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Thursday, 2 May 2019

ASX ANNOUNCEMENT

NAB releases Luxembourg Transparency Law disclosures

NAB will today lodge its “Luxembourg Transparency Law – 2019 Half Year Financial Report” (attached) with the Luxembourg *Commission de Surveillance du Secteur Financier* (CSSF), which is required as part of NAB’s obligation to comply with Article 4 of the Luxembourg Law of 11 January 2008 relating to European Union reporting requirements. These reporting requirements apply to NAB as it has debt securities admitted to trading on the regulated market of the Luxembourg Stock Exchange and is subject to the supervision of the CSSF.

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Luxembourg Transparency Law – 2019 Half Year Financial Report

This report (the Report) is provided in order to comply with the semi-annual financial reporting requirements of Article 4 of the Luxembourg Law of 11 January 2008 relating to transparency requirements, as amended. These requirements apply to National Australia Bank Limited ABN 12 004 044 937 (the Company) because it has debt securities admitted to trading on the regulated market of the Luxembourg Stock Exchange and is subject to the supervision of the *Commission de Surveillance du Secteur Financier* (the CSSF).

1 2019 Half Year Results

This Report must be read in conjunction with the Company's unaudited financial statements for the half year ended 31 March 2019, the notes thereto and the independent auditor review report and the report of the Company's directors, each provided in connection therewith (together, the Half Year Financial Statements), which have been published simultaneously with this Report. The Company's Half Year Financial Statements and this Report have been filed with the CSSF and are stored with the Luxembourg Stock Exchange as the Officially Appointed Mechanism (this Report and the Company's Half Year Financial Statements being collectively referred to as the 'Half Year Financial Report').

2 Risks specific to the Group, including those related to general banking, economic and financial conditions

Set out below are the principal risks and uncertainties associated with the Company and its controlled entities (the Group). These risks and uncertainties are not listed in order of significance and it is not possible to determine the likelihood of these risks occurring. In the event that one or more of these risks materialise, the Group's reputation, strategy, business, operations, financial condition and future performance could be materially and adversely impacted.

Reputational damage may adversely impact the Group's ability to attract and retain customers or employees in the short and long-term and the ability to pursue new business opportunities. It may result in a higher risk premium being applied to the Group, and impact the cost of funding the Group's operations or its financial condition. It may also result in regulators requiring the Group to hold additional capital, pay fines or incur additional costs, including costs to undertake remedial action. These impacts may affect the viability of some or all of the Group's business activities.

The Group's risk management framework and internal controls may not be adequate or effective in accurately identifying, evaluating or addressing risks faced by the Group. There may be other risks that are currently unknown or are deemed immaterial, but which may subsequently become known or material. These may individually or in aggregate adversely impact the Group. Accordingly, no assurances or guarantees of future performance, profitability, distributions or returns of capital are given by the Group.

2.1 Risks specific to the banking and financial services industry

The nature and impact of these external risks are generally unpredictable and are beyond the Group's direct control.

2.1.1 The Group may be adversely impacted by macro-economic and geopolitical risks and financial market conditions.

The majority of the Group's financial services businesses operate in Australia and New Zealand (NZ), with branches in Asia, the United Kingdom (UK) and the United States (US). The business activities of the Group are dependent on the nature and extent of banking and financial services and products required by its customers globally. In particular, levels of borrowing are heavily dependent on customer confidence, employment trends, market interest rates, and other economic and financial market conditions and forecasts.

Domestic and international economic conditions and forecasts are influenced by a number of macro-economic factors, such as economic growth rates, cost and availability of capital, central bank intervention, inflation and deflation rates, and market volatility and uncertainty. Deterioration in any of these factors may lead to:

- Increased cost of funding or lack of available funding.
- Deterioration in the value and liquidity of assets (including collateral).
- Inability to price certain assets.
- An increase in customer or counterparty default and credit losses.
- Higher provisions for credit impairment.
- Mark-to-market losses in equity and trading positions.
- Lack of available or suitable derivative instruments for hedging purposes.
- Lower growth in business revenues and earnings. In particular, the Group's wealth business earnings are highly dependent on asset values, mainly the value of listed equities.
- Increased cost of insurance, lack of available or suitable insurance, or failure of the insurance underwriter.

Economic conditions may also be impacted by climate change and major shock events, such as natural disasters, war and terrorism, political and social unrest, and sovereign debt restructuring and defaults.

The following are examples of macro-economic and financial market conditions that are currently relevant to the Group and may adversely impact its financial performance and position:

- The current global economic growth cycle has started to slow following a period of above-trend global growth. By historical standards, the peak rates of growth were not particularly high, and neither were central bank policy rates (including in regions such as the US). Modest inflation in recent years has led to key central banks keeping their policy rates low relative to historical standards. In the case of the European Central Bank and Bank of Japan, an inability to lift rates in recent years means they have limited conventional monetary policy options available to address the current slowdown in growth.
- The outlook for monetary policy for major central banks has changed significantly in recent months, with the US Federal Reserve announcing in January 2019 that it would be patient, revising earlier guidance that it expected some further gradual rate rises. While globally a more dovish monetary policy position could limit the short-term downside to growth, it risks building on existing imbalances in various asset classes and regions.
- Sustained low central bank policy rates, combined with unconventional monetary policy in a number of regions, has created considerable financial vulnerabilities across the globe with high debt levels and elevated asset prices (by historical or conventional valuation standards) in many regions. Slowing growth, flowing through into incomes, could impact the capacity of borrowers to service debt, leading to asset liquidation, declines in collateral values and increased volatility in markets.
- Low central bank policy rates and compressed risk premiums have led investors to take on more risk in their search for yield. This has resulted in capital flowing towards a range of riskier government (particularly emerging market) and corporate borrowers who are more vulnerable to default as economic growth slows.
- Capital flows from emerging markets could lead to exchange rate and financial market volatility along with higher interest rates and credit downgrades in borrowing countries, particularly those with current account and fiscal deficits and high foreign debt. Negative sentiment could result in contagion across emerging markets, increasing capital outflows. Countries across Latin America, Africa, Asia and Eastern Europe appear vulnerable to movements in capital and some of these countries are key export markets for Australia and NZ.
- Risks are increasing across the banking sector in East Asia. China's banks are exposed to highly geared corporates and real estate, and there is uncertainty over the outlook for Chinese non-performing loans. The high property prices and positive credit growth to gross domestic product gaps that exist in Hong Kong, Singapore and China illustrate potential problems in the event of a negative shock to the region's economies. China's extensive and complex shadow banking sector presents added risks.
- Continued economic growth in China is important to Australia and NZ, with ongoing trade and investment exposed to any sharp slowdown in the rapid pace of Chinese economic growth. China's high and growing debt burden presents a risk to its medium-term

