NATIONAL AUSTRALIA BANK LTD
Form 20-F
December 21, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended 30 September, 2006

Commission file number 1-9945

National Australia Bank Limited

ABN 12 004 044 937

(Exact name of Registrant as specified in its charter)

Victoria, Australia

(Jurisdiction of incorporation)

500 Bourke Street, Melbourne, VICTORIA, 3000 Australia

(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class		Name of each exchange on which registered
Ordinary Shares		**New York Stock Exchange**
American Depositary Shares, each representing five Ordinary Shares		**New York Stock Exchange**
Exchangeable Capital units consisting of 7 7/8% Perpetual Capital Securities and Purchase Contracts		**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: NONE

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: NONE

Indicate the number of outstanding shares of each of the registrant's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary Shares	**1,609,897,524**
Staff Share Scheme shares (partly paid shares)	**390,259 paid to 25 Australian cents**
National Income Securities	**20,000,000**
Trust Preferred Securities	**400,000**
Trust Preferred Securities II	**800,000**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:

Yes x No o

If this is an annual report or transition report, indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934:

Yes o No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer o

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

This Report on Form 20-F shall be deemed to be incorporated by reference in the prospectus included in the Registration Statement on Form F-3 (No. 333-6632) of National Australia Bank Limited and to be part thereof from the date on which this Report, is filed, to the extent not superseded by documents or reports subsequently filed or furnished.

(APPLICABLE ONLY TO ISSERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS) Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

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Chairman s message

I am pleased to report that your Company achieved good growth in profitability and steady progress in its business improvement program in the 2006 year.

Net profit attributable to members of the Company increased 10.0% to $4,392 million and cash earnings before significant items rose 21.9% to $3,967 million.

These results were achieved despite an increasingly competitive lending environment and a substantial amount of management time being devoted to improving the Bank s internal systems and complying with the requirements of new international regulatory frameworks and standards.

The Company s culture change program, initiated in 2005, is achieving early success, especially at senior levels. The program seeks to clarify individual accountability and empower employees at every level to take initiative in their day-to-day decisions and interactions.

The success of these efforts is evidenced by numerous positive developments across the Group from a recovery in the Australian bank s market share in business lending, to the growth of the Integrated Financial Solutions Centre (FSC) business in the UK, the rebuilding of nabCapital and the success of the Unbeatable home loan campaign in New Zealand.

In Australia, our efforts were recognised via Money Magazine s Bank of the Year Award, CFO Magazine s Business Bank of the Year Award and Australian Banking and Finance Magazine s Life Insurance Company of the Year Award for MLC.

Much, however, remains to be done. The principal message being conveyed by the Board to senior management, and through them to employees, is that the Company s goal of providing sustainable satisfactory shareholder returns will only be achieved through an unwavering focus on our customers needs, ethical behaviour at all levels and recognition in the community of our operating companies as good corporate citizens.

The investment of time and money by the Company in developing its systems to meet regulatory requirements is substantial. These investments will ultimately result in an even sharper appreciation of risk across the business.

In the meantime, such demands do result in a lesser focus on market-oriented initiatives than would otherwise be the case.

Increasingly in the markets in which we operate there is strong competition from non-traditional sources, which are not required to meet the same regulatory standards.

The tilting of the playing field in this way works to the detriment of banks, a development that is not in the interest of either our shareholders or our economy. At a time when governments are beginning to recognise the costly burden being placed on companies by regulation generally, this is a trend that needs to be monitored closely.

During the year, the directors declared dividends totalling 167 cents per share, a small increase on that paid in 2005. As a result of the increase in net profit attributable to members of the Company, the Company s dividend payout ratio fell from 79.6% to 67.4% which is closer to the board s target range of 60% to 65%.

In July 2006, Mr Robert Elstone resigned from the Board as a result of his appointment as Chief Executive of the Australian Stock Exchange. Rob s departure is a real loss to the Company, in particular given his keen appreciation of risk across all parts of the finance sector. Rob made a significant contribution during his two years on the Board and we are indebted to him for that.

Fortunately the Board is well placed in respect of finance industry expertise and Mr Paul Rizzo was able to assume the role of Chair of the Risk Committee seamlessly upon Rob s departure.

In closing, I would like to thank my fellow directors and the Company s employees for their dedication and effort over the past year.

/s/ Michael A Chaney AO
Michael A Chaney AO
Chairman

Group Chief Executive Officer s message

2006 at a glance

- Net profit attributable to members of the Company increased 10.0% to $4,392 million;
- Business portfolio aligned to core capabilities;
- Share buy back; and
- Improving customer satisfaction.

National Australia Bank is about to commence the next phase of its development focused on creating sustainable satisfactory shareholder value.

The progress made in all parts of the Group during the past year was very pleasing. All of our key businesses are gaining momentum. Our portfolio is now well suited to our core capabilities and has the ability to produce sustainable growth in shareholder value.

Net profit attributable to members of the Company was up 10.0% to $4,392 million. This was affected by significant items, largely in respect of the UK pension reforms in 2006 and profit on the sale of the Irish Banks and restructuring provisions in 2005. This was all a part of getting the National Australia Bank match fit .

In 2006, net profit attributable to members of the Company before significant items was up 25.3% to $4,154 million. This is a better reflection of the underlying performance of the Group, but was also affected by the introduction of the Australian equivalents to International Financial Reporting Standards.

In line with our commitment to active capital management we will undertake a $500 million on-market share buy back to commence in the first half of 2007. We intend to neutralise the capital impact of shares issued under the dividend reinvestment plan and various employee share plans by either buying back shares issued or purchasing shares on market to satisfy our obligations rather than issuing new shares.

We have carefully managed margins, asset quality remains sound overall and we continued to strive to improve customer satisfaction levels throughout the Group.

The Corporate Centre was reduced in size and is focused on creating value for shareholders, strategic development of our portfolio of businesses, financial and risk performance and governance, developing and retaining talent and capital and balance sheet management.

The establishment of a regional business model has created a more nimble, customer-focused organisation in the regions in which we operate.

In the Australian business, we developed and launched new products, built market share in target areas and managed expenses.

As the major business within our portfolio, Australia also faced the largest challenge in the turnaround and made progress on all fronts.

This was reflected in the increase of 27.0% in net profit attributable to members of the Company to $2,515 million and excluding significant items, was up 10.9%.

In New Zealand, despite challenging economic conditions and fierce competition, our Bank of New Zealand operation performed well. Using the Unbeatable home loan campaign to position itself in a crowded market, net profit attributable to members of the Company increased 26.7% to $389 million and excluding significant items, was up 22.7%.

The United Kingdom operation differentiates National Australia Bank from other Australian banks. The net profit attributable to members of the Company of $868 million, a decrease of 46.7% (largely related to the profit on sale of the Irish Banks in 2005), represents 19.8% of overall Group net profit. Net profit attributable to members of the Company, excluding significant items, was up 15.7% to $618 million.

We successfully worked to rejuvenate the existing branch network, and expand into the southeast of England with Financial Solutions Centres targeting small to medium enterprises, and the mass affluent personal sector.

nabCapital, formerly Institutional Markets and Services increased net profit attributable to members of the Company by 22.9% to $618 million and excluding significant items was up 8.0%, while reducing the amount of capital deployed in the business. nabCapital further evolved its originate warehouse and distribute business model to provide greater linkage between the various parts of its business, and both borrowers and investors.

During the year we continued to develop the Corporate Social Responsibility (CSR) program within our businesses. Paying attention to broader social and environmental issues helps manage risks and identify new opportunities that add value to our business for shareholders and the communities in which we operate. This year we will produce our third CSR Report to outline our progress in this area.

I would like to thank the Board for its support, especially in leading the culture change program. A great deal of practical work has been completed to support the new Corporate Principles and measure behaviours. Over time, I am confident this will result in a fundamental and lasting shift in the culture.

And finally, thank you to all of our staff who worked very hard to contribute towards the National Australia Bank s success in 2006.

/s/ John Stewart

John Stewart
Group Chief Executive Officer

Refer to non-GAAP measures on page 56 for an explanation of the Group s non-GAAP measures, including significant items, and reconciliations of non-GAAP financial measures , including significant items on page 7.

Presentation of information

Basis of presentation

References in this document to this annual financial report refer to this 2006 annual report on Form 20-F filed with the US Securities and Exchange Commission. This annual financial report contains financial information in respect of the Group's parent entity, National Australia Bank Limited, as well as consolidated financial information in respect of the Group. Parent entity financial information is prepared solely to meet Australian reporting requirements.

This annual financial report is prepared in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS) which differ in some respects from US GAAP *(as set out in note 57 in the financial report)*. Comparative amounts have been reclassified to accord with changes in presentation made in 2006, except where otherwise stated.

This is the Group s first annual financial report prepared in accordance with AIFRS. The 2005 annual financial report was prepared in accordance with previous Australian Generally Accepted Accounting Principles (AGAAP), which differs from AIFRS in certain respects *(as set out in note 1 in the financial report*).

Currency of presentation

All currency amounts are expressed in Australian dollars unless otherwise stated. Merely for the convenience of the reader, this annual financial report contains translations of certain Australian dollar amounts into US dollars at specified rates. These translations should not be construed as representations that the Australian dollar amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated. Unless otherwise stated, the translations of Australian dollars into US dollars have been made at the rate of US$0.7461 = A$1.00, the noon buying rate in New York City for cable transfers in Australian dollars as certified for customs purposes by the Federal Reserve Bank of New York (noon buying rate) on September 30, 2006.

Certain definitions and glossary

The Company s fiscal year ends on September 30. The fiscal year ended September 30, 2006 is referred to as 2006 and other fiscal years are referred to in a corresponding manner. The abbreviations $m and $bn represent millions and thousands of millions (ie. billions) of Australian dollars respectively. Any discrepancies between total and sums of components in tables contained in this annual financial report are due to rounding.

A glossary of some of the key terms used in this annual financial report is contained at page 285. In addition, non-GAAP financial measures have been defined at page 56.

Forward-looking statements

This annual financial report contains certain forward-looking statements within the meaning of section 21E of the United States *Securities Exchange Act of 1934*. The United States *Private Securities Litigation Reform Act of 1995* provides a safe harbour for forward-looking information to encourage companies to provide prospective information about themselves without fear of litigation, so long as the information is identified as forward-looking and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the information.

Accordingly, the words anticipate, believe, expect, project, estimate, intend, should, could, may, target, goal, objective, plan, outlook and other similar expressions are used in connection with forward-looking statements.

In this annual financial report, forward-looking statements may, without limitation, relate to statements regarding:

economic and financial forecasts, including but not limited to statements in the financial review and the report on the directors and officers;

anticipated implementation of certain control systems and programs, including, but not limited to those described in risk management; and

certain plans, strategies and objectives of management.

Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the Group, that may cause actual results to differ materially from those expressed in the statements contained in this annual financial report. For example:

the economic and financial forecasts contained in this annual financial report will be affected by movements in interest and foreign currency exchange rates, which may vary significantly from current levels, as well as by general economic conditions in each of the Group s major markets. Such variations may materially impact the Group s financial condition and results of operations;

the implementation of control systems and programs will be dependent on such factors as the Group s ability to acquire or develop necessary technology or systems, its ability to attract and retain qualified personnel and the response of customers and third parties such as vendors; and

the plans, strategies and objectives of management will be subject to, among other things, government regulation, which may change at any time and over which the Group has no control. In addition, the Group will continue to be affected by general economic conditions in Australia and worldwide, movements and conditions in capital markets, the competitive environment in each of its markets and political and regulatory policies.

There can be no assurance that actual outcomes will not differ materially from the forward-looking statements contained in this annual financial report.

Selected financial data

The information hereunder has been derived from the audited financial report of the Group, or where certain items are not shown in the Group s financial report, it has been prepared for the purpose of this annual financial report. Accordingly, this information should be read in conjunction with and is qualified in its entirety by reference to the financial report.

		Group	
	2006 $m	2006 (1) US$m	2005 $m
Income statement summary			
Net interest income	**8,686**	**6,481**	6,944
Net life insurance income	**1,417**	**1,057**	1,505
Gains less losses on financial instruments at fair value	**471**	**351**	639
Other income *(2)*	**4,615**	**3,443**	5,251
Significant revenue	**334**	**249**	1,354
Operating expenses *(3)*	**(7,642)**	**(5,702)**	(7,995)
Charge to provide for doubtful debts	**(606)**	**(452)**	(534)
Significant expenses			(748)
Profit before income tax expense	**7,275**	**5,428**	6,416
Income tax expense	**(2,134)**	**(1,592)**	(1,814)
Net profit	**5,141**	**3,836**	4,602
Net profit attributable to minority interest	**(749)**	**(559)**	(610)
Net profit attributable to members of the Company	**4,392**	**3,277**	3,992
Dividends paid/payable *(4)*	**2,554**	**1,905**	2,454

		Group	
	2006 $m	2006 (1) US$m	2005 $m
Balance sheet summary			
Investments relating to life insurance business	**54,784**	**40,874**	49,783
Loans and advances	**283,777**	**211,726**	264,674
Total assets	**484,785**	**361,698**	422,598
Total risk-weighted assets *(5)*	**318,323**	**237,501**	289,833
Deposits and other borrowings	**222,277**	**165,841**	212,557
Life policy liabilities	**46,475**	**34,675**	42,123
Bonds, notes and subordinated debt	**65,006**	**48,501**	41,490
Other debt issues	**2,274**	**1,697**	1,559
Net assets	**27,972**	**20,870**	31,547
Contributed equity	**12,279**	**9,161**	10,828
Ordinary shares	**7,948**	**5,930**	6,894
Other equity instruments *(6)*	**4,331**	**3,231**	3,934
Total equity (excludes minority interest)	**27,804**	**20,745**	25,323

	Group		
	2006 $	2006 (1) US$	2005 $
Shareholder information			
Earnings per share *(7)*			
Basic	**2.63**	**1.96**	2.46
Diluted	**2.62**	**1.95**	2.42
Dividends per share *(4)*	**1.67**	**1.25**	1.66
Dividends per American depositary share (ADS) *(4)*	**8.35**	**6.23**	8.30
Dividend payout ratio (%) *(4)*	**67.35**	**67.35**	79.56
Net assets per share	**17.38**	**12.97**	20.13
Share price at year end	**36.70**	**27.38**	33.05
Number of ordinary shares at year end (No. 000)	**1,610,288**	**n/a**	1,567,654

	Group	
	2006 %	2005 %
Selected financial ratios		
Average equity (ordinary shareholder funds) to average total assets (excluding statutory funds) *(8) (9)*	**5.4**	5.5
Return on average assets *(10)*	**0.9**	0.9
Return on average equity (ordinary shareholder funds) *(9) (10)*	**18.8**	18.0
Average net interest spread	**1.88**	1.69
Average net interest margin	**2.31**	2.13
Gross impaired assets to gross loans and acceptances *(11)*	**0.30**	0.35
Net impaired assets to equity (parent entity interest)	**3.1**	2.8
Total provisions for doubtful debts to gross impaired assets	**191.3**	235.8
Capital risk asset ratios *(12)*		
Tier 1	**7.3**	7.9
Tier 2	**3.9**	3.6
Deductions	**(0.4)**	(1.0)
Total	**10.8**	10.5

US GAAP measures

	Group					
	2006 $m	2006 (1) US$m	2005 $m	2004 $m	2003 $m	2002 $m
Selected financial data in accordance with US GAAP						
Net income	**4,232**	**3,157**	3,891	2,781	3,667	3,455
Total assets	**485,728**	**362,402**	424,628	417,758	398,448	380,280
Total equity	**25,911**	**19,332**	23,385	23,311	22,297	24,005

	2006 $	2006 (1) US$	2005 $	2004 $	2003 $	2002 $
Selected shareholder information in accordance with US GAAP						
Net income per share *(7)*						
Basic	**2.60**	**1.94**	2.44	1.71	2.30	2.11
Diluted	**2.57**	**1.92**	2.40	1.71	2.22	2.06
Dividends per ADS (US$) *(4) (13)*	**n/a**	**6.38**	6.09	6.13	6.03	4.12
Dividends as percentage of net income (%)	**63.48**	**63.48**	67.45	89.78	64.14	65.59

	2006 %	2005 %	2004 %	2003 %	2002 %
Selected financial ratios in accordance with US GAAP					
Net income as a percentage of					
Average total assets (excluding statutory funds) *(8)*	**1.1**	1.0	0.8	1.0	1.0
Average equity	**17.2**	16.7	12.2	15.8	14.5
Total equity as percentage of total assets (excluding statutory funds) *(8)*	**6.0**	6.3	6.2	6.2	6.9

	Group	
	2006 $m	2005 $m
Reconciliations of non-GAAP measures *(14)*		
Net profit attributable to members of the Company	**4,392**	3,992
Adjusted for		
Significant revenue	**(334)**	(1,354)
Significant expenses		748
Income tax expense/(benefit) on significant items	**96**	(72)
Net profit attributable to members of the Company before significant items	**4,154**	3,314
Net profit to cash earnings before significant items reconciliation		
Net profit attributable to members of the Company	**4,392**	3,992
Adjusted for		
Net profit/(loss) attributable to minority interest	**749**	610
Net profit	**5,141**	4,602
Adjusted for		
Net (profit)/loss attributable to minority interest	**(749)**	(610)
Distributions on other equity instruments	**(254)**	(204)
Treasury shares (after-tax)	**126**	143
Investment earnings on shareholders retained profits and capital from life businesses discount rate variation	**6**	
Revaluation gains/(losses) on exchangeable capital units (after-tax)	**112**	
Net (profit)/loss on sale of controlled entities (after-tax)	**(108)**	
Economic hedge (gain) on proceeds from sale of controlled entities (after-tax)	**(22)**	
Cash earnings	**4,252**	3,931
Adjusted for		
Significant revenue	**(402)**	(1,354)
Significant expenses		748
Income tax expense/(benefit) on significant items	**117**	(72)
Cash earnings before significant items	**3,967**	3,253
Average ordinary shareholder funds reconciliation		
Total average equity *(refer to note 42 in the financial report)*	**26,016**	28,806
Adjusted for		
National Income Securities (average)	**(1,945)**	(1,945)
Trust Preferred Securities (average)	**(975)**	(975)
Trust Preferred Securities II (average)	**(1,014)**	(531)
National Capital Instruments (average)	**(13)**	
Minority interest (average)	**(50)**	(4,281)
Average ordinary shareholder funds	**22,019**	21,074

	Group				
	2006	2005	2004	2003	2002
Employees					
Full-time equivalent *(15)*	**38,433**	38,933	43,517	42,540	43,202

			Group		
	2006	2005	2004	2003	2002
Exchange rates (average and closing per A$1.00)					
Average					
British pound	**0.4150**	0.4141	0.4055	0.3824	0.3622
United States dollar	**0.7467**	0.7654	0.7265	0.6125	0.5324
New Zealand dollar	**1.1432**	1.0847	1.1254	1.1142	1.1992
Closing					
British pound	**0.3991**	0.4326	0.3973	0.4072	0.3474
United States dollar	**0.7478**	0.7617	0.7149	0.6804	0.5440
New Zealand dollar	**1.1439**	1.0991	1.0682	1.1446	1.1565

			Group		
	2006	2005	2004	2003	2002
United States dollar (per A$1.00)					
Average *(16)*	**0.7468**	0.7655	0.7263	0.6167	0.5329
September 30	**0.7461**	0.7643	0.7244	0.6797	0.5628

On November 10, 2006 the noon buying rate was US$0.7673 per A$1.00.

