

This public disclosure is prepared for Teachers Mutual Bank Limited for the quarter ended the 31st March 2014. It complies with prudential standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information and is unaudited.

## Capital management

Capital levels are managed to ensure compliance with Australian Prudential Regulation Authority (APRA) requirements. Those requirements encompass a framework of three pillars.

**Pillar 1** - Minimum capital requirements, including a specific capital charge for operational risk.

**Pillar 2** - Enhanced supervision of capital management including the application of an internal capital adequacy assessment process.

**Pillar 3** - More extensive disclosure requirements.

### Pillar 1

Capital is measured as prescribed by Australian Prudential Regulation Authority (APRA) prudential standards. These standards act to deliver capital requirements in respect of Credit risk, Market risk and Operational risk.

## Credit risk

Credit risk is measured using the Standardised Approach defined in prudential standard APS112. The capital charge attached to each asset is based on weightings prescribed by APRA as detailed in the table below:

On-statement of financial position exposures	Carrying value	Risk weighting	Risk weighted amount
Cash	1,432,373	0%	-
Deposits in highly rated ADIs	353,876,393	20%	70,775,279
Deposits in less highly rated ADIs	362,075,260	50%	181,037,630
Standard loans secured against eligible residential mortgages up to 80% LVR (up to 90% with Lenders Mortgage Insurance)	2,656,461,745	35%	929,761,611
Standard loans secured against eligible residential mortgages over 80% LVR	497,683,115	50%-75%	252,161,539
Other standard mortgage loans	6,442,126	100%	6,442,126
Non-standard mortgage loans	3,868,632	35%-100%	2,477,253
Other loans	295,380,895	100%	295,380,895
Other assets	45,266,507	100%	45,266,507
<b>Total</b>	<b>4,222,487,046</b>		<b>1,783,302,840</b>

Non-market related Off-statement of financial position exposures	Notional principal amount	Credit conversion factor	Credit equivalent amount	Risk weighting	Risk weighted amount
Loans approved and not advanced	145,159,759	100%	145,159,759	35%-100%	67,037,152
Redraws available	389,746,866	50%	194,873,433	35%-100%	74,020,204
Guarantees	100	100%	100	100%	100
Unused revolving credit limits	266,663,140	0%	-		-
Possible contribution to CUFSS	135,109,648	0%	-		-
<b>Total</b>	<b>936,679,513</b>		<b>340,033,292</b>		<b>141,057,456</b>

Market related Off-statement of financial position exposures	Notional principal amount	Credit conversion factor	Potential future exposure	Current exposure	Credit equivalent amount	Risk weighted amount
Residual maturity 1 year or less	130,000,000	0%	-	-	-	-
Residual maturity > 1 year to 5 years	161,700,000	0.5%	808,500	42,919	851,419	170,284
<b>Total</b>	<b>291,700,000</b>		<b>808,500</b>	<b>42,919</b>	<b>851,419</b>	<b>170,284</b>
<b>Total weighted credit risk exposures</b>						<b>1,924,530,580</b>

## Market risk

The bank is not required to allocate capital against market risk as no trading activity is undertaken and the Standardised Approach does not result in any allocation against interest rate risk in the banking book.

## Operational risk

Operational risk is measured using the Standardised Approach defined in prudential standard APS114. The capital charge is based upon portfolio balances and revenue streams with scaling and risk factors applied to reflect APRA's assessment of the particular risk profiles.

### Operational risk capital requirement for retail banking

	30-Jun-11	31-Dec-11	30-Jun-12	31-Dec-12	30-Jun-13	31-Dec-13
Total gross outstanding loans and advances for retail banking	2,771,806,877	2,912,194,314	3,070,330,500	3,212,036,658	3,335,287,137	3,403,852,715
- multiplied by 3.5% scaling factor	97,013,241	101,926,801	107,461,568	112,421,283	116,735,050	119,134,845
- multiplied by 12% risk factor	11,641,589	12,231,216	12,895,388	13,490,554	14,008,206	14,296,181
Average of the 6 half year results = Total operational risk capital requirement for retail banking						13,093,856

## Operational risk capital requirement for commercial banking

	30-Jun-11	31-Dec-11	30-Jun-12	31-Dec-12	30-Jun-13	31-Dec-13
Total gross outstanding loans and advances for commercial banking	689,062,584	792,341,065	645,359,216	687,158,408	684,350,086	759,279,481
- multiplied by 3.5% scaling factor	24,117,190	27,731,937	22,587,573	24,050,544	23,952,253	26,574,782
- multiplied by 15% risk factor	3,617,579	4,159,791	3,388,136	3,607,582	3,592,838	3,986,217
Average of the 6 half year results = Total operational risk capital requirement for commercial banking						3,725,357

