Commonwealth Bank of Australia

Mortgage Covered Bonds

Full Rating Report

Ratings/Outlook

Mortgage Covered Bonds	AAA/Stable

Rating Rationale

Bank IDR/Outlook	AA-/Stable
IDR uplift	0 notches
PCU	6 notches
Tested rating on a PD basis	AA+
Recovery uplift	1 notch
Covered bond rating	AAA
AP Fitch considers in analysis (%)	92
'AAA' breakeven AP (%)	92

Key Data	30 Nov 17
Asset type	Residential mortgages
Bond maturity profile	Hard/soft bullet
Cover assets (AUDbn)[a]	28.2
Covered bonds (AUDbn)	23.6
Nominal AP (%)[a]	83.7
WAL of assets (years)	14.9
WAL of liabilities (years)	5.5

[a] Includes cash in GIC account

PCU Reduction

Asset segregation	No
Alternative manager	No

Rating Constraint

None

Related Research

Commonwealth Bank of Australia (April 2017)

Commonwealth Bank of Australia – Ratings Navigator (March 2017)

APAC Covered Bonds Quarterly – 3Q17 (November 2017)

Covered Bonds Surveillance Snapshot – Amended (October 2017)

'B' Portfolio Loss Rates for Covered Bonds (September 2017)

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Key Rating Drivers

Four-Notch Downgrade Buffer: The 'AAA' covered bond rating is based on Commonwealth Bank of Australia's (CBA) Long-Term Issuer Default Rating (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 92% used in the programme's asset coverage test (ACT) that Fitch Ratings relies upon in its analysis. This is in line with the agency's breakeven AP. The Stable Outlook on the rating reflects the four-notch buffer against a downgrade of CBA's IDR.

Zero IDR Uplift: The IDR uplift remains at zero notches. In Australia, while there is no specific advanced resolution regime, the regulator does have the ability to 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, resulting in the direct enforcement of recourse against the cover pool for the payment of the outstanding covered bonds. Therefore, CBA's Long-Term IDR remains the floor for its covered bond rating.

Strong Liquidity Protection: The PCU of six notches reflects the strong liquidity protection in place in the form of a 12-month extension period on the soft-bullet bonds, equating to 93.1% of issuance. The remaining hard-bullet bonds have a 12-month pre-maturity test with a cure period of six months. While these bonds have less liquidity protection due to the six-month cure period, Fitch considers the risk of cross default to be low. The PCU also reflects three months of interest protection in the form of a reserve should CBA lose its Short-Term IDR of 'F1+'.

Capped Recovery Uplift: The recovery uplift is capped at one notch, as Fitch believes foreign-exchange (FX) risk could affect recoveries should the covered bonds default. This is because the assets are denominated in Australian dollars, while 89.1% of the covered bonds outstanding are denominated in other currencies. While there are liability swaps in place, we expect these to terminate upon a bond default such that longer-dated Australian dollar asset cash flows will provide recoveries in a different currency than most of the bonds.

Mismatches Drive AP: The 'AAA' breakeven AP of 92% equates to a breakeven overcollaterisation (OC) of 8.7% and is driven by the asset disposal loss component of 10.5%. This reflects the programme's asset and liability mismatches, with a weighted-average (WA) residual life of cover assets at 14.9 years and liabilities at 5.5 years. This creates the potential need to sell assets to make timely payments.

The credit loss component contributes 3.1%, whilst the cash flow valuation component, which represents the excess spread modelled by Fitch, decreases OC by 4.9%.

Programme Highlights

Stable Cover-Pool Credit Quality: The cover pool consisted of 111,790 loans secured by AUD24.3 billion of first-ranking mortgages on Australian residential properties at end-November 2017. The pool's WA loan/value ratio (LVR) was 61.5% and WA seasoning was 54 months. Interest-only loans formed 18.3% of the pool, investment loans 22.8% and 14.7% of loans benefit from lenders' mortgage insurance (LMI).

Fitch calculated that, in a 'AAA' scenario, the cover pool would have a cumulative WA foreclosure frequency of 7.8% and WA recovery rate of 54.1% (Fitch Default Model Output).

Selected Peers for Comparison

Issuer/ programme	IDR/ Outlook	Covered bond rating
Australia and New Zealand Banking Group Limited	AA-/ Stable	AAA/ Stable
National Australia Bank Limited	AA-/ Stable	AAA/ Stable
Westpac Banking Corporation	AA-/ Stable	AAA/ Stable

Source: Fitch

Peer Comparison

The table below compares the key rating drivers for CBA with those of three other regulated Australian covered bonds issued by banks rated in the 'AA-' category. The selected peers are listed in the table in the left margin.

Peer Comparison: Key Rating Drivers

	CBA	Selected peer average	Selected peer range
IDR/Outlook	AA-/Stable	AA-/Stable	AA-/Stable
IDR uplift	0	0	0
PCU	6	5	3 to 6
'B' portfolio loss rate (%)	0.6[a]	0.3	0.2 to 0.3
'AAA' breakeven AP (%)	92	92	91 to 94
Breakeven OC components (%)			
Credit loss (%)	3.1	3.6	3.3 to 3.9
Cash flow valuation (%)	-4.9	-6.7	-7.9 to -6.1
Asset disposal loss (%)	10.5	11.7	9.3 to 13.2

[a] This includes a reduction of the WARR due to the application in the analysis of a minimum expected loss (prior to the application of credit to LMI)
Source: Fitch; data as at end-November 2017

CBA's PCU of six notches is on the upper end of the peer range, reflecting strong liquidity in the programme. The breakeven AP is on the low side of the peer average, driven by a smaller contribution of credit loss and asset disposal loss to the overall breakeven OC. The low asset disposal loss reflects solid overall asset-liability matching, which decreases the need to sell assets. See *Covered Bond Surveillance Snapshot (October 2017)* and the related *excel file* for a detailed comparison of rating drivers across Fitch-rated covered bond programmes.