			Group 2006			
	November	October	September	August	July	June
United States dollar (per A$1.00)						
High	0.7889	0.7738	0.7713	0.7677	0.7675	0.7522
Low	0.7619	0.7421	0.7459	0.7573	0.7419	0.7293

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(1) Translated at the noon buying rate on September 30, 2006 of US$0.7461 = A$1.00.

(2) In 2006, other income includes the net profit (before-tax) from the sale of the Custom Fleet business.

(3) In 2006, operating expenses includes the net loss (before-tax) from the sale of the MLC Asia businesses.

(4) Dividend amounts for a year represent the final and interim dividend in respect of that year, irrespective of when they are declared, determined and publicly recommended and includes issues under the bonus share plan in lieu of cash and the dividend reinvestment plan. Dividends and book value per ordinary share and per American depositary share (ADS) calculations are based on year-end fully paid equivalent ordinary shares, adjusted for loans and rights issues as appropriate. Dividend payout ratio is the dividend amounts for a year divided by cash earnings before significant items. Refer to page 7 for a reconciliation of cash earnings before significant items and page 56 for an explanation of non-GAAP financial measures .

(5) The calculation to determine the market risk capital component of risk-weighted assets at September 30, 2006 and September 30, 2005 was carried out under the Standard Method as directed by APRA. The Standard Method as prescribed by the APRA Prudential Standard (APS 113), limits recognition of portfolio effects on outstanding positions and is substantially more restrictive on the rules regarding the matching of positions.

(6) Equity instruments comprise preference shares, National Income Securities, Trust Preferred Securities, Trust Preferred Securities II and National Capital Instruments.

(7) Refer to notes 8 and 57 in the financial report for an explanation of earnings per share.

(8) Statutory funds are excluded given the significant restrictions imposed on these assets by life insurance legislation, regulations and the regulators thereunder. However, current Australian accounting requirements do not allow for these assets and liabilities to be separated and disclosed separately on the balance sheet.

(9) *Refer to page 7 for a reconciliation of average ordinary shareholder funds.*

(10) *Return represents net profit attributable to members of the Company after deducting distributions on other equity instruments.*

(11) *In 2006, this includes loans accounted for at fair value.*

(12) *As defined by APRA (refer to liquidity, funding and capital resources on page 27).*

(13) *Dividend amounts are translated into US dollars per ADS (representing five fully paid ordinary shares) at the exchange rate on each of the respective payment dates for interim and final dividends.*

(14) *Refer to page 56 for explanations of non-GAAP financial measures .*

(15) *Full-time equivalent employees (FTEs) includes part-time staff (pro-rated) and non-payroll FTEs (ie. contractors).*

(16) *The daily average of the noon buying rates.*

Business overview

Introduction

The Group is an international financial services group that provides a comprehensive and integrated range of financial products and services.

The Company traces its history back to the establishment of The National Bank of Australasia in 1858. National Australia Bank Limited is a public limited company, incorporated on June 23, 1893 in Australia, which is the Company s main domicile. Its registered office is 35th floor, 500 Bourke Street, Melbourne Victoria 3000, Australia. The Company operates under the requirements of the *Banking Act* 1959 (Cth) and the *Corporations Act* 2001 (Cth).

In 1981 the National Bank of Australasia merged with the Commercial Banking Corporation of Sydney which was established in 1834.

Globally, as at September 30, 2006, the Group had:

- total assets of $485 billion;
- $97 billion in assets under management and administration;
- $474 billion in funds under custody and investment administration; and
- 8.0 million banking and 2.3 million wealth management customers.

Strategy and corporate principles

The Group s corporate purpose is to generate sustainable satisfactory returns to shareholders.

The Group s strategies are focused on the turnaround of the Group and building new avenues for growth. There has been, and continues to be a focus on:

- re-invigorating the Group s franchise and brand;
- improving the Group s core infrastructure;
- accelerating cultural change around the Group s corporate principles;
- enhancing the Group s disciplined approach to performance improvement;
- improved regulatory and key stakeholder engagement;
- strengthening risk and capital management; and
- leveraging our distinctive capabilities to create new and differentiated growth opportunities.

The Group s corporate principles will continue to be embedded in the Group s culture to ensure that thinking and actions are aligned with the Group s strategic direction.

The five principles are:

- we will be open and honest;
- we take ownership and hold ourselves accountable (for all our actions);
- we expect teamwork and collaboration across our organisation for the benefit of all stakeholders;
- we treat everyone with fairness and respect; and
- we value speed, simplicity and efficient execution of our promises.

Organisational structure and operating model

National Australia Bank Limited is the holding company for the Group, as well as the main operating company. During 2006, the Company had four wholly-owned main operating subsidiaries: Bank of New Zealand, Clydesdale Bank PLC, MLC Limited and National Australia Financial Management Limited.

The Company continues to consider a range of options to optimise its domestic and international operations, including a non-operating holding company. The Company is participating in industry-wide consultation with regulators in the relation to the matter. Consideration of various structural options which involves a range of complex issues, the analysis and subsequent decision on a particular path are expected to take some time to complete.

During the 2006 year, two divestments occurred, the Custom Fleet and MLC Asia businesses. *For further information on these divestments refer to page 45 and page 46 respectively).*

In 2005, one significant divestment occurred. In February 2005, the Group sold the shares of National Europe Holdings (Ireland) Limited, the immediate parent entity of Northern Bank Limited and National Irish Bank Limited. *For further information on this divestment, refer to page 45.*

The business operating model is run along regional lines of business as follows:

- Australia Region comprises Australian Banking and Wealth Management Australia;
- United Kingdom Region comprises United Kingdom Banking and Wealth Management United Kingdom;
- New Zealand Region comprises New Zealand Banking and Wealth Management New Zealand; and
- nabCapital (global).

This is supported by the Group s Other business segment, which includes streamlined functions that support all the regional businesses and comprises Group Funding and Corporate Centre activities.

At September 30, 2006 the Group operated around 1,715 outlets and offices worldwide, of which 58% are in Australia, with the largest proportion of the remainder being in the UK. Approximately 12% of the 1,715 outlets and offices are owned directly by the Group, with the remainder being held under commercial leases.

Refer to note 45 in the financial report for details of the principal controlled entities of the Group and note 21 for details of the Group s property, plant and equipment.

Australia Region

The Australia Region of the Group provides a broad range of banking and wealth management products and services. As well as lending and deposit taking, Australia Region includes the Australian cards, custody and other transactional banking operations, as well as its wealth management activities including insurance, investments and superannuation, in both Australia and Asia. It does not include nabCapital s operations in Australia and Asia.

The Australia Region incorporates an extensive distribution network to service customers. At September 30, 2006, there were 85 integrated financial service centres (catering for customers financial advice needs), 186 business banking centres, 110 agribusiness locations, 27 private banking suites, 787 branches and agencies, and over 3,200 Australia Post GiroPost outlets.

Electronic distribution also provides customers with the choice to meet their financial needs via the internet, over the telephone, through more than 1,290 automatic teller machines (ATM) as at September 30, 2006, or through an extensive network of electronic funds transfer point of sale (EFTPOS) terminals. There were over 1.1 million registered internet banking customers at September 30, 2006.

At September 30, 2006, Australia Region had 22,411 full-time equivalent employees.

In 2005, four key strategies were focused upon:

- customer and employee satisfaction;
- simplifying our business through productivity, efficiency and quality gains;
- re-investing in our critical infrastructure; and
- managing our business units for performance.

Key achievements and actions taken during the 2006 year include:

- awarded Bank of the Year in Money Magazine s 2006 Consumer Finance Awards;
- MLC Insurance Limited awarded Insurance Company of the Year 2006 at the Australian and New Zealand Industry Awards;
- updated its brand in February 2006, supported by significant internal and external communications and sponsorship of the 2006 Commonwealth Games, the Socceroos and the Australian Football League;
- Customer First program a reconfiguration of the business and retail network - with rollout in Queensland completed;
- new and enhanced product offerings, which have delivered substantial revenue growth;
- stable net interest margin and overall risk quality;
- cross-selling of Wealth Management products in bank channels up 31% (investments), up 35% (insurance) and up 22% (debt products) in Wealth Management channels on the 2005 year;

- sale of MLC Asia businesses and Custom Fleet business; and
- the final review by an independent expert, PricewaterhouseCoopers, was conducted, following which APRA and ASIC jointly considered that all actions under the MLC enforceable undertakings and directions issued to the relevant MLC group companies are now complete.

Management also continues to drive significant cultural and behavioural change within Australia Region. Recent internal surveys have highlighted improvement in employees sharing a common vision and having clarity about what they need to do to help the region meet its goals and objectives. Importantly customer satisfaction improved significantly this year due to the region s commitment to improving the customer experience in the front line through branch refurbishment, service improvement and product innovation.

Five key themes will guide effort over the next few years:

- improving process quality to increase customer satisfaction and lower costs;
- reducing enterprise costs;
- extending customer relationships, to grow revenue, especially cross-selling;
- renewing infrastructure; and
- creating a distinctive NAB way of working and leading.

Commentary on each of the divisions of the Australia Region is provided below.

Business and Private Banking

The Business and Private Banking operation provides lending, deposit, transaction and specialist services to over 1 million customers, including businesses and high net worth individuals in Australia.

During the 2006 year Business and Private Banking implemented a new operating model bringing together both the product management and distribution management aspects of the business. This change has been instrumental in ensuring a consolidation of the turnaround performance of last year and has enabled a continuation of focused sales campaigns, improved product offerings (eg, Business Options, Business Cash Maximiser and the Portfolio Facility) and increased capacity for our people.

The Company continues to be Australia s largest business lender with a market share of 19.0% (source: RBA financial system, company data, September 2006), and largest business deposit-taker with a market share of over 24.9% (source: APRA banking system, company data, September 2006). The business is underpinned by an extensive distribution network and excellent business bankers. Improvement in processes has led to improved client service and the capacity release for future growth. Emphasis has been on training to ensure the business has strong credit skills and are able to provide value to clients. Growth has also been underpinned by an embedded performance management framework aligned to the Group s corporate principles.

Management are continuing to improve the service and support offered to business customers with the ongoing development of a new business internet banking platform - the foundation release is currently in use with upcoming releases in the first quarter of 2007.

Other key focus areas include the ongoing refinement of the relationship management model, reinforcing sales capability, customer retention, growing deposits, cross-sales and industry specialisation.

Retail Banking

Retail Banking provides lending, deposit and transaction services to approximately 3.2 million retail customers through extensive physical and virtual distribution networks.

The key areas of focus for Retail Banking during the year have been the re-invigoration of the sales channel and product innovation.

The re-invigoration of the retail distribution sales channel has resulted in significant change at the front line. These efforts have concentrated on improving branch sales capability, empowering front line staff and enhancing the customer experience.

A local market operating model was established during the year, with newly appointed regional executives having financial accountability for their local area. Other key initiatives included a realignment of the mobile banker channel, rollout of a new customer segmentation model and branch refurbishment program. This has increased branch home loan sales capability. The refurbishment of 198 branches was completed by September 30, 2006.

As competitive pressure has continued to characterise the external operating environment, product innovation has been another important area of focus. New products launched during the year have included the Velocity Card, Low Rate Visa Card, Custom Home Loan and the NAB Investment Cash Manager. Coupled with new products launched toward the end of the 2005 year (high-yield internet savings account and the Personal Project Loan), these product developments continue to enhance the Group s product offerings and improve sales through targeted campaigns.

Wealth Management

Under the MLC brand, Wealth Management provides investment, superannuation and insurance solutions to 1.9 million retail and corporate customers. As at September 30, 2006, Wealth Management managed approximately $94 billion on behalf of its customers.

Wealth Management s Financial Planning and Third Party division manages relationships with its network of salaried, self-employed aligned and external financial planners, as well as mortgage brokers. The division provides a range of tools and support services to financial planners and mortgage brokers including practice management support, financial planning software, and business growth and efficiency support.

Wealth Management has more than 1,300 aligned and salaried advisers and relationships with more than 1,200 external advisers at September 30, 2006. At the same time, it has relationships with approximately 12,200 brokers.

In its core Australian market, as at June 30, 2006, MLC held the largest share of total individual risk business with a 15.0% share of inforce annual premiums (source: DEXX&R Life Analysis Report, date: June 30, 2006). At the same time, it was ranked number one in market share of master trusts, with a 15.5% market share of funds under management (source: Plan for Life Australian Retail & Wholesale Investments Market Share & Dynamics Report, date: June 30, 2006).

Focus on the utilisation of the regional model to promote business strategies and deliver improved outcomes for customers continued throughout 2006. Product initiatives in 2006 included:

Masterkey Fundamentals, a no commission version of our MasterKey platform, supporting a growing number of advisers operating under a fee for service model;

MLC Long Term Absolute Return (LTAR) Fund, which is an unconventional investment strategy explicitly designed to maximise the long term net real return to investors over rolling 20-year time frames;

two JANA retail investment trusts; and

MLC EasyCover, a debt insurance solution purpose-built for mortgage brokers.

Wealth Management completed its regulatory undertakings to the Australian Securities and Investments Commission (ASIC) and Australian Prudential Regulation Authority (APRA) and also completed the compensation program for investors in a number of products that were adversely affected by October 2001 unit pricing reductions, as well as two associated historical unit pricing errors.

Asia

The Australia Region is also responsible for the Group s banking and wealth management activities in Asia. In May 2006, the Wealth businesses in Hong Kong and Indonesia were sold to AXA Asia Pacific. The remaining businesses have been consolidated with Hong Kong as the primary base supporting both the Tokyo and Singapore branches. The business commenced a strategic alliance with China Union Pay which claims to have up to 99% of the credit and debit card market in China. Chinese visitors to Australia will have access at NAB ATMs and EFTPOS terminals.

Refer to page 35 for detailed information of the financial performance of the Australia Region.

United Kingdom Region

United Kingdom Region (UK), consists of banking and wealth management activities in the UK that provide financial solutions to approximately 3.1 million customers in the UK. It includes nabCapital s operations in the UK. At September 30, 2006, UK had 8,822 full-time equivalent employees.

The Group s activities in the UK operate under two brands, Clydesdale Bank and Yorkshire Bank, within one legal entity, Clydesdale Bank PLC.

Clydesdale Bank was established in 1838 in Glasgow, has a long history of support for Scottish industries and communities, and has been part of the Group since 1987. Clydesdale Bank is one of Scotland s largest retail banks, as well as one of the country s leading business banks. In the 2006 year, Clydesdale Bank has continued to expand its network of Financial Solutions Centres in the south of England.

Yorkshire Bank was founded in 1859 in Halifax, West Yorkshire, and today maintains a strong regional focus in the north of England and the Midlands. Yorkshire Bank has a strong personal customer base and business capability, and has been part of the Group since 1990.

Each bank offers a broad range of financial products and services to both retail and business customers. Products and services provided by Wealth Management and nabCapital offer customers a further range of financial solutions.

Following the sale of Northern Bank Limited and National Irish Bank Limited to Danske Bank A/S in February 2005, the Group provided transitional services to Danske Bank A/S in respect of the Northern Bank Limited and National Irish Bank Limited operations to assist in the transition of ownership of those businesses. These transitional services were provided at cost and ended in April 2006. Subsequently, any ongoing services provided to Danske Bank A/S have been on commercial business terms.

In the 2005 year, the Group recorded a provision of $266 million to cover costs of restructuring initiatives including the streamlining of operations, reductions in staffing levels and the reconfiguration of its distribution networks. It was anticipated that the restructuring would lead to a total reduction of approximately 1,700 positions across the UK over a 12-to-18 month period, together with the closure of approximately 60 Clydesdale Bank branches and 40 Yorkshire Bank branches. This decision reflected the changing needs of customers and the different ways in which they are banking. The branch closure programme was completed in March 2006, six months ahead of schedule, with a total of 105 branches closed and 99% of the reduced staffing positions being achieved by September 30, 2006.

At September 30, 2006, the Group s UK distribution network comprised 153 Clydesdale Bank branches, 190 Yorkshire Bank branches and 74 Financial Solutions Centres, supported by 2 customer contact centres, internet banking, telephone banking and 921 ATMs.

During the 2006 year, a further 6 Financial Solutions Centres were opened in the south and, as at September 30, 2006, there were 38 centres operating in Scotland and the north of England and 36 centres operating in the south of England. Financial Solutions Centres offer integrated business and private banking services to small-medium sized business customers.

In the retail distribution network, the branch network rationalisation has been completed and other locations with potential have been reinforced with investment in flagship branches, which handle micro businesses as well as retail customers.

Further expansion into the mortgage intermediary market continued with the marketing of Clydesdale Bank branded mortgage products through third party distributors. As at September 30, 2006, more than 450 broker relationships have been established.

In July 2006, Clydesdale Bank established an offshore branch banking operation in Guernsey, initially taking deposits with plans to expand the range of services offered.

Further progress has been made toward centralising, streamlining and simplifying technology and operations. Customer Connect , which is the Bank s sales and service illustration tool, has been rolled out to all Yorkshire branches and a new teller system is now successfully operating in over half of those branches. The programme of process simplification and workload removal has continued with greater process and transaction centralisation. In addition, the processing of third party originated mortgages and procurement was outsourced during the year.

Rationalisation of products continues with a planned reduction in product numbers over the next 12-18 months. New base rate tracker mortgage and savings products and offshore deposit products have been launched to enhance our product offerings.