## Operational risk capital requirement for all other activity

	30-Jun-11	31-Dec-11	30-Jun-12	31-Dec-12	30-Jun-13	31-Dec-13
Adjusted gross income	3,401,488	2,030,846	3,906,064	2,075,673	3,722,777	2,484,320
- multiplied by 18% risk factor	612,268	365,552	703,091	373,621	670,100	447,178
Average of the 3 annual results = Total operational risk capital requirement for all other activity						1,057,270

Total operational risk capital requirement	17,876,483
RWA equivalent amount for operational risk capital requirement = Operational risk capital * 12.50	223,456,034
Total credit and operational risk weighted	2,147,986,614

## Capital resources

### Main features of capital

**Common Equity Tier 1 Capital** - The majority of Tier 1 capital consists of retained profits.

**Tier 2 Capital** - Consists of capital instruments that combine the features of debt and equity in that they are structured as debt instruments, but exhibit some of the loss absorption and funding flexibility features of equity. There are a number of criteria that capital instruments must meet for inclusion in Tier 2 capital resources as set down by APRA. Tier 2 capital generally comprises a reserve for credit losses.

A minimum capital ratio of 8% is required to be maintained at all times. Our policy requires reporting to the board if the capital ratio falls below 14%.

The capital ratio can be affected by growth in assets relative to growth in reserves and by changes in the mix of assets. The bank manages capital through reviewing the ratio monthly and monitoring major movements in asset levels. Further, a 3 year capital projection is maintained to assess how strategic decisions or trends may impact on the level of capital. A stress test based on various asset growth and profitability assumptions is conducted annually.

## Pillar 2 risk capital

Pillar 2 of the Prudential Framework relates to any risk factor to which an ADI might be exposed that is not included in Pillar 1.

These risks fall into 3 categories.

- Pillar 1 risks not fully captured by the Pillar 1 process, for example credit concentration risk.
- Inherent risks not covered by Pillar 1, including:
  - interest rate risk in the banking book
  - liquidity risk
  - strategic risk
  - reputation risk
- Risks arising from external factors such as business cycles effects and the macroeconomic environment.

The bank documents, analyses and sets its own internal capital requirements to meet Pillar 2 risks.

The methodologies used to assess the required capital are a combination of quantitative and qualitative assessment and by their nature are based on a degree of collective subjective judgment of senior management and the board.

### Internal capital adequacy management

The bank manages its internal capital levels for both current and future activities through a combination of committees. The outputs of the individual committees are reviewed by the board in its capacity as the primary governing body. The capital required for any change in the bank's forecasts for asset growth or unforeseen circumstances are assessed by the board. The finance department then updates the forecast capital resources models produced and the impact upon the overall capital position of the bank is reassessed.

## Contingency buffer

Based on historical fluctuations in capital the bank incorporates a contingency buffer of 2% when targeting minimum levels of capital and when preparing its Capital Management Plan to cover volatility in the risks identified above.

	RWA	Minimum capital required	% Equivalent of RWA
Credit risk	1,924,530,580	153,962,446	8.00%
Operational risk	223,456,034	17,876,483	8.00%
Total	2,147,986,614	171,838,929	8.00%
Pillar 2 uplift capital		85,919,465	4.00%
ICAAP capital required		257,758,394	12.00%
Buffer for business cycle volatility		42,959,732	2.00%
Capital available for future growth and product and service development		47,110,702	2.19%
Risk-based capital ratio		347,828,828	16.19%
Common Equity Tier 1 capital ratio		334,472,767	15.57%
Tier 1 capital ratio		334,472,767	15.57%
Tier 2 capital ratio		13,356,061	0.62%

## Credit risk

The credit risk of a financial institution is the risk that customers (members), financial institutions and other counterparties will be unable to meet their obligations to the institution which may result in financial losses. Credit risk arises principally from the bank's loan book and investment assets.

## ADI investments

The risk of losses on ADI investments is mitigated through the application of investment limits per counterparty based upon independent ratings of counterparties and by limiting exposure to groups of counterparties within a rating band.

The exposure values associated with each credit quality step are as follows:

Investments with:	No. of institutions	Carrying value	Past due value	Provision	Average gross exposure in the quarter
ADIs-rated A-1+ to A-1 (short-term)	7	334,395,269	-	-	428,640,832
ADIs-rated A-2 or P-2 (short-term)	7	350,132,065	-	-	294,272,315
ADIs-rated AA+ to AA- (long-term)	1	17,000,000			8,500,000
ADIs-rated A+ to A- (long-term)	1	14,424,319	-	-	14,424,319
Total		715,951,653	-	-	745,837,466

## Loans

Carrying value is the value on the statement of financial position. Maximum exposure is the value on the statement of financial position plus the undrawn facilities (loans approved but not funded, redraw facilities, undrawn overdrafts and credit cards).

