

# **Lonsec Income Investments**

## **CommBank PERLS XII Capital Notes (CBAPI)**

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# Lonsec Income Investments

## CommBank PERLS XII Capital Notes (CBAPI)

### Risk rating categories

	LOW	MOD	HIGH	SPEC
FINANCIAL	●			
STRUCTURAL			●	
MATURITY			●	
LIQUIDITY		●		
INDUSTRY		●		
VOLATILITY			●	
RISK PROFILE		●		

### Key details

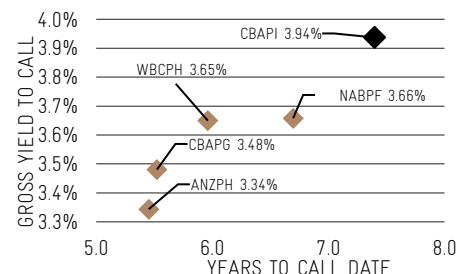
ISSUE NAME	COMMBANK PERLS XII CAPITAL NOTES (CBAPI)
ISSUER	COMMONWEALTH BANK OF AUSTRALIA (CBA)
ISSUE FEATURES	UNSECURED, SUBORDINATED, PERPETUAL, FLOATING RATE, NON-CUMULATIVE, LOSS ABSORBING
CLASSIFICATION	ADDITIONAL TIER 1 CAPITAL
FACE VALUE	\$100
ISSUE SIZE	\$750M, WITH THE ABILITY TO RAISE MORE OR LESS
DISTRIBUTION RATE	INDICATIVE MARGIN <sup>1</sup> OF 3.00-3.20% P.A. OVER 90-DAY BANK BILL RATE. INITIAL CASH YIELD OF 2.69-2.83% <sup>1</sup> OR 3.84-4.04% <sup>1</sup> P.A. GROSSED UP FOR FRANKING
DISTRIBUTION FREQUENCY	QUARTERLY
FRANKING	EXPECTED 100%
OPTIONAL CALL DATE	20 APRIL 2027
MANDATORY EXCHANGE DATE	20 APRIL 2029
PROSPECTUS	WWW.COMMSEC.COM.AU

1 Margin to be set on 17 October 2019  
2 Based on 90 Day BBSW of 0.84% (4 Oct'19)

### Capital Ranking / Security Type

DEPOSITORS, SECURED DEBT	
SENIOR/UNSUBORDINATED DEBT	
SUBORDINATED DEBT	
PERPETUAL CAPITAL NOTE	●
ORDINARY EQUITY	

### Gross Yield to Call for Listed Peers



### Important Dates

BOOKBUILD DATE	16 OCTOBER 2019
OPENING DATE	17 OCTOBER 2019
CLOSING DATE	8 NOVEMBER 2019
COMMENCEMENT OF TRADING	19 NOVEMBER 2019
FIRST DISTRIBUTION PAYMENT	15 MARCH 2020

### Approved – High Risk

CBA intends to raise \$750m via the offer of CommBank PERLS XII Capital Notes (CBAPI). The offer proceeds will be used to satisfy regulatory capital requirements. Note that there is no security reinvestment offer into CBAPI.

CBAPI is structured as a Basel III compliant Additional Tier 1 (AT1) security with terms comparable to earlier issued CommBank PERLS Capital Notes. Lonsec considers CBAPI to have a High risk profile, reflective of the loss absorption risks, capacity to defer distributions and unclear maturity date. However, Lonsec recognises these terms are common to securities issued post December 2012 and believe the probability of adverse outcomes to be low. Accordingly, we expect the Notes to be redeemed for face value on 20 April 2027 (expected 7.5-year term) and for all distributions to be paid in the term to call. The indicative issue margin range of 3.00-3.20% will support an initial cash yield of 2.69-2.83% p.a., or 3.84-4.04% p.a. grossed up for franking credits, which will fluctuate with movements in short-term interest rates.

### Financial risk – Low to Moderate

Overall, Lonsec is comfortable with CBA's financial position and outlook. We expect CBA to be able to meet its distribution payments and repay CBAPI holders their face value on maturity. Accordingly, we assign a 'Low to Moderate' financial risk rating.

CBA is a high-quality issuer with a strong capital position, investment grade credit rating and a proven track record of earnings, dividend and book value growth. Earnings and capital levels are sensitive to general economic and financial market conditions, as well as regulatory change. While the macro-environment in Australia is currently being supported by low interest rates, which are translating into moderate credit growth and low impairments, slower loan growth, increased funding costs and rising impairments are what Lonsec regards as the key risks to earnings growth and capital stability.

### Structural risk – High

Lonsec has assigned a 'High' structural risk rating to this issue, taking into account its low ranking capital status, trigger clauses and discretionary and non-cumulative distribution payments. Refer to Page 8 for further information.

CBAPI are unsecured subordinated notes issued by CBA that qualify as AT1 regulatory capital. They are not deposit liabilities and are therefore not protected by the Government guarantee, nor are they secured against any asset of CBA. The inclusions of the Non-Viability and Capital Triggers mean the Notes could rank equally to ordinary shares and be subordinated to the claims of senior ranking creditors and depositors in a return of capital during a winding up of CBA, as it is likely that a mandatory conversion trigger event will have occurred prior to wind-up. The triggers mean holders are likely to incur a loss (and possible write-off of their investment) should CBA experience extreme financial difficulty, such that APRA regards CBA as 'non-viable', or its Common Equity Tier 1 Capital Ratio falls to or below 5.125%.

The Notes rank for payment of distributions ahead of ordinary shares and equally with other perpetual AT1 securities, but behind the claims of all senior ranking creditors, including Tier 2 debt holders and depositors. Distributions are expected to be paid and reset quarterly at a gross rate equal to the floating rate 90-day BBSW plus the issue margin, so the value of distributions will vary over time. Distributions are discretionary, subject to payment conditions and non-cumulative, but if they are not paid, CBA is prevented from declaring a dividend on ordinary shares or returning any capital to shareholders until one is paid in full on a subsequent payment date, or until the Notes are exchanged or redeemed. As such, Lonsec regards a missed distribution as a low probability event.

### Maturity risk – High

Lonsec has assigned this issue a 'High' maturity risk rating, primarily reflecting its perpetual structure, term to call and lack of holder redemption rights. CBA has the option to redeem the Notes on 20 April 2027 (implied 7.5 year term) or at any time following the occurrence of a tax or regulatory event or if CBA is unable to frank Distributions. If the Notes are outstanding after this date, CBA must exchange CBAPI into \$101 worth of ordinary shares on 20 April 2029, provided the mandatory exchange conditions are satisfied. If the mandatory exchange conditions are not satisfied on that date, exchange will be deferred until the next scheduled distribution payment date where they are satisfied. It is possible the mandatory exchange conditions are never satisfied so the Notes are technically perpetual. However, Lonsec believes CBA's good corporate standing along with the risk of reputational damage should ensure that CBA redeems and replaces the Notes on 20 April 2027, subject to APRA approval. Refer to Page 8 for further information.

### Liquidity risk – Moderate

CBAPI is expected to have an issue size of \$750m, which Lonsec views as an adequate level of liquidity. We do note that recent issues have been considerably higher providing more liquidity for investors and would be concerned should the \$750m was not met by the market. Historically, an issue size of comparable securities has supported weekly turnover of around \$3.5m.

### Industry risk – Moderate

Lonsec has assigned a Moderate industry risk rating in-part due to the industry's leveraged exposure to underlying macroeconomic and financial market conditions and a relatively high degree of regulation. Whilst Australian banks remain exposed to the risk of higher impairments if the economy were to slow significantly, the higher capital requirements being imposed by the regulators enhance the industry's ability to withstand economic shocks.

### Volatility risk – High

Lonsec has assigned the issue a 'High' volatility risk rating, attributable to CBAPI's low-ranking capital status, term to call and loss absorption triggers that may result in a positive correlation with CBA's ordinary share price in times of distress. The market price will fluctuate due to various factors including general movements in credit spreads and economic conditions, which may cause CBAPI to trade below par at some stage. As a result, we recommend investing with the intention of holding CBAPI to maturity.

