Moody's Investors Service

Credit Opinion: Commonwealth Bank of Australia

Global Credit Research - 18 Jan 2010

Sydney, New South Wales, Australia

Ratings

Category	**Moody's Rating**
Outlook	Negative(m)
Bank Deposits	Aa1/P-1
Bkd Deposit Note/CD Program -Dom Curr	Aaa/--
Bank Financial Strength	B
Issuer Rating	Aa1
Senior Unsecured	Aa1
Subordinate	Aa2
Preferred Stock -Dom Curr	*Aa3
Commercial Paper	P-1
Other Short Term	P-1
ASB Finance Limited, London Branch	
Outlook	Stable
Bkd Senior Unsecured	Aa2
Bkd Subordinate MTN	Aa3
Bkd Commercial Paper	P-1
Bkd Other Short Term	P-1

* Placed under review for possible downgrade on November 18, 2009

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Key Indicators

Commonwealth Bank of Australia

	[1]**2009**	**2008**	[2]**2007**	**2006**	**2005**	[3]**Avg.**
Total Assets (USD Millions)	**526,882**	**467,387**	**361,071**	**273,985**	**250,856**	[4]**19.75**
Total Assets (AUD Millions)	**620,372**	**487,572**	**425,139**	**369,103**	**329,035**	[4]**15.18**
Shareholders' Equity (AUD Millions)	**31,442**	**26,137**	**24,444**	**21,343**	**26,060**	[4]**4.79**
NPL/Shareholders' Equity & Loan Loss Reserves(%)	**18.75**	**6.45**	**2.97**	**2.56**	**2.52**	[4]**52.08**
Overhead Ratio (%)	**44.19**	**45.41**	**55.48**	**57.39**	**62.15**	[4]**-8.01**
Shareholders' Equity/Total Assets (%)	**5.07**	**5.36**	**5.75**	**5.78**	**7.92**	[4]**-9.02**
Pre-provision Profit/Avg Total Assets (%)	**1.57**	**1.66**	**1.76**	**1.77**	**1.63**	[4]**2.73**
Liquid Assets/Total Assets (%)	**14.50**	**14.06**	**16.71**	**18.04**	**19.66**	[4]**-8.76**
Total Risk-Weighted Ratio (CAR) (%)	**10.42**	**11.58**	**9.76**	**9.66**	**9.75**	[4]**0.33**
"Non-Performing" Loans/Gross Loans (%)	**1.40**	**0.47**	**0.24**	**0.22**	**0.30**	[4]**36.39**

[1] As of June 30. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate.

Opinion

SUMMARY RATING RATIONALE

Moody's continues to assign ratings to bank obligations independent of the Australian government's guarantee of certain deposits and debt instruments. The rationale for these non-guaranteed ratings is discussed in this research report. Individual bank obligations that are covered by the government guarantee are assigned "backed" ratings, on a case by case basis.

Moody's assigns a bank financial strength rating (BFSR) of B to the Commonwealth Bank of Australia (CBA), which translates into a baseline credit assessment of Aa3. The BFSR addresses the stand-alone credit profile of the bank, and does not incorporate the potential for systemic support, which is included in the bank's deposit and debt ratings.

Like its Australian peers, CBA has demonstrated a high degree of resilience relative to many other major global banks during the course of the global financial crisis. However, CBA's BFSR - and hence its supported ratings - still carry a negative outlook, as a result of sector-wide challenges created by [1] major Australian banks' sizeable wholesale funding requirements and the potential for funding competition-led earnings pressures, and [2] remaining asset quality stress resulting from the economic downturn.

CBA enjoys entrenched franchise positions in the Australian and New Zealand markets, the latter through its subsidiary ASB Bank (Aa2 / P-1 / B- / Negative Outlook). CBA has particular strength in retail deposits and residential mortgage lending in both its major markets. Through its subsidiaries it is also a top three player in the fields of life insurance, funds management and superannuation / retirement savings.

The Australian and New Zealand markets have not experienced the same degree of credit quality issues as other developed markets like the US and UK. Moreover, the current funding crisis has afforded CBA an opportunity to expand its market share in Australia: in 1998 the bank acquired Bank of Western Australia (BankWest) and insurer St. Andrews Australia from HBOS, and separately a 33% stake in mortgage lender Aussie Home Loans.

