

Research Update:

Commonwealth Bank of Australia & Subsidiaries Ratings Lowered On Bank Criteria Change

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Overview

- Following a review of Commonwealth Bank of Australia under Standard & Poor's revised bank criteria (published Nov. 9, 2011), we have lowered our long-term issuer credit rating on Commonwealth Bank of Australia Ltd. (CBA) to 'AA-' from 'AA'. Our 'A-1+' short-term rating on CBA is affirmed. The outlook is stable.
- Our ratings on subsidiaries of CBA have also been lowered following our review (see Ratings List).
- Our ratings on CBA reflect the anchor SACP for a bank operating mainly in Australia; plus the bank's strong business position; adequate capital and earnings, risk position, and liquidity; and average funding.
- The stable outlook reflects our expectations of Commonwealth Bank of Australia's continued satisfactory earnings, credit losses remaining well under control, adequate capitalization, well-managed funding and liquidity and conservative risk appetite.

Rating Action

As previously announced, on Dec. 1, 2011, Standard & Poor's Ratings Services lowered its long-term issuer credit rating on Commonwealth Bank of Australia (CBA) to 'AA-' from 'AA'. The 'A-1+' short-term rating is affirmed. Our long-term issuer credit rating on ASB Bank Ltd. (ASB), CBA's core New Zealand banking subsidiary, has also been lowered to 'AA-'. The ratings on CBA's insurance and wealth-management subsidiaries have also been lowered (see Ratings List). All outlooks are stable.

At the same time, we withdrew the bank fundamental strength rating on the bank.

Rationale

Our ratings on CBA reflect the anchor stand-alone credit profile (SACP) for a bank operating mainly in Australia; plus the bank's "strong" business position; "adequate" capital and earnings, risk position, and liquidity; "average" funding; and potential government support.

Our bank criteria use the BICRA economic risk and industry risk scores to determine a bank's anchor (SACP), the starting point in assigning an ICR. On a weighted basis, the countries in which CBA has exposures have an economic risk of '2' and an industry risk of '2', which corresponds to an anchor rating of

'a-' for CBA. Australia accounts for approximately 85% of CBA's exposures and largely drives the weighted scores. The BICRA score is informed, among other things, by our evaluation of economic risk, whereby we view Australia as a wealthy, open, and resilient economy. We consider that build-up of private sector credit and asset prices has eased in the recent years, and that moderate private sector debt is offset by conservative lending practices and a creditor-supportive legal framework. With regard to industry risk, our assessment of the Australian banking industry is underpinned by the country's conservative and comprehensive regulation and the banking sector's very low risk appetite, partly offset by limited funding support from customer deposits and a material dependence on net external borrowings.

The SACP for CBA is 'a'.

We assess CBA's business position as "strong". This opinion is based on CBA's dominant domestic retail market share, consistent and focused strategy, and competent management team. As the largest retail bank in Australia, with about A\$668 billion of assets at June 30, 2011, a key factor underpinning business stability is a dominant domestic market share of retail deposits (26.9%) and mortgage lending (25.7%). The group's strategy has been consistent over the past few years, and the focus has been on building Australia's finest financial services organization through strategic initiatives such as profitable growth, trust and team spirit, customer satisfaction, business banking, and technological and operational excellence. CBA's Asian expansion is expected to remain targeted on acquisitions and ventures on a relatively small scale. A stable and competent executive team had been in place over the past three years.

We assess CBA's capital and earnings as "adequate", reflecting our expectation that the bank's pre-diversification risk-adjusted capital (RAC) ratio will trend toward 8% over the next 12-18 months. This expectation factors in our view that CBA's internal capital generation would be affected by pressure on net interest margins, and subdued system growth. We expect CBA's ratio of core earnings as a percentage of adjusted assets to be maintained during the next three years. On a regulatory risk-weighted-asset basis, CBA's core ratio is higher than that of the other domestic big four banks and other international peers. Finally, while it is not included in the RAC ratio, we note that CBA's Perls III hybrid debt issue, which has a step-up feature, also contains equity features that, from a qualitative point of view, are factored into our overall assessment of CBA's capital and earnings position.