**We strongly recommend that potential investors read the product disclosure statement or investment statement.** Lonsec Research Pty Ltd • ABN 11 151 658 561 • AFSL 421 445 • This information must be read in conjunction with the warning, disclaimer and disclosure at the end of this document.

# CommBank PERLS XII Capital Notes (CBAPI)

ISSUE DATE: 9-10-2019

## Relative Value

### Comparable Listed Securities

There are 21 comparable major bank Basel III compliant Additional Tier 1 securities listed on the ASX. Each of these securities are issued by one of the Big Four banks, pay 100% fully franked distributions subject to the payment conditions and contain Non-viability and Capital triggers. Within this universe, Lonsec considers ANZPH, CBAPG, NABPF and WBCPH to be the closest comparable securities to CBAPI. Table 1 and Chart 1 below outline the various trading margins for these securities.

**Table 1. Comparable securities trading margin analysis**

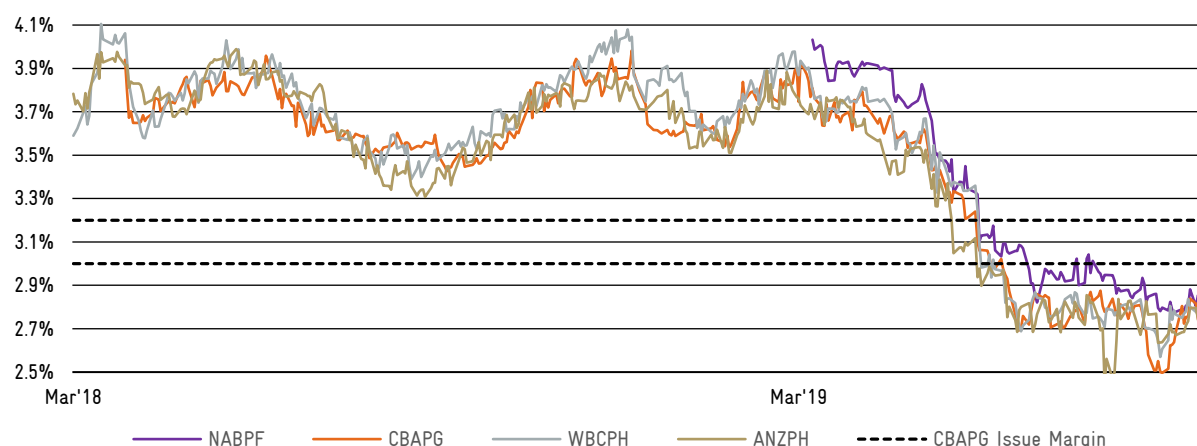
SECURITY	ISSUE SIZE (\$)	LISTING DATE	YEARS TO CALL	CURRENT MARGIN <sup>1</sup>	20-DAY AVERAGE MARGIN	HISTORICAL AVERAGE MARGIN <sup>2</sup>	6-MONTH RANGE	LONSEC RISK RATING
ANZPH	931M	SEPTEMBER 2017	5.5	2.53%	2.69%	3.47%	2.45-3.77%	HIGH
CBAPG	1,250M	APRIL 2018	5.5	2.77%	2.67%	3.48%	2.50-3.79%	HIGH
WBCPH	1,450M	MARCH 2018	6.0	2.82%	2.74%	3.54%	2.57-3.81%	HIGH
NABPF	1,870M	MARCH 2019	6.7	2.86%	2.82%	3.26%	2.77-3.93%	HIGH
CBAPI	750M	NOVEMBER 2019	7.5	3.10%	-	-	-	HIGH

<sup>1</sup> As at 4 October 2019.

Source: Lonsec, Thomson Reuters

<sup>2</sup> Average Spread since listing date

**Chart 1. Trading margins for comparable securities**



### Lonsec View

Lonsec considers NABPF and WBCPH to be the closest comparable securities to CBAPI, reflecting similar structures and term to maturity (first call date). Whilst there are no existing securities with the same tenure as the CBAPI's, Lonsec's belief is that the indicative margin range of 300-320bps represents fair value for this issue, as at 4 October 2019. This view is based on the following:

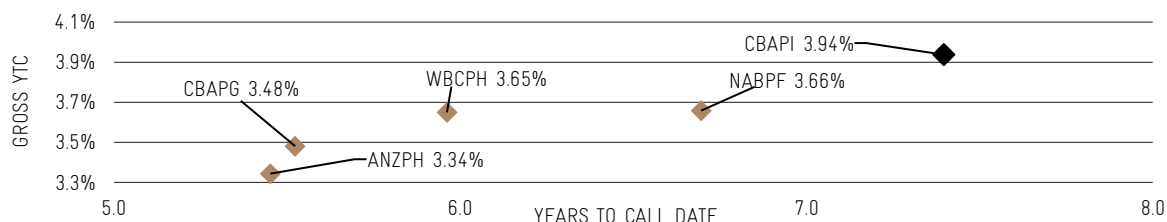
- Based on our estimates, NABPF's current trading margin is 286bps and has averaged 282bps over the past 20 trading days. The CBAPI security is 10 months longer than NABPF.
- Typically, a tighter credit spread margin may be warranted for primary issuance, given the lack of depth and illiquid nature of the secondary market for these hybrid securities.
- The issue margin is in line with CBA's own credit curve, representing the typical premium to more senior bonds and subordinated debt, issued by CBA.

Lonsec note that spreads between Additional Tier 1 securities and senior debt securities has tightened over the last few months. This has partially been a result of a Coalition win that removed the threat of losing cash refunds for franking credits and more recently a falling cash rate that has seen investors search for yield. This has seen yields on Additional Tier 1 securities tighten, lowering their return/risk profile relative to higher ranked securities.

## CommBank PERLS XII Capital Notes (CBAPI)

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Chart 2. Gross Yield to Call – ATI Securities (4 October 2019)



Source: Lonsec, Thomson Reuters. CBAPI assumed issue margin of 310bps

### Financial Risk — Low to Moderate

Lonsec has considered several factors in assessing the financial risks associated with the issue and issuer. As part of its analysis, Lonsec reviews the capital quality, liquidity, credit quality, asset quality, earnings growth forecasts, earnings sensitivities and operating efficiency in the overall assessment.

We regard CBA as a high-quality issuer with an investment grade credit rating that is among the highest of global banks, a leading regulatory capital position, a strong market position, good funding mix, low impairments and a proven track record of steady earnings, dividend and book value growth.

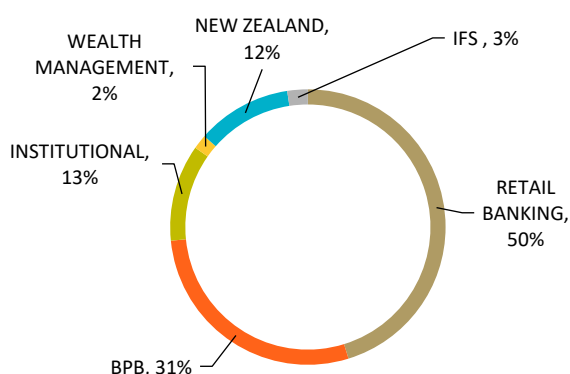
Lonsec regards normalising impairments, slowing credit growth (each of which are contingent on the path of interest rates) and further regulation as the key headwinds to earnings growth and capital stability.

Overall, we are comfortable with CBA's financial position and outlook. We expect CBA to be able to meet its distribution payments and repay CBAPI holders their face value on maturity. Accordingly, we assign a 'Low to Moderate' financial risk rating.

### Issuer Summary

CBA is Australia's largest bank and company by market capitalisation, with \$977bn in total assets and a market capitalisation of \$141bn, as at 2<sup>nd</sup> October 2019.

Chart 3. Business Segment FY19 Earnings



Source: CBA

The Bank's key business segments are retail banking (50% of FY19 earnings), business and private banking (31%), institutional banking and markets (13%), with wealth management, NZ Banking and International Financial

Services completing the rest. It operates predominantly across Australia and New Zealand, but also in the US, UK and multiple countries across the APAC region.

