National Australia Bank

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ASX ANNOUNCEMENT

Tuesday, 14 February 2012

National Australia Bank Limited – 2012 First Quarter Basel II Risk and Capital Report

National Australia Bank Limited (NAB) today released its first quarter Risk and Capital Report (RCR), as required under the Australian Prudential Regulation Authority Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information.

The RCR should be read in conjunction with the NAB 2012 First Quarter Trading Update.

The report is available at http://www.nabgroup.com

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2012 RISK & CAPITAL REPORT

Incorporating the requirements of APS 330

First Quarter Update
as at 31 December 2011

National Australia Bank

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1. Introduction

The Group, as defined in *Section 2. Scope of Application*, applies the Basel II framework as a cornerstone of its risk management framework and capital strategy, and recognises it is critical for achieving the Group's strategic agenda.

This report provides quarterly information on the following:

- Capital Adequacy - Risk-Weighted Assets (RWA) and Capital Ratios
- Credit Risk Exposures
- Credit Risk Provisions, Impaired and Past Due Facilities
- Charges for Specific Provisions and Write-offs

In Australia, the Australian Prudential Regulation Authority (APRA) has regulatory responsibility for the implementation of Basel II through the release of prudential standards.

This Risk and Capital Report addresses the requirements of APRA's Pillar 3 public disclosure standard, *Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information* (APS 330) for the quarter ended 31 December 2011.

All figures in this report are in Australian dollars (AUD) unless otherwise noted.

Capital Ratio Summary

The Group's Tier 1 capital ratio of 10.02% at 31 December 2011 is consistent with the Group's objective of maintaining a strong capital position.

	As at	
	31 Dec 11	30 Sep 11
Capital ratios	%	%
Level 2 Tier 1 capital ratio	10.02%	9.70%
Level 2 total capital ratio	11.46%	11.26%

1.1 The Group's Basel II Methodologies

National Australia Bank Limited and its controlled entities (the National Australia Bank Group) operate in Australia, Asia, New Zealand, the United Kingdom and North America. The following table sets out the approach to Basel II, which is applied across the Group as at 31 December 2011.

Basel II Approach	Credit Risk	Operational Risk	Non-Traded Market Risk	Traded Market Risk
National Australia Bank Limited	Advanced IRB	AMA	IRRBB	Standardised and IMA
Bank of New Zealand	Advanced IRB	AMA	IRRBB	Standardised and IMA
Clydesdale Bank PLC	Standardised	Standardised	IRRBB	n/a
Great Western Bank	Standardised	Standardised	IRRBB	n/a

IRB: Internal Ratings Based approach
AMA: Advanced Measurement Approach
IRRBB: Interest Rate Risk in the Banking Book
IMA: Internal Models Approach

Bank of New Zealand (BNZ) is regulated by the Reserve Bank of New Zealand (RBNZ). Credit risk exposures consolidated in the Group position are calculated under RBNZ requirements.

The National Australia Bank Group's subsidiary in the United Kingdom, Clydesdale Bank PLC, is regulated by the Financial Services Authority (FSA). Clydesdale Bank PLC has been accredited to apply the standardised approach to operational and credit risk management in accordance with the regulatory requirements.

Great Western Bank (GWB) is regulated in the United States of America by the South Dakota Division of Banking, the Federal Deposit Insurance Corporation and the Federal Reserve System.

GWB Credit Risk and Operational Risk RWA are subject to APRA Basel II Standardised methodology. IRRBB RWA relating to GWB were calculated using an interim approach as at 30 September 2011. From 31 December 2011, IRRBB for GWB is calculated using the IRRBB internal model. The net impact of the change was not material.

1.2 Disclosure Governance

The National Australia Bank Group's External Disclosure Policy defines Board and management accountabilities for APS 330 disclosure, including processes and practices to ensure the integrity and timeliness of prudential disclosures and compliance with National Australia Bank Group policies.

The National Australia Bank Group's Chief Executive Officer attests to the reliability of the Group's APS 330 disclosure within the annual declaration provided to APRA under Prudential Standard APS 310 Audit and Related Matters.