Country Risk Impact

This section does not apply, as the programme is not affected by country risk. This is because its 'AAA' rating is in line with Australia's Country Ceiling and is the maximum rating achievable. Please see *Structured Finance and Covered Bonds Country Risk Rating Criteria*.

Sensitivity Analysis

The covered bonds would be vulnerable to a downgrade if the relied upon AP rises above the 'AAA' breakeven AP of 92% or if CBA's Long-term IDR falls more than four notches to below 'BBB+'.

Fitch does not give credit to excess OC in the programme, as under Australia's covered bond legislation cover assets not required to repay the covered bonds are not available to preferred creditors upon issuer insolvency. Therefore, Fitch relies on the AP published monthly within the ACT, which, standing at 92%, is in-line with the agency's breakeven AP. Nevertheless, there is a substantial cushion relative to the current nominal AP of 83.7% based on the cover pool and covered bonds outstanding as of end-November 2017.

The rating on the covered bonds would fall to 'AA', one notch above CBA's IDR, if the nominal AP rises to the maximum 95% contractual AP stipulated in the programme documents.

Related Criteria

Covered Bonds Rating Criteria (December 2017)

APAC Residential Mortgage Rating Criteria (July 2017)

Global Bank Rating Criteria (November 2016)

Structured Finance and Covered Bonds Counterparty Rating Criteria (May 2017)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (May 2017)

Fitch's Cover Assets Refinancing Spread Level (RSL) Assumptions - Excel File (October 2017)

RMBS Lenders' Mortgage Insurance Rating Criteria (June 2017)

Abbreviations

AP: Asset percentage
PCU: Payment continuity uplift
IDR: Issuer Default Rating
OC: Overcollateralisation
PD: Probability of default
WAL: Weighted-average life
WAFF: Weighted-average frequency of foreclosure
WARR: Weighted-average recovery rate

The Issuer

CBA is one of Australia's largest and oldest banks, in operation since 1912. It provides a broad range of financial products and services to retail, business and corporate customers. It has a large domestic branch network, with more than 1,100 branches and 4,300 ATMs. CBA had total assets of AUD971.7 billion at end-December 2016 and a domestic home loan lending market share of 21% as of July 2017. CBA has significant banking operations in Australia and New Zealand and expanding operations in Asia. See Fitch's most recent reports on the bank's ratings, Commonwealth Bank of Australia (April 2017) and *Commonwealth Bank of Australia - Ratings Navigator* (March 2017).

IDR Uplift: Zero Notches

Fitch understands the option to resolve authorised deposit-taking institutions (ADI) is possible as part of the Australian Prudential Regulation Authority's (APRA) supervisory powers under Australia's Banking Act. However, the agency believes the framework does not contemplate the power to bail-in creditors and covered bonds are not explicitly exempt from this, giving rise to the risk of the direct enforcement of recourse against the cover pool for the payment of the outstanding covered bonds. An IDR uplift of zero notches is therefore applicable for all Australian covered bond programmes rated by Fitch.

PCU: Six Notches

The PCU of six notches reflects the strong liquidity protection in place in the form of a 12-month extension period on the soft-bullet bonds, equating to 93.1% of issuance. The remaining hard-bullet bonds have a 12-month pre-maturity test with a cure period of six months. While these bonds have less liquidity protection due to the six-month cure period, Fitch considers the risk of cross default to be low due to the size and distribution of the remaining hard-bullet bonds. They form a small proportion of the liability profile (6.9%), which continues to reduce as a result of maturity and further soft-bullet issuance. The programme also includes interest protection provisions in the form of a rolling reserve that will be funded upon the loss of CBA's Short-Term IDR rating of 'F1+', which will cover three months of interest payments and senior expenses. The PCU corresponds to a maximum tested rating on a PD basis of 'AA+'.

None of the other factors influencing payment continuity analysed by Fitch (see Appendix 2) represents a high risk, which in Fitch's view would be otherwise reflected in a PCU reduction.

Recovery Uplift: One Notch

The recovery uplift on the rating is capped at one notch, as Fitch believes foreign-exchange risk could affect recoveries given a default of the covered bonds. This is because the cover assets are denominated in Australian dollars while 89.1% of the covered bonds outstanding are denominated in other currencies. In a default scenario, Fitch expects the covered bond swap will be terminated such that the longer-dated asset cash flows would provide recoveries in a different currency than most of the covered bonds, which could lower recovery expectations.

