MOODY'S
INVESTORS SERVICE

Credit Opinion: Commonwealth Bank of Australia

Global Credit Research - 20 Dec 2015

Sydney, New South Wales, Australia

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aa2/P-1
Baseline Credit Assessment	a1
Adjusted Baseline Credit Assessment	a1
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Issuer Rating	Aa2
Senior Unsecured	Aa2
Subordinate -Fgn Curr	A3
Subordinate -Dom Curr	A3 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Baa1 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1
ASB Finance Limited	
Outlook	Stable
Bkd Senior Unsecured	Aa3
Bkd Commercial Paper	P-1
Bkd Other Short Term	(P)P-1
Commonwealth Bank of Australia-New York	
Outlook	Stable
Bank Deposits	Aa2/--
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Senior Unsecured	Aa2

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Key Indicators

Commonwealth Bank of Australia (Consolidated Financials)[1]

	[2]**6-15**	[2]**6-14**	[2]**6-13**	[3]**6-12**	[3]**6-11**	**Avg.**
Total Assets (AUD million)	**832,339.0**	**765,902.0**	**715,755.0**	**683,216.0**	**639,988.0**	[4]**6.8**
Total Assets (USD million)	**639,734.2**	**722,896.9**	**655,165.3**	**700,332.1**	**685,168.0**	[4]**-1.7**
Tangible Common Equity (AUD million)	**40,352.0**	**36,935.8**	**32,708.3**	**29,022.0**	**26,036.8**	[4]**11.6**
Tangible Common Equity (USD million)	**31,014.5**	**34,861.9**	**29,939.5**	**29,749.1**	**27,874.9**	[4]**2.7**
Problem Loans / Gross Loans (%)	**0.8**	**0.9**	**1.1**	**1.4**	**1.7**	[5]**1.2**
Tangible Common Equity / Risk Weighted Assets (%)	**10.9**	**10.9**	**9.9**	**9.6**	**9.2**	[6]**10.6**
Problem Loans / (Tangible Common Equity + Loan Loss	**11.4**	**13.5**	**16.7**	**22.3**	**29.0**	[5]**18.6**

Reserve) (%)						
Net Interest Margin (%)	**2.0**	**2.1**	**2.0**	**2.0**	**2.0**	[5]**2.0**
PPI / Average RWA (%)	**3.8**	**3.9**	**3.6**	**3.8**	**3.7**	[6]**3.8**
Net Income / Tangible Assets (%)	**1.1**	**1.2**	**1.1**	**1.1**	**1.1**	[5]**1.1**
Cost / Income Ratio (%)	**41.8**	**40.5**	**41.4**	**42.4**	**43.0**	[5]**41.8**
Market Funds / Tangible Banking Assets (%)	**31.5**	**32.9**	**33.5**	**34.7**	**35.5**	[5]**33.6**
Liquid Banking Assets / Tangible Banking Assets (%)	**17.5**	**16.2**	**15.3**	**15.5**	**14.1**	[5]**15.7**
Gross loans / Due to customers (%)	**135.4**	**138.8**	**140.4**	**142.9**	**149.4**	[5]**141.4**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's Aa2 senior unsecured rating of the Commonwealth Bank of Australia's (CBA) reflects the bank's stable profitability, asset quality and conservative balance sheet settings. In addition, the Aa2 rating incorporates two notches of uplift over CBA's standalone financial strength of a1, in recognition of the bank's systemic importance and the traditionally supportive approach of Australia's bank supervisors.

The bank's ratings have been well supported by positive performance trends over the recent years. Its strong profitability is supported by its domestically-oriented business mix and pricing power. The bank's funding and liquidity settings have seen a significant improvement since the global financial crisis and remain conservative, although improvements in these metrics appear to have run their course. CBA's capital levels are strengthening, reflecting domestic and global regulatory reform. The exceptional current asset quality profile of the bank has been benefiting from a prolonged period of low interest rates, but we expect it to come under greater pressure going forward.

