

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	n.a.
D-cap	4 (Moderate)
Tested rating on a PD basis	AA
Recovery given default uplift (notches)	2
Covered Bonds rating	AAA
AP Fitch considers in analysis (%)	89.5
AAA break-even AP (%)	89.5

Discontinuity Risk (D-Cap of 4)

Overall assessment	Moderate
Asset segregation	Very low
Liquidity gap and systemic risk	Moderate
Systemic alternative management	Moderate
Cover pool-specific management	Moderate
Privileged derivatives	Moderate

Key Data

	Sep 15
Asset type	Residential mortgages
Cover assets (AUDbn)	27.4
Covered bonds (AUDbn)	23.9
Nominal AP (%)	
WAL of assets (years)	14.9
WAL of liabilities (years)	4.1

Related Research

[Commonwealth Bank of Australia \(June 2015\)](#)

[APAC Covered Bonds Quarterly – 3Q15 \(November 2015\)](#)

[Covered Bonds Surveillance Snapshot \(July 2015\)](#)

[Covered Bonds with Extendible Maturities \(October 2014\)](#)

['B' Portfolio Loss Rates for Covered Bonds \(September 2015\)](#)

[Breaking Down Breakeven Overcollateralisation \(July 2014\)](#)

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Key Rating Drivers

Stable 'AAA' Rating: The 'AAA' covered bond rating is driven by Commonwealth Bank of Australia's (CBA) Long-Term Issuer Default Rating (IDR) of 'AA-', an unchanged D-Cap of 4 and the asset percentage (AP) of 89.5% used in the programme's asset coverage test, which is equivalent to Fitch's 'AAA' break-even AP of 89.5%. The Outlook on the covered bonds' ratings is Stable, as the 'AAA' rating could be sustained even if CBA's IDR were downgraded to 'A'.

High Asset-Disposal Loss: The 'AAA' break-even AP of 89.5% equates to a break-even over-collateralisation (OC) of 11.7%. The break-even OC is driven by the asset-disposal loss component (14.3%) due to significant maturity mismatches in the programme, with the weighted-average (WA) residual life of the assets at 14.9 years and liabilities at 4.1 years. The cover pool's credit loss component remains stable at 3.6%. Excess spread in the programme enables a 5.0% reduction of OC, which is reflected in the cash flow valuation component.

Unchanged D-Cap of 4: The D-Cap remains unchanged at 4 notches (Moderate Risk), in line with two other Australian peers, and reflects the Moderate risk assessment for four of the five components. The remaining component – asset segregation – has a very low risk assessment.

Two-Notch Rating Cushion: The mortgage covered bonds' 'AAA' rating would be vulnerable to a downgrade if CBA's IDR were downgraded by three notches to 'A-' or lower, or where the D-Cap falls to 0 (full discontinuity). A downgrade could also stem from the AP that Fitch uses in its analysis rising above the agency's 'AAA' break-even AP of 89.5%.

Reliance on Contractual AP: In its analysis, Fitch relies on the contractual AP used by the issuer in the asset coverage test (ACT), which in this case is 89.5%. Australian covered bond legislation states that assets held in cover pools in excess of the amount required to repay the covered bonds are not considered cover pool assets, but as assets of the issuing bank.

Programme Highlights

Stable Credit Quality: The cover pool is 100% prime Australian residential mortgages, totalling AUD27.4bn with WA seasoning of 54.3 months at end-September 2015. The WA current loan/value ratio (LVR) was 56.2% and Fitch-calculated WA indexed current LVR 51.3%. The agency calculated that in a 'AAA' scenario there would be a cumulative WA frequency of foreclosure of 8.1% (WAFF), and a WA recovery rate including lenders mortgage insurance of 68.8% for the cover pool (Figure 3).

Conversion to Soft Bullet: Soft-bullet issuance with a 12-month extension period equates to 85% of the total issuance outstanding. In October 2015, CBA converted AUD9.6bn equivalent of hard bonds to soft bullet bonds with a 12-month extension period following consent from investors. The remaining hard bullet bonds no longer drive the liquidity gap and systemic risk assessment in the programme.

Interest/FX Risks Hedged: CBA acts as swap counterparty for both the asset swap and the liability swap. The cover assets yield both fixed and floating rates, and a swap is in place to transform the interest collections from the cover assets into a one-month bank bill swap reference rate, plus a spread. The AUD23.8bn of bonds have been issued in Australian dollars (15.9%), Swiss francs (1.9%), euros (35.6%), UK pounds (7.8%), Norwegian krone (2.8%), New Zealand dollars (1.2%) and US dollars (34.7%).