The crisis has also enabled CBA to improve loan product margins, as securitization-funded have exited and foreign lenders have cut back. This has largely offset the earnings drag caused by increased funding costs (but not provisioning costs). However, we are starting to see the re-emergence of some loan price-competition, and funding costs will continue to be affected by [1] competition for deposits (although CBA's higher proportion of transaction accounts may shield it from the worst pricing impact) and [2] the roll-off of cheaper, shorter-term pre-crisis funding to be replaced by longer-tenor funding as the bank continues to lengthen its maturity structure. In this regard,

CBA has significantly increased capital and liquidity over the course of the crisis, which has been an important factor underpinning its ratings to date. Despite its leading share of household deposits, and like its peers, CBA has a structural reliance on wholesale funding. However, the bank has maintained good wholesale market access through much of the crisis - assisted in the wake of Lehman's collapse by the issuance of government-guaranteed debt, which has provided strong support to the bank's ratings during the crisis. As wholesale market conditions improve and crisis-related support measures by the government and central bank are wound down, the bank's stand-alone funding/liquidity profile will likely return to being a key driver of its BFSR.

CBA's long-term, global-scale local currency (GLC) deposit rating of Aa1 is based on the very high probability of systemic support, in case of need - which results in a 2 notch lift from the Aa3 baseline credit assessment. The short-term GLC deposit rating is Prime-1.

Irrespective of the current government bank guarantee, Australia is considered a high support country and CBA is viewed as having very high systemic importance, being one of the country's four major banks with nationwide franchises. Australia's banks play an important role in funding Australia's persistent current account deficit, we believe adding an additional incentive for the authorities to ensure that their strong financial condition is maintained - even after the current crisis abates.

Furthermore, Australia's Aaa is one of the most resilient to stress testing, and is not impacted by the crisis-related increase in government debt - so the sovereign will continue to be able to provide high quality credit enhancement to the banks' ratings

CBA's long- and short-term GLC issuer ratings - which address the risk of senior non-deposit obligations - and its senior debt ratings are also Aa1 / Prime-1, reflecting the same support considerations as the deposit ratings.

Thus the GLC deposit and debt ratings of CBA incorporate three main elements: (1) the bank's BFSR of B, (2) Moody's assessment of a very high probability of systemic support (a component of joint default analysis, referred to as JDA) and (3) the seniority of its deposits and debt.

CBA's foreign currency obligations are rated the same as its local currency obligations. Australia's sovereign ceilings for deposits and debt are at Aaa, and therefore do not constrain the bank's foreign currency ratings.

Credit Strengths

- Global financial crisis support measures by the government and central bank have provided a wholesale funding safety-net - although, like its major bank peers, CBA has demonstrated above-average access to funding during the crisis and has significantly improved its liquid asset cover of short-term maturities

- Entrenched market positions and large market shares in Australia and New Zealand. The bank has made market share gains and improved lending product margins as a result of the current turmoil in financial markets

- Significantly increased capital base and adequate provisioning create a solid cushion to absorb loan-losses

- Australian operating environment has remained significantly stronger than many other developed markets

- Low risk loan book - in particular Australian prime residential mortgages (63% of total non-securitised gross loans and advances) which carry substantial levels of insurance from highly-rated, domestic counterparties

- Domestic leadership in life insurance and retail funds management

- Position as one of Australia's four "pillar" banks confers competitive advantages and enhances systemic importance

Credit Challenges

- Ongoing asset quality issues, although moderate by international comparison

- High single-name borrower concentrations - albeit generally of high quality

- Deposit competition in Australia is eroding liability product margins. Recent deposit gains may have questionable "stickiness" as (i) higher rates have attracted quasi-wholesale money (more particularly in the BankWest franchise) and (ii) depositors may re-allocate funds to other asset classes as financial markets recover.

- Substantial wholesale funding requirement raises sensitivity to market conditions. Depending on how government and central bank support measures are wound down post-crisis, this may become a longer-term rating issue

Rating Outlook

The outlook for CBA's BFSR is negative, which is now driven primarily by the structural sensitivity of Australian bank funding to wholesale market conditions and by margin pressure from higher funding costs and re-emerging competition. With strong home lending growth in 2009, CBA's term funding requirement would appear to be among the upper end of the Australian bank peer group. Counter-intuitively, proposed new regulatory liquidity requirements might also require increased debt issuance to fund purchases of additional "liquid asset" qualifying securities - although a phased introduction now seems likely, providing more time for the bank to adjust its funding requirements.