growth prospects. Due to its export mix, Australia's economy is especially exposed to a sudden downturn in Chinese investment in business, infrastructure or housing. The ongoing trade tensions between the US and China present some additional uncertainty. The likelihood of a deal between the two countries has increased since the start of the calendar year, however, China's policy response to these trade measures also presents a degree of uncertainty. Further, although China is the primary target of US trade measures, value chain linkages mean that other emerging markets, primarily in Asia, may also be impacted. Most of these markets are major trading partners with Australia and NZ.

- As commodity exporting economies, Australia and NZ are exposed to shifts in global commodity prices that can be sudden, sizeable and difficult to predict. Fluctuations in commodity markets can affect key economic variables like national income, tax receipts and exchange rates. Previous sharp declines in commodity prices in Australia and NZ were driven by sub-trend global growth constraining demand, combined with increases in commodity supply. Commodity price volatility remains substantial and the Group has sizeable exposures to commodity producing and trading businesses.
- Residential property prices in certain major metropolitan areas in Australia and NZ are high relative to standard affordability metrics. High levels of immigration have underpinned elevated levels of housing demand, supporting these property market values. A range of factors could contribute to lower residential property prices. This includes regulatory changes which may impact the availability of credit, shifts in government policies that are less favourable to immigration and overseas investment, changes to taxation policy, and rising unemployment. The Group has significant exposure to the real estate and construction sector in Australia and NZ.
- Geopolitical risks continue to present uncertainty to the economic outlook. An increasing fragmentation and a rise in populism in many major democratic economies have led to difficulties in policy implementation. Uncertainty around Brexit negotiations has persisted and remains unresolved, posing greater uncertainty for the European region. In addition, the changing nature of US foreign policy has contributed to higher geopolitical risk, particularly given the ongoing uncertainty around the Korean Peninsula, South China Sea and Iran nuclear sanctions. The potential for a change in government in Australia following an election to be held on 18 May 2019 presents a degree of policy uncertainty across a range of asset classes.
- Slowing growth in Australia and NZ may impact business conditions and labour markets, which may have an adverse effect on credit quality and demand for credit.

2.1.2 The Group is subject to extensive regulation. Regulatory changes may adversely impact the Group's reputation, operations, and financial performance and position.

The Group is highly regulated in the jurisdictions in which it operates, trades or raises funds, and is subject to supervision by a number of regulatory authorities and industry codes of practice. Regulations vary across jurisdictions and are designed to protect the interests of customers, policy holders, security holders, and the banking and financial services system as a whole. Changes to laws and regulations or changes to regulatory policy or interpretation can be unpredictable, are beyond the Group's control, and may not be harmonised across the jurisdictions in which the Group operates. Regulatory change may result in significant capital and compliance costs, changes to corporate structure and increasing demands on management, employees and information technology systems. This may also result in changes in the viability of the Group's participation in certain markets, or the need to divest components of its operations.

The financial services and banking industries in Australia and NZ are currently operating in an environment of heightened regulatory and political scrutiny. Recommendations from reviews and inquiries, and regulatory and legislative changes, may result in significant reforms to the financial services and banking industry. The potential outcome and total costs associated with this regulatory and political scrutiny remain uncertain.

The Royal Commission into 'Misconduct in the Banking, Superannuation and Financial Services Industry'

In December 2017, the Australian Government established a Royal Commission into 'Misconduct in the Banking, Superannuation and Financial Services Industry'. A Royal Commission is a formal public inquiry that can only be instigated by the executive branch of the Australian Government and is directed by terms of reference. Broadly, the Royal Commission was directed to inquire into, and report on, whether any conduct of financial service entities (including the Group) might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fell below community standards and expectations. During 2018, the Royal Commission conducted public hearings on a wide range of matters that relate to the business and operations of the Group, including consumer and business lending, the provision of financial advice, superannuation, insurance, the role and conduct of financial regulators and issues of culture, governance and remuneration. The final report of the Royal Commission was released publicly on 4 February 2019 (the Final Report). In the Final Report, the Commissioner made 76 recommendations, including:

- the creation of a registration, disciplinary and conduct reporting system for financial advisers and financial services licensees;
- that ongoing fee arrangements with financial advisers be reviewed annually, with clearer disclosure of adviser conflicts required;
- the introduction of a duty on mortgage brokers to act in the best interests of borrowers, and a phased prohibition on trailing and other commissions being paid by lenders to mortgage brokers;
- the repeal of grandfathering provisions, and reviews of other exemptions, in relation to conflicted remuneration - with a view ultimately to banning conflicted remuneration;
- the introduction of a single default superannuation fund for all workers, a prohibition on the deduction of advice fees from 'MySuper' superannuation accounts, and limiting the deduction of advice fees from all other superannuation accounts;
- a prohibition on a superannuation trustee assuming any obligations other than those arising from or in the course of its performance of the duties of a trustee of a superannuation fund;
- amending the definition of 'small business' in the 2019 Banking Code of Practice (the Code) to extend the protection of the Code to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than A$5 million;
- the prohibition of 'hawking' or unsolicited selling of superannuation and insurance products to retail clients; and
- the establishment of a national scheme to mediate distressed agricultural loans and the introduction of other measures to protect agricultural borrowers, such as recognising that appointment of receivers or any other form of external administrator is a remedy of last resort.