Major pension reforms were implemented during the 2006 year following consultations with staff, unions and pension fund trustees, including a ballot of employees to seek their agreement to the revised benefits. This has resulted in the three defined benefit schemes moving from final salary to a career average structure for benefits accrued from April 1, 2006. As part of the reforms, the Group made a one-off contribution across the defined benefit schemes during the 2006 year and improvements were made to the defined contribution scheme.

Attention has also been directed to further develop talent and the quality of leadership. A branch development programme has been undertaken with more than 200 senior retail staff to enhance leadership skills in areas such as coaching, mentoring and performance management.

Refer to page 36 for detailed information of the financial performance of United Kingdom Region.

New Zealand Region

New Zealand (NZ) Region consists of NZ Banking and Wealth Management activities, and at September 30, 2006 had 4,505 full-time equivalent employees. It does not include nabCapital s operations in New Zealand.

NZ Banking represents the retail and business banking arm of the Group in NZ, which together with nabCapital operates under the Bank of New Zealand (BNZ) brand. Custom Fleet s operations in NZ were also part of NZ Banking until they were sold on July 31, 2006. NZ Banking provides financial solutions for 1.1 million customers at September 30, 2006 and is the primary contributor of the NZ financial result. The Investment Management arm of the Wealth Management operations was sold during January 2006.

BNZ, acquired by the Group in 1992, is one of the largest financial service providers in NZ and has a strong brand position with comprehensive coverage in a very competitive market.

BNZ has strong market share positions in business, corporate, agribusiness and cards. A major component of BNZ s longer-term strategy is also to drive growth in key personal market segments of housing, small-medium enterprises and youth.

BNZ continued its strong programme of re-investing in its people, products and infrastructure which is reflected in gains in customer satisfaction and brand awareness, and BNZ winning domestic and international awards for its Customer Contact Centres.

Focus on people development, performance and customers, and the ongoing enhancement of the physical distribution network, coupled with improved technology, automation and functionality through electronic and remote channels, continue to be core to the strategy. This, together with the strategic decision to discontinue the mortgage broker distribution channel, reflects BNZ s vision to empower its customers with a range of convenient and cost-effective channels.

The distribution network at September 30, 2006 comprised of 180 outlets, 402 ATMs, and shared access to an extensive nationwide EFTPOS network. BNZ also has well-established telephone banking capabilities, in addition to its internet banking service catering for more than 310,000 registered users as at September 30, 2006.

Refer to page 37 for detailed information of the financial performance of New Zealand Region.

nabCapital (formerly Institutional Markets & Services)

nabCapital is a global business with operations in Australia, the United Kingdom, New Zealand, United States and Asia. At September 30, 2006, it had 2,075 full-time equivalent employees. nabCapital provides debt financing, financial risk management and investor services and products to the Group s customers, and trades financial risk management products. It is also responsible for the management of relationships with top tier corporate clients and financial institutions.

In July 2006, the business was reorganised to establish two global business lines Global Markets and Structuring & Investments - and three regionally focused businesses, Australia (including Asia and the US), the United Kingdom and New Zealand.

Global Markets is focused on traded products and financial risk management solutions. It provides foreign exchange, money market, commodities and derivatives products globally through a dedicated 24-hour dealing capability. Structuring & Investments is responsible for manufacturing investment products and managing nabCapital s assets. The three regions are responsible for managing the franchise and customer relationships, including the provision of corporate finance products and services such as project finance and leveraged finance.

The reorganisation of the business ensures nabCapital s structure aligns to its operating model of originating a more diverse mix of funding and risk management products, repackaging or warehousing the risk around those products, and distributing them to a larger pool of investors. This has helped nabCapital maintain its strong position in Australian bonds, loan syndications and project finance league tables (source: Thomson Financial and Dealogic), and saw positive movement in client satisfaction measures.

A strong emphasis on remediation work remains. The cultural change agenda continues with two-thirds of nabCapital employees participating in a cultural diagnostic which is helping to shape the next steps in the cultural development of nabCapital. In addition, nabCapital has initiated a three year Strategic Investment Program aimed at delivering a simplified, flexible, and cost effective business and technology platform to support its growth initiatives.

The move during the year to a new name and a distinct brand identity reflects more accurately the nature of the business. The new branding applies to nabCapital s global operations except in New Zealand, where it continues to operate under the Bank of New Zealand brand.

Refer to page 38 for detailed information of the financial performance of nabCapital.

Other

The Group s Other business segment includes streamlined functions that support all the regional businesses and comprises Group Funding and Corporate Centre activities. Group Funding acts as the central vehicle for movements of capital and structural funding to support the Group s operations. Corporate Centre activities include strategic development of the portfolio of businesses, financial and risk governance, developing and retaining talent, capital and balance sheet management.

Employees

The following tables summarise the Group s staffing position as at September 30:

	2006 Number	2005 Number	2004 Number
By geographic region			
Australia	**24,263**	23,554	24,567
Europe	**9,197**	9,868	13,324
New Zealand	**4,686**	4,814	4,766
United States	**93**	114	141
Asia	**194**	583	719
Total full-time equivalents *(1)*	**38,433**	38,933	43,517

	2006 Number	2005 Number	2004 Number
By line of business			
Australia Region	**22,411**	22,136	23,128
United Kingdom Region	**8,822**	9,480	12,865
New Zealand Region	**4,505**	4,645	4,596
nabCapital	**2,075**	1,993	2,073
Other	**620**	679	855
Total full-time equivalents *(1)*	**38,433**	38,933	43,517

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(1) *Full-time equivalent employees (FTEs) includes part-time (pro-rated) and non-payroll FTEs (ie. contractors).*

The Group s full-time equivalent (FTE) employee numbers decreased by 500 or 1.3% to 38,433 during the 2006 year. This decrease primarily reflects the following:

the sale of the Group s Custom Fleet and MLC Asia businesses which reduced FTE by 923;

restructuring activities, particularly in Australia and the United Kingdom, which decreased FTE by 1,654; partly offset by

the uplift associated with projects and business initiatives, which increased FTE by 1,815.

The Group s FTE employee numbers decreased by 4,584 or 10.5% to 38,933 during the 2005 year. This decrease primarily reflected the following:

the sale of Northern Bank Limited and National Irish Bank Limited, which had 2,712 FTE at September 30, 2004; and

the significant restructure, reorganisation and integration of all of the Group s businesses, particularly in the Australia, United Kingdom and nabCapital segments, amounting to a reduction of 1,964 FTE.

Refer to page 47 for further information on the Group s restructuring expenses and provisions recorded by the Company during the 2005 year.

The Group continues to work professionally and constructively with the unions in Australia, United Kingdom, New Zealand and in other countries where the Group operates, recognising their members as key stakeholders in the organisation. The Group utilises a number of industrial instruments including individually negotiated contracts and collective agreements.

In Australia, there is a single enterprise agreement, which comprises the terms and conditions for all employees. This agreement was developed and negotiated with the Finance Sector Union and was certified in

February 2006. The agreement replaced all previous agreements and some site agreements to provide a single consolidated version for Australian employees. The agreement runs from 2006 to 2009 and provides for a total of 4% pay increase each year for all employees, excluding those on management levels.

Bank of New Zealand has a collective agreement covering the branch network, contact centres and back-office locations. This collective agreement was renegotiated with FinSec late in calender 2005 and runs from November 2005 to October 2007. A pay increase of 4.35% was paid to these employees in November 2005, with a further 4% paid in November 2006.

Pay negotiations commenced with the UK union, Amicus, during November 2005. A single negotiation process replaced the three separate pay negotiations previously conducted annually. A pool of 3.3% was paid to these employees with a further 0.1% available for lower paid employees.

For further information on the remuneration and reward policies offered by the Group, refer to the remuneration report on pages 78 to 93 of this annual financial report and note 41 shares, performance options and performance rights and note 52 equity instrument holdings of key management personnel in the financial report.

Economic outlook

This section contains forward-looking statements. *Refer to forward-looking statements on page 4.*

Global economic conditions remained strong in 2006. While the US expansion has begun to moderate, China and more generally developing economies performed very strongly. In addition Japanese activity picked up significantly and the Euro area has improved.

Business conditions in the countries that contain the bulk of the Group s assets remained solid but varied by regions and sectors. In New Zealand, slow growth emerged as households adjusted to higher interest rates and cooling property markets. Australian activity remained strong and unemployment levels continue to fall. Resource and related sectors and regions were boosted by high commodity prices, while conditions moderated in retail and manufacturing sectors. UK activity picked up with contributions from both household spending and business investment.

The global growth outlook is for a moderation in activity in 2007. The normalising of interest rates and continued high oil prices are expected to continue to slow the pace of the current global expansion. Growth is also expected to be sustained in the Group s main operating regions. In Australia, some moderation in domestic spending is expected. The drought and slower domestic demand is expected to impact growth. Faced with capacity and inflationary pressures, New Zealand looks set to sustain slow growth in domestic spending. In the UK, growth is expected to remain reasonable with a strong services sector but a weak manufacturing sector.

The Group s main areas of operation continue to face similar economic risks and vulnerabilities. External imbalances and already stretched fiscal positions especially in the US and Europe might limit any response to any increased geopolitical tensions. Any disruption to the current strong growth in China and other emerging economies would also be expected to lead to a marked revaluation of global income growth and asset prices. On the other hand, overly aggressive action by central banks in response to inflation pressures could also trigger negative wealth effects and a marked slowdown in household spending.

Competition

The Australian financial system is characterised by intense competition from a large number of traditional and new players, and well-developed equity and corporate bond markets. There are four major national banks and many other financial conglomerates with national operations offering a complete range of financial services, as well as a number of smaller regional institutions and niche players. Non-bank financial institutions are a force in the Australian financial system, although many have demutualised over the past decade to capture capital-related and other competitive advantages. Non-bank financial institutions offer a wide portfolio of products and services including insurance, investments and superannuation (pensions).

Competition also comes from numerous Australian and, in many cases, international non-bank financial intermediaries including investment and merchant banks, specialist retail and wholesale fund managers, building societies, credit unions and finance companies. Product and functional specialists operate and are important players in the household and business mortgage, credit card deposit and other payment services markets. The rapid development and acceptance of the internet and other technologies have increased competition in the financial services market and improved choice and convenience for customers.

These forces are evident across all of the Group s businesses in each of its geographic markets. Within the broader financial services industry, increased competition has led to a reduction in operating margin, partly offset by fees and other non-interest income and increased efficiencies. The latter has been largely achieved through greater investment in new technologies for processing, manufacturing and retailing products and services. These trends towards increasingly contestable markets offering improved access, wider choice and lower prices for customers are expected to continue in the future.

Risk management

Introduction

Effective management of risk is a key capability for a successful financial services provider, and is fundamental to the Group s strategy. A key component of the Group s risk management strategy is the establishment by the Board of a formal risk appetite statement for the Group.

This places an overall limit on the total amount of risk that the Group is prepared to take. That position is set with respect to the returns that the Group is seeking to provide to shareholders, the credit rating that the Group is seeking to maintain, and the Group s capital position and desired capital ratios.

This position informs the Group s risk, capital and business management limits and policies. It is periodically reviewed by the Board as a part of the strategic planning process, or as the commercial circumstances of the Group change.

The Group manages risk within an established three lines of defence framework. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions at both a Group and regional level, which are accountable for independent monitoring and oversight. The third line of defence relates to Internal Audit independently reviewing, monitoring, and testing business unit compliance with risk policies and procedures, and regularly assessing the overall effectiveness of the risk management framework. Control is exercised through clearly defined delegation of authority, with clear communication and escalation channels throughout the organisation.

The Group Risk Management Committee, chaired by the Group Chief Executive Officer, serves as the principal risk strategy and risk policy decision making management body within the Group, and provides the Board with assurance in the performance of the overall risk management framework. This committee is supported by five sub-committees Group Credit Risk Committee, Group Market Risk Committee, Group Operational Risk and Compliance Committee, Group Asset and Liability Committee, and Group Economic Capital Committee each with a specialised focus.

Each of the four major regions also has a regional Risk Management Committee comprised of senior regional executives, which serves to provide a leadership focus on key risk issues within the region.

Refer to page 61 for Risk Committee members, responsibilities and charter.

In response to the March 2004 APRA report on the foreign currency options trading losses, significant progress has been made to improve market risk systems, governance processes, and organisational culture although the organisation continues to invest in further development of systems and culture. Key outcomes include the reopening in May 2005 of the foreign currency options trading desk, closure of all governance and culture related remedial actions in April 2006 and in December 2006, APRA approved the return to the use of the internal model for the calculation of the market risk component of risk weighted assets, from January 1, 2007.

Risk factors

The following are certain risk factors that may impact the Group s future results. The factors discussed below should not be considered to be the complete list of all potential risks.

For a discussion of the Group s risk mitigation procedures, refer to risk mitigation on pages 16 to 20.

Credit risk

As a financial institution, the Group is exposed to the risks arising from changes in credit quality and the ability of the borrowers or counterparties to fulfil their contractual obligations under loan agreements or other credit facilities. The Group s provision for doubtful debts provides for loan losses incurred in loans and advances. Estimating losses incurred in the loan portfolio is of its very nature uncertain and the accuracy of those estimates depends on many factors, including general economic conditions, rating changes, structural changes within industries that alter competitive positions, and other external factors such as legal and regulatory requirements.

Market risk

The Group s earnings are also subject to a range of market risks, principally changes in market interest and foreign exchange rates, equity and commodity prices, and associated financial derivatives.

Liquidity and funding risk

The Group is exposed to liquidity and funding risk and its banking entities must comply with the relevant regulatory liquidity requirements of the banking and other regulators in the countries they operate in.

Operational risk

As a financial services group, the Group is exposed to operational risks, being the risk of loss resulting from inadequate or failed processes, people or systems or from external events.

Pension risk

Pension risk is the risk that, at any point in time, there are insufficient funds available to meet the pension obligations due now and in the future. There are a number of factors that underpin pension risk, each with differing characteristics. Broadly, pensions risk can be described as being the aggregation of asset risk, liability risk and accounting risk. The Pension Group s principal exposure to pension risk is in the UK business.

Regulatory risk

The Group is subject to substantial regulation in the countries where it operates. The Group s businesses and earnings maybe affected by fiscal or other policies that are adopted by various regulatory authorities, or the failure to meet the requirements of those regulators.

Changes or developments in regulations, including accounting standards, could impact the earnings performance of the Group. The nature and impact of future changes in such policies are not predictable and are beyond the Group s control.

Regulatory agencies have broad administrative power over many aspects of the Group s business, including liquidity, capital adequacy and permitted investments, money laundering, privacy and record keeping. Financial services laws and regulations currently governing the Group, the Group s branches and subsidiaries may change in ways that could have an adverse impact on the Group s business. Also, bank regulators and other supervisory authorities in Australia, the United Kingdom, the US and elsewhere continue to examine payment processing and transactions under regulations governing such matters as money laundering, prohibited transactions with countries subject to sanctions and other anti-corruption matters. If the Group fails to respond appropriately to regulatory developments, actions or measures, the Group s reputation could be harmed and could be subject to additional legal risk, such as fines or penalties.

Strategic risk

Strategic risk is the current or prospective risk to earnings and capital arising from poor business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. These include the quality of the strategic planning process, the achievability of the strategy, the implications of the strategy on risk appetite and the nature of products, services and customers targeted.

Business conditions and general economy risk

As an international financial services group, the Group s businesses are affected by conditions in the markets in which it operates. The profitability of the Group s businesses could be adversely affected by a worsening of general economic conditions in Australia, New Zealand, the UK, the US, or elsewhere, as well as by foreign and domestic trading market conditions.

Legal risk

The Group may be and is subject to legal proceedings, including tax disputes with the taxation authorities in Australia and New Zealand. The outcome of these proceedings could affect earnings.

Refer to note 46 in the financial report for further information on the Group s contingent liabilities, including the tax disputes.

Fluctuations in currency exchange rates

As the Group prepares its annual financial report in Australian dollars, changes in currency exchange rates, particularly between the Australian dollar and the British pound, NZ dollar or US dollar, may have an adverse effect on the earnings that it reports.

Other

Many other types of risks such as those pertaining to payment systems, computer systems fraud, legislative compliance, business continuity, disaster recovery and e-commerce risks exist and are managed throughout the Group.

Risk mitigation

For the major areas of risk, the processes for managing these risks is discussed below:

Credit risk

The Group s credit risk management infrastructure is designed to provide sound management principles and practices to maintain appropriate asset quality across the Group.

The Group has dedicated divisions within Group Risk Management, responsible for the development and maintenance of credit policies, large counterparties credit approvals, and the development and maintenance of key credit risk systems.

Establishing an appropriate credit risk environment

Significant credit risk strategies and policies are reviewed and approved annually by the Risk Committee of the Board, and ultimately the Board. Through such policies, the Board establishes the Group s tolerance for risk. These policies are delegated to management and administered under their guidance and control.

Single large exposure policies and industry concentration limits are in place across the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the regional boards and the Board, and, where required, to the relevant supervisory authorities.

Operating under a sound credit granting process

The Group has established processes for the origination of credit. Key considerations include:

- establishment of overall credit limits at the level of both individual counterparties and groups of connected counterparties for on- and off-balance sheet exposures;
- satisfaction with repayment capacity and integrity of the counterparty;
- use of financial covenants;
- use of collateral;
- consideration of economic and industry conditions; and
- an objective customer risk rating assessment system.

Supporting these considerations are defined and documented policies and processes for the origination of credit. The key elements of the process include:

- clearly defined authorities for the approving of credit; and
- a system of overview of credit approvals by a higher level of authority to ensure adherence to policies and good credit practice.

The delegated authorities are aligned to the counterparty risk by the inclusion of customer risk ratings in the authority matrix. The Group s credit rating system is based on probability of default of a counterparty and provides differentiation of credit risk and focus in pricing for risk.

For consumer credit, scoring systems are in place and are supported by appropriate monitoring tools. These tools provide the essential continual review of data integrity, scorecard performance and decision strategies.

Software to validate and verify input data is used globally to support data integrity and counteract fraudulent activity.

Maintaining adequate controls over credit risk

Monitoring the condition of individual credit exposures in the business units principally rests with the customer-facing relationship managers, with overview by Risk Management credit executives.

There is a formal process, undertaken by specialist units, of independent oversight of credit in each region across the Group. Periodic reporting is submitted to management and the Risk Committee of the Board.

Credit processes and policy compliance are subject to internal auditing. In addition, targeted credit reviews of specific business units or regions are undertaken by Risk Asset Review teams. Credit exposures identified by this team to be outside agreed parameters are reported to the appropriate levels of authority for attention.

