<sup>1</sup>Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call

<sup>2</sup>Resets on 8 March 2027 and every subsequent five years at a rate equal to five-year swap rate + 3.703%

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### Tier 2 Structure

Interest Deferral/Cancellation	Interest is deferrable and cumulative if, prior to the payment of interest, the issuer is not solvent or would not be solvent after payment.
Non-Viability Trigger	Yes, standard Basel III compliant non-viability trigger. If APRA determines the issuer is at risk of becoming non-viable, the terms of the notes indicate that the primary method of loss absorption will be via conversion of the subordinated notes into equity, in-part or in full.

### Perpetual Tier 1 (AT1) Structure

Interest Deferral/Cancellation	Interest is deferrable and non-cumulative. Interest payment is optional and, if unpaid, the issuer has no obligation to pay any deferred amounts later. A cancellation of interest does not constitute a default under the Notes for any purpose.
Common Equity Tier 1 Trigger	If a bank determines, or APRA notifies a bank in writing, that the bank's Common Equity Tier 1 ratio is less than or equal to 5.125%, the bank may be required to write-off some or all the face value of the notes or convert some or all of the notes into ordinary shares.
Non-Viability Trigger	If APRA determines that an issuer requires capital support to prevent it becoming non-viable (a 'non-viability event'), the bank may be required to write-off some or all the face value of the notes or convert some or all of the notes into ordinary shares.
Maturity	The notes do not have a maturity date. This means that the issuer does not have an obligation to repay the principal, although if it elects to do so, it will require APRA approval.

### Strengths

- **Strong capitalisation:** Macquarie Bank Ltd (MBL) is well-capitalised, with a Common Equity Tier 1 (CET1) ratio of 16.5% at 31 March 2022. Under Basel III rules, Australian Prudential Regulation Authority (APRA) requires authorised deposit-taking institutions (ADIs) to have a minimum ratio of Tier 1 capital to risk-weighted assets of 8.5% (including the 2.5% capital conservation buffer), with at least 7.0% in the form of Common Equity Tier 1 capital.
- **Very good term debt maturity profile supported by strong liquidity:** The weighted average term maturity of term funding maturing beyond one year at 31 March 2022 is 3.8 years for the bank, meaning the risk of significant refinancing in a period of potential market dislocation is greatly mitigated.

Market dislocation is also mitigated to an extent as a result of MBL's liquidity position. MBL had an average liquidity coverage ratio (LCR) of ~175% as at year end 31 March 2022, well-above regulatory minimums (100%), as well as domestic peers (~140%). MQG policy requires the bank to have liquidity sources to ensure that at least twelve months of maturing liabilities can met from internal sources.

- **Sound macro environment and regulatory oversight:** Australian financials, benefit from operating in an economy characterised as having a very high degree of economic resilience with low susceptibility to event risk. The Australian economy rebounded strongly after COVID-19 related disruptions, and while the impacts of the pandemic are largely behind us, it remains that institutional and governance frameworks compare well with overseas jurisdictions, providing an additional level of security, against future uncertainty.

Australian banks including MBL are overseen by a highly regarded prudential regulator, APRA, who oversees banking, insurance and superannuation, with the aim of maintaining the integrity, safety and soundness of financial institutions. In response to the COVID 19 pandemic APRA have provided regulatory relief for loans under deferral, and the Reserve Bank of Australia has provided low cost funding through the Term Funding Facility (TFF) to enable Banks to support their customers

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during the period of economic uncertainty caused by COVID-19 (now closed for new drawdown). MBL have a total AUD9.5bn drawn under the TFF.

- **Diversified operations:** MBL's operations are relatively diverse compared with domestic peers. Operating revenues are well-diversified across individual product lines, with no particular product lines of significant concentration. This compares with domestic banks who have a significant concentration to residential property, for example. By extension, and given the global reach of both MQG and MBL, the bank's geographic diversity is also a relative strength, with more than a third of its credit exposures outside of Australia and spread primarily throughout Europe, the America's and Asia.