Asset quality (in particular in relation to capital and loan loss reserves) remains an area of rating caution, but if the economy shows signs of sustained improvement into 2010, there appears a reasonable chance that it will no longer constitute a drag on CBA's ratings by the second half - assuming the bank does not aggressively decrease its current capital levels in response to improving operating conditions.

CBA appears interested in growing its Asian operations. Given their small size and CBA's conservative, deposit-led strategy, any initiatives on this front are very unlikely to have any rating implications.

Because CBA's deposit, issuer and senior debt ratings incorporate 2 notches of systemic support - which is at the high end of what Moody's will normally incorporate in the Aa rating category - the negative outlook applied to the bank's BFSR means that these ratings automatically carry a negative outlook also.

As a result of revised rating criteria - see "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt", November 2009 - the bank's Aa2 junior subordinated debt (Upper Tier 2) and Aa3 preferred stock (Tier 1) ratings were placed on review for possible downgrade on 18 November 2009. The Aa2 "plain vanilla" subordinated debt (lower Tier 2) rating was not affected.

On the regulatory front, a number of enhancements have been proposed to the Basel II framework, as well as to bank liquidity requirements. While the precise impact of the Basel committee's and APRA's consultative proposals on capital and liquidity will take some time to determine, a high-level overview suggests that they are on balance likely to be supportive for Australian bank ratings. (See the relevant sections below for a fuller discussion).

What Could Change the Rating - Down

1) BFSR - Asset quality deterioration and/or decline in capital & reserve coverage of potential loan-losses:

As outlined in "Moody's Approach to Estimating Bank Credit Losses and their Impact on Bank Financial Strength Ratings", there would be negative implications arising from (i) a change to our base case scenario to one where prolonged economic malaise risks lowering CBA's capital metrics to more than 2 notches below the expected level for its BFSR, or (ii) a change to our stressed case scenario that would see CBA's overall credit metrics fall more than 2 notches below its current BFSR. In this regard, CBA's capital raisings in 2008 and 2009 (together with adequate loan-loss provisioning) provide a significantly improved cushion against future losses.

Given that the economic outlook has improved, there appears to be little downside risk to our base or stressed case scenarios. Hence a meaningful reduction in capital would appear to be a more plausible threat to the rating - although in all likelihood, management caution and new regulatory requirements may sustain the bank's capital metrics at a higher level post-crisis

2) BFSR - Decrease in liquid asset coverage of short-term, confidence sensitive funding:

We would not see the bank being able to maintain its current BFSR if it returns to its pre-crisis liquidity/funding profile, once the current crisis has abated and government and central bank support measures have been wound down.

Again, management caution and new regulatory requirements seem likely to sustain the bank's liquidity/funding metrics at a higher level post-crisis, but the issue of stand-alone liquidity / funding is likely to remain a primary rating sensitivity for the BFSR

3) Deposit, issuer and senior debt ratings - Would likely follow the BFSR

Because of the high degree of systemic support uplift already incorporated CBA's deposit, issuer and senior debt ratings, they would likely move in line with the BFSR.

What Could Change the Rating - Up

In order to revise CBA's BFSR outlook back to stable:

1) We would need to be satisfied that the bank and its major operating subsidiaries can maintain credit metrics consistent with their current BFSR bands. This will require some greater certainty around the economic trajectory in the bank's main markets.

2) We would also need to be confident that the bank's Liquidity Management score will continue to fall within the expected range for its rating, once the Australian authorities' crisis-related support arrangements have run off. Accordingly, we would expect CBA to hold increased liquid assets, and/or lengthen the average tenor of its wholesale funding, and/or increase its level of "sticky" deposits, relative to its pre-crisis position.

3) Further improvement in the bank's single-name credit concentrations and margin management would also be positive.

Recent Results and Developments

CBA made a pre-results announcement that it expects to report unaudited cash net profit after tax for 2H09 of approximately A$2.9bn, an increase of around 13% from 2H08. While the result has been boosted by strong loan growth in housing (partly assisted by the exit of price-led competitors and funding constraints of smaller rivals) and lower bad debt costs, a key driver of the result is an A$240m turnaround in "investment experience" in its wealth business - ie positive mark to market moves in equities.

The latest capital ratio disclosure is from its 3Q09 trading update: 8.7% pro-forma on a hybrid Tier 1 capital raising (11.5% pro forma using the UK's FSA Tier 1 calculation methodology).

In line with its peers, CBA's New Zealand subsidiary ASB Bank has agreed an out of court settlement with the New Zealand Commissioner of Inland Revenue in regard to amended tax assessments on four structured finance transactions. ASB has agreed to pay NZD264m, which is fully covered by existing provisions.