Credit exposures showing adverse trends are passed to specialist units that undertake the collections and recovery processes. The Group utilises skilled internal resources supported by external resources. Through the use of due diligence techniques, the Group regularly targets areas of interest or concern within its credit portfolio to review and maintain the quality of the credit portfolio.

The Group also provides quarterly information to APRA, detailing large exposures to individual customers or groups of related customers in excess of 10% of total Tier 1 and Tier 2 capital. APRA applies restrictions on the Group s ability to accept large credit exposures.

Market risk

The management of market risk is segregated between risk derived in the Group s trading activities and risk resulting from mainstream banking activities.

Traded market risk

Traded market risk is mainly due to the trading activity undertaken by the Group through its dealing desks, which focus on traded products and risk management solutions for customers. The Group currently provides foreign exchange, money markets, commodities, credit products and associated derivatives products globally through a dedicated 24 hour dealing capability.

Traded market risk is managed and controlled in accordance with policy approved by the Risk Committee of the Board. Trading is conducted on the basis of specific purpose profit centres authorised to deal in certain instruments approved by a management committee.

Traded market risk is primarily managed and controlled using Value at Risk (VaR) which is a standard measure used in the industry. The global VaR limit is approved by the Board and delegated at the discretion of the Group Chief Executive Officer.

VaR methodology

VaR is an estimate of potential losses resulting from shifts in interest rates, currency exchange rates, traded credit spreads, option volatility, equity prices and commodity prices. The estimate is calculated on an entire trading portfolio basis, including both physical and derivative positions. The Group s VaR is predominantly calculated using historical simulation. This method involves multiple revaluations of the trading books using two years of historical pricing shifts. The pricing data is rolled monthly so as to have the most recent two year history of prices. The results are ranked and the loss at the 99th percentile confidence interval identified. The calculation and rate shifts used assume a one-day holding period for all positions.

In the case of small number of products such as commodities and equities, an alternate contingent loss matrix approach is used. While risk positions in these asset classes are small, efforts are continuing to bring them within the scope of the VaR methodology described above.

The use of a VaR methodology has limitations, which include:

the historical data used to calculate VaR is not always an appropriate proxy for current market conditions. If market volatility or correlation conditions change significantly, losses may occur more frequently and to a greater magnitude than in the VaR measure;

VaR methodology assumes that positions are held for one day and may underestimate losses on positions that cannot be hedged or reversed inside that timeframe;

VaR is calculated on positions at the close of each trading day, and does not measure risk on positions taken and closed before the end of each trading session; and

VaR measure does not describe the directional bias or size of the positions generating the risk.

VaR estimates are checked via backtesting for reasonableness and continued relevance of the model assumptions.

The Group employs other risk measures to supplement VaR, with appropriate limits to manage and control risks, and communicate the specific nature of market exposures to executive management, the Risk Committee of the Board and ultimately the Board. These supplementary measures include stress testing, stop loss, position and sensitivity limits.

Relationship between risk measures

Given the variance in the levels of detail and differing valuation shifts used to calculate these measures, the Group harmonises the specific desk controls with VaR. Market Risk conducts a calibration program supported by ongoing portfolio analysis, to maintain consistency across different risk controls. With the introduction of an Economic Capital framework, the various measures will be linked and derived from the economic capital allocated and used by each of the profit centres within traded market risk.

During the year, the Group s VaR exposure has been maintained within the Board approved limit. The following table shows the Group s VaR for all controlled banking entities trading portfolios, including both physical and derivative positions:

Value at risk at 99% confidence interval	**2006 $m**	**2005 $m**
Average value for year		
Foreign exchange risk	**1**	3
Interest rate risk	**9**	13
Volatility risk	**1**	1
Commodities risk	**1**	
Credit risk *(1)*	**1**	
Diversification benefit	**(3)**	(3)
Total	**10**	14
Minimum value for year *(2)*		
Foreign exchange risk	**1**	1
Interest rate risk	**5**	9
Volatility risk	**1**	1
Commodities risk		
Credit risk *(1)*	**1**	
Diversification benefit	**(1)**	
Total	**7**	11
Maximum value for year *(2)*		
Foreign exchange risk	**4**	7
Interest rate risk	**14**	18
Volatility risk	**1**	3
Commodities risk	**2**	1
Credit risk *(1)*	**4**	1
Diversification benefit	**(10)**	(10)
Total	**15**	20

(1) As of June 1, 2005, market risk included credit VaR as part of the internal model calculation.

(2) VaR is measured individually according to foreign exchange risk, interest rate risk, volatility risk, commodities risk and credit risk. The individual risk categories do not sum up to the total risk number due to diversification benefit.

Non-traded market risk

Non-traded market risk includes structural interest rate risk, structured foreign exchange risk, liquidity and funding risk.

The primary objective for the management and oversight of the risk is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that optimise stable current and future earnings from the impact of market volatility.

Policies, inclusive of risk appetite and limits, are approved by the Board, with Group authority delegated to the Group Asset and Liability Management Committee (Group ALCO) and Regional Asset and Liability Management Committees (Regional ALCOs) for their subsequent implementation and monitoring.

Interest rate risk management across the Group is directed by Group Treasury, with execution on a regional basis.

Risk oversight is the responsibility of the Group Non-Traded Market Risk team which reports directly to the Deputy Group Chief Risk Officer. This team maintains standards of independence and control resilience consistent with traded market risk, with teams in place across the regional businesses.

Structural interest rate risk

Structural interest rate risk is the risk to the Group s earnings and capital that arises out of customers demands for interest rate-related products with various re-pricing profiles. As interest rates and yield curves change over time the Group may be exposed to a loss in earnings and capital due to the re-pricing structure of the balance sheet. It includes:

re-pricing risk the risk of loss of earnings or economic value caused by the differential timing of the re-pricing of assets and liabilities in the banking book;

basis risk the risk of loss of earnings or economic value due to the repricing of assets and liabilities in the banking book relative to different wholesale market rates;

yield curve risk the risk of loss of earnings or economic value due to a change in the slope or shape of the yield curve; and

optionality the risk of loss of earnings or economic value owing to unanticipated changes to balance sheet volumes or rates as a result of embedded options in the banking book.

The objective of the Group is to secure stable and optimal net interest income over both a 12-month period and over the long term, as exemplified via the investment term of equity and non-interest-bearing deposits.

Interest rate risk is principally managed through the use of interest rate swaps, forward rate agreements, overnight index swaps and futures. All products are used within approved mandates, with strategies subject to monthly reporting to Group ALCO and Regional ALCOs.

Basis risk is more difficult to manage, given limited market liquidity in basis risk products. To mitigate this risk, Group Treasury and the Group Non-Traded Market Risk team closely monitor pricing strategies, product innovation and marketing, since these play an important role in reducing the mismatch attributable to repricing characteristics of assets and liabilities provided to customers.

The Group employs VaR as one of its principal measures for interest rate risk, along with an Earnings at Risk (EaR) measure that calculates the impact on future net interest income over the next 12 months. These limit measures are calibrated to calculate structural interest rate risk, incorporating different confidence intervals, holding periods and reporting timeframes than those for traded market risk, and are complemented by sensitivity and scenario analyses.

The table below presents a summary of the aggregated structural interest rate risk relating to non-trading assets and liabilities. The table contains forward-looking statements *(refer to forward-looking statements on page 4)*. Based on the structural interest rate risk position at balance date, the table shows the potential impact on net interest income, for the year ending September 30, 2007 of an immediate 1% parallel movement in interest rates across the whole yield curve.

The non-Australian exposure (expressed in Australian dollars) is the net exposure of offshore controlled branches and controlled entities, excluding life insurance and fund management entities. Structural interest rate exposure in some countries may be biased towards rising interest rates, whilst in others may be biased towards declining interest rates, depending on different economic conditions or cycles.

	Forecast effect on net interest income 2006(1)		Forecast effect on net interest income 2005(2)	
	Rates up 1% $m	Rates down 1% $m	Rates up 1% $m	Rates down 1% $m
Australian Operations	(11)	11	42	(42)
Non-Australian Operations	46	(46)	10	(10)

(1) Represents the forecast effect on net interest income for the year ending September 30, 2007 as calculated by the EaR measure.

(2) Represents the forecast effect on net interest income (as at September 30, 2005) for the year ended September 30, 2006.

Hedging strategies

Regional Treasuries execute hedging strategies to mitigate risk and manage exposures within limits and metrics set by Group and Regional ALCOs, in line with the risk appetite approved by the Board. The Regional Treasuries have a set of approved products to execute hedging strategies, primarily interest rate swaps, forward rate agreements and interest rate futures contracts. These strategies reduce risk via offsetting the exposures to achieve a lower level of VaR/EaR, consistent with the hedge strategy intent. The strategies are targeted to minimise the exposure to a loss of earnings and capital, and are subject to validation by Group Non-Traded Market Risk. In addition to the objective of reducing repricing risk across the balance sheet, the strategies are evaluated with regard to AIFRS reporting requirements. In the majority of cases, hedging relationships that are effective under AIFRS are established. Where the requirements of AIFRS are not met, such derivative financial instruments are classified as non-hedging for accounting purposes.

Hedge relationships are formally documented at inception. The documentation includes identification of the hedged item and the hedging instrument, details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued.

Structural foreign exchange risk

Structural foreign exchange risk arises from investments in the Group s foreign branches and controlled entities. Both earnings and capital are exposed to movements in foreign exchange rates as a result of these investments.

Reported earnings and capital are exposed to movements in exchange rates as a result of the need to translate earnings and net assets of the foreign operations into the Australian dollar consolidated financial statements. This exposure is referred to as an accounting or translation exposure which, in the absence of any long-term realignment in exchange rates, has no lasting impact on underlying economic exposures. As a consequence, the Group does not hedge these exposures as a matter of course.

Transaction foreign exchange exposures arise from the risk that future cash flows will be converted to Australian dollars at less favourable rates than at present. Such cash flows could result from the repatriation of profits or capital back to the Company. The policy of the Group is to fully hedge these exposures at the time of commitment, if they are of a material nature. Hedging of transaction exposures relating to offshore acquisitions and divestments is assessed on a case-by-case basis.

Liquidity and funding risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost, and includes:

intra-day ability of the Group to meet intra-day collateral requirements in relation to clearing and settlement obligations;

operational ability of the Group to meet refinancing requirement for a predefined period i.e. up to 30 days; and

structural liquidity risk profile of the Group balance sheet to accommodate the Group strategic plan and Board risk appetite.

Funding Risk is the appetite and capacity of the market to provide adequate diversified term and short term funds to meet the Group s strategic plan objectives, and includes:

concentration risk - ability of the Group to diversify its funding sources to prevent undue reliance on a single or related counterparties;

tenor risk - ability of the Group to raise adequate longer term funds (maturity at issue in excess of 12 months); and

market access risk - the risk that the Group cannot access the market either domestically or via other banking subsidiaries within the Group at the time funding is needed.

The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal prudential limits that are in addition to regulatory requirements.

Regulatory supervision of banking liquidity in Australia is undertaken by APRA through its Prudential Standard APS 210 Liquidity (APS 210). In accordance with the requirements of APS 210, risk is measured and managed in the Group s banking entities on a cash flow basis. Each regional bank is required to monitor under both going concern and name crisis scenarios, and cash flow mismatch limits have been established to limit the Group s exposure. An additional prudential requirement of the regional banks is to maintain liquid asset portfolios to meet unexpected cash flow requirements.

Regulatory authorities in some countries in which the Group operates impose their own requirements to ensure that liquidity is managed prudently. These requirements may involve the bank maintaining a reserve deposit account with the central bank, holding a portfolio of highly liquid securities and overseeing the internal prudential supervision of liquidity.

Short term funding (under one year) is managed by nabCapital and Regional Treasuries on a Regional basis, consistent with the Group s Liquidity objectives. Funding over one year is managed by Group Treasury.

A three-level contingency plan has been established for the management of an escalated liquidity requirement where the Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers on each level, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

Refer also to liquidity, funding and capital resources on page 24.

Life insurance and funds management market risk

The life insurance business is exposed to market risk arising from adverse movements in market prices affecting fee income on investment-linked policies and the returns obtained from investing shareholder funds held in each life company. Market risk is also affected by mismatches between assets and the guaranteed returns offered on some classes of policy, which may not have been effectively hedged through the matching of assets.

The Group attempts, wherever possible, to segregate policyholder funds from shareholder funds. Appropriate investment mandates are then developed for each. The Group attempts to match asset characteristics with the nature of policy obligations. The shareholder funds are invested so as to meet the likely obligations of those funds in the event adverse risks transpire. However, certain clauses included in policy and sales documents, regulatory constraints or the lack of suitable investments may affect this.

The majority of the policyholder assets are held for investment-linked policies where the policyholder bears the risk of movements in the market value and determines the allocation of the assets. Should markets fall, fee income of the Group will decrease as it is based on the amount of assets invested.

Operational risk

Various reports are produced at management, Board committee and Board level to assist with their oversight and monitoring obligations. This incorporates regional reporting of risk profiles, key operational risk events, as well as consideration of external events and their relevance to the Group. This process generates visibility and understanding of the Group s overall operational risk profile.

The Operational Risk Framework is based on a set of core principles and defines the Group s standards for operational risk management. Its design recognises the importance of embedding operational risk into business-as-usual activities. It has particular focus on defining and implementing the right behaviours and incorporating risk considerations into the Group s systems and processes.

The Operational Risk Framework includes:

- a structured risk management process to facilitate the identification, assessment, quantification, monitoring and management of operational risks within the Group s operational risk appetite;
- systematic management and oversight of the Group s operational risk; and
- reference to the Group Risk Charter which contains an established governance structure that is used to ensure consistent application, management and reporting of the operational risk management process.

Regulatory risk

Regulatory risk arises from the risk of regulatory change or from failure to meet the requirements of law or regulation. Material impacts can include reputation impact, incurring restrictive conditions on how the Group does business or loss or suspension of licence to engage in certain activities. To mitigate this risk, the Group actively participates in regulatory developments with the regulatory authorities of the Australian Government, foreign governments and international agencies. The Group also places significant emphasis on maintaining appropriate internal compliance arrangements to ensure we meet these requirements.

Regulation of the financial services system

Australia

APRA is the prudential regulator of the Australian financial services industry, including authorised deposit-taking institutions (ADIs), life and general insurance companies, reinsurance companies, friendly societies and most members of the superannuation industry. ADIs are bodies corporate such as banks, credit unions and building societies that are authorised by APRA to conduct banking business in Australia.

The Reserve Bank of Australia (RBA) has overall responsibility for monetary policy, financial system stability and, through a Payments System Board, payment system regulation including the operations of Australia s real-time gross settlement system.

ASIC enforces and regulates company and financial services laws to protect consumers, investors and creditors. ASIC is an independent government body that regulates financial markets, corporations, securities, futures and consumer protection in superannuation, insurance and deposit taking.

ASIC has granted the Group its Australian Financial Services Licences issued pursuant to the *Corporations Act* 2001 (Cth). The Group s Australian operations are operating under 19 licences representing the wide variety of financial services that it offers.

The Australian Competition and Consumers Commission (ACCC) administers the *Trade Practices Act* 1974 (Cth). The ACCC promotes competition and fair trade in the market place to benefit consumers, business and the general community.

Consumer affairs offices in each Australian State and Territory are responsible for specific credit and fair trading legislation.

The Australian Transaction Reports and Analysis Centre (AUSTRAC) oversees compliance with the requirements of the *Financial Transactions Reports Act* 1988 (Cth), which obliges the Group to identify its customers and collect and report information about certain transactions. AUSTRAC has dual roles as Australia s anti-money laundering regulator and specialist financial intelligence unit.

The *Banking Act* 1959 (Cth) allows APRA to issue prudential standards that, if breached by ADIs or groups containing ADIs, can trigger legally enforceable directions. Under the *Banking Act* 1959 (Cth), APRA has strong and defined powers to direct the activities of an ADI in the interests of depositors or when an ADI or a group containing an ADI has contravened its prudential framework. These direction powers enable APRA to impose corrective action without taking the step of assuming control. The *Banking Act* 1959 (Cth) also requires an ADI to inform APRA of breaches of prudential requirements and of any materially adverse events (whether in respect of an ADI in a group or the overall group containing that ADI).

APRA has maintained prudential standards covering capital adequacy, market risk, funds management and securitisation, liquidity, credit quality, large exposures, associations with related entities and group risk management, outsourcing, business continuity management, risk management of credit card activities and audit and related arrangements for prudential reporting.

With effect from July 1, 2006, revisions to the prudential standards covering capital adequacy, credit quality, large exposures and funds management and securitisation were issued by APRA to address its response to AIFRS. APRA has also issued two new prudential standards with effect from October 1, 2006, covering fitness and propriety of key responsible persons and corporate governance.

Further, APRA is in the process of fully updating its suite of capital adequacy standards to reflect the introduction of the Basel II Capital Accord framework (*refer to further discussion under changing regulatory environment*).

APRA requires ADIs to provide regular reports covering a broad range of information, including financial and statistical data relating to their financial position and prudential matters. APRA gives special attention to capital adequacy, sustainability of earnings, loan loss experience, liquidity, concentration of risks, potential exposures through equity investments, funds management and securitisation activities, and international banking operations.

In carrying out its supervisory role, APRA supplements its analysis of statistical data collected from ADIs with selective on-site visits by specialist teams to overview discrete areas of banks operations.

APRA also formalises a consultative relationship with each ADI s external auditor with the agreement of the ADI. The external auditors provide additional assurance to APRA that prudential standards applying to ADIs are being observed, and that statutory and other banking requirements are being met. External auditors also undertake targeted reviews of specific risk management areas selected at the annual meeting between the ADI, its external auditor and APRA. In addition, each ADI s chief executive officer attests to the adequacy and operating effectiveness of the risk management systems established to monitor and manage the key risks facing the ADI group.

Under APRA s prudential framework, the Company is required to obtain APRA s prior approval for the establishment or acquisition of a regulated presence domestically or overseas. There are also prior consultation requirements whereby the Company must consult with APRA before establishing or acquiring a subsidiary (other than certain special purpose financing entities), committing to acquire more than a 10% equity interest in an entity that operates in the field of finance, or in certain circumstances taking up an equity interest in an entity in a workout situation. Further, under section 63 of the *Banking Act* 1959 (Cth), without the consent of the Treasurer of the Commonwealth of Australia, no ADI may enter into any agreement or arrangement for the sale or disposal of its business (by amalgamation or otherwise), or for the carrying on of business in partnership with an ADI, or effect a reconstruction.

