2010 RISK & CAPITAL REPORT

Incorporating the requirements of APS 330

First Quarter Update

31 December 2009

National Australia Bank

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1. Introduction

Australian Prudential Regulation Authority ("APRA") has prudential oversight of the operations of all locally incorporated ADIs in Australia. 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"). This report provides quarterly information on the following:

- Capital Adequacy - Risk Weighted Assets and Capital Ratios as at 31 December 2009
- Credit Risk Exposures - As at 31 December 2009 and 3 month average
- Credit Risk Provisions - As at 31 December 2009
- Charges for Specific Provisions and Write-offs - 3 months ended 31 December 2009

The Group, as defined in Section 2 - Scope of Application, operates in multiple regulatory jurisdictions. The following table sets out the methodologies applied across the Group as at 31 December 2009.

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	n/a
Clydesdale Bank PLC	Standardised	Standardised	IRRBB	n/a
Great Western Bank	Basel I	n/a	n/a	n/a

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

Great Western Bank is reported under 'Standardised – Other' for the purposes of calculating the consolidated banking group position. Bank of New Zealand credit risk exposures consolidated in the Banking Group position are calculated under Reserve Bank of New Zealand ('RBNZ') requirements as mandated by APRA.

More detailed qualitative and quantitative disclosure in the Group's Risk and Capital Report for the year ended 30 September 2009 is available on the National Australia Bank Group's website (www.nabgroup.com).

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

Disclosure Governance

The 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 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*.

Disclosure controls and procedures have been designed and implemented to effectively manage prudential reporting risk.

2. Scope of Application

As required under APS 330, this disclosure applies to the Level 2 consolidated Group, being the National Australia Bank Limited ("the Company") and the entities it controls subject to certain exceptions set out in this part ("the Group").

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

Under guidelines issued by APRA, life insurance and funds management entities activities are excluded from the calculation of Basel II risk weighted assets 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* 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.

Differences arising in consolidation between Regulatory and Accounting approaches

The primary difference in consolidation between the regulatory approach and the accounting approach as defined by the Australian equivalents to the International Financial Reporting Standards ("AIFRS") is the area of investments in life insurance, funds management and securitisation. Under AIFRS, all entities, including special purpose vehicles, where the National Australia Bank Group has the power to govern the financial and operating policies so as to obtain benefit from their activities, are consolidated. This includes life insurance, funds management and special purpose vehicles used to house assets securitised. A list of material controlled entities included in the consolidated National Australia Bank Group for accounting purposes can be found in the National Australia Bank Group's 30 September 2009 financial report.

Restrictions on the transfer of funds or regulatory capital within the National Australia Bank Group

The transfer of regulatory capital and funding within the National Australia Bank Group is subject to restrictions imposed by National Australia Bank Group or local regulatory requirements as reflected in internal policies.

Further, for funding transfers within the National Australia Bank Group, *Prudential Standard APS 222 Associations with Related Entities* establishes limits on the level of exposure (for example debt and equity) that the Company may have to a related entity. National Australia Bank Group policy requires compliance with these limits and that the Company takes account of risks associated with dealings with other members of the National Australia Bank Group.

3. Regulatory Environment

Proposed Enhancements to the Basel II Framework

On 21 December 2009 APRA issued proposed changes to Prudential Standards relating to Capital Adequacy in response to a series of enhancements to the Basel II Framework announced by the Basel Committee on Banking Supervision ("BCBS") in July 2009. This will involve changes to:

- *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital;*
- *Prudential Standard APS 116 Capital Adequacy: Market Risk;*
- *Prudential Practice Guide APG 116 Market Risk;*
- *Prudential Standard APS 120 Securitisation;*
- *Prudential Practice Guide APG 120 Securitisation;*
- *Prudential Standard APS 310 Audit and Related Matters; and*
- *Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information.*

Written submissions are due to APRA by 28 February 2010. APRA envisages that changes to the Prudential Standards will come into effect from 1 January 2011.