The Reserve Bank of Australia's November 2009 decision to continue to accept internal RMBS for repo, even after wholesale debt market conditions improve, reinforces our view that it is appropriate to incorporate significant systemic support into major Australian bank ratings.

DETAILED RATING CONSIDERATIONS

Detailed rating considerations for CBA's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a BFSR of B to CBA. As a point of reference, the assigned BFSR is higher than the unadjusted outcome of Moody's bank financial strength scorecard at B-. However, there are a number of factors which are not fully captured by the scorecard's standard definitions. If adjustments are made for these factors, the scorecard result rises up to the assigned rating level of B.

- The Australian regulator has exercised a number of national discretions with regards to its calculation methodology for regulatory capital under Basel II, such that risk-weighted assets appear higher, and Tier 1 capital lower, than in many other jurisdictions

- the franchise value of CBA's status as one of Australia's four "pillar" banks is hard to capture under the standard definitions

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Improving

Like its major bank peers, CBA has been able to take advantage of the current financial markets crisis to extend its market share in Australia. Firstly, very tight issuance conditions in the securitization market virtually eliminated competition from non-deposit-funded mortgage lenders - and while there are signs of recovery in the RMBS market, high pricing may continue to operate in favour of diversified funders such as a major bank like CBA. Secondly, institutional/corporate borrowers dramatically increased bank funding in 2008/09 as a result of the weak state of the capital markets and the exit of major international banks from the Australian market. Thirdly, there has been consolidation amongst Australian banks, in which CBA participated by acquiring Bank of Western Australia (BankWest). In New Zealand, CBA has also stood to gain from a flight to quality in the retail deposit market.

CBA's strong franchise value is a reflection of its position as one of Australia's four "pillar" banks. CBA enjoys leading market shares in deposits and residential mortgage lending in its home market. CBA's position in the business banking sector was boosted by the BankWest acquisition, having traditionally lagged its competitors.

CBA, through Colonial First State (CFS), continues to be a leading manager of investment funds in Australia, placing it in a good position to capture fund flows on the back of Australia's compulsory superannuation (retirement) savings scheme.

In New Zealand, CBA owns ASB Bank, which has been strengthening its position in the nation's largest city, and enjoys strong customer satisfaction and a low-risk residential mortgage focus.

CBA appears to be interested in boosting its Asian investment strategy, which is much more limited in scope than its major bank peer ANZ, to tap into the region's growth. CBA has a strong niche deposit business in Indonesia (PT Bank Commonwealth) and 20% stakes in two regional banks in China, Quilu Bank and Bank of Hangzhou.

Referencing the scorecard, CBA's franchise value score of B- is lower than its BFSR at B, which we to believe to be an inadequate reflection of its actual strength. We note that after adjusting (i) the market share score to A from B, to recognize CBA's systemic importance as one of the four "pillar" banks in Australia, and its position as one of the big four banks in New Zealand, that the overall franchise value score rises to B, in line with the bank's assigned rating.

Factor 2: Risk Positioning

Trend: Neutral

In common with its peers, CBA has a strong corporate governance framework. The bank tends to take a relatively conservative stance on credit risk, with a focus on prime residential mortgage lending in Australia and New Zealand, which has proven to be low risk. In common with other Australian banks, CBA runs a very low level of market risk.

Despite its retail focus, CBA has a slightly higher single borrower concentration level than the norm for its rating level, reflecting the concentrated nature of its main markets. Single-name concentrations increased in 2008 as corporate borrowers returned to bank borrowing due to reduced access to capital markets funding in the current crisis. On the upside, CBA's corporate exposure concentrations are therefore generally of high quality: the majority are either investment grade or well secured. Furthermore, following years of good operating conditions, Australian and New Zealand corporate balance sheets are generally in sound shape. High end commercial real estate borrowers have boosted their financial profiles by equity issuance during the crisis.

With reference to the scorecard, CBA's overall risk positioning score of B is in line with its rating, albeit that the bank's individual borrower concentration sub-score comes out at C. CBA's risk management subfactor scores are in line with the overall score of B, with the market risk score being a positive outlier at A.

Factor 3: Regulatory Environment

Trend: Neutral

All Australian banks are subject to the same score on regulatory environment. This factor does not address bank specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Moody's views the Australian regulatory environment as a positive factor that provides a strong underpinning to Australian bank ratings. Please refer to Moody's Banking System Outlook for Australia to obtain a detailed discussion on the Regulatory Environment.

Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all Australian banks. Moody's assigns an A- for the overall operating environment. Economic volatility is low - although not the lowest amongst developed countries - and the country has a strong legal system with good enforceability of creditor claims. We see these factors as supporting average bank asset quality and profitability over economic cycles. Please refer to Moody's Banking System Outlook for Australia to obtain a detailed discussion on the Operating Environment.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Weakening

While provisioning pressures will remain on CBA's bottom line in 2009/10, there are some positive factors supporting CBA's pre-provision income, which is particularly important from a rating perspective.

CBA's pre-provision profit / risk-weighted assets improved in FY09 on the back of better loan product margins due to the exit of marginal / price-led competitors that has allowed improved pricing for risk. This is particularly the case in the corporate and middle market sectors, with benefit expected to continue into early 2010 as the back book is repriced.

In common with its peers, CBA's markets related income rose on the back of high levels of volatility in 4Q08-2Q09, although to a lesser extent than at its peers due to their greater focus on the institutional market. This revenue stream may decline in importance as financial markets calm.

Negative pressures on pre-provision profit do remain: wholesale funding costs have been reducing in 2H09 as risk appetite returns, but are likely to remain well above pre-crisis levels. In addition, strong competition has significantly increased the cost of deposits, in what is likely a secular shift. As Australia's largest deposit-taker, CBA is sensitive to this trend.

With regards to CBA's net income outlook, further asset impairment charges are expected flow through in 2H09/2010 (see Factor 9: Asset Quality).

As discussed below in Factor 7: Capital, due to conservative risk-weighted asset definitions in Australia, CBA's profitability ratios would be higher if calculated on basis used by the UK's FSA, for example, although not sufficiently to change the profitability sub-score.

Factor 6: Liquidity

Trend: Improving

The Australian Government's Guarantee Scheme, and the Reserve Bank of Australia's broadened repo eligibility criteria have been providing a strong backstop to CBA's funding and liquidity position since their introduction in 3Q/4Q08.

Like its peers, CBA has very substantially increased its liquid assets during the crisis period. It has also created an "internal securitization" of residential mortgage assets (RMBS) which could be repo'd with the RBA if required. And with its large, high quality mortgage book, CBA has a very strong ability to create more of such repo-eligible assets.

Given that wholesale funding market conditions are improving, we would not expect further increases in liquid assets - absent increased regulatory requirements - but we do expect the bank to maintain a conservative level of liquidity while economic conditions remain weak in 2010.

The bank has also increased the weighted-average term of its funding by (i) increasing the proportion and tenor of its long-term funding, assisted since 4Q08 by market appetite for government-guaranteed debt, and (ii) increasing the amount of 1 year funding to lengthen its "short-term" maturity profile.

Looking further ahead, the funding and liquidity profile of Australia's major banks, including CBA, is likely to remain a key rating sensitivity.

Australia's major banks are structurally reliant on wholesale funding, which is a reflection of (i) the marked deposit disintermediation trend in Australia, which results from tax incentives to allocate funds to non-deposit products, in particular through superannuation (retirement) schemes, and (ii) Australia's persistent current account deficit, which is majority-funded by the banks' offshore borrowings.

Pre-crisis, the weighted-average tenor of major Australian banks' wholesale funding was quite short relative to other banks in the Aa category, yet the majors had relatively low levels of liquid assets. Despite this, we maintained high BFSRs because (i) unsecured wholesale market liquidity was very strong, (ii) Australian banks had low-risk loan books which were unlikely to be a cause of concern to investors (as has in fact been the case during the crisis) and (iii) the banks could swiftly monetize their high quality mortgage books by issuing RMBS, because market demand was deep and growing.

However, it does not seem likely that, post-crisis, wholesale market liquidity (and pricing) - in particular in the RMBS market - will swiftly return to pre-crisis levels. Therefore, we would not see the bank being able to maintain its current BFSR if it returns to its pre-crisis liquidity/funding profile, once the current crisis has abated and government and central bank support measures have been wound down. We would therefore expect to see one or more of the following: a longer-weighted-average term of wholesale funding, a higher level of liquid assets and/or more "sticky" deposit funding.