The Group s wealth management business is regulated by both ASIC and APRA. ASIC administers legislation relating to Wealth Management s key financial services, including managed investments, superannuation, retirement income streams and insurance. Its role is to ensure industry participants comply with legislation, while promoting fair, confident and informed participation in the Australian market by investors and consumers. APRA provides prudential regulation through the oversight of Wealth Management s life insurance companies and approved trustees of superannuation funds and responsible entities of managed investment schemes. As with ADIs, APRA undertakes both off-site and on-site assessment of this activity at both a Wealth Management group and individual entity/business line level. APRA s industry focus over the past year has been on the re-licensing of approved trustees.

Non-Australian jurisdictions

APRA, under the international Basel framework, assumes the role of home banking supervisor and maintains an active interest in overseeing the operations of the Group, including its offshore branches and subsidiaries.

The Group s branch and banking subsidiaries in the UK are subject to supervision by the Financial Services Authority (FSA). The Group s banking subsidiary in New Zealand is subject to supervision by the Reserve Bank of New Zealand (RBNZ). In other offshore areas of banking and wealth management activity, the Group is subject to the operating requirements of relevant local regulatory authorities.

The local UK regulatory frameworks are broadly similar to those in force in Australia, which incorporate risk-based capital adequacy guidelines in accordance with the framework developed by the Basel Committee on Banking Supervision. The FSA also regulates the Group s UK wealth management operations, and is responsible for maintaining market confidence, promoting public awareness, protecting customers and reducing financial crime. The FSA has also introduced since October 2004, comprehensive frameworks addressing the provision of mortgage and general insurance.

In New Zealand, the emphasis of the RBNZ s regulatory approach is primarily on enhanced disclosure and directors attestations to key matters. Under conditions of registration, banks are required to comply with minimum prudential and capital adequacy requirements. The RBNZ monitors banks financial condition and conditions of registration, principally on the basis of published disclosure statements.

The Group s largest branch in the Asian region is in Hong Kong. The primary regulator in Hong Kong is the Hong Kong Monetary Authority, which is responsible for maintaining monetary and banking stability by regulating banking business and deposits and the supervision of authorised institutions.

In the US, branch operations are subject to supervision by the Office of the Comptroller of the Currency. The other key regulators of financial services are the Securities and Exchange Commission (SEC), the Board of Governors of the Federal Reserve System and the Office of Foreign Assets Control.

Changing regulatory environment

Both within the financial services industry and more generally, businesses are working within a changing regulatory environment. An outline of the more significant current or pending regulatory changes impacting the Group is set out in the following sections.

Anti-money laundering

Each of the major countries in which the bank operates are undertaking revisions to their Anti-Money Laundering and Counter Terrorist Financing law and regulation.

On December 12, 2006, the *Anti-Money Laundering and Counter-Terrorism Financing Act* 2006 (Cth) became effective. The Group has been actively working with peer banks and external stakeholders in the development of the act and the attendant rules. The implementation of the requirements within the act will update and revise the anti-money laundering activity undertaken by the bank s Australian business operations. The bank has initiated a change program and project to implement the requirements of the act and rules within the business operations.

Revised requirements are being developed in New Zealand and are anticipated to proceed through the legislative process from late 2007.

The FSA in the UK have revised their approach to anti-money laundering and have updated the anti-money laundering Sourcebook, replacing it with high level provisions in the Senior Management Systems and Controls sourcebook and placing more onus on the Joint Money Laundering Steering Group (JMLSG) guidance. Her Majesty s Treasury approved the revised JMLSG guidance in February 2006. The revised guidance changes the way that the processes designed to detect money laundering and terrorist financing regulation are managed, enabling the UK financial services industry to take a sharper risk-based approach to anti-money laundering activity. The UK is also revising the Money Laundering Regulations in order to implement the requirements contained in the 3rd European Union (EU) Directive.

Basel II Capital Accord

In 1988, the Bank for International Settlements (BIS) developed the Basel Capital Accord that set out international benchmarks for assessing banks capital adequacy requirements. In response to changes in banking practices, BIS reviewed the Basel Capital Accord and released a revised regulatory framework known as the Revised Framework or Basel II. Amongst various objectives the Revised Framework seeks to encourage the development and use of more risk-sensitive capital calculations and to do so through greater use of risk assessments provided by banks own internal systems.

The new framework incorporates changes to the measurement of banks minimum regulatory capital requirements and additional identification of risk types. The framework is structured on:

- minimum capital requirements;
- key principles of supervisory review processes and banks internal capital assessment processes; and
- market discipline (public disclosure).

APRA has commenced releasing draft prudential standards in conformity with the Revised Framework which is expected to commence in Australia at the start of calendar year 2008.

Consistent with APRA requirements, the Group has submitted its first parallel run report for Basel II accreditation. This forms part of an accreditation process that will continue throughout calendar year 2007.

The Group continues to work with its key regulators in Australia and overseas to ensure that the Group s Basel II program aligns with regulatory requirements.

Payment system reforms in Australia

The RBA s reforms which significantly reduce interchange fees for EFTPOS Debit purchases and Visa Debit came into force on November 1, 2006.

Members of the Australian Payments Clearing Association and the RBA have finalised their access regime to allow new entrants to more easily connect to the EFTPOS bilateral network. These reforms have taken effect in September 2006.

UK *Consumer Credit Acts* 1974 and 2006

The provision of credit to personal consumers in the UK is currently regulated by the *Consumer Credit Act* 1974 (CCA). The CCA regulates all aspects of lending to consumers from advertising and documentation through to settlement and default procedures. Major revisions were made to the advertising and documentation regulations in 2004 and 2005. A new *Consumer Credit Act* 2006 (CCA) was passed earlier this year which supplements the 1974 Act.

The provisions of the new Act include:

- new requirements for account maintenance and dealing with default;
- additional scope for borrowers to challenge unfair lending; and
- the removal of the current GBP25,000 financial limit to bring most consumer lending with the scope of the Act.

Implementation is phased, with the majority of the changes taking place in 2008. A project is underway to assess the impact and implement the changes.

MiFID (Markets in Financial Institutions Directive)

MiFID is an EU directive, which will result in a major rewrite of the conduct of business rules for investment services in the UK. It was developed as part of the European Commission s Financial Services Action Plan, and is expected to come into force by November 1, 2007, replacing the current Investment Services Directive.

According to the FSA s November 2005 publication, Planning for MiFID, its implementation will significantly alter financial services regulation in the UK, how firms operate their businesses and the way they interact with customers . Most firms conducting investment business will be affected by MiFID. For example, the FSA will be re-writing significant sections of its handbook, which will affect all firms conducting investment business, changing the nature of their regulatory obligations to clients and their supervisory relationship with the FSA.

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Certain legal proceedings

Entities within the Group are defendants from time to time in legal proceedings arising from the conduct of their business.

The Company received a document request from the SEC Division of Enforcement in February 2004 as part of an investigation into certain Australian registrants and public accounting firms. The SEC Division of Enforcement has requested documents and information and is investigating issues that have occurred since at least as early as October 1, 2000 (the commencement of the 2001 year) regarding independence of the Company s former auditor, KPMG, and regarding the Company s accounting and internal controls, including the unauthorized foreign currency options trading matter and Homeside US.

During the 2003 and prior fiscal years, KPMG employees performed non-audit services for the Group, including loan reviews in the Credit Restructuring unit in Australia and in the tax and internal audit functions, while on secondment to entities within the Group. KPMG was the external auditor of the Company until January 31, 2005. All KPMG internal audit secondments were terminated by the end of the 2002 year and all KPMG secondments ceased from the end of the 2003 year. KPMG has also informed the Company and the SEC that during the 2004 year, 12 KPMG professionals maintained savings and checking accounts and three had loans with the Company that are not permitted by the SEC s auditor independence rules. While KPMG has reported that some of these circumstances were potential violations of the SEC independence rules, KPMG has advised the Company that it does not consider its independence to have been compromised. The SEC is also reviewing services of KPMG relating to potential or actual borrowers from the Company, such as acting as receiver and manager, investigating accountant, monitoring consultant and an agent for a mortgagee in possession, and legal services provided to the Group by a UK law firm formerly affiliated with KPMG.

The SEC Division of Enforcement has also requested information about the Company s investment in HomeSide US, which resulted in the recognition of a $1,323 million (after tax) impairment loss on mortgage servicing rights (MSRs), $1,436 million provision for changes in valuation assumptions to reduce the carrying value of the MSRs to an estimated market sale value and a $858 million goodwill write down in 2001. The Company has also provided to the SEC information about the Company s unauthorized foreign currency options trading announced in January 2004. In the investigation of these losses, it was found that, in the Institutional Markets & Services division, there was inadequate supervision and failures in control procedures and risk management systems. Following a review conducted by APRA, the Company s prudential regulator, the Company has taken steps to improve its control systems. The issues identified in the APRA review have either been fully remediated or alternative controls have been reviewed and relied upon for financial reporting. A key outcome was the reopening in May 2005 of the foreign currency options trading desk.

The Company continues to cooperate fully with the SEC regarding this matter. While the Company cannot predict action the SEC may take in response to its investigation, it has authority to impose or negotiate a broad range of possible sanctions for any breaches. These include requiring the Company to make a monetary payment, entry of a cease-and-desist order or injunction requiring the Company to cease future violations of the U.S. securities laws or face substantial monetary sanctions, and requiring the Company to improve the Company s internal controls or policies, change or curtail the Company s business, change the Company s management or take other steps, such as engaging an independent consultant to evaluate and report on the Company s controls, policies or other matters and the Company s progress towards improvement within mandated timeframes.

The Group does not consider that the outcome of any proceedings, either individually or in aggregate, is likely to have a material effect on its financial position. Where appropriate, provisions have been made.

For further information on contingent liabilities of the Group including disputes with the Australian Taxation Office and the New Zealand Inland Revenue Department, refer to note 46 in the financial report.

Liquidity, funding and capital resources

Liquidity and funding

The Group s banking entities comply with the regulatory liquidity requirements of the banking regulators in Australia, the United Kingdom, New Zealand, United States and other geographies in which the Group operates as required. The Group s Wealth Management businesses also comply with the regulatory liquidity requirements of its Australian Financial Services Licences and the requirements of its various non-Australian regulators. Liquidity within the Group is also managed in accordance with policies approved by the Board, with oversight from regional and Group Asset and Liability Management Committees *(for further information refer to Risk management on page 15 for a detailed discussion).*

The principal sources of liquidity for the Group are:

- trading securities and investments - available for sale;
- interest received from customer loans;
- customer deposits;
- life insurance premiums;
- proceeds from commercial paper, certificates of deposit, bonds, notes and subordinated debt issues;
- fee income; and
- interest and dividends from investments.

The Group s primary source of funding is from deposits and other borrowings on-demand and short-term deposits, term deposits, and bank issued certificates of deposit. Of total liabilities at September 30, 2006 of $456,813 million (2005: $391,051 million), funding from customer deposits and certificates of deposit (including amounts accounted for at fair value) amounted to $207,745 million (2005: $186,027 million) or 45.5% (2005: 47.6%). Although a substantial portion of customer accounts are contractually repayable within one year, on-demand, or at short-notice, such customer deposit balances have provided a stable source of core long-term funding for the Group.

Deposits taken from the inter-bank market of $37,489 million as at September 30, 2006 (2005: $36,322 million) supplement the Group s customer deposits. The Group also accesses the domestic and international debt capital markets under its various funding programs. As at September 30, 2006, the Group had on issue $68,621 million (2005: $41,490 million) of term debt securities (bonds, notes and subordinated debt including bonds, notes and subordinated debt accounted for at fair value) and the following funding programs available to fund the Group s general banking businesses:

Short-term funding programs:

- US commercial paper program National Australia Funding (Delaware) Inc. (unconditionally guaranteed by National Australia Bank Limited);
- Global commercial paper and certificate of deposit program National Australia Bank Limited;
- Global commercial paper program Bank of New Zealand;

Global commercial paper program Bank of New Zealand International Funding Limited (guaranteed by Bank of New Zealand); and

Euro-commercial paper program Clydesdale Bank PLC.

Long-term funding programs:

Global medium-term note program National Australia Bank Limited, Clydesdale Bank PLC and Bank of New Zealand International Funding Limited (guaranteed by Bank of New Zealand);

Debt issuance program National Australia Bank Limited;

Term certificate of deposit program National Australia Bank Limited;

US extendible note program National Australia Bank Limited;

US medium-term note program National Australia Bank Limited;

Registered transferable deposits program Bank of New Zealand; and

Debt issuance program National Wealth Management Holdings Limited.

Refer to note 32 in the financial report for further details of the Group s funding programs.

At September 30, 2006, the Company s credit ratings were as follows:

	Short-term debt	**Senior long-term debt**
Standard & Poor s Corporation	A-1+	AA-
Moody s Investors Service, Inc.	P-1	Aa3
Fitch, Inc.	F1+	AA

Ratings are not a recommendation to purchase, hold or sell securities, and may be changed, superseded or withdrawn at any time.

The ability to realise assets quickly is an important source of liquidity for the Group. The Group holds sizeable balances of marketable treasury and other eligible bills and debt securities which could be disposed of to provide additional funding should the need arise. As at September 30, 2006, the Group held $13,740 million (2005: $15,154 million) of trading securities and $1,493 million (2005: $3,860 million) of available for sale investments. In addition, the Group held $300,551 million (2005: $264,674 million) of net loans and advances to customers (including loans accounted for at fair value), of which $91,362 million (2005: $79,360 million) is due to mature within one year although a proportion of these maturing customer loans will be extended in the normal course of business.

Within the Group s Wealth Management business, the principal sources of liquidity are premiums received from policyholders, charges levied upon policyholders, investment income and proceeds from the sale and maturity of investments. The investment policies adhered to by the Group s life insurance companies consider the anticipated cash flow requirements by matching cash inflows with projected liabilities.

Based on the level of resources within the Group s businesses, and the ability of the Group to access wholesale money markets and issue debt securities should the need arise, overall liquidity is considered sufficient to meet current obligations to customers, policyholders and debtholders.

The following table sets out the amounts and maturities of the Group s long-term contractual cash obligations at September 30, 2006:

	Payments due by period				
	Less than 1 year $m	**1 to 3 year(s) $m**	**3 to 5 years $m**	**After 5 years $m**	**Total $m**
Long-term debt dated	5,748	29,396	17,288	16,189	68,621
Other debt issues undated				2,274	2,274
Operating leases	364	521	359	1,217	2,461
Capital expenditure commitments	97	1			98
Total contractual cash obligations	6,209	29,918	17,647	19,680	73,454

The above table excludes deposits and other liabilities taken in the normal course of banking business and short-term and undated liabilities, including life insurance policy liabilities.

The following table sets out the amounts and maturities of the Group s contingent liabilities and other commercial commitments at September 30, 2006:

	Amount of commitment expiration per period				
	Less than 1 year $m	**1 to 3 year(s) $m**	**3 to 5 years $m**	**After 5 years $m**	**Total $m**
Contingent liabilities					
Guarantees	1,747	326	666	343	3,082
Letters of credit	4,217	698	1,720	226	6,861
Performance-related contingencies	3,028	219	26	341	3,614
Other contingent liabilities	193				193
Other commercial commitments					
Other binding credit commitments *(1)*	102,175	14,567	7,574	3,942	128,258

Investment commitments *(2)*	1,040				1,040
Total commercial commitments	112,400	15,810	9,986	4,852	143,048

(1) Credit-related commitments arise from contracts entered into in the normal course of business generally relating to financing needs of customers (refer to note 46 in the financial report).

(2) In the normal course of business of the Group s life insurance business statutory funds, various types of investment contracts are entered into that give rise to contingent or future obligations.

Refer to note 46 in the financial report for further discussion of contingent liabilities and credit commitments.

Description of off-balance sheet arrangements (special purpose entities)

Special purpose entities (SPEs) are entities that are typically set up for a specific, limited purpose and generally would not enter into an operating activity or have any employees. These SPEs do not have, or are not reasonably likely to have, a current or future effect on the Company s financial condition, revenue or expenses, and results of operations.

The primary purposes of SPEs relating to the Group are to:

- assist customers to securitise their assets;
- provide diversified funding sources to customers; and
- tailor new products to satisfy customers funding requirements.

The most common form of SPE involves the acquisition of financial assets that are funded by the issuance of securities to external investors. The repayment of these securities is determined by the performance of the assets acquired by the SPE. These entities form an integral part of many financial markets.

The Group generally does not hold any material interest in the SPEs that it sponsors or sets up, but may provide arm s length services to the SPEs. The Group may provide standby liquidity facilities to SPEs. Generally, an SPE may only make a drawing under a standby liquidity facility in certain limited circumstances such as market circumstances (where commercial paper is unable to be issued at an economic rate on a maturity date). Standby liquidity facilities are not available to be drawn where an obligor defaults in respect of assets held by an SPE. If such an event occurs, the commitment in respect of the liquidity facility is reduced to the extent of the amount in default.

An important feature of financial accounts prepared under AIFRS is that they are required to present a true and fair view, which includes reflecting the economic substance of transactions and arrangements and not just their legal form or structure.

Australian Accounting Standard AASB 127 Consolidated and Separate Financial Statements (AASB 127) requires a company to consolidate entities it controls and not just entities in which it has majority ownership. Therefore, an SPE would be required to be consolidated if the Group had the capacity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of the SPE, so as to enable the SPE to operate with it in pursuing the objectives of the Group.

Further, Urgent Issues Group Interpretation 112 Consolidation Special Purpose Entities provides additional guidance as to some of the factors that would indicate control relating to the activities, decision making powers, and exposure to the risks and benefits of an SPE that would generally require the SPE to be consolidated.

An SPE is consolidated in the Group if it either meets the requirements of AASB 127 or if the risks and rewards associated with the SPE lie with the Group such that the substance of the relationship is that of a controlled entity. Substance over form means examining all the agreements in relation to the transaction, including side letters or agreements relating to either the provision of guarantees or collateral on loans, or equity funding based on the value of the entity. The Group, in the ordinary course of business, has established or sponsored the establishment of SPEs for various types of transactions, which are described below.