On 17 December 2009, the BCBS released two consultative documents, *Strengthening the Resilience of the Banking Sector and International Framework for Liquidity Risk Measurement, Standards and Monitoring.* The papers address several proposals on the regulatory capital base, risk coverage, leverage ratio, liquidity risk standards, and measures to reduce pro-cyclicality. A global quantitative impact study will be undertaken in the first half of 2010 to assess the impact and ensure that the proposals are appropriately calibrated. On current planning, the BCBS aims to implement the new requirements by the end of 2012.

The Group is currently reviewing and assessing the impact of the proposed changes to the Prudential Standards and BCBS proposals in line with the submission date for comments.

General Reserve for Credit Losses

The Group has been engaged in discussions with APRA in relation to the calculation of the general reserve for credit losses ("GRCL"). This is an industry issue, and also foreshadows probable changes to loan loss methodology being deliberated by the International Accounting Standards Board.

Accounting standards state that impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of events that occurred after the initial recognition of the asset (a 'loss event'). Losses expected as a result of future events, no matter how likely, are not recognised. Prudential standards require that specific provisions and a GRCL are adequate at all times to absorb credit losses. This includes losses identified as being incurred and incurred-but-not-yet-reported, as well as credit losses estimated but not certain to arise in the future extending over the life of all facilities.

Effective 31 December 2009, the Group changed the GRCL calculation methodology and created an additional reserve to cover these credit losses estimated but not certain to arise in the future extending over the life of all facilities. This additional reserve has been reflected as a transfer from retained earnings for regulatory capital calculation purposes, and the portion relating to the IRB portfolio added to eligible provisions for the purpose of calculating the eligible provisions to expected loss capital deduction, which further reduced the 50/50 deductions from Tier 1 and Tier 2 capital. Overall, the revised calculation of the GRCL lead to a reduction in the Group's Tier 1 capital ratio of approximately 13 basis points.

Consistent with the requirements of *Prudential Standard APS 220 Credit Quality*, the GRCL is reported on an after-tax basis at 31 December 2009.

As the changes to the GRCL were effective 31 December 2009, 30 September 2009 comparative period disclosures have not been restated. Reconciliations have been included on pages 7 and 8 of this report to further explain how the GRCL was calculated at each reporting period.

4. Capital

Capital Adequacy [APS 330 Tables 16a – e]

The following table provides the Basel II risk weighted assets for the Group.

	As at 31 Dec 09 RWA $m	As at 30 Sep 09 RWA $m
Credit risk [1]		
IRB approach		
Corporate (including SME) [2] [8]	129,183	137,460
Sovereign [3]	1,141	1,041
Bank [4] [5]	5,620	6,914
Residential mortgage	47,708	47,924
Qualifying revolving retail [5]	4,112	4,031
Retail SME [2]	7,956	6,994
Other Retail	3,901	3,916
Total IRB approach	**199,621**	**208,280**
Specialised lending (SL) [6]	**28,206**	**23,218**
Standardised approach		
Australian and foreign governments [3]	45	91
Bank [4]	319	777
Residential mortgage	22,811	20,336
Corporate	31,558	32,465
Other	8,545	8,799
Total standardised approach	**63,278**	**62,468**
Other		
Securitisation	10,995	10,968
Equity	1,240	1,030
Other [7]	6,363	6,011
Total Other	**18,598**	**18,009**
Total credit risk	**309,703**	**311,975**
Market risk	**4,014**	**3,415**
Operational risk	**22,750**	**22,972**
Interest rate risk in the banking book	**3,416**	**4,160**
Total risk weighted assets	**339,883**	**342,522**

Capital ratios [9]	**%**	**%**
Level 2 total capital ratio	11.87%	11.48%
Level 2 Tier 1 capital ratio	9.28%	8.96%

(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) *Effective 1 October 2009 the Group received approval from RBNZ to segment the BNZ Retail SME portfolio classification (which was previously included in the Group's Corporate portfolio).*

(3) *Effective December 2009 the Group received approval from RBNZ to change the treatment of the BNZ Sovereign asset class from the Standardised to Advanced IRB approach.*

(4) *As at 31 December 2009 the Group held $5.9 billion (September 2009: $4.1 billion) of government guaranteed Financial Institution Debt. This resulted in the application of lower risk weights on these holdings with a reduction in RWA of $1.7 billion (September 2009: $1.8 billion) and an effective increase in Tier 1 capital ratio of 0.05% (September 2009: 0.05%) and Total capital ratio of 0.06% (September 2009: 0.06%). This debt is assessed in accordance with normal credit approval processes.*

