

## Commonwealth Bank of Australia

## Mortgage Covered Bonds

## Update

## Ratings/Outlook

Mortgage Covered Bonds	AAA/Stable
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## Rating Rationale

IDR/Outlook	AA-/Stable
IDR uplift	0 notches
Payment continuity uplift	6 notches
Tested Rating on a probability of default (PD) basis	AA+
Recovery given default uplift	1 notch
Covered bond rating	AAA
Asset percentage Fitch considers in analysis (%)	90.5
AAA breakeven asset percentage (%)	92.0

## Key Data

	Oct 2016
Asset type	Residential mortgages
Cover assets (AUDbn) <sup>a</sup>	32.8
Covered bonds (AUDbn) <sup>b</sup>	29.1
Nominal AP (%)	88.5
WAL of assets (years)	14.7
WAL of liabilities (years) <sup>b</sup>	4.8

<sup>a</sup> Includes cash in GIC account

<sup>b</sup> As at 30 November 2016

## Key Rating Drivers

**Four-Notch Downgrade Buffer:** The 'AAA' covered bond rating is based on Commonwealth Bank of Australia's (CBA) Long-Term IDR of 'AA-', an IDR uplift of zero notches, a payment continuity uplift (PCU) of six notches, a recovery uplift of one notch and an asset percentage (AP) of 90.5% used in the programme's asset coverage test, on which Fitch Ratings relies for its analysis. The AP provides more protection than Fitch's 'AAA' breakeven AP of 92%.

The Outlook on the covered bonds' rating is Stable, as the 'AAA' rating could be sustained even if CBA's IDR were downgraded to 'BBB+'.

**Zero IDR Uplift:** The IDR uplift remains at zero notches. Australia does not have a specific advanced resolution regime, but the regulator can resolve a bank under its regulatory powers pursuant to the Banking Act. Even so, covered bonds are not explicitly exempt from bail-in should a bank be resolved, giving rise to the risk of enforcement of the cover pool. Therefore, CBA's Long-Term IDR remains the floor for its covered bond rating

**High PCU Uplift:** Fitch's PCU of six notches reflects the strength of liquidity protection in place in the form of a 12-month pre-maturity test on the hard-bullet bonds, which has a cure period of six months, and the 12-month extension period on the soft-bullet bonds. While the issued hard-bullet bonds have less liquidity protection due to the six-month cure period, the likelihood of cross default caused by them is not considered likely by Fitch. It also reflects three-month interest protection in the form of a reserve, funded once CBA's Short-Term IDR rating is 'F1'.

**Foreign-Exchange Caps Recovery Uplift:** The recovery uplift is capped at one notch, as foreign-exchange risk could affect recoveries given a default of the covered bonds. This is because the assets are in Australian dollars, while 79% of the covered bonds outstanding are denominated in other currencies. Swaps are in place on the liabilities, though we expect the swaps to terminate upon a bond default. This means the longer-dated Australian dollar asset cash flows will provide recoveries in a different currency than most of the covered bonds.

**Mismatches Drives AP:** The 'AAA' breakeven AP of 92% equates to a breakeven over-collateralisation (OC) of 8.7%. The breakeven OC is driven by the asset-disposal loss component (10.4%) due to significant maturity mismatches in the programme, with the weighted-average (WA) residual life of the assets at 14.7 years and liabilities at 4.8 years. The cover pool's credit loss component is 3.1% and excess spread modelled in the programme enables a 4.8% reduction of OC, which is reflected in the cash flow valuation component.

## Programme Highlights

**Cover Pool Credit Stable:** The cover pool is 100% prime Australian residential mortgages, totalling AUD28.9bn, with WA seasoning of 56 months at end-October 2016. The WA current loan/value ratio (LVR) was 56.4% and the Fitch-calculated WA indexed current LVR was 51.5%. Investment loans formed 25.8% of the cover pool, while 22.3% of the pool was classified as interest-only loans. Approximately 15.3% of the loans in the cover pool benefit from lenders mortgage insurance coverage.

The agency calculated that in a 'AAA' scenario, there would be a cumulative WA frequency of foreclosure of 8.2% (WAFF), and a WA recovery rate including credit to lenders mortgage insurance of 56.5% for the cover pool (see [Fitch Default Model Output](#)).

## Related Research

Commonwealth Bank of Australia  
(May 2016)

APAC Covered Bonds Quarterly – 3Q16  
(November 2016)

Covered Bonds Surveillance Snapshot  
(October 2016)

'B' Portfolio Loss Rates for Covered Bonds  
(September 2016)

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## Cover Pool Mortgage Characteristics: Oct 2016

Current balance (AUDbn)	28.9
Number of loans	134,999
WA current LVR (%)	56.4
WA Fitch calculated indexed current LVR (%)	51.5
WA interest rate (%)	4.5
WA remaining term to maturity (years)	24.0
Investment property (%)	25.8

### Substitute assets

Cash in GI account (AUDbn)	3.9
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### Mortgage insurance (%)