Asset securitisation

The Group makes use of asset securitisation arrangements. SPEs for securitisation are created when the Group has a financial asset (eg. a residential mortgage loan portfolio), which it sells to an SPE. The SPE in turn sells interests in the asset as securities to investors. This type of securitisation program benefits the Group by providing an alternative source of funding and enables the Group to monetise long-term assets which reduces the Group s credit exposure and positively impacts the Group s regulatory capital requirements.

During the year ended September 30, 2006, the Group securitised Australian residential mortgage loans amounting to $3,406 million. No loans were securitised during the 2005 year. During the year ended September 30, 2004, the Group securitised Australian residential mortgage loans amounting to $2,483 million, and during the year ended September 30, 2001, the Group securitised Australian residential mortgage loans amounting to $1,924 million. Outstanding securitised loans off these programs totalled $4,245 million as at September 30, 2006 (2005: $1,919 million). Neither the Company nor the Group stands behind the capital value or performance of securities or assets of the programs except to the limited extent provided in the transaction documents for the programs through the provision of arm s length services and facilities. The Company and the Group do not guarantee the payment of interest or repayment of principal due on the securities. The Company and the Group are not obliged to support any losses that may be suffered by the investors and do not intend to provide such support. The Company and the Group have no obligation to repurchase any of the securitised loans other than in limited circumstances. The Company has transacted with the SPEs on an arm s length basis to act as servicer in relation to the loans and to provide the SPEs with fixed and basis swaps, and limited redraw and liquidity facilities.

Multi-seller securitisation conduits

The Group manages two multi-seller securitisation conduits, Titan Securitisation Limited and Quasar Securitisation Limited. These conduits provide off-balance sheet funding for the Group s corporate customers. This type of securitisation program has no material impact on the Group s liquidity, capital resources or credit risk because the substance of the economic arrangement is to provide a securitisation service to the Group s customers. These securitisation conduits use SPEs to provide access to funding via the asset-backed commercial paper and medium-term note (MTN) investor markets.

These securitisation arrangements generally involve the sale of financial assets by customers to SPEs, which then issue commercial paper or MTNs to fund the purchases. The assets acquired by the conduits, which totalled $5,589 million at September 30, 2006 (2005: $3,479 million), included debt securities, mortgages, lease receivables, commodity receivables and loans. These financial assets do not represent assets of the Group and are not reported on the Group s balance sheet at September 30, 2006. Certain administrative activities and the provision of liquidity and credit facilities to the programs are performed by the Group under arm s length contracts that it or the conduits independent board of directors can terminate. Fees received by the Group for performing these services are recorded as fees and commission income when earned.

Repackaging securitisation

The Group sponsors and manages a special purpose vehicle, Script Securitisation Pty Limited (Script). Script raises funds by issuing debt instruments to customers of the Group and uses those funds to acquire or invest in assets such as approved investments and derivative contracts. Approved investments can consist of appropriately rated debt instruments or other securities. The assets acquired by Script are ring fenced and are intended to generate sufficient income and principal to cover the liabilities of Script linked to those assets. This type of securitisation or repackaging arrangement has no material impact on the Group s liquidity, capital resources or credit risk because the substance of the economic arrangement is to provide a securitisation service to or provide investment product for the Group s customers.

Structured finance transactions

The use of an SPE to isolate cash flows and assets is common in the banking industry to enable a customer to minimise their funding cost or maximise their investment returns, and the bank to have access to specific collateral. The Group has relationships with numerous SPEs to provide financing to customers. Any financing relationships are entered into under normal lending criteria and are subject to the Group s credit approval process. The assets arising from these financing activities are generally included in loans and advances to customers, investment securities, or shares in entities and other securities depending on the economic substance of the transaction. The Group also has relationships with SPEs to enable the placement of customers surplus funds with the Group. These surplus funds are in all cases included in the Group s balance sheet as deposits and other borrowings.

Capital resources

The Group assesses its capitalisation against market, regulatory and ratings agency expectations, having regard to Australian and international peers, and the Group s own asset base, risk profile and capital structure. The Group believes it has sufficient capital to meet current and likely future commitments.

Capital adequacy

The Group s primary prudential supervisor is APRA. APRA establishes capital adequacy requirements on banks, the prime objective of which is to ensure that an adequate level of capital is maintained, thereby providing a buffer to absorb unanticipated losses. Consistent with the international standards of the Basel Committee on Banking Supervision, APRA s current approach, in accordance with Basel I to assessing capital adequacy of banks, focuses on three main elements: the credit risk associated with a bank s exposures, the market risk associated with a bank s trading activities, and the form and quantity of a bank s capital.

In order to provide a broad indication of relevant credit risk, all assets are allocated into four categories of risk weighting (0%, 20%, 50% and 100%). The assets to which those weightings apply are described more fully below *(refer to risk-adjusted assets and off-balance sheet exposures)*. Off-balance sheet transactions are converted to balance sheet equivalents, using a credit conversion factor, before being allocated to a risk-weight category.

Off-balance sheet activities giving rise to credit risk are categorised as follows: direct credit substitutes such as financial guarantees and standby letters of credit; trade and performance-related contingent items such as performance bonds, warranties, and documentary letters of credit; long-term commitments such as formal credit lines with a residual maturity exceeding one year; and market-related transactions such as foreign exchange contracts, currency and interest rate swaps and forward rate agreements.

Market risk is defined as the risk of losses in on- and off-balance sheet positions arising from movements in market prices pertaining to interest rate-related instruments and equities in the trading book, and foreign exchange risk and commodity risk throughout the Group. APRA s current capital requirements for market risk, which involves creating equivalent risk-weighted exposures *(refer to risk-adjusted assets and off-balance sheet exposures on page 31)* are broadly consistent with the recommendations of the Basel Committee on Banking Supervision.

For regulatory purposes, capital comprises two elements, eligible Tier 1 and Tier 2 capital, from which certain deductions are made to arrive at Tier 1 and Tier 2 capital. Tier 1 capital includes paid-up ordinary shares, hybrid instruments (such as National Income Securities), reserves (excluding asset revaluation reserves, cash flow hedging reserves and the general reserve for credit losses), retained profits less goodwill and other intangible assets, and certain other deductions. In addition, where recognised deferred tax assets are greater than deferred tax liabilities, the net deferred tax asset is deducted from Tier 1 capital. Tier 2 capital includes a portion of asset revaluation reserves, collective provisions for doubtful debts (net of associated deferred tax assets) and the general reserve for credit losses, certain hybrid debt/equity instruments and subordinated long-term debt.

The total amount of the resultant capital is subject to further deductions to form the capital base. Such deductions include net assets in controlled entities that are deconsolidated for regulatory capital purposes and provision of first loss guarantees to securitisation entities. Tier 2 capital is limited to 100% of net Tier 1 capital. Lower Tier 2 capital is restricted to 50% of Tier 1 capital, with Upper Tier 2 representing the balance.

Under guidelines issued by APRA, investments in life insurance and funds management entities are deconsolidated for the purposes of calculating capital adequacy and those activities are excluded from the calculation of risk-weighted assets. The tangible component of such investments, comprising net tangible assets on acquisition, is deducted from the total capital base. The goodwill (being the difference between acquisition costs and the tangible component at acquisition) is deducted from Tier 1 capital. Additionally, any profits from these entities included in the Group s results, to the extent that they have not been remitted to the Company in the form of dividends are excluded from the determination of Tier 1 capital.

As the measure of capital adequacy, Australian banks are required to maintain a minimum ratio of capital base to total risk-weighted assets of 8.0%, of which a minimum of 4.0% must be held in Tier 1 capital. The numerator of the ratio is the capital base. The denominator of the ratio is the total risk-weighted asset exposure (ie. sum of credit risk-weighted exposures and the equivalent market risk-weighted exposure). Ultimately, a breach of the required ratios under the prudential standards may trigger legally enforceable directions by APRA, which can include a direction to raise additional capital or cease business.

The Basel Committee on Banking Supervision has released wide-ranging and detailed proposals for the reform of capital adequacy guidelines for banks known as the Basel II Capital Accord. The Basel Committee on Banking Supervision s reform objective is to develop more risk-sensitive, internationally accepted, capital adequacy guidelines that are aligned more accurately with the individual risk profiles of banks.

Regulatory changes

On May 31, 2006, APRA issued its revised Prudential Standards, APS 110, Capital Adequacy, and APS 111, Capital Adequacy: Measurement of Capital, with related Guidance Notes, to be applied from July 1, 2006. The revised Prudential Standards define how the Group calculates and manages its regulatory capital under AIFRS. Capital adequacy at September 30, 2006 is measured in line with these revised Prudential Standards.

The revised APS 111 redefines Tier 1 capital and introduces the concept of Non-Innovative Tier 1 capital. Up until January 1, 2008, the hybrid limit of 20% applies to total Tier 1 capital before deductions, and could consist entirely of Innovative Tier 1 capital. Innovative Tier 1 capital includes any instrument that includes features such as an incentive for the issuer to call, such as a step-up in distribution rate, or is issued indirectly through a special purpose vehicle. Under the revised APS 111, from January 1, 2008 Residual Tier 1 capital is limited to 25% of net Tier 1, with Fundamental capital representing the balance. Residual Tier 1 is defined as being made up of two categories being Innovative Tier 1, which will be limited to 15% of net Tier 1 capital, and a new category of Non-Innovative Tier 1 representing the balance of residual Tier 1 capital. Non-Innovative Tier 1 capital is defined as perpetual non-cumulative preference shares that satisfy the relevant criteria set out in the related Guidance Note. APRA has confirmed that the Group s National Income Securities will qualify for Non-Innovative Treatment. Fundamental Tier 1 is defined as consisting of paid up ordinary shares, other reserves (excluding general reserve for credit losses, cash flow hedge reserves and asset revaluation reserves), retained earnings, current year earnings and foreign currency translation reserve.

Capital ratios

In addition to the Tier 1 and total capital regulatory capital ratios, the Group also uses the adjusted common equity (ACE) ratio to manage its capital position. The ACE ratio measures the core equity capital available to support banking operations and is generally calculated as Tier 1 capital less residual Tier 1 instruments, the tangible component of the investment in non-consolidated controlled entities and any other items deducted from total capital. The ACE ratio is a key measure used by analysts and rating agencies to assess a financial institution s capital strength.

Capital ratios are monitored against internal capital targets, which are set by reference to factors such as market, regulatory and rating agencies expectations and the Group s risk profile. During the year to September 30, 2006, the Group announced changes to its Board approved target capital ranges. The changes better align the Group s capital ranges with peers and its target credit rating and have a wider spread to accommodate the increased volatility arising from the application of AIFRS. The ranges at September 30, 2006, and comparatives at September 30, 2005 are as follows:

	Target ranges at September 30, 2006 %	**Target ranges at September 30, 2005** %
ACE ratio	**4.25 - 5.00**	4.75 - 5.25
Tier 1 ratio	**6.25 - 7.00**	7.00 - 7.50
Total capital ratio	**10.00 - 10.50**	10.00 - 10.50

The total capital target range reflects the APRA imposed requirement in 2004 for the Group s internal target for total capital to rise to 10.0% of risk-weighted assets. Previously, the Group s internal target capital ratio was 9.0% to 9.5%.

	2006 %	**2005** %
Adjusted common equity	**5.4**	5.5
Tier 1	**7.3**	7.9
Tier 2	**3.9**	3.6
Deductions	**(0.4)**	(1.0)
Total capital	**10.8**	10.5

APRA required regulatory capital to be calculated in accordance with AGAAP accounting principles until July 1, 2006. As a result, 2005 comparatives are calculated under the prudential standards and guidelines applicable at the time and have not been reclassified.

Capital ratios were calculated under AGAAP at September 30, 2005 and AIFRS at September 30, 2006. During the 2006 year, the Group s ACE and Tier 1 capital ratios fell, primarily as a result of the implementation of AIFRS. AIFRS reduced the Group s Tier 1 capital by $3.6 billion mainly relating to defined benefit pension plans and Tier 1 deductions relating to capitalised software and the wealth management business. Following the revision to the Group s targets, the capital ratios are above the Group s stated target ranges at September 30, 2006.

The Tier 1 and Total Capital ratios also reflect the issue of two tranches of National Capital Instruments in September 2006. The Group raised approximately $400 million ($397 million net of issue costs) through the issue of 8,000 National Capital Instruments of $50,000 each. In addition, the Group raised EUR400 million ($679 million) through the issue of 8,000 National Capital Instruments of EUR50,000 each. These securities qualify as Tier 1 capital. An additional impact was the conversion of $566 million in exchangeable capital units into ordinary shares. *Refer to note 33 and note 37 in the financial report for further detail.* Further impacts include the sale of Custom Fleet and the sale of the MLC Asia businesses.

The capital position also increased due to the reinvestment of dividends under the Company s dividend reinvestment plan (DRP), bonus share plan (BSP), and employee share and option plans. During the years ended September 30, 2006 and 2005, 9.1 million and 11.5 million fully paid ordinary shares respectively, were issued under the DRP and BSP to shareholders at varying prices. There was also significant subordinated debt issuance, contributing to Tier 2 capital.

The capital ratios also continue to be impacted by the change in methodology of the calculation of the market risk component of risk-weighted assets from an Internal Model Method to the Standard Method as directed by APRA in 2004. The Standard Method, as prescribed by APRA in Prudential Standard APS 113, limits recognition of portfolio effects on outstanding positions and is substantially more restrictive on the rules regarding the matching of positions. The effect of using the Standard Method was an increase in risk-weighted assets of $9,923 million at September 30, 2006 ($10,076 million at September 30, 2005).

Regulatory capital

	2006 $m	2005 $m
Tier 1		
Contributed equity	**12,279**	11,486
Reserves	**1,064**	667
Retained profits	**14,461**	15,903
Minority interest in controlled entities	**168**	6,224
Total equity *(1)*	**27,972**	34,280
Adjusted for:		
Exchangeable Capital Units - embedded derivative and foreign exchange movements	**572**	
National Capital Instruments - debt *(2)*	**679**	
Treasury shares	**966**	
Eligible deferred fee income	**186**	
Adjusted total equity *(1)*	**30,375**	34,280
Estimated reinvestment under the dividend reinvestment plan and bonus share plan *(3)*	**57**	152
Deduct:		

Banking goodwill	**(553)**	(522)
Estimated final dividend	**(1,367)**	(1,304)
Goodwill and intangible assets - Wealth Management	**(3,921)**	(2,448)
Asset revaluation reserve	**(100)**	(18)
Deconsolidation of Wealth Management profits (net of dividends)	**(110)**	(1,293)
Profit on sale arising from Wealth Management restructure *(4)*	**494**	494
Deferred tax assets (DTA) (excluding DTA on the collective provision for doubtful debts) *(5)*	**(199)**	(143)
Non-qualifying minority interest in controlled entities	**(168)**	(6,224)
Capitalised expenses *(6)*	**(69)**	(195)
Cash flow hedge reserve	**(52)**	
Capitalised software (excluding Wealth Management)	**(687)**	
General reserve for credit losses	**(135)**	
Defined benefit pension surplus	**(161)**	
Total Tier 1 capital	**23,404**	22,779

	2006 $m	2005 $m
Tier 2		
Eligible collective provision for doubtful debts	**1,389**	1,443
General reserve for credit losses *(7)*	**135**	
Total collective provision for doubtful debts	**1,524**	1,443
Asset revaluation reserve	**45**	18
Perpetual floating rate notes	**334**	328
Dated subordinated debts	**9,786**	7,422
Exchangeable Capital Units	**665**	1,231
Notional revaluation of investment securities to market		(18)
Total Tier 2 capital	**12,354**	10,424
Other deductions *(8)*	**(1,351)**	(2,922)
Total regulatory capital	**34,407**	30,281

(1) For the 2005 year, total equity has been calculated on an AGAAP basis. APRA required regulatory capital to be calculated on an AGAAP basis until July 1, 2006.

(2) National Capital Instruments (Euro tranche) issued on September 29, 2006 are classified as debt for accounting purposes but qualify as Tier 1 capital for regulatory capital purposes.

(3) The amount is derived from reinvestment experience on the Company s dividend reinvestment and bonus share plans.

(4) Relates to the profit, arising in the banking group, from the sale of the life and insurance businesses of Bank of New Zealand and National Australia Group Europe to NAFiM subsidiaries on January 1, 2002. The capital position of the National s banking and wealth management entities are separately regulated and assessed. In accordance with this approach, the profit on sale of $494 million arising in the banking entities concerned is recorded as Tier 1 capital of the National. With effect from December 31, 2007, the National expects the regulatory capital treatment to change, and for the profit on sale to be excluded from Tier 1 capital.

(5) APRA requires that any excess deferred tax asset (DTA) (excluding DTA on the collective provision for doubtful debts) over deferred tax liabilities be deducted from Tier 1 capital.

(6) Comprises capitalised costs associated with debt raisings and securitisations. Loan origination fees are now netted against eligible deferred fee income.

(7) In line with APRA s requirements, a general reserve for credit losses was established at July 1, 2006. This is an appropriation from retained earnings to non-distributable reserves and qualifies as Tier 2 capital. The reserve is calculated on a basis which aligns the Group s coverage ratios with the APRA benchmark of 0.5% (post-tax effect) of total risk-weighted credit risk assets.

(8) Includes $1,223 million (2005: $2,922 million) investment in non-consolidated controlled entities, net of intangible component deducted from Tier 1 capital.