	Carrying value on-statement of financial position	Commitments	Other non-market off-statement of financial position exposures	Maximum exposure	Average gross exposure in the quarter
	\$'000	\$'000	\$'000	\$'000	\$'000
Housing	2,877,691	481,346	-	3,359,037	3,308,479
Personal	583,847	320,167	-	904,014	896,853
Total-natural persons	3,461,538	801,513	-	4,263,051	4,205,332
Corporate borrowers	9	57	-	66	66
Total	3,461,547	801,570	-	4,263,117	4,205,398

## The commitments set out above comprise

<b>Outstanding loan commitments</b>	<b>\$'000</b>
The loans approved but not funded	145,160
<b>Loan redraw facilities</b>	
The loan redraw facilities available	389,747
<b>Undrawn loan facilities</b>	
Loan facilities available to members for overdrafts and credit cards are as follows:	
Total value of facilities approved	363,566
Less: amount advanced	(96,903)
Net undrawn value	266,663
These commitments are contingent on members maintaining credit standards and ongoing repayment terms on amounts drawn.	
Total loan commitments	801,570

## Impairment

Impairment of a loan is recognised when there is reasonable doubt that not all the principal and interest can be collected in accordance with the terms of the loan agreement. Impairment is assessed by specific identification in relation to individual loans and by estimation of expected losses in relation to loan portfolios where specific identification is impracticable.

Bad debts were written off when identified and are recognised as expenses in the statement of comprehensive income.

All loans and advances are reviewed and graded according to the anticipated level of credit risk. The classification adopted is described below:

Non-accrual loans are loans and advances, including savings accounts drawn past their approved credit limit, where the recovery of all interest and principal is considered to be reasonably doubtful. Interest charged and not received on this class of loan is not recognised as revenue. APRA has made it mandatory that interest is not recognised as revenue after irregularity exceeds 90 days for a loan facility or 15 days for an over limit overdraft and credit card facility or 15 days for overdrawn savings account.

Restructured loans arise when the borrower is granted a concession due to continuing difficulties in meeting the original terms and the revised terms are not comparable to new facilities of comparable risk. Loans, where interest has been stopped or is less than the bank's average cost of funds, are included in non-accrual loans.

The level of impaired loans by class of loan is set out below:

- Carrying value is the balance gross of provision (net of deferred fees).
- Past due loans as per APS 220 Credit Quality is the 'on-statement of financial position' loan balances which are behind in repayments by 90 days or more, well-secured and not impaired.
- Impaired loans value is the 'on-statement of financial position' loan balance and includes non-accrual loans and restructured loans. Provision for impairment is the amount of the impairment provision allocated to the class of impaired loans.
- The losses in the quarterly period equate to the additional provisions set aside for impaired loans and bad debts written off in excess of previous provision allowances.

	Carrying value on-statement of financial position	Value of loans that are past due	Value of loans that are impaired	Provision for impairment	Provision for impairment quarterly movement	Bad debts in the quarter
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Housing	2,877,691	-	8,202	93	15	-
Personal	583,847	-	4,111	1,616	(290)	482
Total-natural persons	3,461,538	-	12,313	1,709	(275)	482
Corporate borrowers	9	-	2	1	-	-
Total	3,461,547	-	12,315	1,710	(275)	482

The impaired loans are generally not secured against residential property. Some impaired loans are secured by mortgage over motor vehicles or other assets of varying value. It is not practicable to determine the fair value of all collateral as at the balance date due to the variety of assets and condition.

### Reserve for credit losses

The General Reserve for Credit Losses is a reserve in respect of credit losses prudently estimated but are not certain to arise over the full life of all the individual facilities comprising the business of the bank.

The methodology to calculate the reserve is based on the Probability of Default and Loss Given Default approach. This method is applied across the loans portfolio including the aggregate of all drawn on-statement of financial position loans, redraw rights attached to loans paid in advance and irrevocable credit commitments model.

The Board utilises the model described above when exercising experienced credit judgment as well as considering any other internal and external factors to determine the appropriate reserve balance required.

The amount of the reserve is currently \$13,356,061.

### Securitisation exposures

**On-statement of financial position** - The bank has established an internal securitisation of residential mortgages, linked to a repurchase agreement facility with the Reserve Bank of Australia, as a liquidity contingency. The bank has not derecognised these loans from the statement of financial position and does not qualify for capital relief under APS 120 Securitisation. The amount of the facility is currently \$282,855,143 consisting of mortgages secured loans. During the quarter no loans were securitised.

**Off-statement of financial position** - The bank has an arrangement with Integrus Securitisation Services Pty Limited whereby it acts as an independent contractor to promote and complete loans on their behalf, for on sale to an investment trust. In addition, the bank is able to assign mortgage secured loans to Integrus at the book value of the loans, subject to acceptable documentation criteria. The amount of the facility is currently \$492,949 consisting of mortgage secured loans. During the quarter no loans were securitised.