### Profitability

In August 2019, CBA reported FY19 cash profit of \$8.5bn, down 4.7% on the prior comparable period, impacted by continued remediation costs and elevated risk and compliance expenses. Whilst there were positives in lending and deposit growth, lower operating income and higher expenses resulted in negative jaws. There was also a slight uptick in personal and home loan arrears over the year, albeit easing in the second half.

Operating income was 2% lower with growth in lending and deposits offset by a lower Net Interest Margin (NIM), customer fees removals and weather events. Home loan growth was solid at 1.3x system, delivering 4% volume growth, but interestingly delivered via increased reliance on the mortgage broker channel. NIM fell 5bps to 2.10% on FY18, but was flat over 2H19, reflecting the impact of customers switching from interest only to principal and interest, variable to fixed, and investor to owner occupied loans, increased competition, offset by pricing.

Operating expenses rose 2.5% due to customer remediation costs, wage inflation and IT costs and increased compliance spend that has seen an increase of circa 600 new compliance staff in FY19. Investment spend was up 9% of which 64% of the spend was risk and compliance related highlighting just how much is being done in this area. This all lead to an increase in the cost-to-income ratio of 210bps to 46.2%, although CBA guided for this to be below 40% over time.

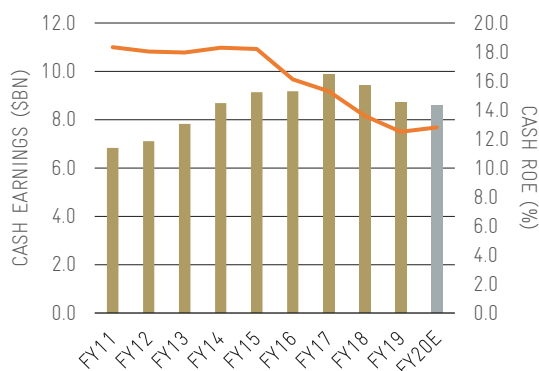
Recently, CBA has seen earnings deteriorate (-3.1% EPS 5-year CAGR) due to tighter regulatory and capital requirements and tempered lending growth. Despite this, CBA has maintained a relatively flat dividend (0.5% DPS 5-year CAGR). Nonetheless, the fall in EPS growth has led to the bank's ROE being impacted. Regardless, profitability remains healthy, with ROE at 12.5% for FY19, still the highest of the Australian banks and high by international standards.

We regard losses from higher impairments as the key risks to earnings, noting impairments are currently at cyclical lows. However, Lonsec acknowledges that loan serviceability and asset quality are being supported by low interest rates, which are unlikely to move dramatically higher in the foreseeable future.

# CommBank PERLS XII Capital Notes (CBAPI)

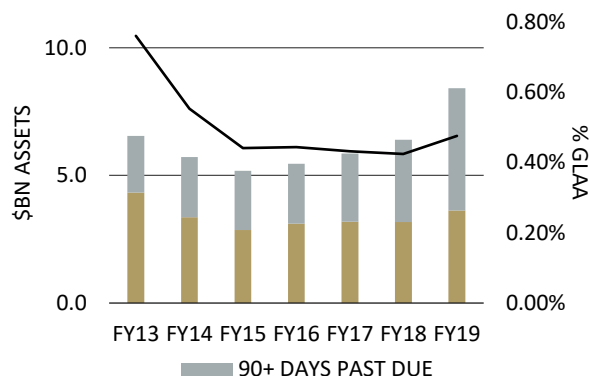
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Chart 4. Full Year Cash Earnings and Cash ROE



Source: CBA, Lonsec, Thomson Reuters

Chart 6. Historical Loss to Average Gross Loans and Acceptances



Source: CBA

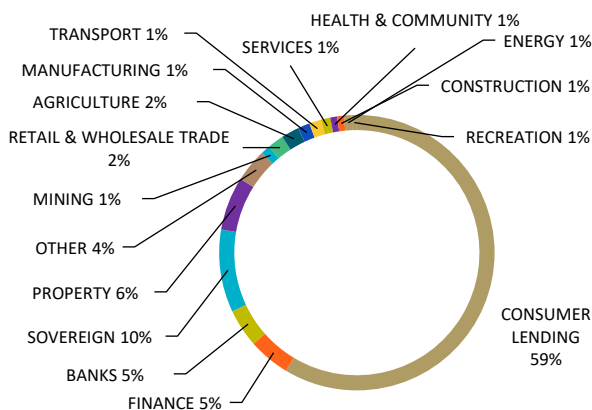
## Asset quality

CBA's risk weighted asset mix is overweight residential mortgage lending (59%), which is generally higher than US and UK banks, in part reflecting Australia's above average home-ownership rates and increase in household leverage. The balance of the book is diversified across corporate, SME and specialised lending and 'other'.

Lonsec regard CBA's Australian mortgage lending portfolio to be relatively low risk, attributable to full recourse lending, low dynamic LVR (52%) and lenders' mortgage insurance on high LVR lending. Along with ANZ, CBA has the lowest exposure to investment loans (31% of its Australian mortgage portfolio) of the major banks, providing it with a strong mortgage book. Lonsec notes the household sector is very highly leveraged (household debt to income is 200%) and is therefore mindful of the impact higher mortgage rates will have on mortgage serviceability. Following regulatory capital changes, CBA has reduced interest only portion of total home loan business to 22% in FY19, down from 30% in FY18.

Beyond consumer lending (59% of credit exposure), CBA's loan book is diversified across various industries, including Government (9.7%) and property (6.3%). Mining exposure (1.1%) is low from both an absolute perspective and relative to peers and, similarly, CBA has a relatively low agriculture exposure (2.1%). These two industries historically are the most volatile and riskiest exposures to have.

Chart 5. Credit Exposure by Industry



Source: CBA, Lonsec

After trending downwards over a number of years and stabilising, CBA's gross impaired assets to gross loans ratio moved upwards for the first time in many years. Whilst still significantly below FY13 levels of 0.76%, it did rise 6bps to 0.48% in FY19, nonetheless it remains low. The majority of stress in the portfolio can be traced to mining, oil and gas investments, which CBA has low overall exposure to. Home loan arrears are low sitting around 0.68%, the majority of arrears reflecting deteriorating credit quality in NT and WA. Total credit quality remains strong, with the loan impairment expense to average gross loans at 16bps.

Overall, Lonsec assesses asset quality to be sound with low interest rates, solid employment, asset price growth and generally healthy business balance sheets helping to keep impaired assets below historical averages and the lowest of the Australian banks.

## Funding and liquidity profile

CBA relies on customer deposits as well as wholesale debt to fund its business activities and as a source of liquidity. Deposit funding is generally perceived as more stable than short-term wholesale debt, with deposits considered to be 'sticky' and longer term in nature. Wholesale funding is also important as it helps to diversify the funding base, reduce liquidity risk and is typically cheaper than deposit funding. CBA's funding approach is focussed on attracting customer deposits, which at June 2019 accounted for 69% of its funding mix.

Funding costs are at their lowest since the Global Financial Crisis, enabling opportunity to lengthen tenor at relatively attractive wholesale funding costs.

CBA's liquidity coverage ratio of 132% at 30<sup>th</sup> June 2019 is above the 100% minimum imposed by APRA. The weighted average maturity of outstanding wholesale debt with a residual maturity beyond 12 months is 5.1 years, which reduces reliance on wholesale funding markets.

Whilst Lonsec is comfortable with CBA's financial position, if market conditions deteriorate or there is a major systemic shock on the Australian financial system or other financial systems due to economic, financial, political or other reasons, there is a risk that CBA's funding activities may be adversely affected and its liquidity, funding and lending activities may be constrained. Lonsec notes that these events are unlikely and difficult to predict but would likely negatively impact CBA's business, financial performance and capital position.