The bank's current strong credit profile needs to be placed in the context of a patchy operating environment in Australia. Our central scenario assumes steady, but below-trend economic growth, supported by an accommodative monetary policy. However, the Australian economy is undergoing a period of transition, characterised by a sharp fall in the resources sector investment, as well as growing imbalances in the property market. On balance, CBA remains well-positioned for a period of continuing economic uncertainty with a strong balance sheet, a low-risk loan book and a high level of operating efficiency. As a result, CBA's rating remains strongly positioned within its ratings band.

Rating Drivers

- Australia's Very Strong macro profile

- Exceptional franchise value supporting strong profitability

- Bad debt charge at very low levels, expected to over time revert toward long-term averages

- Strengthening capital metrics

- Improved funding and liquidity profile, but still an area of rating focus

Rating Outlook

CBA's ratings have a stable outlook. The outlook reflects the bank's flexibility to absorb potential losses in the event of a sharp deterioration in the operating environment.

What Could Change the Rating - Down

CBA's stable rating outlook is based on our core scenario of resilient economic growth in Australia. An unexpectedly severe adverse change in economic conditions, leading to an increase in the amount of nonperforming loans, would be a negative. The rating would come under downward pressure should the Australian housing market experience any substantial further acceleration in house prices, raising the risk of a sharper-than-expected correction.

The rating outlook is also predicated upon a stable funding profile: a reversion toward a greater proportion of confidence-sensitive funding and in particular short-term (<1 year) offshore wholesale debt issuance, not accompanied by a commensurate increase in liquid assets, could result in downward pressure on the rating.

What Could Change the Rating - Up

In light of CBA's already high baseline credit assessment, and the potential for global wholesale funding markets to remain sensitive to reversals in investor confidence, an upgrade does not appear likely in the near term.

DETAILED RATING CONSIDERATIONS

CBA's ratings reflect the following considerations:

CBA'S RATING IS SUPPORTED BY AUSTRALIA'S VERY STRONG MACRO PROFILE

Australian banks, including CBA, benefit from operating in an economy with a very high degree of economic resilience, institutional and government financial strength, and a low susceptibility to event risk. Australia is in its 24th year of uninterrupted economic growth, albeit the economy is currently confronting challenges of reducing investment in the resources sector and falling commodity prices.

Our baseline scenario assumes GDP growth in the low 2% range for 2016. The economy will continue to shift away from resources investment towards growth in sectors stimulated by low interest rates and a weakened Australian dollar, such as residential construction and export-oriented services industries, primarily tourism and education. The relatively labour-intensive nature of these sectors as well as subdued wages growth have helped to stabilize the unemployment rate in the 6.0-6.5% range. At the same time, the continuing unwinding of the commodities cycle is exerting pressure on regional economies and sectors exposed to mining.

Threats emanating from house price inflation have been rising. Since June 2013, house prices in the key Sydney and Melbourne market have increased by 43% and 29% respectively. To a substantial extent, the rapid appreciation has been driven by a sharp increase in the investor housing segment, which we view as a material downside risk. Regulatory action taken during 2015, designed to curb investment lending and, in turn, dampen asset price appreciation, is starting to bear fruit with a decline in investment lending in Q3 2015 and a sharp deceleration in property auction activity. However, the full effects of regulatory measures may take some time to emerge.

Our view of the operating environment also reflects banks' strong pricing power as a result of a highly concentrated banking sector. The sector's most important vulnerability remains Australia's structural reliance on external financing: on a net basis, Australia's foreign debt funding has traditionally been sourced primarily through the banking system, exposing Australian banks to the risk of sudden shifts in foreign investor sentiment.

EXCEPTIONAL FRANCHISE VALUE SUPPORTING STRONG PROFITABILITY

CBA has an entrenched franchise position in the Australian and New Zealand markets as one of Australia's `four pillar' banks (which combined maintain approximately 80% of total resident assets with 22% for CBA; source: Australian Prudential Regulation Authority (APRA) Monthly Banking Statistics). CBA has looked to further entrench its competitive position through an update of its core IT systems, with the view of enhancing customer loyalty and improving operational efficiencies. Moreover, Australia's "four pillars" policy, which prohibits the four major banks from merging with each other, lessens the risk of M&A, and allows CBA to maintain relatively conservative loan underwriting standards and adequate risk-adjusted pricing. In addition, its Advanced Internal Ratings-Based (IRB) accreditation under the Basel capital rules provides it with a competitive edge vis-à-vis smaller Australian banks operating under the Standardised approach (albeit we expect this advantage to narrow over time as a result of increasing residential mortgage risk weights for Australian IRB banks, further likely risk weight reform under the guidance of the Basel Committee for Bank Supervision and the potential for Australian regional banks to obtain IRB accreditation).