(5) *For IRB approach: 'Bank' includes ADIs, overseas banks and non-commercial public sector entities. 'Qualifying revolving retail' exposures are revolving, unsecured and unconditionally cancellable (both contractually and in practice), for individuals and not explicitly for business purposes.*

(6) *Specialised lending exposures are subject to slotting criteria. As part of an industry review with APRA, changes to the classification of the commercial property portfolio meeting the slotting criteria were introduced in the December 2009 quarter. This resulted in a net increase to RWA of $2.7 billion.*

(7) *'Other' includes non-lending asset exposures which are not covered in the above categories. Non-lending assets are specifically excluded from credit risk exposures shown on pages 5 to 6 of this report.*

(8) *As part of the Group's normal annual review cycle, Loss Given Default ('LGD') models for all non-retail models were updated in the quarter ended 31 December 2009. The overall impact of these changes was not considered material.*

(9) *On 17 December 2009, the Group announced that it had agreed certain key terms with AXA Asia Pacific ("AXA AP") for NAB to acquire AXA AP's Australian and New Zealand businesses. This report should be read in conjunction with NAB's Trading Update dated 19 February 2010 which provides further information relating to the proposed acquisition.*

5. Credit Risk Exposures

Total Gross Credit Risk Exposures [APS 330 Table 17a]

This table provides the amount of credit risk exposures subject to the Standardised and Advanced IRB approaches. The Group has no credit risk exposures subject to Foundation IRB approaches. Exposures exclude non-lending assets, equities and securitisation.

	As at 31 Dec 09			
	On-balance sheet exposures	Non-market related off-balance sheet	Market related off-balance sheet	Total exposures [1]
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	127,965	42,640	14,189	**184,794**
Sovereign	20,421	784	4,561	**25,766**
Bank	18,855	1,647	49,249	**69,751**
Residential mortgage	178,650	31,629	-	**210,279**
Qualifying revolving retail	5,241	4,974	-	**10,215**
Retail SME	13,916	3,332	-	**17,248**
Other Retail	3,545	1,269	-	**4,814**
Total IRB approach	**368,593**	**86,275**	**67,999**	**522,867**
Specialised lending (SL)	**27,890**	**4,491**	**678**	**33,059**
Standardised approach				
Australian and foreign governments	4,118	192	-	**4,310**
Bank	7,668	363	4,487	**12,518**
Residential mortgage	34,753	2,351	-	**37,104**
Corporate	28,367	4,787	639	**33,793**
Other	8,143	379	-	**8,522**
Total standardised approach	**83,049**	**8,072**	**5,126**	**96,247**
Total exposures (EaD)	**479,532**	**98,838**	**73,803**	**652,173**

(1) Total credit risk exposures are Exposure at Default ("EaD") estimates of potential exposure, according to product type, for a period of 1 year including an estimate of future lending for undrawn balance sheet commitments. For off-balance sheet exposures, the EaD is calculated using Credit Conversion Factors ("CCFs") that convert the exposure into an on-balance sheet equivalent. For derivatives, the exposure is defined as the mark-to-market value plus a potential value of future movements. For the IRB approach, EaD is reported gross of specific provisions, 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.

	As at 30 Sep 09			
	On-balance sheet exposures	Non-market related off-balance sheet	Market related off-balance sheet	Total exposures
Exposure type	**$m**	**$m**	**$m**	**$m**
IRB approach				
Corporate (including SME)	138,160	42,162	14,967	**195,289**
Sovereign	9,410	1,429	2,720	**13,559**
Bank	22,940	1,709	37,048	**61,697**
Residential mortgage	176,533	31,886	-	**208,419**
Qualifying revolving retail	4,955	5,032	-	**9,987**
Retail SME	12,009	3,162	-	**15,171**
Other Retail	3,502	1,304	-	**4,806**
Total IRB approach	**367,509**	**86,684**	**54,735**	**508,928**
Specialised lending (SL)	**21,778**	**4,118**	**782**	**26,678**
Standardised approach				
Australian and foreign governments	5,529	224	74	**5,827**
Bank	9,320	370	3,701	**13,391**
Residential mortgage	29,327	2,306	-	**31,633**
Corporate	29,569	4,487	742	**34,798**
Other	8,330	437	-	**8,767**
Total standardised approach	**82,075**	**7,824**	**4,517**	**94,416**
Total exposures (EaD)	**471,362**	**98,626**	**60,034**	**630,022**

Average Credit Risk Exposure [APS 330 Table 17a]

This table provides the average credit risk exposures being the sum of the gross credit risk exposures at the beginning of the period plus the gross credit risk exposures at the end of the reporting period divided by two. Exposures exclude non-lending assets, equities and securitisation.