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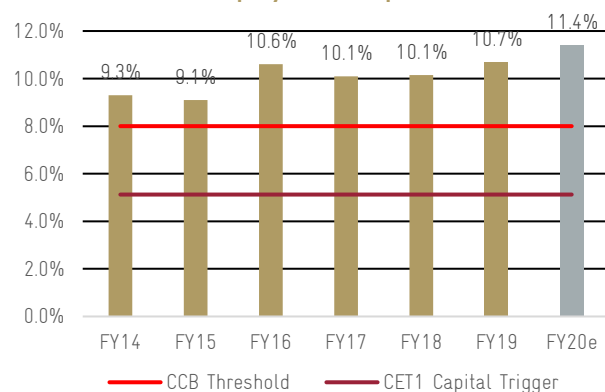
## Capital position

CBA is regulated by APRA and other regulatory bodies which require CBA to hold an adequate level of capital and liquidity to cover the risks of its operations and protect its solvency. Regulatory capital requirements have been increasing for CBA and the major banks, the intention being to set capital standards such that Australian Authorised Deposit Taking Institutions are 'unquestionably strong' and comfortably positioned within the top quartile of internationally active banks. Accordingly, from 1 January 2020 the major banks are expected to maintain a Common Equity Tier 1 Capital Ratio (CET1) above 10.5%, 250bps higher than the current requirements and a proposed minimum leverage ratio of 3.5% from 1 January 2022.

As of 30 June 2019, CBA's leverage ratio (Tier 1 capital to total exposures) was 5.6%, which is also higher than the 3-5% range recommended by the Financial System Inquiry. Similarly, CBA's CET1 Capital Ratio of 10.7% is above current regulatory requirements, and positions CBA to meet the 'unquestionably strong' level to be introduced in 2020. As at 30 June 2019, CBA had \$12.2bn of capital above CBA's capital conservation buffer (CCB) and \$25.2bn of capital above CBAPI's Capital Trigger level. These buffers are expected to strengthen moving forward. Should CBA's capital levels be threatened in the future, CBA's ability to pay dividends and hybrid distributions will be restricted and Lonsec would therefore expect management to take steps to restore its capital position.

CBA is likely to target a higher capital level in the future, which will add further stability to CBA and lower the probability of a trigger event occurring. Overall, Lonsec is comfortable with CBA's capital position and outlook and expects it to continue to strengthen its capital profile over the medium term.

Chart 9. Common Equity Tier 1 Capital Ratio



Source: CBA, Lonsec

## Regulatory Update

### CommInsure

- In October 2019, Commonwealth Bank of Australia's life insurance arm CommInsure has been charged with 87 counts of hawking life insurance products, in a case that will be prosecuted by the Commonwealth Department of Public Prosecutions.
- The Australian Securities and Investments Commission (ASIC) alleges between October and December 2014 CommInsure unlawfully sold life insurance policies known as "Simple Life" over the phone.
- ASIC alleges calls to CBA customers "were unsolicited and did not comply with all of the hawking exceptions in section 992A(3) of the Corporations Act".

- The maximum penalty for each of the charges is \$21,250, meaning it faces a total penalty of \$1.859 million.

### Royal Commission

- In February 2019, Kenneth Hayne submitted the final recommendations from the Banking Royal Commission. In all 76 recommendations made, many of which have not been implemented. The Banks were mostly affected by the "fee for no service" issue to which large remediation costs have been accrued.

### AUSTRAC

- In June 2018 CBA agreed to pay a \$700m penalty to resolve the Federal Court proceedings relating to serious breaches of anti-money laundering and counter-terrorism financing (AML/CTF) laws.
- In August 2017, AUSTRAC initiated civil penalty proceedings in the Federal Court against CBA for serious and systemic non-compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006.

### APRA

- In November 2018 APRA stated it was proposing to raise the minimum Leverage Ratio to 3.5% from 1 January 2022.
- In July 2017, APRA announced the four major Australian banks need to have CET1 ratios of at least 10.5%, from 1 January 2020 to meet the 'unquestionably strong' benchmark.

## Structural Risk – High

Lonsec has assigned a 'High' structural risk rating to this issue, primarily reflecting its low-ranking capital status, trigger clauses and discretionary and non-cumulative distribution payments.

CBAPI are fully paid, subordinated and unsecured capital notes issued by Commonwealth Bank of Australia (CBA). CBAPI are not deposit liabilities or protected assets of CBA under the Banking Act and are not protected by the Government guarantee, nor are they secured against any asset of CBA or any other person. The Notes will qualify as Additional Tier 1 capital for the purposes of CBAPI's regulatory capital requirements and, accordingly, CBAPI is structured to comply with Basel III standards.

Lonsec regards the key risks to CBAPI as the inclusion of the Non-Viability and Capital Triggers, as well as its discretionary and non-cumulative distributions and CCB buffer.

However, acknowledging these risks, Lonsec is comfortable with CBA's financial position and regard non-viability, insolvency or non-payment of a distribution as an unlikely scenario within the period to maturity.

## Capital Ranking

CBAPI rank for payment of distributions and a return of capital ahead of common equity, equally with other preference shares and below the claims of all senior creditors and depositors. However, the ranking of holders for a return of capital in a winding up of CBA will be adversely affected, as it is likely that a Non-Viability or Capital Trigger Event will have occurred prior to wind up, in which case the Notes will be exchanged into ordinary equity and holders will rank for payment and a return of capital equally with other CBA shareholders.

# CommBank PERLS XII Capital Notes (CBAPI)

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**Table 2: Capital Structure**

RANKING	CAPITAL TYPE	EXAMPLE
HIGHER RANKING	PREFERRED AND SECURED DEBT	DEPOSITS, EMPLOYEE ENTITLEMENTS, SECURED CREDITORS
	UNSUBORDINATED UNSECURED DEBT	TRADE AND GENERAL CREDITORS, BONDS, NOTES, DEBENTURES
	SUBORDINATED & UNSECURED DEBT	TIER 2 CAPITAL
	HYBRID CAPITAL & PREFERENCE SHARES	PERLS VII (CBAPD), PERLS VIII (CBAPE), PERLS IX (CBAPF), PERLS X (CBAPG), PERLS XI (CBAPH), PERLS XII (CBAPI)
LOWER RANKING	ORDINARY EQUITY	CBA ORDINARY SHARES

Source: CBA, Lonsec

## Loss absorption events

Since 1 January 2013, APRA has required Additional Tier 1 capital securities be structured with a Capital and Non-Viability Trigger. The inclusion of these terms is intended to protect CBA's solvency and reduce any reliance on government bail-outs in times of significant financial difficulties.

**A Capital Trigger Event** occurs when CBA's Common Equity Tier 1 Capital Ratio falls to or below 5.125%. The Common Equity Tier 1 Capital Ratio is the ratio of CBA's Common Equity Tier 1 Capital, which includes ordinary equity and retained earnings, to risk-weighted assets. As at June 2019, CBA's Common Equity Tier 1 Capital Ratio was 10.7%, which equates to a surplus of \$25.2bn above the 5.125% Capital Trigger Event level.

**A Non-Viability Event** occurs when APRA notifies CBA in writing that it believes conversion of all or some CBAPI, or a public injection of capital is necessary because, without it, CBA would become non-viable. Whether a Non-Viability Trigger Event will occur is at the discretion of APRA and there are currently no precedents to this. While APRA has provided little guidance on the parameters used to determine non-viability, it is expected to include serious concern about CBA's capital levels, funding profile, liquidity levels and/or ability to raise money in the public or private markets.

The occurrence of either event requires CBA to automatically exchange the number of CBAPI (or a percentage of the face value) into ordinary shares that will return its CET1 to 5.125% or satisfy APRA that CBA will be viable. The value of shares received on exchange will depend on the market price of ordinary shares at the relevant time and as a loss absorption event will only occur during times of significant financial stress, such an exchange may occur at a time when CBA's share price is low. CBA is required to exchange the Notes on an approximate pro-rata basis among themselves and other relevant securities or in a manner that is otherwise, in the opinion of CBA, fair and reasonable. CBAPI and other Tier 1 securities will be exchanged or written off before any Tier 2 Capital instruments are. Because the maximum exchange number will limit the number of shares received, holders will receive less than \$101/share on exchange if CBA's share price is below approximately \$15.60 (i.e. 80% below the issue date VWAP, assuming it is \$78.00) at the time of exchange. If exchange of the Notes is not effective for any reason within five business days of a Capital or Non-Viability Trigger Event occurring, the Notes will be written

off and all rights in relation to the Notes, including to payment of distributions and face value, will be terminated.