Cover Pool

CBA's Cover Pool

Characteristics as of end-November 2017

General		**Geographical breakdown (%)**	
Current principal balance (AUDbn)	24.3	New South Wales	33.5
Number of loans	111,790	Victoria	30.3
Number of borrowers	107,777	Queensland	15.8
Average loan per borrower (AUD)	217,714	Western Australia	11.5
WA seasoning (months)	54.3	South Australia	5.4
WA interest rate (%)	4.5	Tasmania	2.1
WA remaining term to maturity (years)	24.1	Northern Territory	1.0
WA current LVR (%)	61.5	Australian Capital Territory	0.4
Maximum loan balance (AUD)	2,624,983		
Interest only (%)	18.3	**Loan type (%)**	
Investment loans (%)	22.8	Fixed	12.3
Loans with LMI coverage (%)	14.7	Variable	87.7
Substitute assets		**Loan arrears (%)**	
Cash in GIC account (AUDm)	3,880	>30 days and <= 60 days	0.23
		>60 days and <=90 days	0.11
		>90 days	0.00

Source: CBA

Default Model Output (%)

Rating	WAFF	WARR	WA MVD	Loss rate
AAA	7.8	54.1	60.0	3.6
AA+	7.2	58.4	57.0	3.0
AA	6.6	62.6	54.0	2.5

MVD: Market value decline
Loss rate = WAFF * (1-WARR)
Source: Fitch

Cover Pool Credit Analysis

Fitch analysed the collateral portfolio using its applicable mortgage loss criteria for Australia in its *APAC Residential Mortgage Rating Criteria*. CBA's quality of origination, servicing procedures and staff qualifications are in line with other Australian prime lenders and Fitch's expectations. The composition and credit quality of the cover pool may change over time because of the dynamic nature of the programme.

The cover pool comprised 111,790 individual loans, with an aggregate outstanding amount of AUD24.3 billion as of end-November 2017. All loans are secured by a first-ranking mortgage. The WA current LVR was 61.5% and the WA seasoning of the mortgage loans was 54.3 months. Interest-only loans formed 18.3% of the pool, while 22.8% of the pool was investment loans. The cover pool was geographically diversified across Australia, with the largest concentration by balance in New South Wales (33.5%) followed by Victoria (30.3%). The cover pool composition is in line with the eligible assets described in Appendix 4 and Fitch views the cover pool to be of high quality.

CBA has provided Fitch with a comprehensive set of loan-by-loan data, which includes the majority of data fields used in the agency's analysis of Australian residential mortgages. Fitch has adjusted the default probability of the cover pool by 5%, as the programme allows further advances to borrowers on mortgages included in the cover pool.

According to Fitch's methodology, the two key components of the default probability on the residential loans are the willingness and ability of a borrower to make payments on the loan. Willingness to pay is usually measured by the current LVR: higher default probability is assigned to high LVR loans. The ability to pay is measured by the ratio of the borrower's income to the mortgage payments: the debt/income ratio. CBA does not supply Fitch with income information to assess ability to repay. Therefore, Fitch makes a conservative assumption based on the originator's underwriting standards and market information. In this case, the agency increased the PD on the loans by 20%, corresponding to a Fitch debt burden/borrower income class of 5 (35% to 40%).

Fitch further adjusts default probability to account for borrower- and asset-specific characteristics. The recovery rates are mainly driven by market value decline (MVD) assumptions.

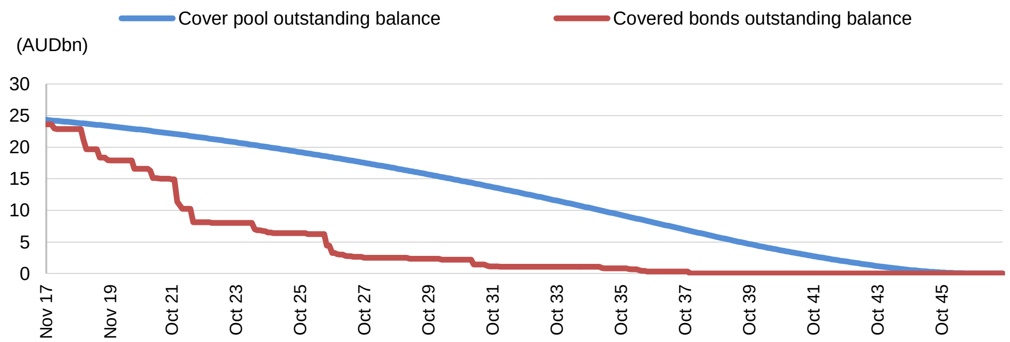
Fitch derived a stressed cumulative default rate and recovery rate for the cover pool based on the loan-by-loan analysis of the cover assets and taking into account the features of the mortgages. In a 'AAA' rating scenario, the WA foreclosure frequency (WAFF) equated to 7.8% and the WA recovery rate (WARR) 54.1% (see *Default Model Output*). The 'AAA' expected loss rate of 3.6% incorporates in the analysis the application of a minimum expected loss floor that includes credit to LMI as part of the calculation of the 'AAA' WARR.

Cash Flow Analysis

Fitch's cash flow model simulates asset cash flows to reflect prepayments, servicing costs, delinquencies, defaults and recoveries in multiple stress scenarios under various issuer default timings. The model tests whether the cover pool can service principal and interest payments on the covered bonds in a timely manner, while hypothesising a switch to the cover pool as a source of payment at different dates. Based on Fitch's analysis, an AP of 92% is sufficient to withstand Fitch's 'AA+' tested rating on a PD basis under the covered bonds cash flow model.