Figure 1

Cover Pool Mortgage Characteristics: Sep 2015

Current balance (AUDbn)	27.4
Number of loans	127,929
WA current LVR (%)	56.2
WA Fitch calculated indexed current LVR (%)	51.3
WA interest rate (%)	4.8
WA remaining term to maturity (years)	24.1
Investment property (%)	28.1

Substitute assets

Cash in GI account (AUDbn)	3.6
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Mortgage insurance (%)

QBE LMI	0.1
Genworth	15.4
No primary insurer	84.5

Loan type (%)

Fixed	12
Variable	88

Repayment type (%)

Principle and interest	77.9
Interest only	22.1

Property type (%)

House	89.1
Unit	10.3
Other	0.6

Loan arrears (%)

>30 and <= 60 days	0.23
>60 and <=90 days	0.11
>90 days	0.00

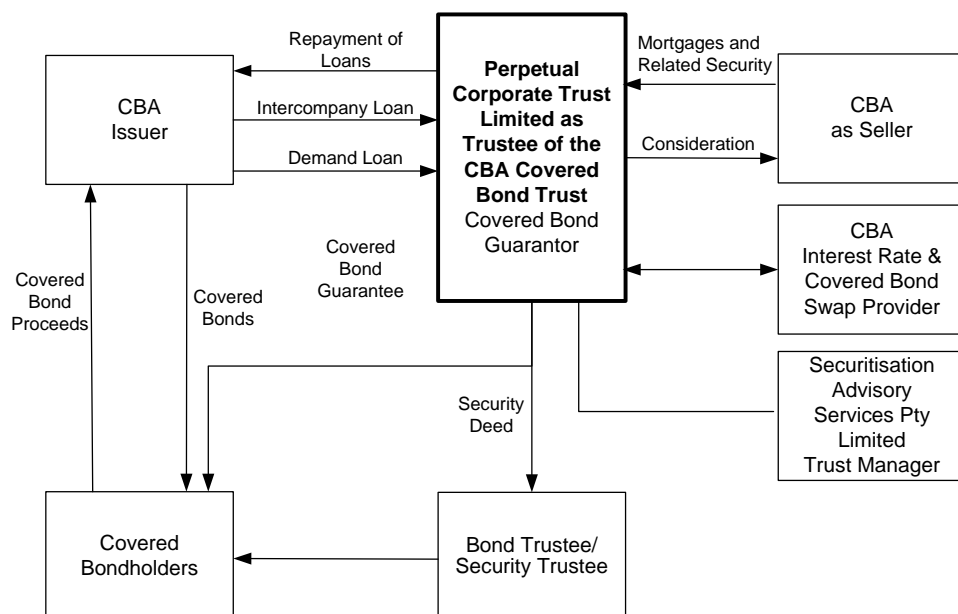
Geographic distribution (%)

New South Wales/ACT	33.2
Victoria	31.0
Western Australia	12.3
South Australia	6.3
Queensland	13.8
Tasmania	2.3
Northern Territory	1.0

Source: CBA, Fitch

Figure 2

Structure Diagram



Source: Programme documents

Figure 3

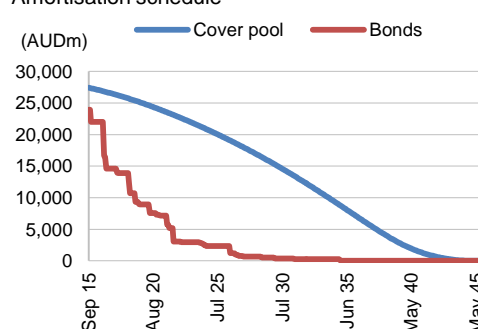
Fitch Default Model Output (%)

Rating level	'AAA'	'AA+'	'AA'
WA frequency of foreclosure (WAFF)	8.1	7.4	6.8
WA recovery rate (WARR)	68.8	73.0	77.2

Source: Fitch

Figure 4

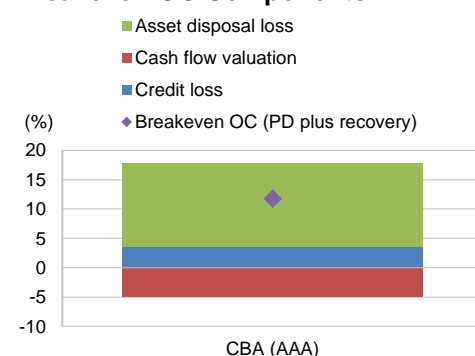
Commonwealth Bank of Australia Amortisation schedule



Source: Fitch

Figure 5

Breakeven OC Components



Source: Fitch

Figure 6

Outstanding Mortgage Covered Bonds Volume

Currency	Amount outstanding	Hedged AUD equivalent amt.	No. of issues	% of total Issue	WA Life (yrs.)
AUD	3,784,000,000	3,784,000,000	5	15.9	1.8
CHF	450,000,000	462,363,814	2	1.9	4.5
EUR	6,343,500,000	8,498,101,644	22	35.6	5.9
GBP	1,150,000,000	1,871,870,312	3	7.8	7.5
NOK	4,125,000,000	673,615,918	2	2.8	6.3
NZD	314,000,000	291,957,229	1	1.2	5.2
USD	7,900,000,000	8,269,135,325	8	34.7	2.4

Source: Fitch, CBA

Related Criteria

[Covered Bonds Rating Criteria \(July 2015\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds \(May 2014\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum \(May 2014\)](#)

[Covered Bonds Rating Criteria – Mortgage Liquidity and Refinancing Stress Addendum \(September 2015\)](#)

[APAC Residential Mortgage Criteria \(July 2015\)](#)

[Global Criteria for Lenders' Mortgage Insurance in RMBS \(June 2015\)](#)

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