	3 months ended 31 Dec 09			
Exposure type	**On-balance sheet exposures $m**	**Non-market related off-balance sheet $m**	**Market related off-balance sheet $m**	**Average total exposures $m**
IRB approach				
Corporate (including SME)	133,062	42,401	14,578	**190,041**
Sovereign	14,915	1,107	3,640	**19,662**
Bank	20,897	1,678	43,149	**65,724**
Residential mortgage	177,592	31,757	-	**209,349**
Qualifying revolving retail	5,098	5,003	-	**10,101**
Retail SME	12,963	3,247	-	**16,210**
Other Retail	3,524	1,286	-	**4,810**
Total IRB approach	**368,051**	**86,479**	**61,367**	**515,897**
Specialised lending (SL)	**24,834**	**4,305**	**730**	**29,869**
Standardised approach				
Australian and foreign governments	4,823	208	37	**5,068**
Bank	8,494	367	4,094	**12,955**
Residential mortgage	32,040	2,328	-	**34,368**
Corporate	28,968	4,637	691	**34,296**
Other	8,237	408	-	**8,645**
Total standardised approach	**82,562**	**7,948**	**4,822**	**95,332**
Total exposures (EaD)	**475,447**	**98,732**	**66,919**	**641,098**

	6 months ended 30 Sep 09			
Exposure type	**On-balance sheet exposures $m**	**Non-market related off-balance sheet $m**	**Market related off-balance sheet $m**	**Average total exposures $m**
IRB approach				
Corporate (including SME)	147,141	45,681	16,692	**209,514**
Sovereign	4,705	714	1,360	**6,779**
Bank	23,285	2,019	39,736	**65,040**
Residential mortgage	173,902	30,989	-	**204,891**
Qualifying revolving retail	5,410	5,382	-	**10,792**
Retail SME	6,005	1,581	-	**7,586**
Other Retail	3,014	895	-	**3,909**
Total IRB approach	**363,462**	**87,261**	**57,788**	**508,511**
Specialised lending (SL)	**21,333**	**4,147**	**1,162**	**26,642**
Standardised approach				
Australian and foreign governments	11,026	491	2,300	**13,817**
Bank	10,422	396	3,524	**14,342**
Residential mortgage	30,538	1,908	-	**32,446**
Corporate	31,447	5,026	849	**37,322**
Other	8,962	574	-	**9,536**
Total standardised approach	**92,395**	**8,395**	**6,673**	**107,463**
Total exposures (EaD)	**477,190**	**99,803**	**65,623**	**642,616**

6. Credit Risk Provisions

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

The following table sets out credit risk provision information by Basel II asset class, excluding non-lending assets, equities and securitisation exposures. Definitions of impairment and past due facilities are based on APRA Prudential Standard APS 220: Credit Quality and related guidance notes. The determination of specific provisions is in accordance with APRA Guidance Note AGN 220.2: Impairment, Provisioning and the General Reserve for Credit Losses. Impaired facilities are disclosed in accordance with APRA's definition of impaired facilities under Guidance Note AGN 220.1: Impaired Asset Definitions paragraph 7.