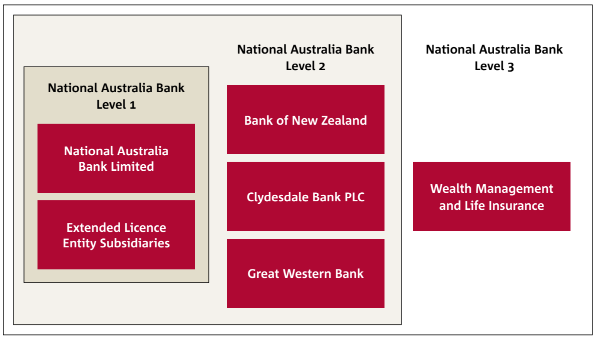
2. Scope of Application

APRA measures the National Australia Bank Group's capital adequacy by assessing financial strength at three levels:

- Level 1: comprises National Australia Bank Limited and its subsidiary entities approved by APRA as part of the Extended Licensed Entity (ELE);
- Level 2: comprises National Australia Bank Limited and the entities it controls, subject to certain exceptions set out below; and
- Level 3: comprises the Conglomerate Group.

This report applies to the Level 2 consolidated Group (the Group).

National Australia Bank Group Consolidation for Regulatory Purposes



The controlled entities in the Group include the Bank of New Zealand, Clydesdale Bank PLC, Great Western Bank and certain other financial entities (eg finance companies and leasing companies).

Life insurance and funds management entities activities are excluded from the calculation of Basel II RWA and the related controlled entities are deconsolidated from the National Australia Bank Group for the purposes of calculating capital adequacy. Capital adequacy deductions are applied to the investments in, and profits of, these activities.

In addition, certain securitisation special purpose vehicles (SPVs) to which assets have been transferred in accordance with APRA's requirements as set out in *Prudential Standard APS 120 Securitisation* (APS 120) have been deconsolidated from the National Australia Bank Group for the purposes of this disclosure. For regulatory purposes credit risk is removed from the sold assets and there is no requirement to hold capital against them.

3. Capital

Capital Adequacy [APS 330 Tables 16a – e]

The following table provides the Basel II RWA and capital ratios for the Group.

	As at 31 Dec 11 RWA $m	As at 30 Sep 11 RWA $m
Credit risk [(1)]		
IRB approach		
Corporate (including SME)	113,763	112,620
Sovereign	1,362	1,170
Bank	7,453	7,617
Residential mortgage [(2)]	54,917	51,620
Qualifying revolving retail	4,469	4,377
Retail SME	8,083	8,227
Other retail	3,581	3,594
Total IRB approach	**193,628**	**189,225**
Specialised lending (SL)	**44,227**	**41,752**
Standardised approach		
Australian and foreign governments	79	76
Bank	166	163
Residential mortgage	17,932	23,202
Corporate	31,088	32,863
Other	3,297	3,618
Total standardised approach	**52,562**	**59,922**
Other		
Securitisation	8,771	9,049
Equity	2,085	1,949
Other [(3)]	5,342	6,751
Total other	**16,198**	**17,749**
Total credit risk	**306,615**	**308,648**
Market risk	2,935	2,968
Operational risk	22,666	22,255
Interest rate risk in the banking book	5,358	7,198
Total risk-weighted assets	**337,574**	**341,069**

Capital ratios	**%**	**%**
Level 2 Tier 1 capital ratio	10.02 %	9.70%
Level 2 total capital ratio	11.46 %	11.26%

(1) *RWA which are calculated in accordance with APRA's requirements under Basel II are required to incorporate a scaling factor of 1.06 to assets that are not subject to specific risk weights.*

(2) *As at 31 December 2011, the Advantedge portfolio was calculated under the APRA Basel II Advanced IRB approach. This resulted in RWA being reclassified from Standardised 'Residential Mortgage' to Advanced IRB 'Residential Mortgage'. The net impact of this change was not material.*

(3) *'Other' includes non-lending asset exposures that are not covered in the above categories. Non-lending assets are specifically excluded from credit risk exposures shown on pages 4 to 7 of this report.*

4. Credit Risk Exposures

Total and Average Credit Risk Exposures [APS 330 Table 17a]

This table provides the amount of gross credit risk exposure subject to the Standardised and Advanced IRB approaches. The Group has no credit risk exposures subject to the Foundation IRB approach. Gross credit risk exposure refers to the potential exposure as a result of a counterparty default prior to the application of credit risk mitigation. It is defined as the outstanding amount on drawn commitments plus a credit conversion factor on undrawn commitments on a given facility. For derivatives, the exposure is defined as the mark-to-market value plus a potential value of future movements. The average credit risk exposure is the sum of the gross credit risk exposure at the beginning of the reporting period plus the gross credit risk exposure at the end of the reporting period divided by two.

