

SUBMISSION

Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the impairment of customer loans



CommonwealthBank

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Executive Summary

Commonwealth Bank's goal when providing credit is to support economic and social development through prudent lending to households and businesses. It is in the legal, financial and reputational interests of both Commonwealth Bank and our customers that they are able to continually service their loans.

Indeed in circumstances where customers are encountering difficulty in maintaining their loans we have demonstrated our willingness to work with those customers to find appropriate solutions, including giving them time to address arrears and return to sustainable payment arrangements.

Commonwealth Bank acknowledges recent commentary around the circumstances of customers defaulting on their loans and banks realising on security held.

We believe it is never in the interests of a customer, the bank or the economy to lend money to a customer who is unlikely to meet their contractual obligations and default on their loan.

We recognise that a small proportion of customers will default on their loans. However the number and value of those loans which end in default can be minimised by applying careful risk assessment both when the loans are issued and by monitoring loans throughout their life.

To this end, Commonwealth Bank controls its credit risk by adopting prudent credit risk management policies and procedures.

Some commentary has suggested that for some customers the loan to valuation ratio has been improperly used to manufacture customer defaults. We have seen no evidence of such activity happening at either a systemic or an individual level. Indeed, we believe there is no incentive for doing so.

At Commonwealth Bank, when assessing whether a loan will continue to be viable, the ability to meet repayments and interest (serviceability) remains the key consideration and is more important than loan criteria such as a borrower's loan to valuation ratio.

To Commonwealth Bank's knowledge, it is exceedingly rare for a bank to instigate recovery proceedings on the basis of loan to valuation ratios or 'non-monetary' covenants alone and in the absence of missed payments. More commonly, both types of contractual breach occur before a bank takes legal steps to recover money it is owed.

This submission outlines Commonwealth Bank's process for creating new customer loans, monitoring the ongoing serviceability of loans, the way we support customers in hardship and our process for realising on security held in the small number of cases where it is necessary. It also addresses specific circumstances that relate to the purchase of Bankwest in 2008 and the way we manage lending to agribusiness.

1. Introduction

The Commonwealth Bank of Australia Group (Commonwealth Bank) welcomes the opportunity to provide a submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the impairment of customer loans.

Commonwealth Bank is Australia's leading provider of integrated financial services including retail banking, premium banking, business banking, institutional banking, funds management, superannuation, insurance, investment and sharebroking products and services. Commonwealth Bank is one of the largest listed companies on the Australian Securities Exchange and one of the largest tax payers in the country.

Commonwealth Bank provides a full range of retail banking services including home loans, credit cards, personal loans, transaction accounts, and demand and term deposits through its Commonwealth Bank and Bankwest brands. Commonwealth Bank has leading domestic market shares in home loans, personal loans, retail deposits and discount stockbroking, and is one of Australia's largest credit card issuers. Commonwealth Bank also offers a full range of commercial products including business loans, equipment and trade finance, and rural and agribusiness products.

Our goal when providing credit is to support economic and social development through prudent lending to households and businesses. It is in the legal, financial and reputational interests of both Commonwealth Bank and our customers that they are able to service their loans. Commonwealth Bank also bears a responsibility to our customers, our shareholders and the broader financial system to ensure that we actively monitor the ongoing serviceability of loans.

This submission outlines Commonwealth Bank's process for creating new customer loans, monitoring the ongoing serviceability of loans, the way we support customers in hardship and our process for realising on security held in the small number of cases where it is necessary.

It also addresses specific circumstances that relate to the purchase of Bankwest in 2008 and the way we manage lending to agribusiness.

We note the Committee's request of 30 June 2015 to provide timelines and processes that the bank and its associated entities are required to follow, or choose to follow when customer loans move into impairment, default, and foreclosure. We have sought to outline our standard practices in this document, noting that each customer case is different and that usually a qualitative, principles based approach is taken rather than a quantitative, rules based approach. This provides flexibility to ensure that the bank is best able to support customers who are experiencing difficulties.