The below graph shows the amortisation profile of the assets assuming no prepayments and the amortisation of the outstanding covered bonds.

Amortisation Schedule



Source: Fitch/CBA

Maturity Mismatches

The cover assets are amortising, with an average remaining maturity of 14.9 years, while the covered bonds had an average residual maturity of 5.5 years as of end-November 2017. As a result, temporary liquidity surpluses or shortfalls may arise, straining available resources. Fitch models any cash not needed to repay liabilities as being reinvested with a new deposit account provider at an assumed rate of 50bp below the one-month bank bill reference rate (BBSW).

The agency assumes that if there is a liquidity shortfall, an alternative manager would be able to sell part of the mortgage portfolio within the timeframe provided by the maturity extension on the covered bonds. The ability to find a buyer will depend on a number of factors, including buyer appetite in light of the economic environment and the proportion of the portfolio required to be liquidated.

Under the documents, the amount of assets that can be sold for any one bond is contractually restricted to a pro rata proportion of that bond against the total covered bond liabilities outstanding. This restriction ensures earlier-maturing covered bonds cannot use additional cover pool assets over and above their pro rata allocation to the detriment of later-maturing bonds (see Appendix 1: section 1.3). Fitch replicated this feature in its cash flow modelling of the programme.

To determine the stressed price at which such asset sales would occur, Fitch has assumed a refinancing cost (shown in the table on the following page) for any potential buyer. However, in light of the lack of a precedent in Australia, there is no guarantee that a portfolio can be realised in any prevailing economic environment.

Refinancing Spread Levels

(bp)	AAA	AA	A	BBB	BB	B
Australian mortgage loans	250	218	189	165	144	125

Source: Fitch

Hedging

The covered bond guarantor (CBG) has entered into an interest-rate swap agreement with CBA to swap the interest paid on the loans into a BBSW plus a margin every month. The CBG has also entered into a covered bond swap for each series of covered bonds with CBA to hedge currency-exchange risk between the Australian dollar flows received from the interest-rate swap and those due on the foreign-currency-denominated covered bonds. The covered bond swaps in place are forward-starting swaps; this means there will be no exchange of cash flow under the covered bond swaps as long as CBA acts as swap counterparty and no issuer event of default has occurred. No FX stresses are applied, as the programme is hedged.

Summary of Hedging in Programme

Swap type	Currency	(%)	Swap provider	Rating
Fixed-floating (assets)	No	100	CBA	AA-/Stable/F1+
Fixed-floating (liability)	Yes	100	CBA	AA-/Stable/F1+

Source: Fitch, CBA

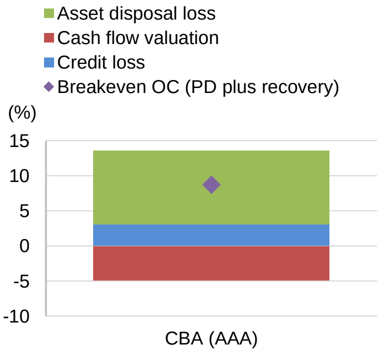
The cover assets, which are a mix of fixed- and variable-rate mortgages, are hedged with a total return swap provided by CBA. Fitch models the lower of the swap margin for the fixed-rate mortgage loans and 2%, which is the maximum swap margin given credit for in the modelling of the programme. For the variable-rate products, we assume a stressed-asset margin of 2% as we do not expect the total return swap to be replaced for the variable-rate products.

Fitch models all liabilities with floating rates in Australian dollars as this is their post-swap status and all swap documentation entered into provides mitigants to counterparty risk. This is in line with Fitch's criteria.

Breakeven AP for the Rating

Fitch calculated a 'AAA' breakeven AP of 92%, which equates to an OC of 8.7%. The 'AAA' breakeven AP relates to a 'AA+' tested rating on a PD basis and one-notch recovery uplift to the 'AAA' covered-bond rating. The breakeven AP is dependent on multiple factors that could be affected by significant movements in the WA interest rate on the bonds or a change to the WA remaining term. Fitch will regularly reassess the breakeven AP in line with the covered bond ratings and upon new issuances or cover pool changes.

Breakeven OC Components



Source: Fitch

The equivalent 'AAA' breakeven OC of 8.7% is driven by the asset disposal loss component of 10.5% due to the maturity mismatches between the cover assets with a WA residual life of 14.9 years and the covered bonds with 5.5 years. The credit loss component contributes 3.1%, and the cash flow valuation component decreases the breakeven OC by 4.9%, due to the available excess spread modelled by Fitch in the programme based on a stressed WA life of the assets (7.8 years inclusive of prepayments) versus the stressed WA life of the liabilities (5.3 years inclusive of extension period) post an assumed switch to the cover pool as simulated by Fitch in its cash flow analysis.

The breakeven AP for the rating will be affected, among other things, by the cover pool's credit quality and the profile of the cover assets relative to the outstanding covered bonds. These factors can change over time.

AP Fitch Relies On

Fitch does not give credit to excess OC in the programme. See *Sensitivity Analysis* for details.

Programme Review

Fitch will periodically review the credit quality of the cover pool and perform a cash flow analysis to assess whether the AP taken into account by the agency provides protection against identified risks commensurate with the rating of the covered bonds issued by CBA under this programme. Cover pool and covered bond information is updated quarterly and displayed on Fitch's covered bond surveillance tool (available at *www.fitchratings.com*) and in the quarterly *Covered Bonds Surveillance Snapshot*.