## Distribution Payments

Distributions are paid and reset quarterly at a gross rate equal to the 90-day Bank Bill swap rate plus the issue margin. CBA has guided for the issue margin to be between 300-320bps. The final margin will be determined under the Bookbuild and communicated to the market on 17 October 2019. The 90-day Bank Bill Swap Rate is the rate at which major Australian financial institutions lend short term cash to each other over a 90-day period. This rate is influenced by multiple factors and varies over time. Because of movements in the underlying bank bill swap rate, the level of distribution payments will vary over time.

Distributions are expected to be 100% franked, though the franking rate may vary over time. To the extent that a distribution is not fully franked, CBA will pay an additional amount in cash to compensate the holder for the unfranked component. Therefore, a lower than 100% franking rate will result in a larger cash distribution with a smaller franking credit attached to the distribution.

Distributions are not mandatory and are subject to the absolute discretion of CBA as well as the following payment conditions;

1. Payment will not result in a breach of CBA's regulatory capital requirements.
2. Payment will not result in CBA becoming insolvent.
3. APRA does not object to the payment.

In the event that CBA's CET1 Capital Ratio falls below its 8.0% **Capital Conservation Buffer**;

1. CBA can distribute a maximum 60% of earnings as dividends, AT1 Capital distributions and discretionary staff bonuses if its CET1 Capital ratio is below 8.000% but above 7.125%.
2. CBA can distribute a maximum 40% of earnings as dividends, AT1 Capital distributions and discretionary staff bonuses if its CET1 Capital ratio is below 7.125% but above 6.250%.
3. CBA can distribute a maximum 20% of earnings as dividends, AT1 Capital distributions and discretionary staff bonuses if its CET1 Capital ratio is below 6.250% but above 5.375%.
4. CBA cannot make any distributions if its CET1 Capital ratio is below 5.375%.

Non-payment of a distribution will not be an event of default and CBA will have no liability to holders in respect of the unpaid distribution. Distributions that are not paid do not accrue and will not subsequently be paid, however if distributions are not paid, CBA is prevented from declaring a dividend or returning any capital to shareholders until a distribution is paid in full on a subsequent distribution payment date, or until the Notes are exchanged or redeemed. As such, we expect CBA to give priority to payment of Tier 1 capital distributions (including CBAPI). As at 30 June 2019, CBA had a CET1 Capital buffer of \$12.2bn above the CCB threshold. Lonsec regards a missed distribution as a low probability event.

## CommBank PERLS XII Capital Notes (CBAPI)

ISSUE DATE: 9-10-2019

### Maturity Risk — High

Lonsec has assigned this issue a 'High' maturity risk rating, primarily reflecting its perpetual structure, term to call and lack of holder redemption rights. However, Lonsec regards the perpetual outcome as unlikely and expects the issue to be redeemed on 20 April 2027.

### Mandatory Exchange Conditions

CBA has the option<sup>1</sup> (but not the obligation) to redeem all or some of the Notes on 20 April 2027, or at any time following the occurrence of a tax<sup>2</sup> or regulatory<sup>3</sup> event or if CBA is unable to frank distributions, subject to APRA approval. On that date, holders will receive \$100/note face value plus any accrued distribution up to the redemption date.

If the Notes are outstanding after the 20 April 2027 call date, CBA must exchange CBAPI into \$101 worth of ordinary shares on 20 April 2029, provided all three mandatory exchange conditions (see below) are satisfied. CBA is also required to exchange the Notes on the occurrence of a Change of Control Event<sup>4</sup>.

### Mandatory Exchange Conditions

1. The VWAP of CBA ordinary shares on the 25th business day before (but not including) a potential mandatory exchange date is greater than 56% of the Issue Date VWAP, which is expected to be around \$43.68/share (based on a VWAP of \$78.00).
2. The VWAP of CBA ordinary shares during the period of 20 business days before (but not including) a potential mandatory exchange date is greater than 50.51% of the issue date VWAP, which is expected to be around \$39.40/share (based on a VWAP of \$78.00).

3. CBA shares are listed or admitted to trading on the ASX as at the Mandatory Exchange Date.

The first and second mandatory conversion conditions are intended to provide some protection for holders against exchange occurring when the price of ordinary shares has fallen to such a level that you would only receive the maximum exchange number. The third condition is intended to ensure holders have capacity to sell the ordinary shares they receive on the ASX if they wish to do so.

Investors should note that if the mandatory exchange conditions are not satisfied on 20 April 2029, exchange will be deferred until the next scheduled distribution payment date when the mandatory exchange conditions are satisfied. It is possible the mandatory exchange conditions are never satisfied and that CBAPI may never be converted. Accordingly, the Notes are technically considered to be perpetual.

However, Lonsec believes CBA's good corporate standing along with the risk of reputational damage should ensure that CBA redeems and replaces the Notes on 20 April 2027 (implying a 7.5-year term), subject to APRA approval, its capital position and prevailing credit spreads at that time. CBA have never had an issue with previous issuances and have met their specified maturity dates.

Holders of CBAPI have no right to request early redemption, but investors seeking liquidity can sell on-market depending on the prevailing on-screen liquidity that is available.



# CommBank PERLS XII Capital Notes (CBAPI)

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Table 3: Difference between PERLS XII and other types of investments in CBA

	SAVINGS ACCOUNT	TERM DEPOSIT	PERLS XI	PERLS XII	ORDINARY SHARES
LEGAL FORM	DEPOSIT	DEPOSIT	UNSECURED SUBORDINATED DEBT OBLIGATION	UNSECURED SUBORDINATED DEBT OBLIGATION	ORDINARY SHARE
GUARANTEE UNDER THE AUSTRALIAN GOVERNMENT FINANCIAL CLAIMS SCHEME	YES	YES	NO	NO	NO
TERM	AT CALL	ONE MONTH TO FIVE YEARS (USUALLY)	PERPETUAL, CBA MUST EXCHANGE FOR ORINARY SHARES ON 26 APRIL 2026 IF THE MANDATORY EXCHANGE CONDITIONS ARE SATISFIED	PERPETUAL, CBA MUST EXCHANGE FOR ORINARY SHARES ON 20 APRIL 2029 IF THE MANDATORY EXCHANGE CONDITIONS ARE SATISFIED	PERPETUAL
MARGIN	N/A	N/A	3.70% PER ANNUM	3.00-3.20% PER ANNUM <sup>5</sup>	N/A
INTEREST/DISTRIBUTION /DIVIDEND RATE	VARIABLE	FIXED (USUALLY)	FLOATING	FLOATING	VARIABLE DIVIDENDS ARE PAYABLE
INTEREST/DISTRIBUTION /DIVIDEND PAYMENT DATES	MONTHLY (USUALLY)	END OF TERM PER ANNUM (USUALLY)	QUARTERLY	QUARTERLY	SEMI-ANNUALLY
TRANSFERABLE	N/A	NO	YES – QUOTED ON ASX	YES – QUOTED ON ASX	YES – QUOTED ON ASX
REDEMPTION AT CBA'S OPTION (SUBJECT TO APRA APPROVAL AND CERTAIN OTHER CONDITIONS)	NO	NO	YES, ON 26 APRIL 2024 AND IN CERTAIN SPECIFIED CONDITIONS	YES, ON 20 APRIL 2027 AND IN CERTAIN SPECIFIED CONDITIONS	NO
CONVERSION TO ORDINARY SHARES ON A CAPITAL TRIGGER OR NON-VIABILITY EVENT	NO	NO	YES, FOLLOWING A CAPITAL TRIGGER EVENT (CET1 CAPITAL RATIO EQUAL TO OR LESS THAN 5.125%) OR NON-VIABILITY TRIGGER EVENT		N/A

Source: CBA

<sup>1</sup> Subject to certain conditions including APRA approval.

<sup>2</sup> A tax event will occur if CBA is obliged to pay additional amounts, is exposed to a significant increase in taxes or other costs in relation to CBAPI or there is a material risk that CBA would not be able to frank distributions.