We expect that over the next 12-18 months, the low interest rate environment, rising credit costs and competitive tension in the Australian market are likely to place CBA's net interest margins (NIM) under increasing pressure, Its entrenched market position and pricing power should allow it to maintain a NIM in the relatively healthy 2.00%-2.05% range. We also expect it to retain a mid-to-high teens ROE through the cycle. Over the recent past, the bank has been able to pass on some of the increased funding costs - as well as costs of increasing capital levels - to borrowers. The bank's NIM is also supported by attenuating competition for less stable, high-cost deposits in recent reporting periods. To reflect CBA's structurally strong profitability, we apply a positive adjustment to this section of our scorecard, assessing Profitability at `aa3'.

BAD DEBT CHARGE AT VERY LOW LEVELS, EXPECTED TO OVER TIME REVERT TOWARD LONG-TERM AVERAGES

CBA's asset quality metrics are currently exceptional, reflected in our assigned `aa2' Asset Risk score. For FY 2015 the loan impairment charge was 0.16%, significantly below estimated long-term averages of 0.35-0.40%.

Whilst we see CBA's asset quality performance as a clear positive, its long-term sustainability is doubtful. The credit cycle appears to have peaked and we see any further material improvement in asset quality as unlikely. We expect further gradual increases in loan impairment over the next 12-18 months, reflecting the more challenging operating environment in Australia. The bank's strong asset quality metrics are underpinned by the following three factors:

1. A material portion of the improvement in credit performance can be attributed to the lower interest rate environment since 2013. Mortgage interest rates are currently at multi-decadal lows. In addition Australian borrowers are on average materially ahead of their repayment schedules. Similarly, Australian corporates have been cautious and currently maintain considerable liquidity reserves. Although low interest rates will continue underpinning good asset quality in the short run, the economic transition Australia is undergoing will inevitably create some pockets of weakness and will eventually move credit costs from their current low base. In addition, borrowers will inevitably come under greater stress when interest rates start rising again.

2. CBA's asset quality benefits from its focus on the domestic Australian market and on residential mortgage lending, which has continued to perform well. Australian mortgages were ~70% of CBA's gross loans as at June 2015 (Source: APRA Monthly Banking Statistics). We also note loan-to-value ratios of banks' mortgage portfolios are at a cyclical low (the current dynamic average loan-to-value ratio for CBA is 48%). In addition, in Australia, higher loan-to-value exposures are covered by A-rated domestically-incorporated mortgage insurers. Our central scenario remains for stability in asset quality in the housing market. That said, household leverage in both Australia and New Zealand is high, and the tail risk of a potential correction in the housing market should economic circumstances shift or in response to higher interest rates cannot be dismissed.

3. CBA's corporate exposure concentrations are generally of high quality: the majority is either investment grade or well-secured. The portfolio is well diversified by industry. Its direct exposure to resources industries, undergoing transition, is low (3.0% of total committed credit exposure as at December 2014, including coal ports and transport terminals), albeit as with all Australian banks CBA retains high second-order exposure to the commodities cycle should its unwinding result in more negative effects on the Australian economy than currently anticipated. CBA's single borrower concentration is moderately high, reflecting the concentrated nature of its main markets and the small size of corporate bond markets in Australia and New Zealand. In common with other Australian banks, CBA runs a very low level of market risk.

STRENTHENING CAPITAL METRICS

CBA currently has a 10.8% Tangible Common Equity capital ratio. Its Common Equity Tier 1 (CET1) ratio is 9.1% (on an APRA Basel III basis, equating to 12.7% on an internationally comparable Basel III calculation basis). Coupled with adequate provisioning, this creates a solid cushion to absorb credit losses. Our stress tests indicate that although in a severe recession - equivalent to loss rates observed in the US between 2008-11 - CBA's capital cushion would be materially eroded, it would not fall under the 4.5% headline regulatory minimum (albeit we note that Australian banks are subject to individual Prescribed Capital Ratios set by APRA).