Disclaimer

References in this report to the content and impact of relevant legislation and/or regulation represent Fitch's interpretation. Fitch relies on legal opinions or memoranda provided by issuers' and/or other outside legal counsel. As Fitch has always made clear, Fitch does not provide legal advice or confirm that a country's legal or regulatory framework, the legal opinions or memoranda, or any other programme documents or any structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

Appendix 1: Programme Summary

CBA can issue up to USD30 billion of covered bonds under this programme. The bonds are guaranteed by the CBG and secured by a dynamic pool of Australian residential mortgages. The covered bonds rank pari passu among themselves and are CBA's direct, unconditional, unsecured and unsubordinated obligations. Covered bond holders benefit from dual recourse against the guarantor secured by the cover assets and an unsecured, unsubordinated recourse against CBA.

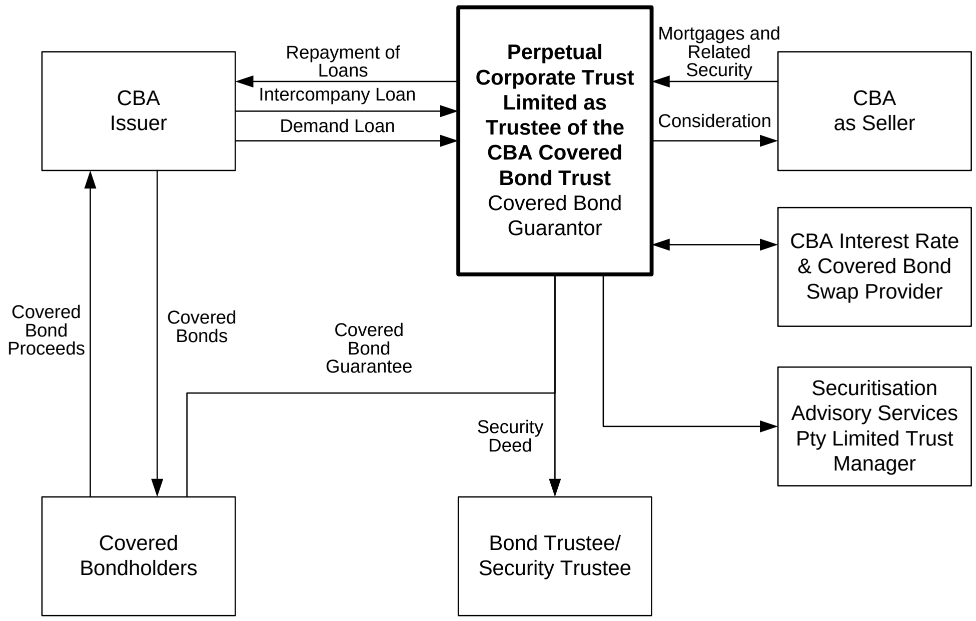
The CBG will borrow funds from CBA through an intercompany loan that is split into two components – guarantee loan and demand loan. It will use these funds to purchase residential mortgages on an equitable assignment basis or substitute assets from CBA. The CBG has been established solely to provide an unconditional and irrevocable guarantee whereby it will pay, under certain circumstances, interest and principal on the covered bonds when they become due.

Role	Counterparties	Long/Short Term Ratings
Issuer	Commonwealth Bank of Australia	AA-/Stable/F1+
Seller/originator	Commonwealth Bank of Australia	AA-/Stable/F1+
Servicer	Commonwealth Bank of Australia	AA-/Stable/F1+
Intercompany loan provider	Commonwealth Bank of Australia	AA-/Stable/F1+
Demand loan provider	Commonwealth Bank of Australia	AA-/Stable/F1+
Interest-rate swap provider	Commonwealth Bank of Australia	AA-/Stable/F1+
Covered bond swap provider	Commonwealth Bank of Australia	AA-/Stable/F1+
Account bank	Commonwealth Bank of Australia	AA-/Stable/F1+
CBG	Perpetual Corporate Trust Limited	Not rated
Trust manager	Securitisation Advisory Services Pty Limited	Not rated
Bond trustee	Deutsche Trustee Company Limited	Not rated
Security trustee	P.T. Limited	Not rated
Principal paying agent	Deutsche Bank AG, London Branch	BBB+/Stable/F2
Cover pool monitor	PricewaterhouseCoopers	Not rated