In this submission 'Commonwealth Bank' covers both Commonwealth Bank and Bankwest, unless otherwise stated.

2. Commonwealth Bank's Approach to Lending

Commonwealth Bank aims to provide high quality service and information to our customers about products which are suitable to their needs.

A fundamental role of a bank when lending funds to customers is assessing and managing the risk that the customer may at some point be unable to repay the loan. The best outcomes for customers, the bank and the economy occur when a customer repays their debt according to the loan agreement. This provides the customer with the funds they need to achieve their goals, the depositors' funds are repaid with the agreed interest and a positive outcome for the broader economy is achieved through activity facilitated by the flow of funds.

We believe it is never in the interests of a customer, the bank or the economy to lend money to a customer who is unlikely to meet their contractual obligations and default on their loan.

Commercial loan creation

Each time Commonwealth Bank lends to a customer it faces the risk that the customer will fail to repay the loan. As a substantial portion of each loan is sourced from depositors' funds, it is vital that Commonwealth Bank lends prudently and monitors the borrower's ongoing financial health to minimise the risk of losing depositors' funds.

Lending by Commonwealth Bank is underpinned by its credit risk appetite and the types and degrees of risk we are willing to accept. Risk appetite can vary over time, depending on market conditions and regulatory requirements.

Commonwealth Bank considers many different factors when assessing credit risk, including: the purpose of the loan, capacity to service and repay, credit ratings, the type of security being held against the loan, the ongoing value of that security, the industry sector in which lending is occurring, the diversity of the overall lending book and the requirements of APRA. As a provider of debt, Commonwealth Bank assumes a lower level of risk (and a lower potential reward) than equity investors, with the expectation that the original loan will be repaid including interest.

During the life of a commercial or agricultural loan there are many factors which can increase or decrease the risk that the borrower will be able to repay their loan. These risks differ significantly from the risk that a retail customer may not repay their mortgage. When lending to retail customers and households, the overwhelmingly important information to assess risk is the customer's earning capacity over their life. Commercial lending, often involving much larger loans and more volatile earning profiles, requires many additional factors be taken into consideration.

While the average consumer is likely to be employed in some capacity for the majority of their life, businesses often have a much shorter life span. For example, of the 294,210 new businesses set up in the 2010-11 financial year, only 50 per cent were still operating in June 2014¹. Businesses are also more exposed than consumers to market volatility and trends which may impact their profitability. Compared to the rate of business closures, unemployment in Australia is low. The majority of workers maintain an income stream which can be relied upon to repay their debts, while businesses are more likely to face a situation where they have little to no additional earning capacity.

¹<http://www.abs.gov.au/ausstats/abs@.nsf/mediareleasesbytitle/950EC94DB899312ECA2573B00017B8F4?OpenDocument>

While it is unavoidable that some customers default on their loans, prudent risk assessment when issuing loans is important in ensuring that Commonwealth Bank mitigates the number and value of loans it provides to customers which end in default. To this end, Commonwealth Bank controls its credit risk by adopting prudent and effective credit risk management policies and procedures.

These policies and procedures apply, in particular, to the recognition, measurement and reporting of, and provisioning for, impaired loans. APRA sets requirements because failing to lend prudently would increase the level of risk in the financial system. Imprudent lending would also result in financial loss for the bank and contravene obligations under Australian Financial Services Licence (AFSL) conditions and the National Consumer Protection Act 2009.

The importance of prudent lending requires a bank to be conscious of the credit risks at the point of loan creation, but also to monitor this risk over the term of the loan. Often this helps the borrower as experienced experts within the bank can provide guidance to the borrower on risks to their business which they may not have considered or which have arisen from a change in circumstances. To continually assess the credit risk of a loan, and for the bank to meet regulatory requirements, customers agree to undertake certain actions and provide the bank with certain information over the term of the loan.

Ongoing credit assessment

Ongoing credit assessments of commercial loans are undertaken and each commercial loan is allocated a Credit Risk Rating (CRR). The CRR is a rating from one to nine with one the lowest level of risk, and nine the highest.