A number of measures were recommended to improve the effectiveness and oversight of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) in deterring, and imposing appropriate penalties for, misconduct. These included a recommendation for ASIC to change its approach to enforcement, with a focus on instigating court actions in relation to conduct matters that are not solely administrative.

Recommendations were made requiring financial service entities to conduct regular ongoing reviews of the design and implementation of their employee and management remuneration systems, and their culture and governance policies and practices, with a particular focus on the management of non-financial risks and reducing the risk of misconduct.

The Australian Government and opposition Labor Party have each responded to the Final Report, both confirming their support for 75 of the 76 recommendations. The Australian Government will seek further review of the implications of removing trail commissions and the feasibility of continuing upfront commission payments to mortgage brokers. The opposition Labor Party proposes that lenders may pay mortgage brokers a standardised upfront commission capped at a fixed percentage of the amount drawn down by the borrower.

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The Royal Commission's recommendations are likely to result in legislative and regulatory change. The details of many of these changes and the timeframe for implementation are not certain. When implemented, these changes may result in significant compliance costs, and may have an adverse impact on the Group's business, operations, financial performance and prospects.

The Commissioner has referred a number of instances of potential misconduct to ASIC and APRA for consideration. Where these matters relate to the Group, it may result in proceedings being brought against Group entities, which could result in the imposition of civil or criminal penalties on the Group and may also result in class actions or other litigation against the Group. The scale of penalties, if any, is not known.

The Group supports 72 of the recommendations and intends to work with the Australian Government and regulators with a view to taking positive action as quickly as possible on the remaining areas, which relate to broker arrangements, definition of small business and executive accountabilities.

The Group is currently progressing through implementing 26 of the recommendations and some of these changes were announced ahead of the release of the Final Report.

Other reviews and inquiries that may impact the financial services and banking industries include:

- In May 2018, the NZ Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) initiated a review of conduct and culture in the NZ banking industry, with a number of industry-wide recommendations included in a report published on 5 November 2018. Some further specific findings were provided to individual NZ banks (including Bank of New Zealand (BNZ)) in November 2018. BNZ provided its response to the FMA and RBNZ on 29 March 2019 and anticipates formal feedback by the end of June 2019. The FMA and RBNZ have also undertaken a review of life insurance providers in NZ, releasing their thematic report in January 2019, and insurer specific reports in February 2019 with responses due 30 June 2019. The outcome of these reviews may lead to increased political or regulatory scrutiny of the banking industry in NZ, which could adversely impact BNZ.
- In May 2018, APRA released the final report of its 'Prudential Inquiry into the Commonwealth Bank of Australia'. APRA requested that the other major banks (including the Company) conduct a self-assessment against each of the issues raised by the report. The Group submitted its self-assessment to APRA on 29 November 2018 and also made it publicly available. The Group is now addressing its findings and will report on its progress in doing so. If the Group does not deliver the actions identified in its self-assessment, this may adversely impact the Group's reputation.
- Supervision, regulation and enforcement in relation to anti-bribery and corruption, anti-money laundering (AML) and counter-terrorism financing (CTF) laws and trade sanctions has increased. In June 2018, Australia's financial intelligence agency, AUSTRAC, reached an agreement with another major Australian bank for a A$700 million penalty relating to serious breaches of AML/CTF laws.
- Legislation to implement the Banking Executive Accountability Regime (BEAR) came into effect for the Group from July 2018. This legislation is intended to increase the responsibility and accountability of Authorised Deposit-taking Institutions (ADIs) and their directors and senior executives. The Royal Commission has made a number of recommendations regarding BEAR, including to extend BEAR to all APRA-licenced entities and to introduce a new accountable person responsible for the entire product chain of an ADI, and any necessary remediation of customers in respect of an ADI's products. The Royal Commission has also recommended that BEAR be jointly administered by ASIC and APRA with ASIC overseeing consumer protection and market conduct and APRA overseeing prudential aspects. The Australian Government has indicated its support for these recommendations.
- In April 2019, the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019 passed both Houses of Parliament. The new law imposes additional obligations on the Group regarding the design and distribution of financial products. There is a two year phase-in period for the design and distribution obligations. ASIC's product intervention powers where it believes significant consumer detriment may occur, will apply with immediate effect.
- ASIC announced in August 2018 that it plans to strengthen its enforcement and supervisory capabilities, including embedding dedicated supervisory staff within large financial institutions to monitor their governance and compliance with laws. This regime is now operational.
- The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2018 introduces a stronger penalty framework for corporate and financial sector misconduct, including clarifying that the courts are to give priority to victim compensation over the ordering of financial penalties.
- In March 2018, legislation was passed to extend and enhance APRA's powers to address crises affecting financial sector entities. The legislation confers broad powers on APRA to intervene in the operation of ADIs and, in some cases, their subsidiaries.
- There have been a number of other ongoing inquiries such as the Australian House of Representatives Standing Committee on Economics' 'Review of the Four Major Banks' and the Australian Competition and Consumer Commission's 'Residential mortgage products price inquiry' and 'Inquiry into foreign currency conversion services'.

