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Commonwealth Bank of Australia

18 October 2023

Sector: Financials
Sub-sector: Banks
Country: Australia
Ownership: Public

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Issuer Outline

The Commonwealth Bank of Australia (CBA) is one of the four major banks that dominate banking in Australia and New Zealand. It is the largest bank in Australia by assets and market capitalisation (AUD169.5bn as at 18 October 2023), accounting for over a quarter of the retail banking market. The bank provides personal banking and business/corporate banking services primarily across four main operating divisions:

- Retail banking services (AUD5.2bn FY23 cash earnings): banking and general insurance products to personal and private bank customers;
- Business banking (AUD4.0bn): business, corporate and agribusiness customers, as well as equities trading and margin lending through CommSec;
- Institutional banking and markets (AUD1.0bn): serves the commercial and wholesale banking needs of corporate, institutional, and government clients;
- New Zealand (AUD1.4bn): retail and business banking in New Zealand, including wealth management and insurance.

Key Financials (AUDm)

LTM (30 Jun)	2023
Net interest income	23,056
Credit loss provisions	(1,108)
NPAT	10,090
Gross loans	933,251
Customer deposits	864,995
Net interest margin (%)	2.07
Non-performing loans (%)*	0.82
Credit losses (benefit) (%)	0.12
CET 1 ratio (%)	12.2

*Source: Company, FIIG Securities. *As measured by stage 3 loans (impaired and 90-days past due)*

Summary Bond Details (see last page for full list)

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3CB0293769	AUD 900m	Unsec. Sub. T2	6.86%[2]	Semi-Annual	9 Nov 2027	9 Nov 2032
AU3FN0073029	AUD 1,100m	Unsec. Sub. T2	3M BBSW+2.70%	Quarterly	9 Nov 2027	9 Nov 2032
AU3FN0067989	AUD 700m	Unsec. Sub. T2	3M BBSW+1.90%	Quarterly	14 April 2027	14 April 2032
AU3CB0288389	AUD 400m	Unsec. Sub. T2	4.946%[3]	Semi-Annual[2]	14 April 2027	14 April 2032
AU3FN0062600	AUD 1,500m	Unsec. Sub. T2	3M BBSW+1.32%	Quarterly	20 Aug 2026	20 Aug 2031
AU3FN0070579	AUD 1,400m	Snr. Unsecured	3M BBSW + 1.02%	Quarterly	N/A	18 Aug 2027
AU3FN0070561	AUD 1,200m	Snr. Unsecured	3M BBSW + 0.80%	Quarterly	N/A	18 Aug 2025
AU3CB0291672	AUD1,000m	Snr. Unsecured	4.20%	Semi-Annual	N/A	18 Aug 2025

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.

[2]Coupon resets to 3M BBSW + 270bps (paid quarterly) if not redeemed at first call date. [3]Coupon resets to 3M BBSW + 190bps (paid quarterly) if not redeemed at first call date.

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Tier 2 Structure	
Interest Deferral/Cancellation	Interest will be deferred only in the highly unlikely circumstances that the payment would result in the issuer becoming insolvent. Any missed interest payment will accumulate.
Non-Viability Trigger	If the prudential regulator determines that the issuer is at the point of non-viability (loosely defined as the point in which the issuer is failing or likely to fail), the issuer may be required to convert into equity or write-off some or all the face value of the Tier 2 notes.

Strengths

- Dominant market position: CBA is one of the four major banks that dominate banking in Australia and New Zealand, and is the largest bank in Australia by assets and market capitalisation, accounting for over a quarter of the retail banking market in Australia. Major bank profitability metrics have migrated toward the middle of global peers as yields have fallen and capital requirements have increased in recent years. Despite this, they remain highly profitable. Credit metrics are typically toward the stronger-end of global comparisons.
- Strong capitalisation, underpinned by high quality earnings profile: CBA exhibits a strong regulatory capital ratio, recently reporting a Common Equity Tier 1 capital ratio of 12.2% at 30 June 2023, comfortably above minimum requirements and approximately AUD8.9bn above APRA's "unquestionably strong" target of 10.25%. Composition of regulatory capital is comparable with peers for CBA, with common equity accounting for 84% of Tier 1 capital. Quality of earnings is strong and again comparable with averages across Australia given the bank's predominant exposure to residential mortgage lending, with net interest income accounting for 86.3% of operating revenues. Net interest income is typically viewed favourably in terms of earnings quality, as it has many recurring characteristics that are largely dependent of the ability of households and business to repay their loans.
- Relatively low-risk lending book: CBA's asset quality benefits from a focus on relatively lower risk residential mortgage lending, with the bank reporting non-performing loans (impaired and past due) of 0.82% (toward the lower end of global peers), most of which relates to housing (and as such, is well-secured). Single-name concentrations within CBA's corporate and institutional book are relatively modest by global standards.
- Sound macro environment: Australian financial institutions benefit from operating in an economy characterised as having a very high degree of economic resilience with low susceptibility to event risk. While the Australian economy has recovered relatively strongly from the direct impacts of the pandemic, the current high inflation environment and associated interest rate increases by the Reserve Bank of Australia have the potential to put strain on the post-pandemic recovery, with increased pressure on consumers. The current low level of unemployment and significant savings accumulated over the past two years should provide a buffer. Nevertheless, CBA maintains adequate level of credit provisioning to account for this uncertain outlook. Australian banks including CBA are overseen by a highly regarded prudential regulator, APRA, who oversees banking, insurance and superannuation, with the aim of maintaining the integrity, safety and soundness of financial institutions.
- Strong investment-grade credit ratings down the capital structure: CBA, along with its peers, remains one of the highest rated financial institutions across the globe, which extends down the capital structure (including the most junior-ranked securities (Tier 1 perpetual hybrids), which are rated investment grade).