QBE LMI	0.2
Genworth	15.1
No primary insurer	84.7

### Loan type (%)

Fixed	13.1
Variable	86.9

### Repayment type (%)

Principle and interest	77.7
Interest only	22.3

### Property type (%)

House	85.6
Unit	13.7
Other	0.7

### Loan arrears (%)

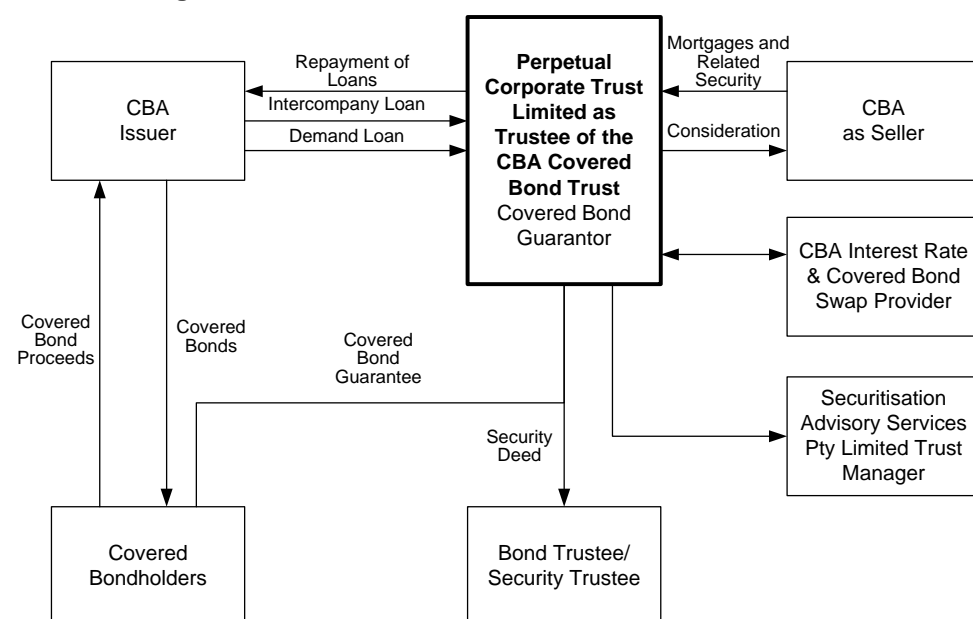
>30 and <= 60 days	0.3
>60 and <=90 days	0.1
>90 days	0.0

### Geographic distribution (%)

Australian Capital Territory	0.4
New South Wales	32.7
Victoria	30.1
Western Australia	12.7
South Australia	5.9
Queensland	14.9
Tasmania	2.2
Northern Territory	1.1

Source: CBA, Fitch

## Structure Diagram



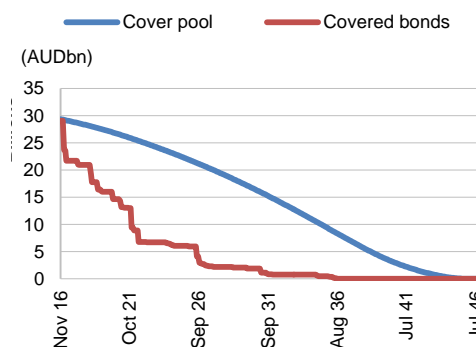
Source: Programme documents

## Fitch Default Model Output (%)

Rating level	'AAA'	'AA+'	'AA'
WA frequency of foreclosure (WAFF)	8.2	7.5	6.9
WA recovery rate (WARR)	56.5	60.0	63.4

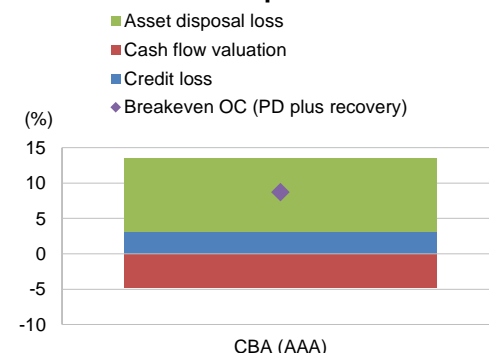
Source: Fitch

## Amortisation Schedule



Source: Fitch

## Breakeven OC Components



Source: Fitch

## Outstanding Mortgage Covered Bonds Volume

Currency	Amount outstanding	Hedged AUD equivalent amt.	No. of issues	(%) of total issue	WA life (years)
AUD	6,084,000,000	6,084,000,000	8	20.9	2.5
CHF	450,000,000	462,363,814	2	1.6	3.4
EUR	9,498,500,000	13,249,393,148	34	45.6	6.7
GBP	1,187,000,000	1,936,237,594	4	6.7	6.3
NOK	4,125,000,000	673,615,918	2	2.3	5.2
NZD	314,000,000	291,957,229	1	1.0	4.1
USD	5,900,000,000	6,363,829,047	7	21.9	1.9

Data as at 30 November 2016

Source: Fitch, CBA

## Related Criteria

[Covered Bonds Rating Criteria \(October 2016\)](#)

[APAC Residential Mortgage Criteria \(August 2016\)](#)

[Global Criteria for Lenders' Mortgage Insurance in RMBS \(July 2016\)](#)

[Global Bank Rating Criteria \(November 2016\)](#)

[Counterparty Criteria for Structure Finance and Covered Bonds \(September 2016\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum \(July 2016\)](#)

[Fitch's Cover Asset Refinancing Spread Level \(RSL\) Assumptions - Excel File \(October 2016\)](#)

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