Implementation of the Basel Committee on Banking Supervision's (BCBS) reforms will continue in Australia and other jurisdictions relevant to the Group. In December 2017, the BCBS finalised the Basel III Standards. Regulatory changes that have followed include:

- In Australia, APRA commenced consultation on revisions to the capital framework in February 2018 and reaffirmed its intention to strengthen banking system resilience by establishing 'unquestionably strong' capital ratios. The major Australian banks are expected to have Common Equity Tier 1 Capital ratios of at least 10.5% by January 2020. Consultation will continue throughout 2019, and has to date included consideration of 'benchmarks for capital strength', 'risk sensitivity' and 'transparency, comparability and flexibility' of the capital framework. Final revised prudential standards are expected to be released in 2020, with implementation commencing 2022.
- In NZ, the RBNZ is undertaking a review of the capital adequacy framework applying to registered banks incorporated in NZ. The aim is to identify a framework for setting capital requirements for NZ banks, while taking into account how the current framework has operated and international developments in bank capital requirements. In December 2018, the RBNZ proposed a significant increase in banks' required capital levels over a staged transition period of five years, for consultation through May 2019. The proposed changes which aim to strengthen the NZ banking system and further protect depositors by reducing the likelihood of bank failures, would, if implemented, have a significant impact on Tier 1 Capital levels required to be held by NZ banks. Tier 1 Capital requirements for banks deemed systemically important (including BNZ) are proposed to increase to 16% of risk weighted assets (RWA), consisting of a minimum Tier 1 requirement of 6% RWA and prudential capital buffers of 10% RWA. The RBNZ's proposals follow the RBNZ's previous release of 'in-principle' decisions on the definition of capital, which included the removal of contingent capital instruments, and on the calculation of RWA. It remains unclear the extent to which APRA will incorporate aspects of the RBNZ's proposals as part of its review of the Australian capital framework.

Other current and potential regulatory changes impacting the Group include:

- The Australian Government announced its support for recommendations arising from the release of the report and public consultation on the 'Review into Open Banking in Australia'. This is designed to increase access to banking products and data by customers and third parties. Consultation on the exposure draft legislation for the regime has commenced, with reforms expected to phase in from July 2019. This, in addition to the passing of

legislation to relax restrictions on the use of the term 'bank', is expected to reduce the barriers to new entrants to, and increase competition in, the banking industry.

- On 8 November 2018, APRA released a discussion paper outlining its proposals for increasing the loss-absorbing capacity of ADIs. The proposals are consistent with the Financial System Inquiry recommendation to implement a framework sufficient to facilitate the orderly resolution of Australian ADIs and minimise taxpayer support. The paper outlines, for Domestic Systemically Important Banks (D-SIBs), an increase in the total capital requirement of between 4-5% of RWA. It is anticipated that D-SIBs (including the Group) would satisfy this requirement predominantly with the issue of additional Tier 2 Capital, which is expected to increase the Group's ongoing cost of funds. APRA's requirements are expected to be finalised in 2019, with adjusted capital requirements to apply by 2023.
- In July 2018, APRA commenced consultation regarding revisions to the related parties framework, including proposals to update related entity exposure limits and the extended licensed entity framework. The final framework is scheduled to be implemented from January 2020.
- On 25 March 2019, APRA released a discussion paper outlining its proposed revisions to the credit risk management framework for ADIs as set out in prudential standard APS 220. The proposals cover the broadening of credit risk management practices, proposed revision to credit standards and alignment of asset classification and provisioning with recent accounting standard changes and guidance from the BCBS.
- The RBNZ issued its revised Outsourcing Policy in September 2017 which focuses on services outsourced by NZ registered banks, including services provided by parent banks offshore. Compliance with the policy is required by September 2022. Implementation of, and compliance with, the final policy may impact the Group's operations.
- The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019 gives effect to improved accountability measures in superannuation and changes to the superannuation prudential framework to lift operational governance practices of APRA-regulated superannuation trustees.
- Changes to financial benchmarks, including their supervision and regulation, derivatives reform, particularly implementing initial margin requirements for non-centrally cleared derivatives, payments, data protection and privacy laws, data quality, accounting and reporting requirements, tax legislation and bank specific tax levies.

The full scope, timeline and impact of current and potential inquiries and regulatory reforms such as these, or how they will be implemented (if at all in some cases), is not known. Depending on the specific nature of the requirements and how they are enforced, they may have an adverse impact on the Group's business, operations, structure, compliance costs or capital requirements, and ultimately its reputation, financial performance and prospects.

2.1.3 The Group faces intense competition, which may adversely impact its financial performance and competitive position.

There is substantial competition across the markets in which the Group operates. Increasing competition for customers can lead to compression in profit margins or loss of market share. The Group faces competition from established financial services providers as well as new market entrants, including foreign banks and non-bank competitors with lower costs and new operating and business models. Evolving industry trends and anticipated rapid changes in technology may impact customer needs and preferences. The Group may not predict these changes accurately or quickly enough, or have the resources and flexibility to adapt in sufficient time to keep pace with industry developments and meet customer expectations.

2.2 Risks specific to the Group

There are a number of risks which arise directly from the operations of the Group as a major participant in the banking and financial services industry and from the specific structure of the Group. The Group's financial performance and position are, and in the future may continue to be, impacted by these risks, as set out below.

2.2.1 The Group is exposed to credit risk, which may adversely impact its reputation, and financial performance and position.

Credit risk is the potential that a customer will fail to meet its obligations to the Group in accordance with agreed terms. Lending activities account for most of the Group's credit risk. Other sources of credit risk also exist in banking and trading books, other financial instruments and loans, extension of commitments and guarantees, and transaction settlements.

The Group's lending portfolio includes residential housing loans, a material component of the Group's total gross loans and acceptances, and commercial real estate loans (largely in Australia and NZ). Credit risk may increase in response to adverse business or economic conditions (including deterioration in valuations or prices of residential and commercial property), a decline in employment levels, volatility in the political environment, or high levels of household debt in Australia and NZ.

The Group may also be exposed to the increased risk of counterparty or customer default should interest rates rise above the record or near record lows of recent years. In particular, the Group's portfolio of interest-only loans across retail and non-retail segments and the residential investor mortgage portfolio may be susceptible to losses in the event of a rise in interest rates or a decline in property prices. The Group may also be exposed to counterparty default in the event of deterioration in the market for apartments, through retail lending and non-retail lending to property developers.