Analysis of CBA's funding mix post-crisis will necessarily entail a greater consideration of behavioural characteristics. For example, Australian banks have been competing aggressively for deposits during the crisis, and we would not consider the high-cost term-deposits recently acquired from non-transaction customers as constituting particularly "sticky" funding. (In this regard, CBA's leading position in retail transaction deposits would suggest favourable characteristics relative to the system average). Conversely, some wholesale funding relationships have remained very solid throughout the crisis: for example, intermediated superannuation savings, directed to cash funds, tend to flow back to high-quality issuers such as the major banks.

In all likelihood, management caution and new regulatory requirements (which seem likely to be phased in over time) may sustain the bank's liquidity/funding metrics at a higher level post-crisis. Until then, this issue is likely to remain a key rating sensitivity.

The Basel committee's December 2009 proposal on liquidity is broadly in line with an earlier proposal by the Australian regulator, which would appear to require banks to increase their holdings of liquid assets. Like the proposal to increase capital requirements, holding more (liquid asset qualifying) low-yielding assets would have negative revenue implications. However, given that - in common with its major bank peers - CBA's liquidity/funding mix is the single greatest point of sensitivity for its BFSR, there may be more benefit to the BFSR from improving liquidity than there would be a drag on the rating created by weaker earnings.

We have not changed the Liquidity Management score in the current BFSR scorecard to reflect the crisis-related support measures offered by the authorities, because they are expected to have a life shorter than the 3-5 year time-horizon covered by our ratings. (However, the support measures do positively influence the bank's deposit and debt ratings - see Joint Default Analysis section below).

Factor 7: Capital Adequacy

Trend: Improving

In the wake of its successive capital raisings taking Tier 1 up to 8.7% pro forma at end September 2009, CBA is significantly better positioned to accommodate the impact of credit downgrades and increased impairment charges resulting from the crisis. It also carries the highest total credit provisions to risk-weighted assets of the major Australian banks at 2.02%

While the 3Q09 capital level is significantly higher than its normal capital target range of over 7%, we would anticipate relative stability in this factor while financial market and economic uncertainty persists, and in anticipation of a potential increase in regulatory requirements - with perhaps some moderate downward pressure as a result of further provisioning. The potential for M&A in the banking space is probably very limited: the competition regulator has indicated it would be unwilling to see significant strengthening of major bank franchises. There may be some potential in the field of wealth management, although CBA is already well positioned.

When looking at Australian AIRB bank capital ratios, it is worth noting that the Australian regulator has exercised its national discretion in a number of areas with regards to the ratio calculation methodology. As a consequence, Australian Basel II capital ratios contain a strong element of conservatism and cannot be compared directly to global peers.

Work by Ernst & Young suggests that Australian bank Tier 1 ratios would be up to 2% higher if calculated under the UK's FSA rules (CBA estimated a 3Q09 FSA Tier 1 ratio of 11.5%). For example, Australian banks include Interest Rate Risk in the Banking Book (a Pillar II item) in their Pillar I calculation, and the regulator sets minimum LGD assumptions on residential mortgages. The Australian Bankers Association publishes a comprehensive guide to the calculation differences:

http://www.bankers.asn.au/default.aspx?ArticleID=1260

With regards to the Basel committee's consultative proposals on capital, the impact on CBA may not be as pronounced as on some major international banks.

- CBA's low level of market risk and exposure to "resecuritisations" will limit the impact of new requirements in this area.

- CBA also has a low capital / assets ratio relative to some major international banks.

- Due to the limited scope of its capital markets activities, exposures to major bank counterparties is lower than some international peers. But it could still be quite significant: due to the shortage of government securities to hold as liquid assets, Australian banks tend to hold securities issued by other commercial banks because they are eligible for repo with the RBA

- CBA is an active issuer of hybrid securities, which may compose up to 25% of Tier 1 capital in Australia.

Should the proposals eventually require additional issuance of common equity, CBA's strong underlying financial performance should allow it to compete well for capital. Meanwhile, higher minimum capital requirements obviously reduce the potential for capital returns, which is likely to continue to support the strong performance of CBA in our ongoing stress-test analysis, and would be a source of support for the bank's existing BFSR.

A final point to note is that at end June 2009, USD 201.5m of CBA's Tier 1 capital base and AUD 275m of its Tier 2 capital consists of long-dated and undated debt instruments guaranteed by the Commonwealth of Australia under transitional arrangements in the Commonwealth Bank Sale Act 1995. The earliest maturity is February 2011, for USD64m, which will have an insignificant impact the bank's capitalization.