<sup>3</sup> A regulatory event will occur where an unexpected change of laws or APRA's prudential standards prevent CBA from treating all CBAPI as Tier 1 regulatory capital.

<sup>4</sup> A change of control event occurs when, in respect of CBAPI, a takeover bid is made or a scheme of arrangement is proposed, and certain conditions are satisfied.

<sup>5</sup> Indicative margin range.

# CommBank PERLS XII Capital Notes (CBAPI)

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## Liquidity Risk — Moderate

Lonsec assesses liquidity risk with reference to the average weekly turnover relative to the size of the issue and accordingly, we have given this issue a 'Moderate' liquidity risk rating.

CBA has announced an initial offer size of approximately \$750m, with the ability to raise more or less. Lonsec also notes previous PERLS issuances, including similar 'new money' issuances, have been well supported by the market across a range of market conditions. Hence, Lonsec expects at least the indicated \$750 million to be raised. The issue size should support an adequate level of liquidity for retail investors. Historically, such an issue size of comparable securities has supported weekly turnover of around \$3.5m. Other factors that will influence CBAPI's liquidity include the free float, issue margin, credit spreads and the underlying market conditions. Liquidity is less of a concern for small investors or those intending to hold to maturity.

## Industry Risk — Moderate

Lonsec has assigned a Moderate industry risk rating in-part due to the industry's leveraged exposure to underlying macroeconomic and financial market conditions and a relatively high degree of regulation.

The Australian banking system is in a relatively strong position with each of the banks holding strong global credit ratings and top quartile capital levels.

The four major banks (Big Four) dominate market share in Australia and New Zealand. Since the GFC, the major banks have improved their funding, liquidity and capital positions, although there is still a major reliance on wholesale funding, which represents a little over 30% of their total assets. Net interest margins remain at around 2% and cash return on equity around 12%. Gross impaired assets represent 0.3% of gross loans and acceptances, which is low relative to history and other developed economies.

The exposure of Australian banks to Europe remains minimal following National Australia Bank Ltd's (NAB) divestment of its UK assets, although European instability does indirectly affect the cost and access to wholesale funding in global markets.

Rising spreads, higher funding costs and the state of the Australian housing and commercial property market can be regarded as some of the key factors that could adversely impact the banks financial position and profitability. House prices fell over 2018 and through to June in 2019, with lending growth tightening, as the impact of the recent measures put in place by regulators to curb investor demand and interest only lending is beginning to take effect. However, house prices started to turn in August 2019 as reduced uncertainty around housing-related tax policy, back to back 25bps cuts from the RBA in June and July, and some easing in regulatory guidelines for loan serviceability assessments began to flow through.

Regardless, accommodative monetary policy and Australia's reasonably strong economy in comparison to global peers should support a relatively low level of delinquencies and residential impairments moving forward. Additionally, the mining downtrend which brought a rise in impairments in WA and QLD appears to have ceased.

Lonsec anticipates flat to low single digit earnings growth in the medium-term for the major banks, with the introduction of the major bank levy in July 2017, the continued need to slow the flow of new interest only lending and eventual mean reversion of impairments complicating the growth outlook.

The Hayne report was released in February 2019, with its recommendations not expected to lead to drastic structural changes for the major banks. The major banks are going through a period of remediation as they compensate customers in relation to their "fee for no service" scandal. To date, the Big Four have provisioned total remediation costs over \$7 billion, with the propensity to increase in future years. This will inevitably be accompanied by considerably increased compliance and regulation costs going forward.

## Volatility Risk — High

Lonsec has assigned the issue a 'High' volatility risk rating, attributable to CBAPI's low-ranking capital status, term to call and loss absorption triggers that may result in a positive correlation with CBA's ordinary share price in times of distress.

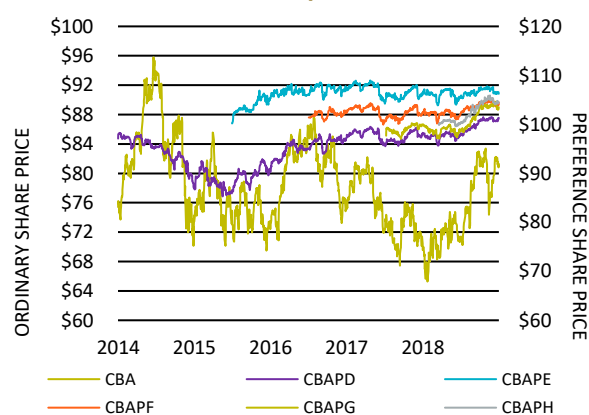
The market price of this issue will fluctuate due to various factors. These include changes to credit spreads, general market conditions, investor sentiment, interest rates, economic conditions, CBA's financial position and credit rating, movements in the market price of CBA ordinary shares or senior or subordinated debt or the perception of or likely occurrence of a Capital Trigger Event, Non-Viability Trigger Event or distribution deferral.

The main driver of volatility is the prevailing credit spreads at the time. Higher credit spreads will lower the market price of CBAPI and vice versa for lower credit spreads. Credit spreads are currently at all-time lows so any mean reversion will cause CBAPI to trade below par.

CBAPI's low-ranking capital status, Capital Trigger and Non-Viability Trigger may result in positive correlation with CBA's ordinary share price in times of distress and may cause CBAPI to trade below par at some stage.

Investors can look to CBA's other compliant listed AT1 securities (CBAPD, CBAPE, CBAPF, CBAPG and CBAPH) to guide volatility expectations, with CBAPD trading within a range of \$85.29 to \$101.50 since listing in October 2014.

Chart 10. Listed Tier 1 Security Price Histories



Source: Lonsec, Thomson Reuters

Any of the other aforementioned factors may also cause the Notes to trade below par at some stage and therefore CBAPI may not be an appropriate investment for short-term or risk averse holders. Lonsec recommends investing with the intention of holding to maturity.

# CommBank PERLS XII Capital Notes (CBAPI)

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## Summary of Key Investment Risks identified in the prospectus

Investment in CBAPI is an investment in CBA and may be affected by the ongoing performance, financial position and solvency of CBA. CBAPI are not guaranteed by any Australian government, government agency or compensation scheme of Australia or any other jurisdiction.

### Risks associated with CBA

The CBA Group's activities are subject to risks that can adversely impact its business, operations and financial conditions and, in turn, an investment in CBAPI. These include, but are not limited to, exposure to risks associated with lending and extending credit to customers and other parties, the Australian property market, internal processes, people and systems, a change in CBA's credit rating, legal proceedings such as AUSTRAC, acquisitions and divestment opportunities or regulatory fines and sanctions.

### Risks associated with the Royal Commission

Any recommendations, adopted outcomes or regulatory action from the Royal Commission of the banking and financial services sector may adversely affect CBA's business, financial performance or financial condition.

### Unsecured investment

CBAPI are not deposit liabilities and are therefore not protected by the Government guarantee, nor are they secured against any asset of CBA. Investors face the risk of a loss of capital if CBA is under financial stress.

### Unclear maturity date

CBAPI are perpetual, exchangeable and redeemable capital notes with no fixed maturity date. It is possible CBA do not elect to redeem the Notes at the call date, and that the mandatory exchange conditions at the scheduled mandatory exchange date are never satisfied. Alternatively, redemption may occur on dates not previously contemplated by holders.

### Fluctuating distribution payments

The interest rate is calculated for each distribution period by reference to the 90-day Bank Bill Swap Rate, which is the rate at which major Australian financial institutions lend short term cash to each other over a 90-day period. This rate is influenced by several factors and varies over time. Because of movements in the underlying bank bill swap rate, the level of interest rate payments will vary over time.

### Distributions may not be paid

Distributions are discretionary and subject to the payment conditions being satisfied. Non-payment of a distribution will not be an event of default and the holder has no claim in respect of such non-payment. Distributions that are not paid do not accrue and will not be subsequently paid.

### Liquidity

The market for CBAPI may not be liquid and may be less liquid than that of equity. If liquidity is low, there is a risk that, if investors wish to sell CBAPI, they may not be able to do so at an acceptable price or at all.