For the IRB approach, Exposure at Default (EaD) is reported gross of specific provisions and partial write-offs and prior to the application of on-balance sheet netting and credit risk mitigation. For the Standardised approach, EaD is reported net of any specific provision and prior to the application of on-balance sheet netting and credit risk mitigation. Exposures exclude non-lending assets, equities and securitisation.

	As at 31 Dec 11				3 months ended 31 Dec 11
	On-balance sheet exposure	Non-market related off-balance sheet	Market related off-balance sheet	Total exposure	Average total exposure
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	116,698	47,386	24,815	**188,899**	**189,391**
Sovereign	23,902	719	12,486	**37,107**	**36,494**
Bank	27,301	877	40,405	**68,583**	**70,010**
Residential mortgage	230,556	36,146	-	**266,702**	**258,831**
Qualifying revolving retail	5,780	5,339	-	**11,119**	**11,049**
Retail SME	15,272	4,076	-	**19,348**	**19,502**
Other retail	3,372	1,187	-	**4,559**	**4,574**
Total IRB approach	**422,881**	**95,730**	**77,706**	**596,317**	**589,851**
Specialised lending (SL)	**43,737**	**6,940**	**1,654**	**52,331**	**50,869**
Standardised approach					
Australian and foreign governments	4,221	172	-	**4,393**	**4,403**
Bank	7,039	27	1,457	**8,523**	**9,515**
Residential mortgage	31,618	2,013	-	**33,631**	**39,582**
Corporate	27,124	3,930	439	**31,493**	**32,348**
Other	3,612	168	-	**3,780**	**3,937**
Total standardised approach	**73,614**	**6,310**	**1,896**	**81,820**	**89,785**
Total	**540,232**	**108,980**	**81,256**	**730,468**	**730,505**

Exposure type	As at 30 Sep 11 On-balance sheet exposure $m	Non-market related off-balance sheet $m	Market related off-balance sheet $m	Total exposure $m	6 months ended 30 Sep 11 Average total exposure $m
IRB approach					
Corporate (including SME)	115,493	45,225	29,164	**189,882**	**183,727**
Sovereign	27,104	631	8,146	**35,881**	**31,397**
Bank	27,995	920	42,523	**71,438**	**64,831**
Residential mortgage	217,224	33,736	-	**250,960**	**245,000**
Qualifying revolving retail	5,597	5,381	-	**10,978**	**10,835**
Retail SME	15,696	3,960	-	**19,656**	**19,681**
Other retail	3,376	1,214	-	**4,590**	**4,566**
Total IRB approach	**412,485**	**91,067**	**79,833**	**583,385**	**560,037**
Specialised lending (SL)	**42,389**	**5,516**	**1,501**	**49,406**	**48,124**
Standardised approach					
Australian and foreign governments	4,215	197	-	**4,412**	**3,681**
Bank	8,841	13	1,654	**10,508**	**8,631**
Residential mortgage	42,904	2,629	-	**45,533**	**43,278**
Corporate	28,278	4,370	554	**33,202**	**30,634**
Other	3,918	177	-	**4,095**	**6,909**
Total standardised approach	**88,156**	**7,386**	**2,208**	**97,750**	**93,133**
Total	**543,030**	**103,969**	**83,542**	**730,541**	**701,294**

5. Credit Provisions and Losses

Credit Risk Provisions [APS 330 Table 17b – c]

The following tables set out information on credit risk provision by Basel II asset class, excluding non-lending assets, equities and securitisation exposures. Definitions of impairment and past due facilities are based on APS 220 Credit Quality and related guidance notes or return instructions. The determination of specific provisions is in accordance with APRA Guidance Note AGN 220.2: Impairment, Provisioning and the General Reserve for Credit Losses.