### Relative strength of Tier 2 instruments compared to Perpetual AT1 instrument

- **More favourable terms:** Tier 2 instruments have terms and conditions that are generally viewed as more investor friendly than Perpetual Additional Tier 1 (AT1) hybrids. While both are unsecured and deeply subordinated, the Tier 2 instruments would rank ahead of AT1 instruments and the conversion to equity or write-off would occur earlier for AT1's than Tier 2's noting that, practically, a full write-off or conversion of a AT1 hybrid would likely be accompanied by an at least partial conversion of the Tier 2. We also note that interest deferral provisions are more investor friendly for Tier 2 since deferred interest payments are cumulative whereas they are non-cumulative for AT1 (meaning investors retain a claim for deferred payment in a Tier 2 structure only). We note that, while Tier 2 instruments have more protection and therefore might not be exposed to the same level of risk, in the event a AT1 instrument suffers a write-down or is subject to an interest payment cancellation with no similar impact on Tier 2 instruments, it is highly likely that the capital price of the Tier 2 instrument would be at a very deep discount to par given that Tier 2 instruments would be at a high risk of experiencing the same events.

### Risks

- **Performance of capital markets business exposed to market volatility:** Some of the markets in which MBL operates in are complex and volatile compared to the relatively vanilla retail and commercial banking activities of Australia's domestic banking market. The proportion of earnings with 'annuity-type' characteristic is also lower relative to domestic peers, with net interest income at less than 50% (by comparison, domestic banks generally generate more than two-thirds of its earnings from net interest income). MBL's Commodities and Global Markets business operates in and depends on the operation of global markets. Sudden declines and significant volatility in the prices of assets may substantially curtail or eliminate the trading markets for certain assets, which make it very difficult to sell, hedge or value such assets, and in turn may negatively affect the bank's earnings, capital and liquidity.
- **Diversity raises issues around complexity and geopolitical risks:** Although diversity is a relative strength, the increased complexity can counterbalance some of the stability generally observed in banking. Jurisdictions in which MBL does business may be negatively impacted by slow growth rates or recessionary conditions, market volatility and/or political unrest.
- **Rating downgrades:** Ratings on both issuers and issues can be influenced by factors that do not necessarily reflect the financial strength or credit quality of a specific issuer, such as the Australian sovereign rating, the rating agencies' view on the economic prospects of the country or relative strengths of the regulatory framework. For example, in 2020 both S&P and Moody's placed the ratings on a number of Australian financial institutions, including MBL (S&P only), on negative outlook due to concerns about the economic outlook for Australia.

### Risks relevant to Subordinated Unsecured Tier 2 and AT1 instrument

- **Deeply subordinated ranking:** Tier 2 and additional Tier 1 (AT1) hybrids are unsecured and deeply subordinated instruments, ranking ahead only of ordinary shares. Tier 2 and AT1 hybrids rank behind senior creditors, which includes depositors, senior unsecured and senior non-preferred creditors (mostly relevant for European banks, only), noting that Tier 2 instruments will rank ahead of AT1 hybrids.

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- **Optional call dependent on regulatory approval:** Tier 2 and AT1 notes include an early call feature where the face value of the notes may be repaid early in cash from a given date stated in the terms and conditions of the instrument. The optional redemption requires regulatory approval, which may not be provided.

In general, regulators are unlikely to provide approval for a Tier 2 or AT1 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

- **Conversion or write-down following a Non-Viability Trigger Event:** A Non-Viability Trigger Event occurs when APRA determines conversion to ordinary shares (or write-off) of some or all of an issuer's contingent capital securities (AT1 and Tier 2) is necessary to prevent that financial institution becoming non-viable. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability. If such event occurs, the issuer may be required to convert some or all of its AT1 or Tier 2 notes into ordinary shares. In a more severe scenario, the issuer may be required to write-off the value of these notes. We note that it is expected that the conversion / write-off would be expected to be applied first to AT1 hybrids and only then to the Tier 2 if the AT1 conversion / write-off was not sufficient to restore the issuer to a viable position.
- **Capped equity conversion:** Conversion of Tier 2 and AT1 notes following a capital trigger event (for AT1 only) or a non-viability trigger event is subject to a maximum number of shares being issued. As such, if the notes are converted into ordinary shares, the value of ordinary shares an investor receives may be significantly less than the face value of their notes.

### Relative risks of Perpetual AT1 instruments compared to Tier 2 instrument

- **No fixed maturity:** The AT1 notes do not have a fixed maturity date and are perpetual. This means that the issuer does not have an obligation to repay the notes on any date and will only do so if it elects to provide a notice of redemption and obtain APRA approval beforehand. As such, there is no certainty that the issuer will issue such notice of redemption.
- **Common Equity Trigger Event:** In addition to a Non-Viability Trigger Event, AT1 notes also included a Common Equity (or Capital) Trigger Event which occurs when a bank determines, or APRA notifies the bank in writing, that the bank's Common Equity Tier 1 ratio is less than or equal to 5.125%.

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