In August 2015, CBA announced a AUD 5 billion capital raising, which will bring CBA's CET1 ratio to 10.4% on an APRA basis, and 14.3% on a self-reported internationally comparable basis. We see CBA's capital management initiatives as reflective of the changing regulatory requirements faced by the Australian banking sector. In July 2015, APRA announced that mortgage risk weights will be rising to at least 25% for the four Australian major banks from the current 15%-18% (16% for CBA). Furthermore, end-point minimum regulatory capital levels are likely to increase on the back of the recommendations made in November 2014 by Australia's independent Financial System Inquiry and, globally, changes overseen by the Financial Stability Board.

The strengthening capital metrics will better position the bank ahead of anticipated regulatory reform. At the same time, its ultimate, end-point regulatory capital needs remain unclear, with a possibility of greater-than-anticipated increases in regulatory capital requirements. In our view, CBA and its peer Australian major banks have entered a more rapid capital accumulation phase, likely to extend well into 2016.

Given CBA's strong organic capital generation and ability to adjust its net dividend payout, including through the use of its dividend reinvestment plan, we expect the bank to be able to meet the higher capital requirements within the likely implementation timetable. Overall, we consider CBA's capital profile to be relatively strong, and have accordingly adjusted this section of our scorecard to `a2' from `baa1'.

IMPROVED FUNDING AND LIQUIDITY PROFILE, BUT STILL AN AREA OF RATING FOCUS

Australia's major banks, including CBA, have a structural reliance on wholesale funding, with an important offshore component. However, this reliance reduced steadily since the global financial crisis as a result of strong deposit growth and deleveraging by households and the corporate sector. CBA has rebalanced its funding base towards deposits, with deposit funding at 63% as at June 2015. In addition, CBA has continued to increase the tenor of its new wholesale issuance, which has lifted the average tenor of its long-term wholesale portfolio to 3.8 years.

We view the lengthening of wholesale funding tenors to be credit positive, directly addressing the key rating sensitivity of Australian banks, which is their sensitivity to funding market conditions. Similarly, we view the longer-term trend towards increased deposit funding to be broadly favorable: competition for less-stable, high cost deposits appears to have attenuated and there is more focus on deposits with more stable characteristics. We do note, however, the improvement in CBA's funding profile has now run its course, with funding metrics broadly stable over the past year. So long as the bank maintains a conservative maturity profile, we view a moderate increase in debt funding from current levels to be credit-neutral. Overall, we have adjusted the Funding Structure score to the `baa1' from `baa3' to reflect the strength of CBA's deposit franchise and improvement in the maturity structure of its liabilities.

At the same, we note that the bank's wholesale funding task remains relatively large and continues to expose CBA to market conditions. Although not our central scenario, should demand for loans accelerate and deposit growth slow further or reverse, how the bank responds will be a critical rating consideration. Any increase in confidence-sensitive funding - such as short-tenor debt issuance, in particular abroad, or high-yield uninsured deposits - not accompanied by a commensurate increase in liquid assets, would be viewed as rating negative.

The bank has reported a Liquidity Coverage Ratio (LCR) of 120% as at June 2015. The LCR regime came into effect in Australia in January 2015. CBA's liquid assets for the purposes of the LCR calculation include an AUD 66 billion Committed Liquidity Facility (CLF) from the Reserve Bank of Australia, and approved by APRA, and total LCR liquid assets stand at AUD 132 billion. Overall, we have adjusted the Liquid Resources score to `a3', primarily reflecting the strong systemic support received by Australian banks due to the CLF.

Notching Considerations

There is currently no statutory bail-in in Australia. As a result, we do not consider Australia to have an operational resolution regime (as defined in our methodology). We apply a basic loss-given-failure (LGF) approach in rating Australian banks' junior securities.

In determining whether Australia has an operational resolution regime we take into account both the current resolution framework and the Australian policymakers' public stance. Although Australia is a member of the Financial Stability Board (FSB) and the FSB has highlighted the lack of statutory bail-in as a gap relative to international standards, the Australian authorities have thus far adopted a more cautious and nuanced public stance on this issue. The Treasury has commented that further consideration is warranted, but noted concerns about the workability of bail-in for large institutions. At the same time, while supporting to the objective to minimize the burden of bank resolution costs on tax payers, the RBA has opined that the policy "toolkit" should retain the ability to "take an institution under public ownership before selling it again when the risk appetite of the private sector has returned to more normal levels".