In the event that a loan achieves a CRR of between seven and nine, it is considered that the borrower could experience difficulty in meeting their obligations and that the risk to the bank will have increased. If a loan is considered a nine on the CRR scale it is deemed to be “impaired”. Impairment occurs when a bank believes that it will not be repaid its funds in full and will make a financial loss on the loan.

If a bank considers that it will make a loss on a loan, that loan is required by APRA to be designated as such. An impaired loan is not simply a loan where the customer has defaulted under the contractual terms. Rather, a loan is only considered impaired when the lending institution believes that it will make a financial loss on the loan. Equally, a designation as an impaired loan is not a terminal outcome; such loans can be and are rehabilitated to a satisfactory position.

Table 1 illustrates CRR scores their corresponding APRA classification.

TABLE 1: Commonwealth Bank Credit Risk Rating and equivalent APRA classification

CRR grade	Bank rating classification	APRA classification
7	Troublesome	Special mention
8	Troublesome	Substandard
9	Impaired/Loss	Doubtful/Loss

If a commercial loan is deemed to be troublesome or impaired, it is moved to a specialised division of Commonwealth Bank which deals only with such circumstances, known as Group Credit Structuring (GCS). This division of experienced risk professionals works with customers (and often alongside the customer's banker) to identify and implement strategies to achieve an improvement in credit and risk profile and improvement in the CRR grade. This outcome is achieved in approximately 40 per cent of the cases which are referred to GCS. Where this outcome cannot be achieved, our commitment is to develop and implement solutions that repay the debt while minimising loss for the customer.

To monitor the ongoing risk of a loan and inform the assessment of an accurate risk rating, as required by APRA and prudent banking practice, loan contracts often include conditions and reporting obligations ("criteria") that a customer must continue to meet. These conditions can relate to factors separate to the ongoing repayment of interest, or interest and principal, but which have a significant impact on the likelihood of repayment and the risk associated with the loan into the future.

Criteria can often include but are not limited to:

- not entering into administration or insolvency;
- satisfying staff payroll and superannuation obligations;
- maintaining minimum levels of profit/ loss and cashflow;
- not being convicted of certain offences;
- not being the subject of material litigation proceedings;
- not making false or misleading statements to the bank;
- the loan to valuation ratio; and
- meeting all tax obligations.

These criteria are accepted when a customer agrees to a loan contract and play a role in assessing an accurate ongoing CRR to ensure that unacceptable risk does not eventuate after the loan has been established. In particular, indicators are essential for both the bank and the customer as early warning signs so that corrective or protective action can be taken before a customer's financial position worsens substantially. If this were to occur it would be disadvantageous for the customer and the bank's depositors.

Specific criteria can differ from contract to contract depending on the nature of the business, the borrower's credit history or the industry in which the business operates.

Box A – Example of loan criteria

When lending to licensed venues such as bars or taverns, Commonwealth Bank often includes criteria in the loan contract which require the business to be in possession of relevant licences to operate. When a customer experiences events which could impact their licences, they are required to report these breaches.

For example, New South Wales legislation allows for the Office of Liquor, Gaming & Racing to impose strikes on a licensee if they are convicted of a serious offence under the Liquor Act. This could include permitting violent conduct, permitting intoxication or selling alcohol outside of authorised trading hours.

If the licensee receives three strikes, consequences can include licence cancellation. In these circumstances it is clear that the business' viability would be significantly diminished. By requiring that licensed venues report when they receive strikes, Commonwealth Bank can monitor the increased risk of the loan.

Breaches of loan criteria act as an early warning system and enable the bank to monitor increases in risk during the life of the loan. This allows the bank to work with the customer in rectifying their situation as soon as possible.

When assessing whether a loan will continue to be viable, the ability to meet repayments (serviceability) remains the key consideration and is more important than other criteria such as a borrower's loan to valuation ratio.