Source: Fitch

1.2 Structure Diagram

Structure Diagram



Source: Programme documents

1.3 Commonwealth Bank of Australia: Summary of Structural Features

Structural feature	Explanation
CBG	Provides credit support to the issuer.
Pre-maturity test	Provides liquidity to the CBG in relation to amounts of principal due on the final maturity date of the hard bullet covered bonds.
ACT	Ensures a minimum level of OC on the covered bonds to protect bondholders against specific credit and market risks. It is calculated monthly, both before and after an issuer event of default, so long as bonds are outstanding under the programme. If breached, failure to satisfy the ACT on or before the immediately succeeding monthly calculation date after the breach will constitute an issuer event of default. The ratio between covered bonds and cover assets may not exceed 95% (the maximum AP) at any time.
Amortisation test	After an issuer event of default, an amortisation test verifies whether the value of the cover pool, including any cash held in the GIC account and substitute assets, adjusted to account for delinquencies and collateral value, is higher than the notional amount of the outstanding covered bonds. Failure to pass the amortisation test will trigger a CBG event of default, which allows the bond trustee to serve a guarantor acceleration notice. The CBG will be obliged to sell the loans and the proceeds will be used to repay, pro rata, the outstanding covered bonds. The amortisation test mitigates time subordination of covered bonds within the programme.
Reserve fund	Established in the GIC account to trap available revenue receipts or to credit the remaining proceeds of a term advance if CBA's short-term credit rating falls below 'F1+'. The reserve fund amount will cover interest payments and senior expenses on a rolling three-month basis.
Selected asset required amount	The amount of assets that can be sold for any one bond is contractually restricted to that of the bond’s pro rata proportion of the committed amount of OC. This restriction is so that earlier-maturing covered bonds cannot use cover pool assets over and above their pro-rata allocation to the detriment of later-maturing ones.
Soft bullet extension	If the issuer fails to pay the final redemption amount of the relevant series of covered bonds on the maturity date (subject to applicable grace periods), then payment of the unpaid amount pursuant to the covered bond guarantee that cannot be paid by the CBG on the final bond maturity date shall be automatically deferred (12 months after bond maturity date). Any amount representing the final redemption amount due and remaining amount unpaid on the extension determination date may be paid by the CBG on any interest payment date thereafter, up to the relevant extended due for payment date.

Source: Programme documents

1.4 Outstanding Mortgage Covered Bonds Volume

Currency	Amount outstanding	Hedged AUD equivalent amount	Number of issues	% of total issue	WA life (years)
AUD	2,584,000,000	2,584,000,000	6	10.9	4.6
CHF	450,000,000	462,363,814	2	2.0	2.4
EUR	8,948,500,000	12,724,115,148	37	53.8	7.1
GBP	1,487,000,000	2,454,422,799	4	10.4	5.2
NOK	4,125,000,000	673,615,918	2	2.9	4.2
NZD	314,000,000	291,957,229	1	1.2	3.1
USD	3,850,000,000	4,439,730,354	5	18.8	1.7

Data as at 30 November 2017
Source: Fitch, CBA

Appendix 2: Other Payment Continuity Risk Considerations

Asset Segregation

Fitch expects that ringfencing of the cover pool will be effective given the 'all or nothing' nature of this risk. The ringfencing of cover assets from the claims of unsecured creditors of the defaulted financial institution is achieved by virtue of law – often in the form of an exemption to normal bankruptcy legislation or through a transfer of the assets to a bankruptcy-remote special-purpose vehicle (SPV) acting as a guarantor of the issued covered bonds.

Asset Segregation: No Impact on PCU

Component driver	Fitch assessment
Segregation of cover pool from other creditors of issuer	SPV model used – contractually achieves asset segregation from the issuer's insolvency estate through the "true sale" of the mortgage assets to the SPV by way of equitable assignment to the CBG. Upon title perfection, full legal title is transferred to the CBG. The cover assets will be unavailable to any other creditor of the issuer until the claims of preferred creditors are satisfied fully, unless part of the pool is deemed as excess assets in accordance with legislation in Australia.
Excess OC at risk	Excess cover assets, defined under legislation as assets that are not required to repay the covered bonds, will not be available to preferred creditors after issuer insolvency.
Asset and liability claw-back risk	Asset claw-back risk is addressed through the provision of solvency certificates by the issuer as a condition of each sale of assets, providing evidence that the issuer is solvent at the time of entering into the sale. There is no feature to mitigate the claw-back risk on covered bond payments. However, the programme documentation does not include claw-back amounts as part of the guaranteed amounts the CBG is contractually required to pay.
Commingling risk	CBA currently provides the GIC account. In the event that its rating falls below a Short-Term IDR of 'F1' or a Long-Term IDR of 'A', or if the servicer is rated below 'F1+' or 'A+' and placed on Rating Watch Negative, the GIC account is to be replaced within 30 days with a financial institution rated at least 'A'/'F1'. Commingling risk is sufficiently addressed by security over the collection account in the name of the CBG, which should remain bankruptcy-remote in the event of issuer insolvency. It is also mitigated through the transfer of collections to the GIC account within two business days of receipt if the servicer's rating falls below a Short-Term IDR of 'F1' or Long-Term IDR of 'A' or if the servicer is rated below 'F1+' or 'A+' and the rating is placed on Rating Watch Negative.
Set-off risk for deposits	Set-off of deposits is specifically disallowed within the underlying mortgage agreements entered into by borrowers.

Source: Fitch

Alternative Management

Systemic Alternative Management

Fitch takes into consideration the framework or contractual clauses governing the appointment of a substitute manager – together with the length of time required to appoint one – any potential conflict of interest (in cases where a single administrator in a bankruptcy takes care of covered bonds and other creditors), the manager's responsibilities in the servicing and liquidation of the cover assets to meet payments due on the covered bonds and any further protection due to oversight or potential support for regulated covered bonds.

If Fitch assesses that systemic alternative management represents a high risk to payment continuity, the otherwise achievable PCU for the programme will be reduced by one notch if the otherwise achievable PCU is in the one-to-three-notch range and by two notches if it is in the four-to-eight-notch range.