The Group's large business lending market share in Australia and NZ exposes it to potential losses and reputational damage should adverse conditions be experienced by customers in the non-retail segment. Similarly, the Group has a large market share in the Australian and NZ agricultural sectors, particularly the dairy sector in NZ. Volatility in commodity prices, foreign exchange rate movements, disease and introduction of pathogens and pests, export and quarantine restrictions, extreme weather events and other risks may adversely impact these sectors and the Group's financial performance and position.

Key sources of potential credit risk currently include:

- A decline in the value of residential property has been observed in a number of areas of Australia. Should this trend continue, the Group may be subject to an increase in credit losses from lending secured by these assets. Declining house prices will affect the collateral value and may impair the Group's ability to recover losses following defaults. In the residential mortgage book, customers in high Loan to Value Ratio (LVR) brackets remain most at risk following material correction in housing prices. A significant decline in the value of residential property also has the potential to increase credit losses of businesses involved in residential real estate developments, and in the Business Lending portfolio where residential property is used for security.
- The retail trade sector is confronting challenges that may impact the ability of some retail traders and owners of retail property to meet their credit obligations. These include low household income growth, international entrants, and the growth of online channels.
- Climate change may present risks arising from extreme weather events that affect property or business operations, the effect of new laws and government policies designed to mitigate climate change, and impacts on certain customer segments as the economy transitions to renewable and low-emission technology. As a result, there is a risk of the Group funding customers secured by assets in sectors experiencing structural decline and with limited liquidity.
- Parts of eastern Australia are experiencing severe drought conditions. The impact of these conditions is expected to extend beyond primary producers, to customers who are suppliers to the agricultural sector, and to those who reside in and operate businesses within regional and rural communities.
- A significant decrease in global dairy prices, milk solid pay-outs, or both, could materially and adversely impact the NZ dairy sector's ability to service debt.

The Group provides for losses in relation to loans, advances and other assets. Estimating losses in the loan portfolio is, by its very nature, uncertain. The accuracy of these estimates depends on many factors, including general economic conditions, forecasts and assumptions, and involves complex modelling and judgements. If the information or the assumptions upon which assessments are made prove to be inaccurate, the provisions for credit impairment may need to be revised. This may adversely impact the Group's financial performance and position.

2.2.2 The Group may suffer losses due to its exposure to operational risks, which may adversely impact its reputation, and financial performance and position.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This includes legal risk but excludes strategic and reputational risk. Operational risks are a core component of doing business arising from the day-to-day operational activities of the Group as well as strategic projects and business change initiatives. Given that operational risks cannot be fully mitigated, the Group determines an appropriate balance between accepting potential losses and incurring costs of mitigation.

An operational risk event may give rise to substantial losses, including financial loss, fines, penalties, personal injuries, reputational damage, loss of market share, property or information, customer redress, litigation, or a fall in the Company's share price. In addition, the event may adversely affect the perceptions of the Group held by the public, shareholders, investors, customers, regulators or ratings agencies. Social media may also influence perceptions of the Group. Losses from operational risk events may adversely impact the Group's reputation, and financial performance and position. Examples of operational risk events include:

- Fraudulent or unauthorised acts by employees, contractors and external parties.
- Systems, technology and infrastructure failures, cyber incidents, including denial of service and malicious software attacks, or unauthorised access to customer or sensitive data.
- Process errors or failures arising from human error, including incorrect or incomplete data capture and records maintenance, or inadequate design of processes or controls.
- Operational failures by third parties, including offshored and outsourced service providers.
- Weaknesses in employment practices, including diversity, discrimination and workplace health and safety.
- Deficiencies in product or service design, distribution or maintenance.
- Business disruption and property damage arising from events such as natural disasters, climate change, biological hazards or acts of terrorism.

In addition, the Group is dependent on its ability to retain and attract key executives, employees and Board members. On 7 February 2019, the Group Chief Executive Officer (CEO) Andrew Thorburn, and Chairman Ken Henry AC, announced that they would be leaving the Group. On 6 March 2019 the Board appointed current Director and interim CEO, Philip Chronican as the next Chairman of the Company. He will replace Ken Henry AC as Chairman later in 2019. The Board has established a special committee to manage the selection process for the CEO role. These changes, the unexpected loss of further key resources, or the inability to attract personnel with suitable experience, may adversely impact the Group's ability to operate effectively and efficiently, or to meet strategic objectives.

Models are used extensively in the conduct of the Group's business, for example, in calculating capital requirements and measuring and stressing exposures. If the models used prove to be inadequate or are based on incorrect or invalid assumptions, judgements or inputs, this may adversely affect the Group's financial performance and position.

2.2.3 The Group may be exposed to compliance and conduct risk, which may adversely impact its reputation, and financial performance and position.

Compliance risk is the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives, as well as internal policies, standards, procedures and frameworks. This includes compliance with financial crime obligations in the jurisdictions in which the Group operates. Conduct risk is the risk that any action of the Group, or those acting on behalf of the Group, will result in unfair outcomes for customers. This may include detrimental practices, such as:

- Selling or unduly influencing customers to purchase products or services that do not meet their needs or are not suitable.
- Conducting inappropriate market practices or being a party to fraudulent or illegal transactions.
- Non-adherence to applicable fiduciary requirements or provision of financial advice which is inappropriate or not in the best interests of customers.
- Delays in appropriately escalating regulatory issues.
- Failure to resolve issues and remediate customers on a timely basis.

Significant regulatory change and public scrutiny of the global financial services industry by conduct-based regulators and government is driving increased standards and customer expectations.

If the Group's compliance and conduct related controls were to fail significantly, be set inappropriately, or not meet legal, regulatory or community expectations, then the Group may be exposed to:

- Increased costs of compliance, fines, additional capital requirements, public censure, litigation, settlements and restitution to customers.
- Increased supervision, oversight or enforcement by regulators or other stakeholders.
- Unenforceability of contracts such as loans, guarantees and other security documents.
- Enforced suspension of operations, amendments to licence conditions or loss of licence to operate all or part of the Group's businesses.
- Other enforcement or administrative action or agreements, such as enforceable undertakings.