	As at 31 Dec 11			3 months ended 31 Dec 11	
	Impaired facilities [(1)]	**Past due facilities ≥90 days**	**Specific provisions** [(2)]	**Charges for specific provisions**	**Net Write-offs**
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	2,515	359	829	264	116
Sovereign	-	-	-	-	-
Bank	34	-	34	-	-
Residential mortgage	638	1,144	160	30	25
Qualifying revolving retail	-	60	-	48	49
Retail SME	175	132	89	19	17
Other retail	13	44	3	18	21
Total IRB approach	**3,375**	**1,739**	**1,115**	**379**	**228**
Specialised lending (SL)	**1,453**	**93**	**291**	**49**	**33**
Standardised approach					
Australian and foreign governments [(3)]	-	75	-	-	-
Bank	-	-	-	-	-
Residential mortgage	94	131	27	3	5
Corporate	1,344	258	273	133	99
Other	8	28	4	23	24
Total standardised approach	**1,446**	**492**	**304**	**159**	**128**
Total	**6,274**	**2,324**	**1,710**	**587**	**389**
Additional regulatory specific provisions [(2)]			468		
General reserve for credit losses [(4)]			2,693		

(1) Impaired facilities includes $261 million of restructured loans (September 2011: $235 million), which includes $16 million of restructured fair value assets (September 2011: $16 million).

Impaired facilities includes $174 million of gross impaired fair value assets (September 2011: $186 million).

In the United States there is US$94 million (September 2011: US$100 million) of "Other Real Estate Owned" assets where the Group assumed ownership or foreclosed in the settlement of debt. Of this amount, US$82 million (September 2011: US$83 million) is covered by the Federal Deposit Insurance Corporation (FDIC) Loss Sharing Agreement, where the FDIC will absorb 80% of losses arising in recovery of these assets. The real estate assets are included in other assets on the Group's balance sheet and are not included as impaired facilities.

(2) Specific provisions for prudential purposes include all provisions for impairment assessed on an individual basis in accordance with IFRS excluding securitisation. All collective provisions on defaulted or otherwise non-performing assets, regardless of expected loss, such as those for 90+ days past due retail and in default with no loss non-retail exposures, have been reported as additional regulatory specific provisions and shown in this report as a separate item.

Specific provisions includes $76 million (September 2011: $71 million) of specific provisions on gross impaired fair value assets.

(3) Past due facilities ≥ 90 days includes amounts relating to the acquisition of certain assets of TierOne Bank in June 2010. These amounts are reported gross of the FDIC loss sharing agreement, where the FDIC absorbs 80% of the credit losses arising on the majority of the acquired loan portfolio.

(4) The General Reserve for Credit Losses (GRCL) at 31 December 2011 is calculated as follows:

	$m
Collective provision for doubtful debts	*3,392*
Less collective provisions for securitisation and management overlay for conduit assets and derivatives	*(160)*
Less collective provisions reported as additional regulatory specific provisions	*(468)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (pre-tax basis)	*2,764*
Less tax effect	*(701)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (after-tax basis)	*2,063*
Plus reserve created through a deduction from retained earnings	*630*
General reserve for credit losses (after-tax basis)	*2,693*

Exposure type	Impaired facilities $m (As at 30 Sep 11)	Past due facilities ≥90 days $m (As at 30 Sep 11)	Specific provisions $m (As at 30 Sep 11)	Charges for specific provisions $m (6 months ended 30 Sep 11)	Net Write-offs $m (6 months ended 30 Sep 11)
IRB approach					
Corporate (including SME)	2,430	350	691	330	255
Sovereign	-	-	-	-	-
Bank	34	-	34	-	-
Residential mortgage	667	1,006	161	90	69
Qualifying revolving retail	-	65	-	96	96
Retail SME	177	135	87	43	43
Other retail	9	38	4	53	50
Total IRB approach	**3,317**	**1,594**	**977**	**612**	**513**
Specialised lending (SL)	**1,463**	**83**	**287**	**201**	**192**
Standardised approach					
Australian and foreign governments	-	89	-	-	-
Bank	-	-	-	-	-
Residential mortgage	117	183	31	28	10
Corporate	1,472	168	243	245	221
Other	8	33	4	30	22
Total standardised approach	**1,597**	**473**	**278**	**303**	**253**
Total	**6,377**	**2,150**	**1,542**	**1,116**	**958**
Additional regulatory specific provisions			454		
General reserve for credit losses [(1)]			2,805		