While these criteria can trigger a downgrade of a loan to 'troublesome', to Commonwealth Bank's knowledge it is exceedingly rare for a bank to instigate recovery proceedings on these criteria alone and in the absence of missed payments. More commonly, both types of contractual breach occur.

Commonwealth Bank has conducted an internal review of the 306 commercial customers in recovery as at 31 March 2015. We are not aware of any cases where a loan to valuation ratio breach was the sole cause of default.

Processes for commercial customers in financial distress

In the event that a customer experiences problems in servicing their loan, such as a severe short term cash flow issue, the bank commonly works with the customer to find a sustainable plan for how they will rectify the situation.

In such circumstances, discussions with the customer and their lender commonly cover:

- canvassing options for improving business profitability or cash flow;
- changes to repayment arrangements;
- sale of security or other assets to pay down debt;
- alterations to the term of loans; or
- alterations to the value of loans.

Box B: Example of working with customers to restore their loans

A customer whose business provided electrical and mechanical maintenance and servicing for mining equipment was downgraded to 'troublesome' status due to a downturn in work from the mining sector, meaning equipment which was leased out was not earning income.

With the loss of revenue from this mining equipment, the income supporting the debt was earned by three principals who each had independent employment. After several months, some new contracts were obtained to lease out the mining equipment. So that Commonwealth Bank could fully understand the implications for the servicing of the debt, an independent accountant was engaged to work with the borrower to develop projections which could be relied upon to understand and assess the risk.

Upon finalisation of the independent report, the position described was one that both parties could understand and support and the borrower's rating was returned to satisfactory levels.

During the time the loan was supervised by GCS, interest rates were left unchanged as our preference in a time of constrained funding was for the borrower to use its limited free cash flow to engage the independent accountant. This provided the best chance to understand the risks and for the borrower to be restored to a satisfactory rating at the earliest opportunity.

It is Commonwealth Bank's preference, as well as in our financial interest, that the customer is able to restore their loan to a satisfactory position. It is only when it is clear that a customer is in default without the possibility of rectifying the situation that Commonwealth Bank will need to recover the funds it is owed through selling assets held as security.

Loans assessed as troublesome or impaired as at March 2015 have spent an average of 17.5 months in categories seven, eight or nine.

In the year to 31 March 2015 more than 40 per cent of commercial customers rated as troublesome or impaired returned to a satisfactory position. These data demonstrate our willingness to give customers time to address arrears and return to sustainable payment arrangements.

Loans rated as troublesome or impaired are a small minority of Commonwealth Bank's total loan book, and of these loans, a smaller number again are in recovery. The following table illustrates total loans impaired or in recovery at 31 March 2015.

TABLE 2: Number of commercial customers at key stages within Group Credit Structuring (GCS), 31 March 2015

	Farming Enterprises	Other (non-Farm) Loans	Total
Customers rated as 'impaired'	81	709	890
Customers 'in recovery'	35	271	306

The number of loans in recovery represents less than 0.15 per cent of all non-farm commercial loans and less than 0.40 per cent of farm loans.

Commonwealth Bank is committed to working with customers experiencing financial difficulty. In some cases, such as where a customer has experienced misfortune, we will consider options such as repayment holidays or interest free periods to relieve distress to the customer. In times of natural disasters, Commonwealth Bank enacts a range of special assistance initiatives to help business in the affected areas.

Commonwealth Bank is bound by various codes, regulations and legislation which set the standards and rules on how we must deal with customers in financial distress. For example, section 28 of the Code of Banking Practice sets out requirements relating to when a customer gives us a hardship notice and the time frames within which we must respond.

No enforcement action is undertaken while a customer is either being assessed for hardship assistance or while approved for hardship assistance.

Complaints and Dispute Resolution

Commonwealth Bank and Bankwest each have dedicated Group Customer Relations teams in order to appropriately handle customer complaints.

These teams operate within Commonwealth Bank's own policies and procedures as well as consistently with the Australian Securities and Investment Commission's (ASIC) requirements (including RG165) which sets standards for internal dispute resolution mechanisms.