This may adversely impact the Group's reputation, and financial performance and position.

There have been a number of domestic and international firms facing high profile enforcement actions, including substantial fines, for breaches of laws or regulations. In some cases, these enforcement actions have also given rise to class actions.

From time to time, Group members are subject to regulatory reviews, which may be industry-wide or specific to the Group. In addition, the Group carries out investigations of certain conduct itself or with the assistance of a third party.

Currently, there are a number of ongoing reviews, investigations and court proceedings involving the Group. These include matters relating to: the provision of financial advice; the inappropriate charging of fees for services; selling practices and advice in relation to consumer credit insurance products; compliance with licence conditions; and the identification, notification and remediation of AML/CTF compliance issues and weaknesses. Refer to 'Notes to the Financial Statements', *Note 13 Contingent liabilities* page 78 in the *2019 Half Year Results* for further details on some of the matters referred to above and other regulatory compliance and conduct investigations and reviews, class actions and court proceedings involving the Group. The potential outcome and total costs associated with these investigations, reviews and court proceedings remain uncertain at this time, and it is possible that further class actions, regulatory investigations or the imposition of new licence conditions could arise in relation to these matters or other matters of which we are not yet aware.

The Royal Commission has referred two matters to APRA regarding conduct of the Group's superannuation trustee, NULIS Nominees (Australia) Ltd (NULIS), on the basis that NULIS may have

contravened its duties as a trustee. It is possible that APRA may bring proceedings against NULIS in relation to these matters.

The Royal Commission has also referred other instances of potential misconduct to ASIC for consideration. If these referrals relate to the Group, it may result in proceedings being brought by ASIC, which could result in the imposition of civil or criminal penalties on the Group or the issuing of a class action or other civil litigation against the Group.

Public debate continues about conduct revealed during the course of the Royal Commission and it is possible that further consequences may arise for the Group or relevant individuals within the Group.

The interpretation of, and guidance in relation to, responsible lending obligations under the *National Consumer Credit Protection Act 2009* has evolved in recent years. Changes to these regulations or their interpretation, including by the courts, or the potential for increased regulatory and public scrutiny in relation to these obligations may necessitate the changing of processes or procedures in relation to consumer lending. To date, another major Australian bank has had action brought against it by ASIC as well as a class action in relation to alleged breaches of its responsible lending obligations.

In August 2018, plaintiff law firm Slater & Gordon announced that it would be launching a series of class actions against bank-owned superannuation funds. The actions are expected to focus on certain financial advice fees, as well as circumstances in which superannuation trustees are alleged to have failed to act in the best interests of members (for example, by not obtaining the most competitive interest rate available on cash investments). To date, one class action of this nature has been filed against another major bank.

Where appropriate, provisions are held for conduct and litigation matters based on a number of assumptions derived from a combination of past experience, forecasts, industry comparison and the exercise of subjective judgement based on (where appropriate) external professional advice. Risks and uncertainties remain in relation to these assumptions and the ultimate costs of redress to the Group. These factors mean that the eventual costs of conduct and compliance-related matters may differ materially from those estimated and further provisions may be required, adversely impacting the Group's reputation, and financial performance and position.

2.2.4 Disruption of technology systems or breaches of data security may adversely impact the Group's reputation, operations, and financial performance and position.

Most of the day-to-day operations of the Group are based on technology, and therefore the reliability and security of the Group's information technology systems and infrastructure are essential to its business. Technology risk may arise from an array of factors including complexity within the technology environment, failure to keep technology up-to-date, inadequate resilience, a failure of the Group's systems to operate effectively, an inability to restore or recover such systems in acceptable timeframes, a breach of data security, or other forms of cyber-attack or physical attack. These factors may be wholly or partially beyond the control of the Group. Such events may result in significant disruption for customers, disruption to operations and compliance with the Group's obligations, customer compensation, reputational damage, adverse impact on speed and agility in the delivery of change and innovation, litigation, loss or theft of customer data, or regulatory investigations and penalties. These risks may adversely impact the Group's reputation, and financial performance and position.

The rapid evolution of technology in the financial services industry and the increased expectation of customers for internet and mobile services on demand, expose the Group to new challenges in these areas.

The Group processes, stores and transmits large amounts of personal and confidential information through its computer systems and networks. The Group invests significant resources in protecting the confidentiality and integrity of this information. However, threats to information security are constantly evolving and techniques used to perpetrate cyber-attacks are increasingly sophisticated. The Group may not be able to anticipate a security threat, or be able to implement effective measures to prevent or minimise the resulting damage. An information security breach may result in operational disruption, regulatory enforcement actions, financial losses, theft or loss of customer data, or breach of privacy laws, all of which may adversely impact the Group's reputation, and financial performance and position.

As with other business activities, the Group uses select external providers (in Australia and overseas) to store confidential data and to also develop and provide its technology solutions, including the increasing use of cloud infrastructure. The failure of any external providers to perform their obligations to the Group or the failure of the Group to appropriately manage those providers, may adversely impact the Group's reputation, and financial performance and position.

2.2.5 Certain strategic decisions, including acquisitions or divestments, may adversely impact the Group's reputation, and financial performance and position.

Strategic risk is the risk associated with the pursuit of the Group's strategic objectives, and includes the risk that the Group may fail to execute the chosen strategy. There is a risk that the assumptions underlying the Group's strategic decisions are (or prove to be) incorrect, or that the conditions underpinning those strategic decisions may change. The Group may not have the resources or flexibility to adapt quickly (or at all) to such change. In addition, any one or more of the Group's strategic initiatives may prove to be too difficult or costly to execute effectively. The Group regularly considers a range of corporate opportunities including acquisitions, divestments, joint ventures and investments. Opportunities that are pursued may change the Group's risk profile and capital structure, and inherently come with transaction risks including over-valuation of an acquisition (or under-valuation of a divestment), and exposure to reputational damage and financial risks.