From a scorecard perspective, we therefore see CBA's capital as well positioned for its rating - and providing a buffer against potential rises in asset impairment.

Factor 8: Efficiency

Trend: Improving

The bank's cost to income ratio obtains an B grade on the scorecard, in line with its BFSR. Its efficiency measures have improved over recent reporting periods as the bank has consolidated its operations during the crisis.

Factor 9: Asset Quality

Trend: Weakening

Asset quality continues to weaken as the impact of economic slowdown flows through to bank balance sheets, with our base case scenario assuming that write-downs peak in 2010. Nevertheless, CBA's credit losses are likely to remain well below those at banks in weaker developed economies, such as the US or UK.

CBA's residential mortgage losses are likely to remain very low relative to banks in many other developed economies. It is true that high household leverage in Australia and New Zealand have increased sensitivity to interest rate rises and unemployment (which always lags the economic cycle). Also, the bank's participation in the subsidised first-time home buyers market during the crisis period creates an exposure to high loan-to value borrowers that may be particularly vulnerable to unemployment in case of a renewed economic shock. As both interest rates and unemployment rose through 3Q09, CBA's home loan delinquencies (including borrowers covered by concessionary loan repayment schedules under the bank's hardship provisions) continued to rise. However, house price declines during the crisis period were relatively slight in both Australia and New Zealand, and prices have been rising again in Australia to above pre-crisis levels on economic strength and a housing supply shortage being exacerbated by strong net immigration. Moreover, CBA's ultimate credit losses are likely to be contained by the bank's low exposure to high loan-to-value mortgages, absence of subprime-style lending and extensive mortgage insurance cover on its Australian mortgages from highly rated, domestic counterparties.

The outlook for Australian and New Zealand corporate asset quality is bolstered by modest levels of gearing in both markets. Meanwhile, middle market and SME books tend to be secured by relatively high levels of collateral. CBA has experienced levels of exposure to major troubled corporates in line with its peers. While its acquisition of BankWest has brought exposure to stressed commercial real estate in particular in Western Australia, CBA's overall delinquency levels remain in line with the broader banking sector.

With regards to the scorecard, which measures problem exposures relative to capital and provisions, please refer to the comments under Factor 7: Capital about conservative Basel II calculations in Australia. At June 2009, the ratio of (Impaired Loans + Loans 90 Days Past Due) / (Equity + Loan Loss Reserves) was just under 19%, or just within the range expected for a BFSR of B. There would be some tolerance to exceed this level for a limited period of time at the bottom of the cycle.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's JDA analysis is used to assess the potential for systemic support during normal market conditions. Moody's will continue to incorporate this approach into its ratings of bank obligations that are not covered by the Australian government's Guarantee Scheme for Large Deposits and Wholesale Funding. Guaranteed obligations are assigned separate "backed" ratings, on a case by case basis.

Moody's assigns a global local currency (GLC) deposit rating of Aa1 to CBA.

The GLC deposit rating is supported by the bank's Baseline Credit Assessment of Aa3 as well as by Australia's local-currency deposit ceiling (LCDC) of Aaa. Australia's Aaa is one of the most resilient to stress testing, and is not impacted by the crisis-related increase in government debt. CBA receives a 2 notch uplift from its Baseline Credit Assessment, bringing the GLC deposit rating to Aa1.

CBA and the other three major banks are the only institutions in Australia to receive 2 notches of uplift for systemic support, which is generally the greatest amount of uplift we will assign in the Aa category during non-crisis conditions. (During the global financial crisis we have been prepared to assign higher levels of support to banks receiving extraordinary support, but only at the Aa3 level and below).

We view Australia as a high support country. The Australian regulator has a proactive approach to system management, favouring an open resolution approach to prevent problems arising at individual institutions, so as to safeguard financial system stability and safeguard depositor interests (and by extension, creditor interests). The Australian authorities have also demonstrated a pronounced willingness to provide liquidity support - directly from the central bank, or indirectly through supporting the liquidity of the country's major banks - on numerous occasions in recent decades.

During the global financial crisis the Reserve Bank of Australia (RBA) expanded the range of securities it is willing to accept for repo, notably to include self-originated RMBS, and in November 2009 announced that this would become a "permanent feature" of its open market operations. While the RBA indicated that it would not expect banks to fund by means of internal RMBS repo on a regular basis, the existence of such a facility creates a very strong underpinning to the banks' supported ratings, because in case of need they would quickly be able to monetize their large, high quality mortgage books.