[(1)] *The General Reserve for Credit Losses (GRCL) at 30 September 2011 is calculated as follows:*

	$m
Collective provision for doubtful debts	*3,398*
Less collective provisions for securitisation and management overlay for conduit assets and derivatives	*(160)*
Less collective provisions reported as additional regulatory specific provisions	*(454)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (pre-tax basis)	*2,784*
Less tax effect	*(695)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (after-tax basis)	*2,089*
Plus reserve created through a deduction from retained earnings	*716*
General reserve for credit losses (after-tax basis)	*2,805*

6. Glossary

Term	Description
ADI	Authorised Deposit-taking Institution.
Advanced IRB approach	The Advanced Internal Ratings Based (IRB) approach refers to the processes employed by the Group to estimate credit risk. This is achieved through the use of internally developed models to assess potential credit losses using the outputs from the PD, LGD and EaD models.
APRA	The Australian Prudential Regulation Authority.
Company	National Australia Bank Limited ABN 12 004 044 937.
EaD	Exposure at Default (EaD) is an estimate of the total committed credit exposure expected to be drawn at the time of default for a customer or facility that the Group would incur in the event of a default. It is used in the calculation of RWA.
Foundation IRB	Foundation Internal Ratings Based (FIRB) approach refers to an alternative approach to Advanced IRB for non-retail credit risk defined under Basel II where a Group develops its own PD models and seeks approval from its regulator to use these in the calculation of regulatory capital, and the regulator provides a supervisory estimate for LGD and EaD.
Group	The Level 2 Group, being the Company and the entities it controls subject to certain exceptions set out in *Section 2 Scope of Application*.
IFRS	International Financial Reporting Standards.
Impaired facilities	Impaired facilities consist of Retail loans (excluding unsecured portfolio-managed facilities) which are contractually 90 days or more past due with security insufficient to cover principal and arrears of interest revenue. Unsecured portfolio managed facilities are classified as impaired assets when they become 180 days past due (if not written off) as per ARF 220 instructions; Non-retail loans that are contractually 90 days or more past due and/or sufficient doubt exists about the ultimate ability to collect principal and interest; and Impaired off-balance sheet credit exposures, where current circumstances indicate that losses may be incurred.
IRRBB	Interest rate risk in the banking book (IRRBB).
LGD	Loss Given Default (LGD) is an estimate of the expected severity of loss for a credit exposure following a default event. Regulatory LGDs reflect a stressed economic condition at the time of default. It is used in the calculation of RWA.
National Australia Bank Group	National Australia Bank Limited and its consolidated entities.
Net write-offs	Write-offs on loans at amortised cost net of recoveries.
Past due facilities	Past due facilities ≥ 90 days consist of well-secured assets that are more than 90 days past due and portfolio-managed facilities that are not well secured and between 90 and 180 days past due.
PD	Probability of Default (PD) is an estimate of the likelihood of a customer defaulting or not repaying their borrowings and other obligations to the Group within the next 12 months.
RWA	Risk-Weighted Assets.
SME	Small and medium-sized entities.
Specific provisions	Specific provisions for prudential purposes include all provisions for impairment assessed on an individual basis in accordance with IFRS excluding securitisation; all collective provisions on defaulted or otherwise non-performing assets, regardless of expected loss, are reported as additional regulatory specific provisions.
Standardised approach	Standardised refers to an alternative approach to the assessment of risk (notably credit and operational) whereby the institution uses external rating agencies to assist in assessing credit risk and/or the application of specific values provided by regulators to determine RWA.
Tier 1 capital ratio	Tier 1 regulatory capital, as defined by APRA, divided by RWA.

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