Risks may arise through the integration or separation of a business, including failure to realise expected synergies, disruption to operations, diversion of management resources or higher than expected costs. In addition, the Group may have ongoing exposures to divested businesses, including through the provision of continued services and infrastructure (such as the transitional services being provided to MLC Limited) or the retention of liabilities, including through warranties and indemnities in sale agreements.

In addition to the risks described above, a number of specific risks exist in connection with the sale of 80% of MLC Limited to Nippon Life Insurance Company (Nippon Life) in 2016. The Company gave certain covenants, warranties and indemnities in favour of Nippon Life, a breach or triggering of which may result in the Company being liable to Nippon Life. The Company also entered into long-term agreements in relation to the distribution of life insurance products and the continued use of the MLC brand by MLC Limited. The duration and nature of these agreements give rise to certain risks, including that changes in the regulatory or commercial environment may impact the commercial attractiveness of these agreements and limit future opportunities for the Company through non-compete arrangements.

The Company agreed to take certain actions to establish MLC Limited as a standalone entity, including the provision of transitional services, data migration and the development of technology systems. As this work is yet to be completed, there is a risk that implementation costs may ultimately prove higher than anticipated. The Company may also be liable to MLC Limited if it fails to perform its obligations in accordance with the agreements relating to these matters. Refer to 'Notes to the Financial Statements', *Note 13 Contingent liabilities* on page 78 in the *2019 Half Year Results* under the heading *MLC Limited life insurance transaction.*

As announced on 3 May 2018, the Group intends to pursue a divestment of its Advice, Platform & Superannuation and Asset Management businesses (MLC Wealth Divestment). The Group's decision to proceed with, and ability to execute, the MLC Wealth Divestment is subject to a number of factors, including market conditions, the impact of regulatory change and investigations, including any findings from the Royal Commission, the cost and complexity of separation, and obtaining Board and regulatory approvals. On 7 February 2019, the Group advised that the current regulatory and operating environment for wealth businesses remains

challenging, and the intended public markets exit of MLC is likely to be delayed to the 2020 financial year. If the Group does proceed with the MLC Wealth Divestment, the Group will incur costs associated with the transaction and the terms of the transaction and execution of separation may create risks and uncertainty for the Group and its customers, aligned advisors, employees, suppliers and other counterparties. If the Group decides not to, or is unable to, proceed with the MLC Wealth Divestment, the Group will incur costs associated with the incomplete transaction and uncertainty may be created for customers, aligned advisors, employees, suppliers and other counterparties of the Advice, Platform & Superannuation and Asset Management businesses.

2.2.6 Transformation and change programs across the Group may not deliver some or all of their anticipated benefits and may adversely impact the Group's reputation, and financial performance and position.

The Group invests significantly in change across the organisation, including technology, infrastructure and cultural transformation. There is a risk that these programs may not realise some or all of the anticipated benefits. The Group also continues to pursue business process improvement initiatives and invest in technology to achieve its strategic objectives, meet changing customer expectations and respond to competitive pressures. These process changes may increase operational, compliance and other risks, which may adversely impact the Group's reputation, and financial performance and position.

2.2.7 The Group may be exposed to losses if critical accounting judgements and estimates are subsequently found to be incorrect, which may adversely impact the Group's reputation, and financial performance and position.

Preparation of the Group's financial statements requires management to make estimates and assumptions and to exercise judgement in applying relevant accounting policies, each of which may directly impact the reported amounts of assets, liabilities, income and expenses. Some areas involving a higher degree of judgement, or where assumptions are significant to the financial statements, include the estimates used in the calculation of provisions (including those pertaining to conduct-related matters), the valuation of goodwill and intangible assets, and the fair value of financial instruments. Changes in the methodology or assumptions on which the assessment of goodwill and intangible balances is based, together with expected changes in future cash flows (including changes flowing from current and potential regulatory reforms), could result in the potential write-off of a part or all of that goodwill or intangible balances.

If the judgements, estimates and assumptions used by the Group in preparing consolidated financial statements are subsequently found to be incorrect, there could be a significant loss to the Group beyond that anticipated or provided for, which may adversely impact the Group's reputation, and financial performance and position.

2.2.8 Litigation and contingent liabilities arising from the Group's business conduct may adversely impact its reputation, and financial performance and position.

Entities within the Group may be involved from time to time in legal proceedings arising from the conduct of their business. The aggregate potential liability and costs in respect thereof cannot be accurately assessed.

Refer to 'Notes to the Financial Statements', *Note 13 Contingent liabilities* on page 78 in the *2019 Half Year Results* for details in relation to the Group's material legal proceedings and contingent liabilities.

2.2.9 If there is a "second strike" shareholder vote against the 2019 Remuneration Report and a spill resolution is passed at the 2019 Annual General Meeting, there is a risk of disruption to the governance and oversight of the Group.

At the Company's 2018 Annual General Meeting, 88.11% of votes cast on the resolution to adopt the Company's 2018 Remuneration Report were cast against the resolution, constituting a "first strike" under the Corporations Act. If at least 25% of the votes cast on the resolution to adopt the Company's 2019 Remuneration Report at its 2019 Annual General Meeting are cast against that resolution, the Company will receive a "second strike" and be required to put a "spill resolution" to its shareholders at that meeting. If the "spill resolution" is passed by a simple majority, then at a subsequent meeting to be held within 90 days of the 2019 Annual General Meeting, all of the Company's directors who approved the 2019 Remuneration Report (other than the CEO) will be required to stand for re-election at the meeting. If the Company was to receive a second strike, and the spill resolution was passed at its 2019 Annual General Meeting, there is a risk that the composition of the Board may change, causing disruption to the governance and oversight of the Group.

2.2.10 Insufficient capital may adversely impact the Group's reputation, operations and financial performance and position.