Systemic Alternative Management: No Impact on PCU

Component driver	Fitch assessment
Administrator takes exclusive care of covered bondholders? When are they appointed?	In an issuer event of default, it falls upon the CBG to make arrangements in the interest of covered-bond holders in accordance with programme documents. The security trustee can also appoint an administrator where there is a covered bond event of default by the CBG.
Importance of timeliness of payments in the legal provisions	Following a switch of recourse to the cover pool, the CBG is required to ensure timely payment of the covered bonds. CBA currently acts as servicer. The servicer will be replaced where its Long-Term IDR falls below 'BBB-'. If the servicer defaults, it needs to be replaced immediately; the CBG takes on this role until an appropriate servicer is appointed.
Substitute manager able to sell cover assets or borrow to make timely payments?	Should liquidation of the cover pool be contemplated, the CBG can appoint a sales advisor to manage the asset sale on behalf of the CBG. A sales advisor can be an investment bank or an accountant of recognised standing that will have incentives to achieve the highest possible market price available at that time. The conditions of the sale would be subject to the security trustee's consent.
Regulatory oversight	Fitch considers oversight by APRA to be positive. Covered bond issuers have ongoing reporting requirements to demonstrate that the covered bond programmes fulfil the requirements of the legislation and APRA's prudential requirements under Prudential Standard APS 121: Covered Bonds.

Source: Fitch

Cover-Pool-Specific Alternative Management

Fitch focuses on the likely ease of the transferability of relevant data and IT systems to an alternative manager and buyer, basing its judgement on the quality and quantity of data it receives.

If Fitch assesses cover-pool-specific alternative management to represent a high risk, we will lower the programme PCU. It will reflect a greater link to the Long-Term IDR of the issuing institution via a reduction of one notch if the otherwise achievable PCU is in the one-to-three notch range and two notches if it is in the four-to-eight notch range.

Cover Pool Alternative Management: No Impact on PCU

Component drivers	Fitch assessment
Cover assets, debtors' accounts and privileged swaps clearly identified within IT systems	Adequate IT systems and processes are in place, which allow for the identification of cover assets and swaps belonging to the covered-bond programme.
Standardised or custom-made IT systems used.	CBA's IT system, loan documentation processes and data are deemed to be satisfactory by the agency. The mortgage business's core IT platform has been sourced externally and can produce data in a format that can readily be used by alternative IT systems. Borrower loan accounts and cash flows belonging to the cover pool are flagged in the system, making them easily identifiable. The system provides the raw data, which is loaded into CBA's Helios system. Helios performs the calculations and reporting required for CBA to manage its covered bond programme.
Automation and speed of cover pool reporting	CBA provides data that Fitch considered as highly adequate and within the agency's requirements, with only a minimal amount of data missing.
Adequate filing of loan documentation, evidence of security	Fitch considers the filing of loan documentation as satisfactory.

Source: Fitch

Appendix 3: Origination and Servicing

Origination

Loan applications are received from the lender via CommSee Home Loans. Applicants are accepted or declined by the credit scorecard system or referred to a credit-approval officer. The approval process involves assessing the borrower's ability to fund their mortgage commitments, verifying application details and determining the mortgaged property's eligibility and valuation.

Borrower verification involves checks to provide evidence of income and genuine savings through statements and recent payslips, proof of identity and employment details. At least two years' annual financial statements are required for self-employed borrowers; if there is a 20% variance between the last two years' statements, a more rigorous analysis is carried out.

For refinancing, credit checks are performed to provide evidence of no previous disruption in mortgage repayments. All loan applications are submitted electronically and each applicant's assessment is done on-screen using dual screens to allow applications and supporting documents to be viewed simultaneously.

An assessment of each applicant's debt-servicing history is carried out following the verification process. The applicant must demonstrate an acceptable credit history and satisfy a minimum disposable income level after all commitments, including the proposed housing loan, with an allowance for interest-rate increases. The credit assessment decision is carried out via two channels: the credit scorecard and credit-approval authority. In some cases, the outcome may trigger additional external credit checks, for instance, new customers and loans requiring LMI. Loans that are not credit scored or referred by the scorecard are directed to a credit analyst. Credit decisions are made by CBA employees with varying levels of delegated authority, based entirely on seniority and experience within the credit-approval team. Each credit analyst must be assessed prior to receiving credit approval for delegated authority and CBA has a process that constantly monitors and reviews each analyst's performance.

Arrears Management/Special Servicing

Where a housing loan is in arrears, the system allocates the loan to designated collections officers. Borrowers are initially contacted with an SMS reminder once the repayment is two days overdue, followed up with a call by one of the collection officers once the repayment is 21 days overdue. When a loan is 60 days delinquent, a statutory default notice is issued and appropriately served on the borrower, advising that if the matter is not rectified within 30 days CBA will be entitled to start loss-mitigation proceedings without further notice. The asset is classified as impaired once the borrower is 90 days delinquent.

Once the statutory default notice expires, the loss-mitigation team implements a strategy to either take possession of the mortgaged property or implement a hardship plan depending on the arrears history, level of equity in the property and any previous arrangements with the borrower to meet overdue payments. All hardship requests undergo a full financial assessment, together with appropriate supporting documentation as evidence of the borrower's financial situation. The LMI provider must be notified once hardship is approved to borrowers where LMI is concerned. There are several hardship options available, including deferral of payments, waiving fees and charges and deferral of enforcement proceedings. Accounts classified as hardship are monitored for three months after the curing of arrears. Hardship mortgage accounts are monitored by the Customer Assist team and remain classified as in arrears until cured.