Risks

- Relatively high reliance on wholesale funding: Although the major banks, including CBA, benefit from a strong funding franchise, both domestically and offshore, and across various currencies and instruments, they remain highly reliant on wholesale funding compared with global peers. In recent years, the major banks have greatly extended the maturity of their wholesale term debt, reducing the exposure to a short-term dislocation in wholesale funding markets.

- Modest diversity by global peer standards: Like its peers, CBA exhibits a modest level of diversity by both product and geography, with its lending base heavily weighted toward residential mortgages in Australia and New Zealand. This leaves the bank primarily exposed to the performance of the Australian and New Zealand mortgage markets (and as such, the high levels of household debt in both countries). The exposure to residential mortgages is somewhat mitigated by mortgage loans that are full recourse and are fundamentally written with the intention to remain on the balance sheet of the bank.

Risks relevant to Subordinated Unsecured Tier 2 instruments

- Subordinated ranking: Tier 2 instruments are unsecured and subordinated instruments, ranking ahead only of ordinary shares and additional Tier 1 hybrids. Tier 2 instruments rank behind senior creditors, which includes depositors and senior unsecured creditors.
- Interest is deferrable (but cumulative): Interest is deferrable for Tier 2 capital instruments, but typically only in the highly unlikely circumstance that the payment would result in the bank becoming insolvent. Deferred interest does however accumulate.
- Basel III compliant structural features: Tier 2 subordinated instruments are classified as Basel III compliant Tier 2 capital instruments. As such, they contain the following features:
    - Conversion or write-down following a Non-Viability Trigger Event: If the prudential regulator determines that the issuer is at the point of non-viability (loosely defined as the point in which the issuer is failing or likely to fail), the issuer may be required to convert some or all of its Tier 2 hybrids into ordinary shares.

      Generally speaking, it is expected that any Tier 1 hybrids outstanding will be converted into equity before Tier 2 hybrids. If, for any reason, the conversion does not take place, the face value of Tier 2 hybrids set aside for conversion will be written off and noteholders will not be compensated (including for any unpaid distributions or interest).

      Conversion of Tier 2 notes following a non-viability trigger event is subject to a maximum number of shares being issued. As such, if the notes are converted into ordinary shares, the value of ordinary shares an investor receives may be significantly less than the face value of their notes.
    - Optional call dependent on regulatory approval: Tier 2 hybrids include an early call feature where the face value of the instrument may be repaid early in cash. The optional redemption requires regulatory approval, which may not be provided.

      In general, regulators are unlikely to provide approval for a Tier 2 hybrid to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected.

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Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
USQ2704MAB48	USD 1,250m	Unsec. Sub. T2	3.74%	Semi-Annual	N/A	12 Sep 2039
AU3FN0062600	AUD 1,500m	Unsec. Sub. T2	3M BBSW + 1.32%	Quarterly	20 Aug 2026	20 Aug 2031
AU3FN0067989	AUD 700m	Unsec. Sub. T2	3M BBSW + 1.90%	Quarterly	14 Apr 2027	14 Apr 2032
AU3CB0288389	AUD 400m	Unsec. Sub. T2	4.946%[3]	Semi-Annual[2]	14 Apr 2027	14 Apr 2032
AU3CB0293769	AUD 900m	Unsec. Sub. T2	6.86%[2]	Semi-Annual	9 Nov 2027	9 Nov 2032
AU3FN0073029	AUD 1,100m	Unsec. Sub. T2	3M BBSW + 2.70%	Quarterly	9 Nov 2027	9 Nov 2032
AU3CB0303667	AUD 550m	Unsec. Sub. T2	6.446%[5]	Semi-Annual	25 Oct 2028	25 Oct 2033
AU3FN0082251	AUD 700m	Unsec. Sub. T2	3M BBSW + 2.05%	Quarterly	25 Oct 2028	25 Oct 2033
USQ2704MAA64	USD 1,250m	Unsec. Sub. T2	3.61%	Semi-Annual	12 Sep 2029	12 Sep 2034
AU3CB0297653	AUD 1,750m	Unsec. Sub. T2	6.704%[4]	Semi-Annual	15 Mar 2033	15 Mar 2038
AU3FN0070561	AUD 1,200m	Snr. Unsecured	3M BBSW + 0.80%	Quarterly	N/A	18 Aug 2025
AU3CB0291672	AUD1,000m	Snr. Unsecured	4.20%	Semi-Annual	N/A	18 Aug 2025
AU3FN0070579	AUD 1,400m	Snr. Unsecured	3M BBSW + 1.02%	Quarterly	N/A	18 Aug 2027
AU3CB0291680	AUD 900m	Snr. Unsecured	4.40%	Semi-Annual	N/A	18 Aug 2027

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.

[2]Coupon resets to 3M BBSW + 270bps (paid quarterly) if not redeemed at first call date. [3]Coupon resets to 3M BBSW + 190bps (paid quarterly) if not redeemed at first call date.
[4]Coupon resets to 3M BBSW + 245bps (paid quarterly) if not redeemed at first call date. [5]Coupon resets to 3M BBSW + 205bps (paid quarterly) if not redeemed at first call date.

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