Capital risk is the risk that the Group does not have sufficient capital to meet prudential requirements, achieve strategic plans and objectives, cover the risks to which it is exposed, or protect against unexpected losses. The Group is required to hold minimum levels of capital relative to the balance sheet size and risk profile of its operations across jurisdictions.

Prudential capital requirements and proposed changes to these requirements may:

- Limit the Group's ability to manage capital across the entities within the Group.
- Limit payment of dividends or distributions on shares and hybrid instruments.
- Require the Group to raise or use more capital of higher quality, or to restrict balance sheet growth.

Additionally, if the information or the assumptions upon which assessments of capital requirements are made prove to be inaccurate, this may adversely impact the Group's operations, and financial performance and position.

2.2.11 The Group's funding and liquidity position may be adversely impacted by dislocation in global capital markets.

Funding risk is the risk that the Group is unable to raise short and long-term funding to support its ongoing operations, strategic plans and objectives. The Group accesses domestic and global capital markets as well as raising customer deposits to help fund its businesses. Dislocation in any of these capital markets, or reduced investor and customer appetite to hold the Group's securities or place deposit funds, may adversely affect the Group's ability to access funds or require access to funds at a higher cost or on unfavourable terms.

Liquidity risk is the risk that the Group is unable to meet its financial obligations as they fall due. These obligations include the repayment of deposits on demand or at their contractual maturity, the repayment of wholesale borrowings and loan capital as they mature and the payment of interest on borrowings. Any significant deterioration in the Group's liquidity position may lead to an increase in the Group's funding costs, constrain the volume of new lending, or result in the Group drawing upon its committed liquidity facility with the Reserve Bank of Australia. This may adversely impact the Group's reputation, and financial performance and position.

2.2.12 A significant downgrade in the Group's credit ratings may adversely impact its cost of funds, market access and competitive position.

Credit ratings are an opinion on the general creditworthiness of a borrower and may be an important reference for market participants in evaluating the Group and its products, services and securities. Credit rating agencies conduct ongoing review activities which can result in changes to credit rating settings and outlooks for the Group, or for sovereign governments in countries in which the Group conducts business. Credit ratings may be affected by operational and market factors, and changes in the rating methodologies used by the agencies.

A downgrade in the credit ratings within the Group or of the Group's securities, or a downgrade in the sovereign rating of one or more of the countries in which the Group operates, may increase the Group's cost of funds or limit its access to the capital markets. This may also cause a deterioration of the liquidity position and trigger additional collateral requirements in derivative contracts and other secured

funding arrangements. A downgrade to the Group's credit ratings relative to peers could also adversely impact the Group's competitive position.

2.2.13 Changes in interest rates may adversely impact the Group's financial performance and position.

Interest rate risk is the risk that changes in market interest rates adversely affect the Group's financial position in terms of earnings or the economic value of its balance sheet. In the banking industry, such exposure commonly arises from the mismatch between the maturity profile of a bank's lending portfolio compared to its deposit portfolio (and other funding sources).

2.2.14 The Group is exposed to foreign exchange and translation risk, which may adversely impact its financial performance and position.

Foreign exchange and translation risk arises from the impact of currency movements on the value of the Group's cash flows, profits and losses, and assets and liabilities due to participation in global financial markets and international operations.

The Group's ownership structure includes investment in overseas subsidiaries and associates and exposures from known foreign currency transactions (such as repatriation of capital and dividends from offshore subsidiaries). The Group also conducts business outside of Australia and transacts with customers, banks and other counterparties in a number of different currencies. The Group's businesses may therefore be affected by a change in currency exchange rates, or a change in the reserve status of any of these currencies. Any unfavourable movement in foreign exchange rates may adversely impact the Group's financial performance and position.

The Group's financial statements are prepared and presented in Australian dollars, and any fluctuations in the Australian dollar against other currencies in which the Group invests or transacts and generates profits (or incurs losses) may adversely impact its financial performance and position.

2.2.15 The Group may suffer significant losses from its trading activities, which may adversely impact the Group's reputation, and financial performance and position.

Traded market risk is the risk of losses arising from trading activities, including proprietary trading, undertaken by the Group. Losses can arise from a change in the value of positions in financial instruments or their hedges due to adverse movements in market prices. This includes changes in interest rates, foreign exchange rates, commodity and equity prices, and credit spreads.

2.2.16 Failure to sell down underwriting risk may result in losses to the Group and adversely impact its reputation, and financial performance and position.

As financial intermediaries, members of the Group underwrite or guarantee different types of transactions, risks and outcomes, including the placement of listed and unlisted debt, equity-linked and equity securities. The underwriting obligation or guarantee may be over the pricing and placement of these securities, and the Group may therefore be exposed to potential losses if it fails to sell down some or all of this risk to other market participants.

Luxembourg Transparency Law – 2019 Half Year Financial Report

3 Responsibility statement of the persons responsible for the Company in relation to the Group financial statements made in accordance with Article 4(2)(c) of the Luxembourg Law of 11 January 2008 relating to transparency requirements, as amended

The Group Chief Executive Officer and the Group Chief Financial Officer of the Company confirm that, to the best of their knowledge:

(a) The Company's unaudited financial statements and the notes thereto for the half year ended 31 March 2019 as contained in the Company's Half Year Financial Statements, which have been prepared in accordance with the requirements of the *Corporations Act* 2001 (Cth), Australian Accounting Standards and Australian Accounting Interpretations of the Australian Accounting Standards Board give a true and fair view of the assets, liabilities, financial position and profit and loss of the Group; and

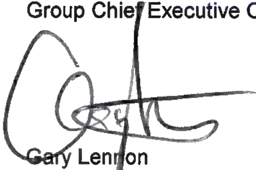
(b) The Company's Half Year Financial Statements and this Report include:

(i) a fair review of the development and performance of the business and position of the Group; and

(ii) a description of the principal risks and uncertainties faced by the Group.

Dated this 2nd day of May 2019:

Philip Chronican
Group Chief Executive Officer



Gary Lennon
Group Chief Financial Officer