	2006 $m	2005 $m
Adjusted common equity		
Total Tier 1 capital	**23,404**	22,779
Deduct:		
National Income Securities	**(1,945)**	(1,945)
Trust Preferred Securities	**(975)**	(975)
Trust Preferred Securities II	**(1,014)**	(1,014)
National Capital Instruments - debt *(1)*	**(679)**	
National Capital Instruments - equity	**(397)**	
Deductions *(2)*	**(1,351)**	(2,922)
Adjusted common equity	**17,043**	15,923

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(1) *National Capital Instruments (Euro tranche) issued on September 29, 2006 are classified as debt for accounting purposes but qualify as Tier 1 capital for regulatory capital purposes.*

(2) *Includes $1,223 million (2005: $2,922 million) investment in non-consolidated controlled entities (net of intangible component deducted from Tier 1 capital).*

Risk-adjusted assets and off-balance sheet exposures

	Balance 2006 $m	Balance 2005 $m	Risk weights %	Risk-adjusted balance (1) 2006 $m	Risk-adjusted balance (1) 2005 $m
Assets					
Cash, claims on Reserve Bank of Australia, Australian Commonwealth and State Governments, OECD central governments and central banks *(2)*	**44,925**	24,852	0		
Claims on Australian banks, local governments and banks incorporated in OECD countries	**13,094**	16,962	20	**2,619**	3,392
Housing loans*(3)*	**148,224**	128,790	50	**74,112**	64,395
All other assets	**197,542**	174,387	100	**197,542**	174,387
Total assets*(4)*	**403,785**	344,991		**274,273**	242,174

	Contract or notional amount 2006 $m	Credit equivalent amount 2006 $m	Risk weights %	Risk-adjusted balance (1) 2006 $m	Risk-adjusted balance (1) 2005 $m
Off-balance sheet exposures					
Financial guarantees, standby letters of credit and other letters of credit	**13,145**	**12,164**	0 100	**6,689**	9,226
Performance-related guarantees, warranties and indemnities	**4,945**	**2,473**	0 - 100	**2,432**	1,731
Commitments to provide finance facilities with residual term to maturity of over 12 months and other commitments	**123,918**	**21,165**	0 - 100	**15,778**	14,428
Foreign exchange, interest rate and other market-related transactions*(5)*	**2,313,958**	**20,384**	0 50	**5,599**	8,981
Total off-balance sheet exposures	**2,455,966**	**56,186**		**30,498**	34,366
Total risk-adjusted assets				**274,273**	242,174
Total risk-adjusted assets and off-balance sheet exposures credit risk				**304,771**	276,540
Add: Risk-adjusted assets market risk*(6) (7)*				**13,552**	13,293
Total assessed risk exposure				**318,323**	289,833

(1) Claims secured by cash, government securities or guarantees from banks and governments reflect the risk weight attaching to the collateral security or a direct claim on the guarantor.

(2) Short-term claims on the Australian Commonwealth Government are those with a residual term to maturity of less than 12 months; longer-term claims are those with a residual term to maturity of greater than 12 months. Both categories held in the banking book attract a 0% risk weighting.

(3) Housing loans approved after September 5, 1994 having a loan to market valuation ratio in excess of 80% must be risk weighted at 100%. However, these loans may qualify for the 50% risk weighting if they are covered by an adequate level of mortgage insurance provided by an acceptable lenders mortgage insurer. These loans are reported under all other assets.

(4) Total assets differ from those in the Group s balance sheet due to the adoption of APRA s classification of certain items for capital adequacy purposes, particularly goodwill and provision for doubtful debts. In addition, fair values of trading derivative financial instruments have been excluded as they have been incorporated into the calculation of the credit equivalent amount of off-balance sheet exposures.

(5) Refer to notes 11 and 58 for additional information on derivative financial instruments.

(6) Under APRA Prudential Standard APS 113 Capital Adequacy: Market Risk , Australian banks are required to hold sufficient levels of capital to cover market risk.

(7) The calculation to determine the market risk capital component of risk-weighted assets at September 30, 2006 and September 30, 2005 was carried out under the Standard Method as directed by APRA. Prior to March 2004, the market risk capital component of risk-weighted assets was calculated using the Internal Model Method. The Standard Method as prescribed by the APRA Prudential Standard (APS 113), limits recognition of portfolio effects on outstanding positions and is substantially more restrictive on the rules regarding the matching of positions.

Financial review

Financial performance summary

	Group	
	2006 $m	2005 $m
Net interest income	**8,686**	6,944
Net life insurance income	**1,417**	1,505
Other income	**5,420**	7,244
Operating expenses	**(7,642)**	(8,743)
Charge to provide for doubtful debts	**(606)**	(534)
Profit before income tax expense	**7,275**	6,416
Income tax expense	**(2,134)**	(1,814)
Net profit	**5,141**	4,602
Net profit attributable to minority interests	**(749)**	(610)
Net profit attributable to members of the Company	**4,392**	3,992

Net profit attributable to members of the Company of $4,392 million in 2006, increased $400 million or 10.0% compared with 2005.

Net interest income of $8,686 million in 2006, was $1,742 million or 25.1% higher than 2005. This result reflects continued solid growth in housing lending and improved business lending, as well as an increase in the net interest margin from 2.13% to 2.31%. The increase also reflects the reclassification of bill acceptance income from loan fees (classified within other operating income in 2005) to net interest income in 2006.

The increase in margins has occurred as a result of AIFRS changes during 2006, which has favourably impacted the net interest margin by 7 basis points. After adjusting for AIFRS impacts during the 2006 year, the net interest margin has increased 11 basis points, primarily due to the reduction in low yielding assets in the Group s businesses. These impacts have been partly offset by continued growth in lower margin mortgages and fixed rate lending within the retail banking businesses, as well as competitive pressures in all regions.

Net life insurance income decreased $88 million from $1,505 million in 2005 to $1,417 million in 2006. This was driven by a decrease in investment earnings resulting from a downturn in global equity markets, partly offset by an increase in policy liabilities and favourable claims experience.

Other operating income of $5,420 million in 2006, was $1,824 million or 25.2% lower than 2005. This outcome reflects:

significant revenue of $319 million due to reforms made to the United Kingdom defined benefit pension funds resulting in the recognition of past service revenue;

significant revenue being the net profit of $1,354 million on the sale of Northern Bank Limited and National Irish Bank Limited (Irish Banks) in 2005;

lower loan fees of $690 million reflecting changes in accounting policy from October 1, 2005 resulting in the reclassification of bill acceptance fees to net interest income and the reclassification of certain loan related fees to net interest income under effective yield requirements, partly offset by growth in third party distribution channels;

on July 31, 2006 the Group sold its Custom Fleet businesses resulting in a net profit from the sale of controlled entities of $196 million before tax;

gains less losses on financial instruments at fair value decreased by $168 million or 26.3% mainly due to a reduction in trading income of $255 million offset by non trading fair value adjustments of $87 million. Trading income reduced largely due to the inclusion of derivative costs associated with short term funding under AIFRS. Under AIFRS, derivatives associated with funding activities are fair valued and recognised in trading income. Previously under AGAAP, these costs were treated as hedges and accrual accounted, and incorporated as part of net interest income; and

revaluation losses on exchangeable capital units of $122 million in 2006.

Operating expenses of $7,642 million in 2006 were $1,101 million or 12.6% lower than 2005. This outcome reflects:

on May 8, 2006 the Group sold its life insurance and related wealth management companies in Asia resulting in a net loss from the sale of controlled entities of $63 million; and

significant restructuring expenses of $793 million in 2005.

Excluding the expenses of disposed operations and significant restructuring expenses, operating expenses increased $104 million or 1.4%, reflecting increased personnel expenses of $229 million as a result of the Group s focus on performance based remuneration and Enterprise Bargaining Agreement related increases. This was partially offset by a decrease in other operating expenses of $123 million. This includes a decrease in operational risk losses of $69 million and a decrease in superannuation charge of $50 million primarily due to reforms made to the UK pension schemes.

The charge to provide for doubtful debts of $606 million in 2006, was $72 million or 13.5% higher than 2005. The increase was primarily due to the deterioration identified in specific consumer segments in Australia in the second half of the year.

Income tax expense of $2,134 million in 2006, was $320 million or 17.6% higher than 2005. The increase in income tax expense in 2006 reflects higher operating profits before tax in all businesses, partly offset by a reduction in tax expense attributable to the statutory funds of the life insurance business. In addition, in 2005, income tax expense was impacted by a one-off tax benefit of $372 million in relation to the non-assessable profit on the sale of the Irish Banks, partly offset by the significant income tax item in respect of the settlement of a tax dispute with the Australian Taxation Office of $97 million in respect of the TrUEPrS[SM] tax matter.

Financial performance adjusted to accord with US GAAP

Adjusted to accord with US GAAP, consolidated net income for the year to September 30, 2006 was $4,232 million compared to $3,891 million in 2005.

Refer to note 57 in the financial report for additional information on the reconciliation with US GAAP and other US GAAP disclosures.

Balance sheet summary

	Group	
	2006 **$m**	**2005** **$m**
Assets		
Cash and liquid assets	**12,768**	8,441
Due from other banks	**24,372**	15,595
Trading derivatives	**13,384**	13,959
Trading securities	**13,740**	15,154
Investments available for sale	**1,493**	3,860
Investments held to maturity	**1,388**	7,466
Investments relating to life insurance business	**54,784**	49,783
Other financial assets at fair value	**22,123**	
Loans and advances	**283,777**	264,674
Due from customers on acceptances	**41,726**	27,627
All other assets	**15,230**	16,039
Total assets	**484,785**	422,598
Liabilities		
Due to other banks	**37,489**	36,322
Trading derivatives	**12,008**	12,613
Other financial liabilities at fair value	**17,680**	1,487
Deposits and other borrowings	**222,277**	212,557
Liability on acceptances	**32,114**	27,627
Life policy liabilities	**46,475**	42,123
Bonds, notes and subordinated debt	**65,006**	41,490
Other debt issues	**2,274**	1,559
All other liabilities	**21,490**	15,273
Total liabilities	**456,813**	391,051
Total equity	**27,972**	31,547
Total liabilities and equity	**484,785**	422,598

Total assets at September 30, 2006 increased by 14.7% to $484,785 million from $422,598 million at September 30, 2005.

Net loans and advances (including loans at fair value) increased $35,877 million or 13.6% to $300,551 million at September 30, 2006. This increase primarily reflects strong growth in housing lending across all regions and continued sound economic conditions, as well as solid business term lending growth.

Due from customers on acceptances increased $14,099 million or 51.0% from $27,627 million at September 30, 2005 to $41,726 million at September 30, 2006. This increase is partly offset by a corresponding increase in liabilities from acceptances. However, as a result of AIFRS transition changes, acceptances repurchased by the Company as part of trading activities have been reclassified from trading securities to acceptances. Excluding the impact of this reclassification, volumes have grown 15.9% during the year as bill acceptances continue to be a product favoured by business customers due to favourable pricing and flexibility.

Investments relating to life insurance business increased by $5,001 million or 10.0% during the 2006 year to $54,784 million. This increase primarily reflects growth in funds under management. The increase was largely offset by an increase in life policy liabilities of $4,352 million or 10.3% to $46,475 million as the movement in investment assets primarily reflects returns made on policyholder contributions to the investment linked businesses.

Amounts due from other banks increased by $8,777 million or 56.3% to $24,372 million at September 30, 2006. This increase was driven by the Group s decision to reduce risk-weighted assets such as marketable debt securities, and reinvest funds in reverse repurchase assets due to its zero risk weighting.

Marketable debt securities (trading securities, available for sale and held to maturity investments) decreased $9,859 million or 37.2% to $16,621 million at September 30, 2006. The decrease in these securities reflects the 2006 AIFRS transition adjustments, including the accounting for acceptances repurchased by the Company and the reclassification of certain securities to other financial assets at fair value.

Total liabilities at September 30, 2006 increased by 16.8% to $456,813 million from $391,051 million at September 30, 2005.

Deposits and other borrowings (including those at fair value) increased by $20,342 million or 9.6% during the year to $232,899 million. This increase reflects sound growth in on-demand and savings deposits, particularly in Australia and the UK and term deposits growth in the UK and New Zealand, partly offset by a decrease in certificates of deposits in Australia reflecting the Group s current strategy of reducing its reliance on short-term borrowings and lengthening its debt maturity profile.

Bonds, notes and subordinated debt (including those at fair value) increased by $27,131 million or 65.4% to $68,621 million at September 30, 2006. The Group has a number of funding programs available, and the increase reflects further issues of the Group s Euro and Domestic medium-term notes programs undertaken to fund asset growth and re-finance maturing short-term and long-term debt. Group subsidiaries also issued debt under the Group s US$30 billion global medium term program.

Total equity in the Group decreased from $31,547 million at September 30, 2005 to $27,972 million at September 30, 2006. However, excluding the impact minority interests relating to the life insurance business of $6,224 million which were reclassified to liabilities from October 1, 2005 under AIFRS, total equity increased by $2,649 million during the year. Total parent entity interest in equity increased by $2,481 million to $27,804 million at September 30, 2006. This increase primarily reflects ordinary share issues, dividend reinvestment and conversion of exchangeable capital units to ordinary shares, as well as the $400 million issue of National Capital Instruments in September 2006.

Balance sheet adjusted to accord with US GAAP

Adjusted to accord with US GAAP, consolidated total assets increased to $485,728 million at September 30, 2006 from $424,628 million at September 30, 2005. Consolidated net assets increased to $25,911 million at September 30, 2006 from $23,385 million at September 30, 2005.

Refer to note 57 in the financial report for additional information on the reconciliation with US GAAP and other US GAAP disclosures.

Return on average equity

	2006 $m	**2005 $m**
Weighted average equity *(1)*	**22,019**	21,074
Return on average equity *(1) (2)*	**18.8%**	18.0%

(1) *Based on average ordinary shareholder funds (refer to page 7 for a reconciliation of average ordinary shareholder funds).*

(2) *Return represents net profit attributable to members of the Company, after deducting distributions on other equity instruments.*

Return on average equity increased to 18.8% in 2006 from 18.0% in 2005. The increase in the return on average equity in the 2006 year compared to the 2005 year has been impacted by the 10.0% increase in net profit, which has more than offset the 4.5% increase in weighted average equity during the year. The increase in weighted average equity reflects the full effect of the issue of Trust Preferred Securities II in the 2005 year and an increase in retained earnings. The increase also reflects an increase in average ordinary share capital as a result of conversions of exchangeable capital units to ordinary share capital and reinvestment of dividends.

Refer to page 32 for a detailed discussion on the Group s improvement in operating performance for the 2006 year.

Earnings and dividends per share

	2006 Cents	2005 Cents
Earnings per share		
Basic	**262.6**	246.3
Diluted *(1)*	**261.8**	242.3
Dividends per share		
Interim	**83.0**	83.0
Final	**84.0**	83.0

(1) Calculated based on the weighted average diluted number of ordinary shares, which includes the impact of performance options and performance rights, partly paid ordinary shares, staff share and allocation and ownership plans and potential conversion of exchangeable capital units, as set out in note 8 in the financial report.

Basic earnings per share increased 16.3 cents or 6.6% in 2006 to 262.6 cents. Diluted earnings per share increased 19.5 cents or 8.0% in 2006 to 261.8 cents. The increase in basic and diluted earnings per share reflects improved earnings in all business segments (after excluding significant items in both the 2006 and 2005 years). *Refer to page 32 for a detailed discussion on the Group s improvement in operating performance for the 2006 year and refer to pages 35 to 39 for a detailed review of the financial performance of the Group s business segments.*

An interim dividend of 83 cents per fully paid ordinary share was paid during the year ended September 30, 2006, compared to an interim dividend of 83 cents per share in 2005. The final dividend declared from the 2006 profit was 84 cents per share, which increased 1 cent from the 2005 final dividend. The 2006 final dividend was paid on December 12, 2006.

The Company expects to continue its policy of paying regular cash dividends; however, there is no assurance as to future dividends. Future dividends will be determined by the Board with regard to the Company s earnings, capital requirements, financial conditions and applicable government regulations and policies. The dividend payout ratio for 2006 was equivalent to 67.4% (2005: 79.6%) of after-tax cash earnings (before significant items), compared to the Board s target range of between 60% to 65%. In addition, the payment of dividends is subject to the restrictions described in note 7 in the financial report.

The interim dividend paid was 80% franked and the final dividend was 90% franked. The franked portion of these dividends carry imputation tax credits at a tax rate of 30%, reflecting the current Australian company tax rate of 30%. For non-resident shareholders for Australian tax purposes, the dividends will not be subject to Australian withholding tax. This is because Australian dividend withholding tax is not imposed on franked dividends, while the unfranked portion of the dividends are paid from the Company s conduit foreign income account which exempts the unfranked dividend from withholding tax.

Net profit by segment

Contribution to Group net profit attributable to members of the Company by operating segment

	2006 $m	2005 $m
Australia Region	**2,515**	1,981
United Kingdom Region	**868**	1,630
New Zealand Region	**389**	307
nabCapital	**618**	503
Other	**2**	(429)
Net profit attributable to members of the Company	**4,392**	3,992

For a detailed discussion of the Group s business operating model, refer to pages 9 to13.

Australia Region

	2006 $m	2005 $m
Net interest income	**4,839**	3,837
Non-interest income	**10,070**	11,848
Net operating income	**14,909**	15,685
Operating expenses	**(10,021)**	(11,120)
Charge to provide for doubtful debts	**(278)**	(257)
Significant items		(406)
Profit from ordinary activities before income tax	**4,610**	3,902
Income tax expense	**(1,346)**	(1,311)
Net (profit)/loss attributable to outside equity interest	**(749)**	(610)
Net profit attributable to members of the Company	**2,515**	1,981
Significant items after tax		287
Net profit attributable to members of the Company excluding significant items	**2,515**	2,268

The region increased its contribution to net profit attributable to members of the Company by $534 million or 27.0% to $2,515 million in 2006, from $1,981 million in 2005. The 2005 result included significant items of $287 million (after tax) in relation to restructuring expenses. Excluding the 2005 significant items, the net profit attributable to members of the Company increased by $247 million or 10.9% to $2,515 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income increased $1,002 million or 26.1% to $4,839 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the reclassification of bill acceptance fees from non-interest income and inclusion of certain loan related fees which are now deferred and amortised in net interest income under effective yield requirements. In addition, net interest income increased due to continued strong growth in volumes in both housing and business lending, as a result of product innovation and the restoration of credit risk settings. Retail deposit volumes also grew due to the introduction of online transaction accounts. The volume increase was partially offset by a 10 basis point reduction in net interest margin to 2.38%, driven by product margin contraction as a result of competitive pressures and adverse changes in product mix caused by the increased proportion of lower margin housing lending in the loan portfolio and lower margin deposit products.

Non-interest income decreased $1,778 million or 15.0% to $10,070 million. This decrease primarily reflects changes in accounting policy from October 1, 2005 resulting in the reclassification of bill acceptance fees to net interest income and the reclassification of certain loan related fees to net interest income under effective yield requirements. There was also a decline in Wealth Management life insurance revenue of $1,204 million, from $8,573 million in 2005 to $7,369 million in 2006. This was impacted by a decrease in investment revenue of $1,183 million (2006: $6,511 million, 2005: $7,694 million) reflecting a downturn in the performance of global equity markets compared to 2005 and is consistent with the decrease in the change in policy liabilities . These decreases have been partly offset by higher fees in banking due to strong growth in transaction and fees driven by lending growth.