### Volatility

The market price of CBAPI may fluctuate due to various factors including changes to general market conditions, investor sentiment, interest rates, credit spreads, economic conditions, CBA's financial position and credit rating, movements in the market price of CBA ordinary shares or senior or subordinated debt, the perception of or likely

occurrence of a Capital Trigger Event, Non-Viability Trigger Event or distribution deferral. This may cause the Notes to trade below par at some stage and therefore CBAPI may not be an appropriate investment for short term or risk averse holders.

### Exchange following a Trigger Event

CBA must immediately exchange all or some of CBAPI into ordinary shares if a Non-Viability or Capital Trigger Event occurs. Because of the maximum exchange number, if a Trigger Event occurs, CBAPI holders may receive less than \$101/note if CBA ordinary shares are trading below 20% of the issue date VWAP. Furthermore, CBAPI holders would subsequently rank equally with ordinary equity in a winding-up. If exchange does not take effect within five business days, then holder's rights will be terminated and the Notes will be written off.

### Equal ranking to equity in a wind up

CBAPI are subordinated and unsecured capital securities. If, after the claims of holders of senior ranking obligations, creditors preferred by law and secured creditors are satisfied there are insufficient assets to pay all amounts owing on CBAPI, there is a risk that investors may lose some or all the money invested in CBAPI. Upon exchange (if exchanged), holders will become holders of ordinary shares of CBA and rank equally with other holders of ordinary shares.

### Regulatory classification

APRA has confirmed that CBAPI, once issued, will qualify as Additional Tier 1 capital under Basel III prudential standards. However, if APRA subsequently determines that all or some of the notes are not or will not be treated as Additional Tier 1 Capital because of a change in law or a change in APRA's prudential standards, CBA may decide a Regulatory Event has occurred, which will allow CBA to redeem the Notes at CBA's discretion (subject to APRA approval).

### Tax consequences

If there is a change in tax laws and that has a materially adverse tax consequence for CBA in relation to CBAPI, then CBA may redeem CBAPI earlier than expected by investors (subject to APRA approval).

### Exchange Price

The ordinary share price used to calculate the exchanged number of ordinary shares may be different to the market price at the time of exchange. As a result, the market value of shares received upon exchange may be lesser or greater than \$101 per note.

### CBA may issue further securities

The terms do not contain any covenants preventing CBA from issuing further senior or equal ranking obligations, which may affect a holder's ability to be repaid on a winding up of CBA.

### Systemic Credit Risk

Although credit risk has been assessed by Lonsec it does not encompass systemic effects such as the global financial crisis. CBA may be adversely affected either directly or indirectly by disruption to global markets.

**Investors should refer to Section 4 of the Prospectus for further details of the risks associated with CBAPI.**

## CommBank PERLS XII Capital Notes (CBAPI)

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### Cash Rate and Credit Spreads

#### Cash Rate

As widely predicted, the RBA initiated a rate cut cycle in June that has seen three rates cuts totalling 0.75%. With the latest 25bps cut in October, the cash rate sits at an historical low of 0.75%. The Governor's statement accompanying the October cut has the market expecting the rate to fall to 0.5% in the near future.

2Q19 GDP grew 0.5% q/q, continuing from 1Q19's 0.5% rise, as strong government spending was held back by weak private demand. Annual growth slowed to 1.4%, a sharp slowdown from 3.1% a year ago. This pace is below population growth of 1.6% and represents the slowest pace since the GFC. The RBA has forecasted GDP growth of 2.4% and 2.8% in 2019 and 2020, respectively, assisted by lower interest rates and recent tax measures.

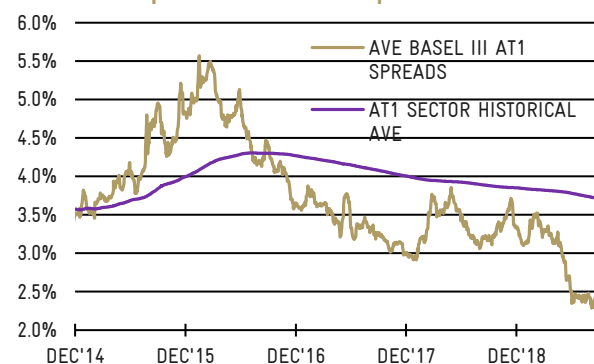
The August Statement on Monetary Policy provided an update of the RBA's forecast for growth and inflation for the next few years. The RBA lowered its 2019 GDP forecast to 2.4% yet increased its 2020 and 2021 GDP forecasts as policy stimulus is expected to flow through. Inflation forecasts were trimmed, with inflation expected to be 1.5% in 2019 (compared with the 1.7% guided for in May 2019) and 1.9% in 2020 (compared with 2.0%). Inflation is expected to take longer to reach the target level as the RBA expects wage growth to increase moderately, due to slower output growth in recent quarters. The RBA continues to be concerned with regards to consumption, with a sustained period of only modest increases in household disposal income continuing to weigh on consumer spending.

The RBA expects inflation pressures to remain, with underlying inflation, currently at an annual rate of 1.6%, expected to remain below the target range of 2-3% until 2021.

For the RBA, weaker than expected growth in the Australian economy, downside risks to the global outlook, subdued inflation and capacity in the labour market continue to support an extended period of low interest rates. The board noted the possibility of further stimulus if needed to support sustainable growth in the economy, full employment and the achievement of the inflation target.

#### Credit Spreads

Chart 12. Major Bank AT1 Credit Spreads



Source: Lonsec, Thomson Reuters

Investment grade credit spreads fluctuated during the quarter on the back of market volatility, but ended June largely flat. High yield spreads did much the same, although widened out approximately 50 basis points in early June before tightening again.

Major bank AT1 spreads closed the quarter 3bps tighter at 2.39%, which is 132bps (1.9 standard deviations) below their long-term average. Therefore, any mean reversion will lead to a price depreciation at current valuations.

# CommBank PERLS XII Capital Notes (CBAPI)

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## Appendix: Lonsec's Listed Income Research Methodology

Lonsec's listed income research follows a structured framework to derive an investment rating and risk assessment. The investment rating is, much like a credit rating, a long-term assessment which remains relatively static, though will be upgraded or downgraded should our 'investment grade' view change. The risk assessment is more dynamic and may vary more frequently throughout the term of the issue. In forming our investment rating, we have assumed that positions are held to maturity and therefore will continue investment coverage through to maturity.

### Investment Rating

Each listed income investment under coverage is assigned either an 'Approved' or 'Not Approved' rating:

#### Approved

The 'Approved' rating indicates that Lonsec believes the security is of 'Investment Grade' quality, meaning we believe the issuer has sound financials, the security will pay all distributions in the term to call and holders will receive face value on maturity, such that the income potential outweighs the potential risks.

#### Not Approved

The 'Not-Approved' rating indicates that Lonsec believes the security is not of 'Investment Grade' quality, meaning we believe the potential risks outweigh the long-term income potential of the security.

These ratings are made regarding the Lonsec risk assessment, which is discussed below, and with consideration to the relative attractiveness of the expected return. The potential return refers to the interest margin on offer over the relevant benchmark rate and any other investment return which may include conversion discounts, in-built call options, entitlements to IPOs and future step-ups in the margin.

### Risk Assessment

The six risk categories identified and assessed (in order of importance) are:

#### Structure

The risks inherent in any listed income security can vary significantly based on the security structure. To assess structure risk, Lonsec examines subordination/capital classification, distribution payment tests, distribution restriction conditions, conversion conditions and Capital and Non-Viability Triggers.

#### Maturity

The risks associated with the maturity structure of the issue are examined in detail and a relevant risk rating is assigned accordingly. One of the key factors in the market's pricing of a listed income security is the maturity terms and conditions, as these determine 'if', 'how' and 'when' the invested capital is returned to the investor. Lonsec forms a view on the expected maturity date of each security, having considered the time horizon to maturity and/or conversion terms, the financial capacity of the issuer, the ascribed equity credit and the significance of the size of the issue to the issuer.