We assess CBA's risk position as "adequate", primarily reflecting our view that the low-risk characteristics of CBA's Australian residential mortgage portfolio are adequately captured by the RAC ratio. CBA has a formal risk-appetite statement that is conservative and embedded in the group and across all divisions. The group's underwriting standards are conservative, and reflected in the group's credit metrics. While CBA's GFC-related losses were lower compared with many highly-rated international banks, we note that the economic and commercial property downturns in Australia and New Zealand were less severe than that experienced in the U.S. and Europe.

We assess CBA's funding as "average" and liquidity as "adequate". While CBA and the other Australian major banks are considered by us to be materially reliant on wholesale funding--this being a fundamentally negative rating factor--we note that much of this risk has been taken into account by us in our recent revision of our BICRA assessment of Australia to group '2' from group '1'. We consider CBA's liquidity to be well managed. Compared to the other large Australian banks, CBA has the second largest proportion of customer funding (61% of total funding). Customer funding increased to A\$349 million from A\$324 million (with the group positioning itself in terms of the new Basel III liquidity requirements), and as a result, customer funding as a percentage of total funding increased to 61% from 58% for the financial year ended June 30, 2011, thereby improving the group's reliance on stable retail funding. Moreover, according to APRA data, CBA has the largest amount and highest proportion of household deposits compared to total deposits (42% at Oct. 31, 2011).

Our counterparty credit rating on CBA is two notches higher than the SACP, reflecting our view of a high likelihood of extraordinary government support in a crisis. This reflects our view of CBA's high systemic importance in Australia, and our assessment of the Australian government as highly supportive of institutions core to the national economy.

We have lowered the issue ratings on CBA's non-deferrable senior subordinated debt to 'A-' from 'AA-', which is one notch below CBA's SACP, because we believe that Australia's legal and regulatory framework could allow authorities to instigate restructuring of a failing bank to the detriment of non-deferrable subordinated debt. We have lowered the issue ratings on ASB's non-deferrable senior subordinated debt to 'A-' from 'AA-' which is one notch below CBA's SACP, reflecting our view that ASB is a core subsidiary of CBA. We have, likewise, lowered the issue ratings on CBA's hybrid capital instruments to 'BBB', which is three notches below the SACP on the bank. Under our criteria, the three-notch differential reflects the narrow-distributable-profits test that is applicable to hybrid-capital instruments issued by Australian banks.

Outlook

The stable outlook is based on Standard & Poor's view that CBA has: continued satisfactory earnings; adequate capitalization; a conservative risk appetite; credit losses well under control; and well-managed funding and liquidity.

We anticipate that CBA's funding and liquidity improvements over recent years--including positive deposit growth as a percentage of liabilities, a reduction in potentially sensitive short-term wholesale funding, and a progressive lengthening of its wholesale liability profile--will be permanent rather than transitory. In the unlikely event of a significant liquidity stress event, we expect that the bank will qualify for central bank and other government support mechanisms.

We consider that an upward revision of the bank's SACP is unlikely. We believe the bank's RAC ratio of 7.5% is likely to remain in the 7%-10% range over the medium-term, which we believe is consistent with our current view of CBA's capital as "adequate", and the SACP of 'a'. We do not envisage downward ratings momentum affecting the bank's SACP in the short-to-medium term, and believe that CBA can even sustain some tolerance of rigidity in non-performing asset levels at the current rating level.

Downward rating momentum could occur in the unlikely event that the bank experienced funding or liquidity stress, in particular if timely and sufficient government-support mechanisms did not manifest in the manner we would anticipate. Downward rating momentum could also be prompted by the emergence of risk outside tolerances within the current SACP, such a reduction in the RAC ratio to below 7%.