Operating expenses decreased $1,099 million or 9.9% to $10,021 million. This decrease was largely driven by a decrease in Wealth Management life insurance expenses of $1,088 million, from $6,915 million in 2005 to $5,827 million in 2006. This reflects a decrease in the change in policy liabilities of $1,114 million (2006: $4,457 million, 2005: $5,571 million) as a result of a downturn in the performance of global equity markets compared to 2005 and is consistent with the decrease in investment revenue. The reduction in operating expenses was also a result of non-depreciation of leased motor vehicles being designated as held for sale from April 1, 2006 up until the sale of the Custom Fleet business on July 31, 2006. This has been partly offset by increased personnel costs reflecting higher annual salaries and enterprise bargaining agreements, net of a reduction in average staff numbers, and higher performance-based remuneration along with increased contractor costs due to increased investment to support frontline operations.

The charge to provide for doubtful debts increased from $257 million in 2005 to $278 million in 2006. This was largely attributable to growth in lending outstandings, a higher specific provision in consumer segments (New South Wales mortgages, credit cards and personal loans) and the internal re-rating of a number of large loans to higher credit risk categories during the year as part of the Group s ongoing credit review process.

For a discussion on the Group s significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group s income tax expense, refer to page 47.

United Kingdom Region

	2006 $m	2005 $m
Net interest income	**1,840**	1,794
Non-interest income	**1,144**	1,249
Net operating income	**2,984**	3,043
Operating expenses	**(1,794)**	(2,036)
Charge to provide for doubtful debts	**(308)**	(216)
Significant items	**348**	1,041
Profit from ordinary activities before income tax	**1,230**	1,832
Income tax expense	**(362)**	(202)
Net profit attributable to members of the Company	**868**	1,630
Significant items after tax	**(250)**	(1,096)
Net profit attributable to members of the Company excluding significant items	**618**	534

The region decreased its contribution to net profit attributable to members of the Company by $762 million or 46.7% to $868 million in 2006, from $1,630 million in 2005. The 2006 result included significant items of $250 million (after tax) in relation to reforms made to the United Kingdom defined benefit pension funds and the release of provisions raised in the 2005 year for disposal costs on the sale of the Irish banks that are no longer required. This compares to significant items of $1,096 million profit (after tax) in relation to the profit on sale of the Irish Banks in 2005, partly offset by restructuring expenses and provisions in 2005. Excluding the 2006 and 2005 significant items the region increased its contribution to the net profit attributable to members of the Company by $84 million or 15.7% from $534 million in 2005 to $618 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income increased $46 million or 2.6% to $1,840 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the inclusion of certain loan related fees that are now deferred and amortised in net interest income under effective yield requirements. The increase reflects the significant growth of the Financial Solutions Centres and third party distribution network with strong underlying volume growth, partly offset by the managed effects of margin contraction and changing portfolio mix along with net interest income earned by the Irish Banks up until their sale on February 28, 2005. Net interest margin declined 18 basis points to 3.51%. A small decrease in balances in higher margin personal loans and credit cards has been offset by strong growth in mortgage and business lending. The margin management across the lending and deposit portfolio through re-pricing has resulted in the anticipated shift to lower margin products by customers. This has been further impacted by the effect of historic high margin product run off as this is replaced with new lower margin offerings.

Non-interest income decreased $105 million or 8.4% to $1,144 million. This decrease primarily reflects changes in accounting policy from October 1, 2005 resulting in the reclassification of certain loan related fees to net interest income under effective yield requirements partly offset by the recognition of hedging ineffectiveness and fair value movements on trading financial instruments. There has also been a decrease as a result of the sale of the Group s Custom Fleet business on July 31, 2006 and the Irish Banks on February 28, 2005. This is partly offset by an increase in income from Danske Bank A/S in respect of the provision for transitional services (offset by an increase in expenses) and an increase in fees driven by the growth of the Integrated Financial Solutions centres and third party propositions.

Operating expenses decreased $242 million or 11.9% to $1,794 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the reclassification of certain fees that are now deferred and amortised under effective yield requirements. There has also been a decrease due to benefits flowing through the current year as a result of restructuring initiatives (including staff reductions and other productivity improvements), lower depreciation and fleet maintenance costs on leased vehicle assets as a result of the Group s sale of it s Custom Fleet business on July 31, 2006, lower superannuation expense as a result of reforms to the United Kingdom s defined benefit pension plans, and the sale of the Irish Banks on February 28, 2005. This is partly offset by an increase in the costs associated with transitional services provided to Danske Bank A/S (offset by increase in revenue) and increased personnel costs reflecting higher annual salaries and performance based remuneration.

The charge to provide for doubtful debts increased from $216 million in 2005 to $308 million in 2006. This was driven by market deterioration in credit cards and unsecured personal lending, together with additional collective provision charges as a result of increased lending growth.

For a discussion on the Group s significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group s income tax expense, refer to page 47.

New Zealand Region

	2006 $m	2005 $m
Net interest income	**775**	739
Non-interest income	**525**	552
Net operating income	**1,300**	1,291
Operating expenses	**(678)**	(785)
Charge to provide for doubtful debts	**(46)**	(38)
Significant items		(14)
Profit from ordinary activities before income tax	**576**	454
Income tax expense	**(187)**	(147)
Net profit attributable to members of the Company	**389**	307
Significant items after tax		10
Net profit attributable to members of the Company excluding significant items	**389**	317

The region increased its contribution to net profit attributable to members of the Company by $82 million or 26.7% to $389 million in 2006, from $307 million in 2005. The 2005 result included significant expenses of $10 million (after tax) in relation to restructuring expenses. Excluding the 2005 significant items, the net profit attributable to members of the Company increased by $72 million or 22.7% to $389 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income increased $36 million or 4.9% to $775 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the inclusion of certain loan related fees that are now deferred and amortised in net interest income under effective yield requirements. There was also an increase as a result of strong volume growth in housing and business lending, and retail deposits, partly offset by increased downward pressure on the net interest margin, which declined by 8 basis points to 2.50%. The decline in the net interest margin reflects competitive pressures in the New Zealand market, combined with a change in product mix, as customers continue to move to lower margin fixed rate products.

Non-interest income decreased $27 million or 4.9% to $525 million. This decrease reflects lower rental income from leased assets as a result of the Group s sale of its Custom Fleet business on July 31, 2006. There has also been a decrease as a result of customers moving towards lower cost channels, fee structures and products, reflecting continuing focus by the business on making the customer proposition more attractive offset by an increase in volume-related fees. The changes in accounting policy from October 1, 2005 resulted in a favourable impact from the recognition of hedge ineffectiveness and fair value movements on financial instruments, partly offset by the reclassification of certain loan related fees to net interest income under effective yield requirements.

Operating expenses in 2005 decreased by $107 million or 13.6% to $678 million. This decrease reflects lower depreciation and fleet maintenance costs on leased vehicle assets as a result of the Group s sale of its Custom Fleet business on July 31, 2006 and lower superannuation expense. This is partly offset by increased personnel costs due to annual salary increases and the introduction of new employee performance based remuneration and share option schemes.

The charge to provide for doubtful debts increased from $38 million in 2005 to $46 million in 2006. This higher charge reflects an overall re-rating of the business and agribusiness portfolios.

For a discussion on the Group s significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group s income tax expense, refer to page 47.

nabCapital

	2006 $m	2005 $m
Net interest income	**937**	502
Non-interest income	**579**	927
Net operating income	**1,516**	1,429
Operating expenses	**(758)**	(742)
Charge to provide for doubtful debts	**24**	(24)
Significant items	**(7)**	(83)
Profit from ordinary activities before income tax	**775**	580
Income tax (expense)/benefit	**(157)**	(77)
Net profit attributable to members of the Company	**618**	503
Significant items after tax	**5**	74
Net profit attributable to members of the Company excluding significant items	**623**	577

nabCapital increased its contribution to net profit attributable to members of the Company by $115 million in 2006 to $618 million, from $503 million in 2005. The 2006 result included significant expenses of $5 million (after tax) relating to reforms made to the United Kingdom defined benefit pension funds, compared to $74 million (after tax) in 2005 relating to restructuring expenses, partly offset by the reversal of the provision for foreign currency options trading losses. Excluding the 2006 and 2005 significant items, the net profit attributable to members of the Company increased by $46 million or 8.0% to $623 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income has increased $435 million or 86.7% to $937 million. This is driven by changes in accounting policy from October 1, 2005 resulting in the cost of derivative financial instruments being amortised in net interest income and the reclassification of certain loan related fees from non-interest income under effective yield requirements. Net interest income was also higher due to increased origination activity in Corporate Finance as a result of new business initiatives and improved performance in Financial Institutions as a result of higher volumes.

Non-interest income decreased $348 million or 37.5% to $579 million. This is driven by changes in accounting policy from October 1, 2005 resulting in the mark-to-market gains or losses on derivative financial instruments being recognised in non-interest income and the reclassification of certain loan related fees to net interest income under effective yield requirements. Non-interest income also decreased due to lower income in Institutional Banking from the strategy to exit low yielding assets, offset by increased sales of risk management products in the Markets business as a result of the increased focus on relationships with regions to better leverage regional distribution channels, and conducive market factors in the form of increased interest and foreign exchange rate volatility.

Operating expenses in 2006 increased by $16 million or 2.2% to $758 million. The increase in operating expenses was due to increased personnel costs as a result of enterprise bargaining agreement salary increases in 2006 and higher performance based remuneration, increased deal related fees and the commencement of the Strategic Investment Program, partly offset by the benefits achieved from rebasing of the Asian, United States and United Kingdom operations.

The charge to provide for doubtful debts decreased from $24 million in 2005 to $24 million provision release in 2006. This reflects recoveries on facilities that had been provided for in prior periods and net reductions in exposures in the September 2006 year as a result of the strategy to improve return on equity.

For a discussion on the Group s significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group s income tax expense, refer to page 47.

Other

	2006 $m	2005 $m
Net operating income (excluding significant items)	**497**	56
Operating expenses (excluding significant items)	**(406)**	(476)
Significant items	**(7)**	68
Profit/(loss) from ordinary activities before income tax	**84**	(352)
Income tax (expense)/benefit (including significant tax item)	**(82)**	(77)
Net profit/(loss) attributable to members of the Company	**2**	(429)
Significant items after tax	**7**	47
Net profit /(loss) attributable to members of the Company excluding significant items	**9**	(382)

The Other segment increased its contribution to net profit attributable to members of the Company by $431 million to a $2 million net profit in 2006, from a $429 million net loss in 2005. The 2006 result included significant expenses of $7 million (after tax) relating to reforms made to the United Kingdom defined benefit pension funds compared to $47 million (after tax) in relation to restructuring expenses, and provision for settlement of a tax dispute with the Australian Taxation Office in 2005. Excluding significant items, the net profit attributable to members of the Company increased by $391 million from a net loss of $382 million in 2005 to a net profit of $9 million in 2006.

The main factors impacting the $391 million increase (excluding significant items) in the Other segment during the 2006 year, were:

A net profit on the sale of the Group s Custom Fleet business on July 31, 2006;

A net loss on the sale of the Group s life insurance and related wealth management companies in Asia;

higher interest income earned on surplus Group funds;

higher income due to an insurance recovery relating to AUSMAQ litigation costs and a favourable legal judgement on a tax matter in the USA;

lower personnel costs as functions are transferred into regions, consistent with the strategy of a regional accountability model; and

lower costs due to one-off costs associated with a Northern Bank Limited robbery in December 2004 and the outcome of a legal action in South Korea awarded against the Group not repeating in 2006.

For a discussion on the Group s significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group s income tax expense, refer to page 47.

Net interest income

2006	$	8,686 million
2005	$	6,944 million

Net interest income increased by $1,742 million or 25.1% to $8,686 million (2005: $6,944 million). The result reflects the favourable impact of the full adoption of AIFRS during 2006. Excluding the impact of AIFRS, net interest income increased 8.9%. This increase partly reflects a rise in the average net interest margin from 2.13% to 2.31% and continued sound growth in housing and business lending volumes in all regions, particularly in Australia and in the United Kingdom.

Volume and rate analysis

The following table allocates movements in net interest income between changes in volume and changes in rate for the year ended September 30, 2006. Volume and rate variances have been calculated on the movement in average balances and the change in interest rates on average interest-earning assets and average interest-bearing liabilities. The variance caused by changes of both volume and rate has been allocated in proportion to the relationship of the absolute dollar amounts of each change to the total.

	2006 Increase/(decrease) due to change in		
	Average balance $m	Average rate $m	Total $m
Interest-earning assets *(1)*			
Due from other banks			
Australia	49	9	58
Overseas	(11)	100	89
Marketable debt securities			
Australia	(544)	10	(534)
Overseas	(63)	(12)	(75)
Loans and advances			
Australia	1,302	(49)	1,253
Overseas	211	567	778
Other interest-earning assets			
Australia	110	(166)	(56)
Overseas	34	153	187
Change in interest income	1,088	612	1,700

(1) From October 1, 2005, under AIFRS, acceptances are interest-earning assets but are excluded from the above table. Prior to October 1, 2005, acceptances were classified as non-interest earning assets. Interest on acceptances in 2006 was $2,750 million.

	2006 Increase/(decrease) due to change in Average balance $m	Average rate $m	Total $m
Interest-bearing liabilities *(1)*			
Term deposits and certificates of deposit			
Australia	(381)	72	(309)
Overseas	392	161	553
On-demand and savings (short-term) deposits			
Australia	446	311	757
Overseas	8	65	73
Government and official institution deposits			
Australia	(1)	4	3
Overseas	5	16	21
Due to other banks			
Australia	(136)	(31)	(167)
Overseas	(225)	247	22
Short-term borrowings			
Australia	181	182	363
Overseas	(93)	141	48
Long-term borrowings			
Australia	406	118	524
Overseas	170	1	171
Other debt issues			
Australia	14	(2)	12
Overseas	(18)	(26)	(44)
Other interest-bearing liabilities			
Australia	(380)	(801)	(1,181)
Overseas	(125)	229	104
Change in interest expense	263	687	950
Change in net interest income	825	(75)	750

(1) From October 1, 2005, under AIFRS, liability on acceptances are interest-bearing liabilities but are excluded from the above table. Prior to October 1, 2005, liability on acceptances were classified as non-interest bearing. Interest expense on liability on acceptances in 2006 was $1,758 million.

Average interest-earning assets for 2006 increased by $50.2 billion or 15.4% to $375.7 billion (2005: $325.5 billion), however excluding acceptances which were classified as non-interest earning in 2005, average interest-earning assets increased $12.3 billion or 3.8%. The impact of the volume growth (excluding acceptances) on interest income was an increase of $1,088 million in 2006. This reflects a continued environment of housing lending-driven volume growth in all regions. In addition, Australian business lending was particularly strong with recent front line investment and strong customer relationships, along with product innovation and restoration of credit risk settings, driving market share gains within a strong operating environment. The movement in rates (excluding acceptances) over the same period resulted in an increase in interest income of $612 million in 2006. This increase in 2006 mainly reflects an environment of rising interest rates in all regions, and improvement in net interest margins.

For a further discussion of the main factors influencing the movement in average interest-earning assets, refer to gross loans and advances on page 48.

Average interest-bearing liabilities increased by $47.6 billion or 16.1% to $342.9 billion (2005: $295.3 billion), however, excluding liability on acceptances which were classified as non-interest bearing in 2005, average interest-bearing liabilities increased $16.9 billion or 5.7%. The impact of the increasing volumes (excluding liability on acceptances) on interest expense was an increase of $263 million in 2006. The movement in rates (excluding liability on acceptances) over the same period resulted in an increase in interest expense of $687 million in 2006. The increase in interest expense mainly reflects growth in short-term borrowings, on-demand and savings deposits and long-term borrowings to fund asset growth. The increase in interest expense is mainly in long-term borrowings in Australia, reflecting the Group s continued strategy of lengthening the maturity profile of the Group s debt issues, a continued increase in on-demand and savings deposits due to a greater product offering with more competitive pricing in 2006, an increase in repurchase agreement volumes in Australia which has been driven by growth in demand, and rising interest rates in all regions during the year.

Net interest spreads and margins

	2006 $m	2005 $m
Group		
Net interest income	**8,686**	6,944
Average interest-earning assets	**375,691**	325,482
Net interest spread (%) *(1)*	**1.88**	1.69
Benefit of net free liabilities, provisions and equity (%)	**0.43**	0.44
Net interest margin (%) *(2)*	**2.31**	2.13
Geographical region		
Average interest-earning assets		
Australia	**239,501**	191,151
Overseas	**136,190**	134,331
Net interest spread *(1)*		
Australia	**1.93**	1.58
Overseas	**1.79**	1.81
Net interest margin *(2)*		
Australia	**2.43**	2.15
Overseas	**2.11**	2.11
Business segment		
Australia Region *(3)*		
Average interest-earning assets *(4)*	**201,829**	153,612
Net interest margin (%) *(2)*	**2.38**	2.48
United Kingdom Region *(3)*		
Average interest-earning assets *(4)*	**52,423**	48,608
Net interest margin (%) *(2)*	**3.51**	3.69
New Zealand Region *(3)*		
Average interest-earning assets *(4)*	**31,003**	28,665
Net interest margin (%) *(2)*	**2.50**	2.58
nabCapital		
Average interest-earning assets *(4)*	**138,174**	136,565
Net interest margin (%) *(2)*	**0.68**	0.37
Other *(5)*		
Average interest-earning assets *(4)*	**(47,737)**	(41,968)
Net interest margin (%) *(2)*	**(0.69)**	(0.24)

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(1) *Net interest spread represents the difference between the average interest rate earned and the average interest rate incurred on funds.*

(2) *Net interest margin is net interest income as a percentage of average interest-earning assets.*

(3) The Australia Region business segment here excludes the Australian Wealth Management business and the Asian banking business.

(4) Average interest-earning assets include intercompany balances.

(5) Other includes the Australian Region Wealth Management business, Asian banking business, Group Funding, Corporate Centre and inter-divisional eliminations.

Net interest margin (geographical basis)

The net interest margin (net interest income as a percentage of average interest-earning assets), increased by 18 basis points to 2.31% in 2006, from 2.13% in 2005. Changes to accounting policies under AIFRS in the 2006 year have had a favourable 7 basis points impact. After adjusting for AIFRS impacts, the Group net interest margin increased 11 basis points from 2005 primarily due to the reduction in low margin assets and a favourable rate environment, partly offset by on-going competitive pressures together with unfavourable portfolio mix impacts from the continuing shift to lower margin lending and deposit products.

The increase in net interest margin in Australia of 28 basis points in 2006 to 2.43% from 2.15% in 2005, resulted primarily fro