#### Financial

The financial strength of the issuer is examined according to the sector in which it operates and the security product. This is primarily designed to ensure the analysis represents a true reflection of the issuer's financial strength and to account for the fact that banks, insurance companies and traditional industrial companies all have very different financial structures. Furthermore, the financials important to Tier 1 securities are different to those that relate to bonds, for instance. Specifically, the key indicators analysed include wholesale credit ratings, balance sheet strength, capital adequacy, funding, outlook, exposures, asset allocation, earnings and cash flow.

#### Liquidity

Liquidity risk is the risk that an investment may not be easily converted into cash with little or no discount to the last traded market value and at minimum delay. A liquidity premium should be required by investors to compensate for lack of liquidity. Low liquidity can also result in higher than desired volatility. Key attributes analysed to rate liquidity include issue size and average weekly turnover.

#### Volatility

Volatility measures how much the market value of an issue fluctuates over its life with respect to its face value. Volatility is often viewed negatively in that it represents uncertainty, however, it can also provide the potential for higher returns. Both capital and income will contain some degree of volatility depending on the nature of the underlying investment. Our assessment of expected volatility takes into consideration metrics including issuer strength, economic and credit market conditions, investor sentiment, equity market conditions, maturity risk, capital ranking/structure, turnover, conversion terms and the volatility of listed peers.

#### Industry

Structural and operational risks associated with the industry in which the company operates can impact the financial position and prospects of the issuer and hence the performance of the listed income security. Industry analysis involves consideration of the following factors: current and forecast industry conditions, domestic and global economic outlook and its expected impact on the industry, regulatory risks and the company's positioning and pricing power within its industry, the power of suppliers and buyers, as well as the life cycle stage of the industry.



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### Risk Rating

Following an assessment of the risks and metrics described above, a risk assessment score is assigned to each of the six risk categories. The risk scores are assessed on a scale of 1 to 5, with 1 implying low risk and 5 implying high risk. Adding the scores of each category derives a total assessment score out of 100, which represents the overall risk assessment for the security. Out of the six risk categories, structural risk and maturity risk are the heaviest weighted categories, followed by financial risk. Liquidity and volatility are the lowest weighted categories, while industry risk assists in understanding the financial outlook.

The risk rating categories range from Low to Speculative and are described below:

#### Low

A low-risk assessment indicates that the weighted risk is low and the overall risk score is less 45, which indicates strong credit quality.

#### Low to Moderate

A low-to-moderate risk assessment indicates that the weighted risk is low to moderate and the overall risk score is between 46 and 53, which indicates solid credit quality.

#### Moderate

A moderate risk assessment indicates that the weighted risk is moderate and the overall risk score is between 54 and 65, which indicates good credit quality.

#### Moderate to High

A moderate-to-high risk assessment indicates that the weighted risk is moderate to high and the overall risk score is between 66 and 73, which indicates reasonably good credit quality, but with some high-risk factors.

#### High

A high-risk assessment indicates that most the risks are rated as high and the overall risk score is between 74 and 85, which indicates low credit quality.

#### Speculative

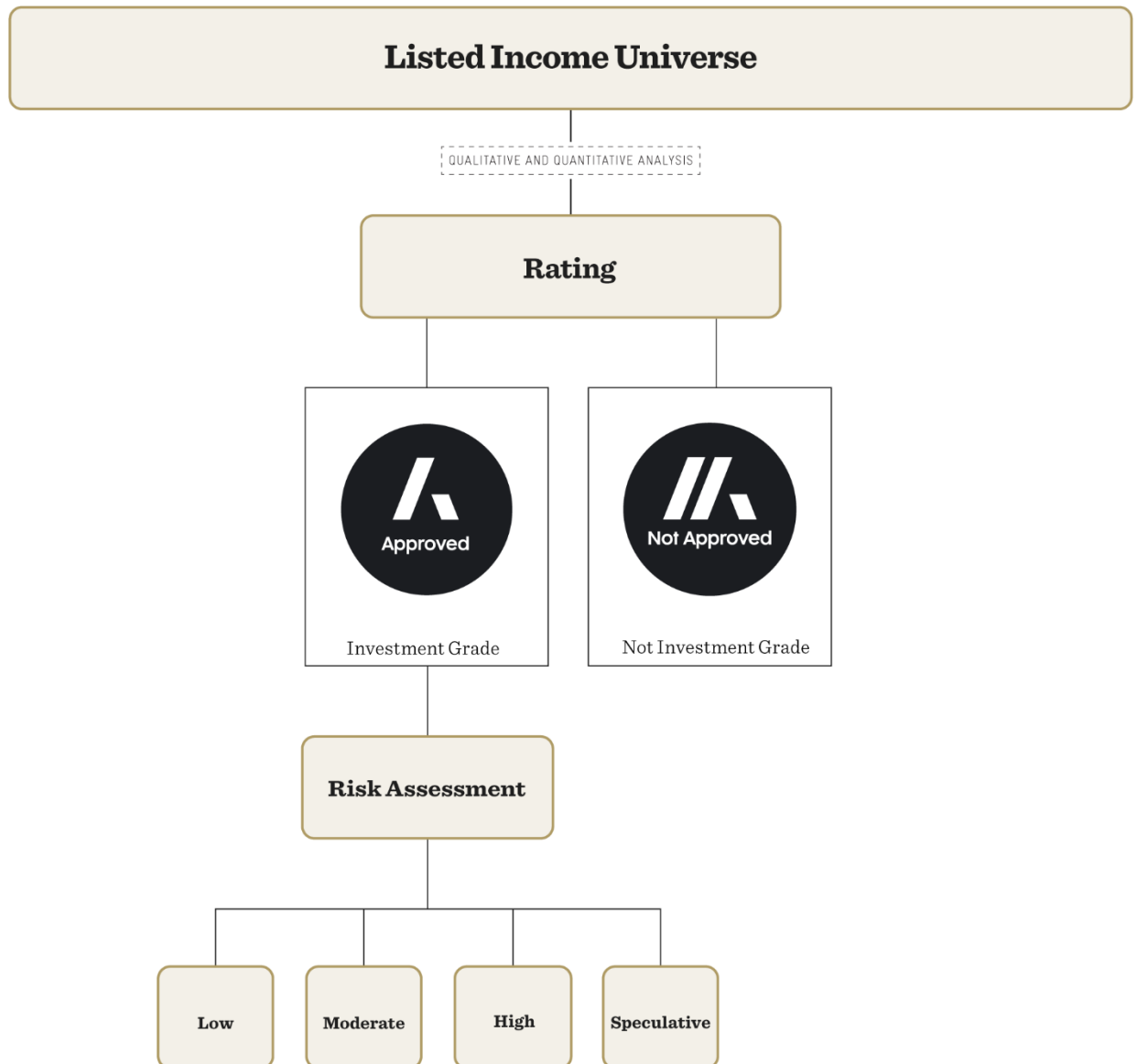
A speculative risk assessment indicates that most the risks are rated very high and that the overall risk score is between 86 and 100, which indicates the issue has speculative qualities.

#### Risk rating categories (example only)

	LOW	MODERATE	HIGH	SPECULATIVE
FINANCIAL	●			
MATURITY		●		
STRUCTURE			●	
LIQUIDITY		●		
INDUSTRY		●		
VOLATILITY		●		
RISK PROFILE		●		

## CommBank PERLS XII Capital Notes (CBAPI)

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For further information on Lonsec listed income research, see the [Lonsec Listed Income Investment Journal](#).

# CommBank PERLS XII Capital Notes (CBAPI)

## Important Notice

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### Date prepared

Friday, 7 October 2019

### Analyst

Chad Troja

### Release authorised by

Peter Green

## Lonsec listed income risk rating spread

	NUMBER	%
LOW RISK	3	7%
LOW-MODERATE RISK	3	7%
MODERATE RISK	1	2%
MODERATE-HIGH RISK	22	50%
HIGH RISK	15	34%
SPECULATIVE RISK	0	0%
TOTAL	44	100%

## Lonsec listed income recommendation spread

	NUMBER	%
APPROVED	43	98%
NOT APPROVED	1	2%
TOTAL	44	100%

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