Ratings Score Snapshot

Issuer credit rating	AA-/Stable/A-1+
SACP	a
Anchor	a-
Business position	Strong (+1)
Capital and earnings	Adequate (0)
Risk position	Adequate (0)
Funding and liquidity	Average and adequate (0)
Support	+2
GRE support	0
Group support	0
Sovereign support	+2
Additional factors	0

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings List

Downgraded

	To	From
ASB Bank Ltd.		

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Certificate of deposit		
Foreign currency	AA-	AA
CBFC Ltd.		
Certificate of deposit		
Local currency	AA-	AA
Colonial Holding Co. Ltd.		
Issuer credit rating	A+/Stable/A-1	AA-/Stable/A-1+
The Colonial Mutual Life Assurance Society Ltd.		
Counterparty credit rating		
Local currency	AA-/Stable/--	AA/Stable/--
The Colonial Mutual Life Assurance Society Ltd.		
The Colonial Mutual Life Assurance Society Ltd. (NZ Branch)		
Financial strength rating		
Local currency	AA-/Stable/--	AA/Stable/--
Commonwealth Bank of Australia		
Senior unsecured (526 issues)	AA-	AA
Subordinated (20 issues)	A-	AA-
Subordinated (1 issue)	BBB	AA-
Preferred stock (2 issues)	BBB	A+
ASB Bank Ltd.		
Senior unsecured (8 issues)	AA-	AA
Subordinated (2 issues)	A-	AA-
ASB Capital Ltd.		
Subordinated (1 issue)	BBB	A+
ASB Capital No.2 Ltd.		
Subordinated (1 issue)	BBB	A+
ASB Finance Ltd. (London Branch)		
Senior unsecured (7 issues)	AA-	AA
Bank of Western Australia Ltd.		
Subordinated (1 issue)	BBB	AA-
CBA Capital Australia Ltd.		
Preference stock (1 issue)	A-	AA-
CBA Capital Trust		
Junior subordinated (1 issue)	BBB	A+
CBA Capital Trust II		
Junior subordinated (1 issue)	BBB	A+

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CBFC Ltd. Senior secured (1 issue)	AA-	AA
Colonial Finance Ltd. Senior unsecured (7 issues)	A+	AA-
Preferred Capital Ltd. Junior subordinated (1 issue)	BBB-	A+
Downgraded; Ratings Affirmed	To	From
Commonwealth Bank of Australia CommBank Europe Ltd. CBA Funding NZ Ltd. Bank of Western Australia Ltd. Issuer credit rating	AA-/Stable/A-1+	AA/Stable/A-1+
ASB Bank Ltd. CBFC Ltd. ASB Finance Ltd. Issuer credit rating	AA-/Stable/A-1+	AA/Stable/A-1+
ASB Bank Ltd. Certificate of deposit Local currency	AA-/A-1+	AA
Bank of Western Australia Ltd. Certificate of deposit	AA-/A-1+	AA
Not Rated Action	To	From
Commonwealth Bank of Australia Bank fundamental strength rating Local currency	NR	A
ASB Bank Ltd. Bank fundamental strength rating Local currency	NR	B+
Ratings Affirmed		
Commonwealth Bank of Australia Certificate of deposit Foreign currency	A-1+	
Commonwealth Bank of Australia Senior unsecured (2 issues)	axAAA	
Senior unsecured (54 issues)	cnAAA	
Certificate of deposit (1 issue)	A-1+	
Commercial paper (2 issues)	A-1+	

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ASB Bank Ltd.		
Certificate of deposit (1 issue)		A-1+
Commercial paper (2 issues)		A-1+
ASB Finance Ltd. (London Branch)		
Senior unsecured (1 issue)		cnAAA
Commercial paper (2 issues)		A-1+
Bank of Western Australia Ltd.		
Certificate of deposit (2 issues)		A-1+
Commercial paper (1 issue)		A-1+
CBA (Delaware) Finance Inc.		
Commercial paper (1 issue)		A-1+
CBA Funding NZ Ltd.		
Commercial paper (1 issue)		A-1+
CBFC Ltd.		
Senior secured (1 issue)		A-1+
Commercial paper (1 issue)		A-1+

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