Once the account reaches 120 days overdue, a letter of demand and notice to vacate is sent, and at 150 days a statement of claim is sent to the borrower. The above periods assume that the borrower has not taken any action or satisfied the arrangements in relation to the arrears.

All properties obtain a full valuation and a reserve price is set before sale at public auction. The experienced asset realisation team sources a number of recovery options, including voluntary sale, guarantees, government assistance schemes and claims on LMI and mortgagee sales. The arrears management performed by the group is fairly typical of market practices.

Document Custody

CBA will act as custodian, hold all mortgage loan documents under its safe-keeping practices and ensure all security packets are correctly marked and segregated for ease of identification.

Business Continuity

CBA has business continuity plans, supported by back-up data centres. CBA's business continuity plans are sufficiently robust to allow for the restart of operations at alternative locations without any significant interruption to operations.

Appendix 4: Legal Framework

The table below is based on Fitch's understanding of certain aspects of the applicable regime and is not a substitute for the original texts or Australian legal advice.

Main Characteristics of Australian Legislative Covered Bonds

Issuer	Australian-based ADI.
Supervision	APRA is the regulator under the covered bond framework. Responsibilities and authority include the issuing of covered bonds, assets in cover pools, the monitoring and maintenance of cover pools and enforcement of compliance with such rules.
CBG requirements	A person who is a statutory trustee or a wholly owned subsidiary of a statutory trustee.
Eligible assets	• Loans secured by mortgages, charges or other security interest over residential properties in Australia and the associated LMI policies or other assets. Residential mortgages with LTV ratios of more than 80% can be included in the pool, but the value of the loan is reduced by the amount of excess (above 80% LTV) for the calculation of the 3% legal minimum OC. • Loans secured by mortgages, charges or other security interest over commercial properties in Australia and the associated LMI policies or other assets. Commercial mortgages with an LTV ratio of more than 60% can be included in the pool, but the value of the loan is reduced by the amount of excess (above 60% LTV) for the calculation of the 3% legal minimum OC. • Derivatives held to: (i) protect the value of another asset in the cover pool; (ii) hedge risks related to another asset in the pool; (iii) hedge risks related to covered bonds. • Substitute assets in the form of Australian-dollar deposits, bank bills and certificates of deposit with a maturity of less than 100 days that are not issued by the covered bond issuer are capped at 15% of the covered bonds issued. Bonds, notes or debentures issued by the Commonwealth, a State or a Territory of Australia are also eligible as substitute assets.
Regulatory limit	No more than 8% of the issuer's banking group assets can be cover assets.
AP	Lowest of either the contractual (maximum) AP or other such percentage notified to the CBG, bond trustee and security trustee on any date, and is applied in the ACT.
ACT	Adjusted collateral value of each loan in the pool, capped at the lower of 80% of the indexed value of the property securing the mortgage and the AP.
Protection against mismatches	Mismatches addressed via contractual arrangements; that is, a 12-month maturity extension on soft-bullet bonds and 12-month pre-maturity test on hard-bullet bonds.
Interest rate and currency risks	Interest rate and currency mismatches are hedged though swaps entered into by the CBG with a suitably rated counterparty, in this case, with the issuer. Should the counterparty be downgraded below 'A'/ 'F1', swap collateral will be posted according to the credit-support agreement. Swap documentation stipulates rating triggers for the replacement of the swap counterparty.
Treatment of swap counterparties	Swap counterparties rank pari passu with covered bond holders in the post-enforcement priority of payments; termination payments due to counterparty default are subordinated to covered bond interest payments.
Bankruptcy remoteness	• SPV model used – contractually achieves asset segregation from the issuer's insolvency estate through the "true sale" of the mortgage assets to the SPV by way of equitable assignment to the CBG. Upon title perfection, full legal title to the underlying mortgages will be transferred. • Asset pool unavailable to any other creditor of the issuer until the claims of the preferred creditors are met unless deemed as excess assets. • Excess cover assets are defined under the legislation as assets not required to repay the covered bonds and will not be available to preferred creditors post issuer insolvency. • Preferred creditors to retain an unsecured claim against the issuer if claims not fully satisfied from the pool.
Title perfection events	• Upon the service of a notice to pay. • The sale of mortgages to a third party, other than the seller. • By order of a court. • Termination of the issuer's role as servicer. • Seller requesting perfection of sale. • An insolvency event in relation to the seller. • The seller's IDR falls below 'BBB-'.
Asset monitor	Qualified auditor, or holds an Australian financial services licence, or exempt to provide such licence and is independent to the issuing ADI to verify the accuracy of the asset register, ACT, amortisation test and compliance of the ADI.
Alternative manager	No alternative or dedicated independent manager appointed upon issuer insolvency. The CBG, who is also the trustee of the SPV, is obliged to select and sell assets with the assistance of a sales advisor to make repayment of the covered bonds. In the event of a CBG default, the security trustee has the power to appoint a receiver, whose duties are prescribed by the specific programme documents.

Source: Fitch

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below