In addition to the resolution processes in place, the Australian Bankers' Association's Code of Banking Practice includes a requirement for banks to provide appropriate complaint handling arrangements and access to an independent external dispute resolution service. This service is primarily provided by the Financial Ombudsman Service (FOS).

FOS is tasked with fairly and independently resolving disputes between consumers – including some small businesses – and financial service providers who are members of the service - including the Commonwealth Bank.

FOS operates on a not-for-profit basis and aims to resolve disputes quickly and efficiently, providing a cheaper alternative than going to court. The service is free of charge for applicants, with the costs of running the service being met by its members.

FOS describes itself as aiming to resolve disputes between consumers and financial services providers:

- in a cooperative, efficient, timely and fair manner;
- with minimum formality and technicality; and
- as transparently as possible, taking into account confidentiality and privacy obligations.

This involves understanding all aspects of a dispute without taking sides, and making decisions based on the specific facts and circumstances of each dispute.

FOS has jurisdiction to handle certain consumer and small business disputes with financial services providers where the customer's complaint to their provider has not been resolved to the customer's satisfaction. It can also, in some cases, award compensation.

The Government recently announced The Australian Small Business and Family Enterprise Ombudsman Bill 2015, which creates a national advocate for small businesses and family enterprises. This new role will work as a concierge for dispute resolution and will refer small businesses to existing alternative dispute resolution services such as FOS. Commonwealth Bank supports this initiative which should further assist small businesses that may be unaware of the independent dispute arrangements or how to access them.

Role of Valuers

Valuations of assets are generally obtained in the following circumstances:

- (a) the initial funding approval process,
- (b) review of existing facilities/term extensions, and
- (c) realisation of assets via sale.

In addition, re-valuations during the course of a review of existing facilities arise from time to time under the terms and conditions of contractual arrangements.

Commonwealth Bank conducts periodic reviews to ensure our clients retain a robust financial position, confirm client repayment capacity and verify the security position together with agreed loan to valuation ratios. Periodic reviews include a refresh of client cash flow analysis and reassessment of asset values relied on as loan collateral. This is standard industry practice and consistent with APRA guidelines.

Commonwealth Bank relies on expert preferred lists (panels) of independent external valuers to undertake valuations under industry and internal standards. This process ensures that valuations are provided by skilled and independent valuers with no perceived or actual influence by Commonwealth Bank.

Valuers used by Commonwealth Bank must:

- be registered or licensed (in states where required);
- comply with the regulatory requirements governing licensing or registration;
- be a member of the Australian Property Institute (API), as a Certified Practising Valuer (CPV);
- comply with annual compulsory training requirements;
- comply with the Code of Ethics and Rules of Conduct of the API;
- be suitably experienced to undertake required valuations (generally a minimum of 5 years' experience in their field of expertise); and
- have suitable and current professional indemnity insurance cover.

The process and standards for valuations include:

- detailed formal written instructions are issued to preferred valuers to undertake valuation reports;
- valuations are to be based on current unencumbered market value (International Valuation Standards);
- valuations must be completed in accordance with API Mortgage Security Professional Practice Standards and reporting requirements;
- valuers must not undertake any valuations where a conflict of interest may occur;
- a director or head of valuations of the valuation firm must complete (or countersign) valuations; and
- valuers must maintain strict confidentiality in respect of customer details.

In a small proportion of cases, especially in remote areas where expert valuers are unavailable Commonwealth Bank has relied on internal bank valuations completed by accredited staff. In these cases, the valuation officer must comply with Commonwealth Bank policy and measures are in place to manage risk.

Where a loan is determined to be troublesome or impaired, Commonwealth Bank policy does not permit the use of internal valuations.

3. Lending to Agriculture Businesses and in Rural Areas

Commonwealth Bank has been supporting agriculture businesses in rural and regional Australia for more than 100 years.

The Commonwealth Bank agribusiness team offers personal service, local knowledge and industry expertise to more than 20,000 clients located in regional and rural Australia.