In its final report, Australia's Financial System Inquiry has recommended that Australia adopts a loss absorbing capacity and resolution framework. The Inquiry expressed preference for introducing securities with contractual bail-in features, rather than creating a statutory bail-in regime. APRA has indicated that it will hold discussions regarding domestic loss absorbency standards during 2016. We expect that these discussions will encompass the broader range of loss absorbency and bank resolution issues, potentially including that of senior creditor bail-in.

The exact resolution mechanisms ultimately adopted in Australia remain to be determined. Accordingly, their impact on bank ratings would depend on the degree to which the positive impact of higher loss-absorption capacity offsets the possible reduction in Moody's assumption of systemic support for the banks' senior obligations.

Under the basic LGF approach we currently apply in Australia, CBA's dated subordinated debt with contractual point-of-non-viability features is rated A3, two notches below the bank's adjusted baseline credit assessment (BCA) of a1. Its non-cumulative preference shares are rated three notches below its BCA, at Baa1.

GOVERNMENT SUPPORT

Potential for systemic support remains very high. CBA's Aa2 deposit and senior debt ratings incorporate two notches of uplift from the bank's BCA of a1, reflecting a high probability that, as a consequence of its size, it would receive systemic support in case of need. At the margin, we also view CBA's position as one of the "four pillars" (the four major banks, which government policy prevents from merging) to increase the potential for support.

As described above, changes in Australia's resolution regime could lead to reduced support assumption for the banks' senior obligation. Increased loss-absorbing requirements could also place pressure on ratings uplift attributable to government support, since they reduce the likelihood of bank resolution taking place by way of bail-out and instead imply a higher level of burden sharing with creditors.

COUNTERPARTY RISK ASSESSMENT

Counterparty Risk Assessments (CR Assessments) are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

CBA's long-term CR Assessment is positioned at Aa1(cr). The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA and therefore above the Preliminary Rating Assessment of senior unsecured debt obligations -- reflecting Moody's view that the probability of default of obligations represented by the CR Assessment is lower than that of senior unsecured debt. Moody's believes that senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

For CBA, the CR Assessment also benefits from government support in line with Moody's `Very High' support assumptions on long-term issuer ratings and senior unsecured debt. This reflects Moody's view that any support provided by governmental authorities to the bank which benefits senior unsecured debt is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with Moody's belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve the bank's critical functions.

ABOUT MOODY'S BANK SCORECARD

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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

Macro Factors						
Weighted Macro Profile	**Very Strong**	**100%**				
Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**

		Score				
Solvency						
Asset Quality						
Problem Loans / Gross Loans	0.9%	aa1	←→	aa2	Sector diversification	Quality of assets
Capital						
TCE / RWA	10.9%	baa1	↑	a2	Expected trend	Risk-weighted capitalisation
Profitability						
Net Income / Tangible Assets	1.1%	a2	←→	aa3	Earnings quality	
Combined Solvency Score		a1		aa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	31.5%	baa3	←→	baa1	Extent of market funding reliance	Market funding quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	17.5%	baa1	←→	a3	Quality of liquid assets	Access to committed facilities
Combined Liquidity Score		baa2		baa1		

Financial Profile	**a1**

Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint	Aaa
Scorecard Calculated BCA range	**aa3-a2**
Assigned BCA	**a1**
Affiliate Support notching	0
Adjusted BCA	**a1**

Instrument class	Assigned LGF Notching	Additional Notching	Preliminary Rating Assessment	Government Support	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	1	0	aa3 (cr)	2	Aa1 (cr)	--
Deposits	0	0	a1	2	Aa2	Aa2
Senior unsecured bank debt	0	0	a1	2	Aa2	Aa2
Dated subordinated bank debt	-1	-1	a3 (hyb)	0	A3 (hyb)	A3 (hyb)
Non-cumulative bank preference shares	-1	-2	baa1 (hyb)	0	Baa1 (hyb)	Baa1 (hyb)

- Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.