	As at 31 Dec 09			3 months ended 31 Dec 09	
	Impaired facilities (1)	Past due facilities ≥90 days	Specific provision balance (2)	Charges for specific provision	Write-offs (3)
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	2,878	398	1,217	255	84
Sovereign	-	1	-	-	-
Bank	-	-	-	-	-
Residential mortgage	701	961	143	26	21
Qualifying revolving retail	-	65	-	48	50
Retail SME	157	135	89	14	14
Other Retail	12	54	6	25	28
Total IRB approach	**3,748**	**1,614**	**1,455**	**368**	**197**
Specialised lending (SL)	**719**	**59**	**139**	**92**	**-**
Standardised approach					
Australian and foreign governments	-	-	-	-	-
Bank	-	-	-	-	-
Residential mortgage	49	192	12	1	5
Corporate	1,149	331	207	104	55
Other	56	70	20	65	61
Total standardised approach	**1,254**	**593**	**239**	**170**	**121**
Total exposures	**5,721**	**2,266**	**1,833**	**630**	**318**
Additional regulatory specific provisions			558		
General reserve for credit losses (4)			2,804		

(1) Impaired facilities include $407 million of restructured loans (September 2009: $384 million). These loans represent facilities which have been classified as restructured for reasons relating to the financial difficulty of the counterparty but exclude $306 million (September 2009:$312m) of facilities which have been classified as restructured for reasons which do not relate to the financial difficulty of the counterparty.

Impaired facilities include $348 million (September 2009: $366 million) of gross impaired fair value assets.

(2) Specific provisions for prudential purposes include all provisions for impairment assessed on an individual basis in accordance with AIFRS 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 include $102 million (September 2009: $98 million) of specific provisions on impaired fair value assets.

(3) Write-offs are net of recoveries.

(4) The GRCL at 31 December 2009 is calculated as follows:

	$m
Collective provision for doubtful debts	3,573
Less collective provisions for securitisation and management overlay for conduit assets and derivatives	(190)
Less collective provisions reported as additional regulatory specific provisions	(558)
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (pre-tax basis)	2,825
Less tax effect	(767)
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (after-tax basis)	2,058
Plus reserve created through a deduction from retained earnings	746
General reserve for credit losses (after-tax basis)	2,804

	As at 30 Sept 09			6 months ended 30 Sept 09	
	Impaired facilities	**Past due facilities ≥90 days**	**Specific provision balance**	**Charges for specific provision**	**Write-offs**
Exposure type	**$m**	**$m**	**$m**	**$m**	**$m**
IRB approach					
Corporate (including SME)	2,962	431	1,117	856	714
Sovereign	-	-	-	-	-
Bank	-	-	-	-	-
Residential mortgage	750	918	137	141	118
Qualifying revolving retail	-	73	-	70	63
Retail SME	124	115	66	66	23
Other Retail	11	56	6	86	80
Total IRB approach	**3,847**	**1,593**	**1,326**	**1,219**	**998**
Specialised lending (SL)	**397**	**10**	**25**	**9**	**32**
Standardised approach					
Australian and foreign governments	-	-	-	-	-
Bank	-	-	-	-	-
Residential mortgage	52	185	17	14	7
Corporate	1,091	268	154	344	363
Other	49	78	20	154	149
Total standardised approach	**1,192**	**531**	**191**	**512**	**519**
Total exposures	**5,436**	**2,134**	**1,542**	**1,740**	**1,549**

Additional regulatory specific provisions	529
General reserve for credit losses [(1)]	2,834

[(1)] *Changes to the calculation of the GRCL were effective 31 December 2009. The GRCL at 30 September 2009 was calculated as follows:*

	$m
Collective provision for doubtful debts	*3,553*
Less collective provisions for securitisation and management overlay for conduit assets and derivatives	*(190)*
Less collective provisions reported as additional regulatory specific provisions	*(529)*
Collective provision for doubtful debts eligible for inclusion in a general reserve for credit losses (pre-tax basis)	*2,834*

7. Glossary

Term	Description
ADI	Authorised Deposit-taking Institution ("ADI") as defined by APRA, and authorised by APRA to take deposits from customers.
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 ("APRA") is the prudential regulator of the Australian financial services industry. APRA has defined its Basel II requirements in a series of Australian Prudential Standards ("APS").
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 within the next 12 months. 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'.
IRRBB	Interest Rate Risk in the Banking Book ("IRRBB") quantifies the inherent risk arising from the Group's banking operations as a result of movements in interest rates. This also includes the impact of differing maturities between assets and liabilities. Quantification of the resulting risk is used in determining capital adequacy.
RWA	Risk Weighted Assets
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 Risk Weighted Assets.

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