During the crisis, the authorities have taken a number of other support measures, including the Government's Guarantee Scheme that will presumably start to be wound down as market conditions normalize. Nevertheless, even when the environment has improved, we believe that the probability of systemic support for CBA in the event of a stress situation will continue to be very high. This is based on the bank's large national market share and relative importance to the country's banking system at 28% of resident customer deposits (excludes CDs and interbank) and 26% of total domestic loans (including securitization) at September 2009 (APRA data). Additionally, the regulator's own Probability And Impact Rating System - which measures the systemic impact of the failure of an individual institution - uses asset size as a major input. As Australia's largest domestic bank, CBA scores highly by this metric.

Importantly for this analysis, CBA is one of Australia's "four pillars", which made up 83% of banking system customer deposits and 82% of loans (including securitization) as at September 2009 (APRA data). The Australian government's four pillar policy restricts domestic M&A amongst the nation's four largest banks (ANZ, CBA, NAB and Westpac) in order to promote competition. We see this policy as implicitly recognising the systemic importance of these four banks - and view it as increasing the potential for them to be supported as a priority, in case of need.

Furthermore, the four pillar banks have a special arrangement to provide each other with liquidity in case of an emergency. Under the interbank deposit agreement, each bank will provide A$2 billion (possibly rising to A$3 billion), so that the recipient would have an additional A$6 billion available for 30 days. The actual dollar amount is probably less significant than the supportive working relationship that this arrangement evidences.

A Financial Claims Scheme was introduced in November 2008, in conjunction with the Guarantee Scheme. The Financial Claims Scheme effectively provides retail depositors with an advance payout on expected recoveries from a bank liquidation, subject to a cap. Currently the cap is A$1 million, but may it be revised substantially downwards in future.

Longer-term, once the current Guarantee Scheme has terminated, the creation of the Financial Claims Scheme offers Australian regulators some new policy options in dealing with troubled banks. It would provide a clear exit mechanism for troubled banks, by reducing the ramifications of a bank's closure for the vast majority of its retail depositors. Potentially this could decrease the likelihood of systemic support being provided and impact our JDA analysis. However, at this stage, such considerations are quite theoretical. Even after the Guarantee Scheme has ended, we would expect that the Australian authorities' propensity to provide liquidity in an emergency will decrease only gradually as public expectations adapt. Furthermore, given the prominent role of Australia's banks in financing the country's persistent foreign funding requirement, we see a significant incentive for the authorities to maintain market confidence in the financial strength of the banks.

Foreign Currency Deposit Rating

The Foreign Currency Deposit ratings of CBA are unconstrained given Australia has a country ceiling of Aaa.

Foreign Currency Debt Rating

The Foreign Currency Debt ratings of CBA are unconstrained given Australia has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the GLC rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of government support for the bank in case a stress situation occurs and the degree of dependence between the issuer rating and the LCDC.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to a high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be reminded that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt obligations may also be constrained by the country ceiling for foreign currency bonds and notes, however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Commonwealth Bank of Australia

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**B**	
Factor: Franchise Value						**B-**	**Improving**
Market Share and Sustainability		x					
Geographical Diversification			x				
Earnings Stability		x					
Earnings Diversification [2]							

Factor: Risk Positioning						**B**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		**x**					
- Risk Management		x					
- Controls		x					
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness			x				
- Quality of Financial Information		x					
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		**x**					
Market Risk Appetite	**x**						
Factor: Operating Environment						**A-**	**Neutral**
Economic Stability		**x**					
Integrity and Corruption	**x**						
Legal System	**x**						
Financial Factors (50%)						**B-**	
Factor: Profitability						**B**	**Weakening**
PPP % Avg RWA - Basel II		3.44%					
Net Income % Avg RWA - Basel II		2.02%					
Factor: Liquidity						**C**	**Improving**
(Mkt funds-Liquid Assets) % Total Assets					23.09%		
Liquidity Management		x					
Factor: Capital Adequacy						**B**	**Improving**
Tier 1 ratio (%) - Basel II			8.12%				
Tangible Common Equity / RWA - Basel II	8.24%						
Factor: Efficiency						**A**	**Improving**
Cost/income ratio	44.80%						
Factor: Asset Quality						**B**	**Weakening**
Problem Loans % Gross Loans		0.93%					
Problem Loans % (Equity + LLR)		12.60%					
Lowest Combined Score (15%)						**C**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**B-**	
Assigned BFSR						**B**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

Moody's Investors Service

RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.