Commonwealth Bank understands the unique circumstances that farm businesses face. The agriculture sector can be highly cyclical and particularly vulnerable to climatic variations. The management of farming properties can also require technical expertise and often relies upon narrow windows for time sensitive operational activity.

We have worked with farmers in difficult circumstances over many years. It is a priority for Commonwealth Bank when working with farmers in financial distress to try to protect the farming operations and the interests of the customer. The optimal outcome in all circumstances is a robust farming business which is able to meet its obligations to repay interest and debt.

As with non-farming commercial loans, the number of loans to farming enterprises which are regarded as troublesome or impaired is low. Of Commonwealth Bank's loans to farm enterprises, 288 are managed by GCS, 81 are deemed to be impaired (less than one per cent of all farm customers) and just 35 loans (less than 0.4 per cent) are formally in recovery as of 31 March 2015.

The limited number of farm enterprise loans which are the subject of recovery action have, on average, been designated troublesome or impaired for 38.6 months, a longer period than the average non-farm commercial loan (26.8 months).

The time taken to deal with farm enterprise loans and the consideration they are given is also assisted when jurisdictions have farm debt mediation (FDM) schemes in place. Commonwealth Bank views the FDM process as positive and constructive. We believe it greatly assists in delivering the best outcome for farmers and Commonwealth Bank alike.

New South Wales and Victoria have legislated FDM schemes in place. Queensland's regime is the product of an agreement between the banking industry and rural organisations which self-regulate the mediation process. Western Australia has also recently established a scheme.

Commonwealth Bank considers that a nationally consistent FDM scheme would benefit both farmers and the finance industry. A national scheme should be modelled around the principles of the existing schemes which provide the highest level of certainty for farmers.

These principles should include:

- a requirement for the creditor to notify the farmer of the availability of mediation if the creditor intends to take enforcement action in respect of the farm mortgage;
- requirement for both parties to participate in the mediation in good faith;
- an independent mediator, appointed and funded by the State Government in which the farm is located;
- a need for creditors to receive approval from an independent mediator before taking control of assets; and
- penalties for financial institutions which fail to act in good faith or engage in FDM.

A robust national scheme would provide greater certainty for all borrowers and lenders, regardless of the domicile of the loan, on how to proceed during stressful times of financial difficulty. It would also ensure that the few properties which ultimately end up in recovery have been assessed by an independent national public sector authority.

In the unfortunate circumstances where FDM is unsuccessful, we are required to enforce the security we hold against a loan to a farming enterprise. When this occurs we will allow the farmer time and dignity to exit their farm. We recognise that for a farmer and their family these are stressful circumstances, which is why Commonwealth Bank has a dedicated agricultural team within GCS to assist them in the most appropriate and considerate way.

Assistance to farming communities

Commonwealth Bank has also frequently extended assistance to farmers in rural and regional areas to help to manage short and medium term crises, including drought, floods, cyclones and bushfires. The nature of assistance is usually determined on a case by case basis, recognising that individual customers will have unique requirements even in response to the same event.

For example, in December 2014 Commonwealth Bank announced support for drought affected rural and agribusiness customers and a dedicated hotline for customers in distress due to the drought. The support measures that we indicated we would consider at the time included:

- a business loan or mortgage repayment holiday;
- interest free period for an agreed term;
- extending the business or mortgage loan term agreement; and
- waiving fees and charges.

Often such assistance is not only extended to customers of farming enterprises but also to upstream and downstream rural businesses.

4. Allegations about the Purchase of Bankwest

Commonwealth Bank's acquisition of Bankwest coincided with the height of the Global Financial Crisis (GFC). During this period of unprecedented uncertainty in the banking sector the acquisition provided stability for Bankwest and its customers.

At this time there was uncertainty over the ongoing funding provided by Bankwest's parent company HBOS plc. HBOS was subsequently acquired by the Lloyds banking group and funding support provided by the UK Government. The acquisition by Commonwealth Bank provided strong and local ownership and a funding structure which has enabled Bankwest to continue to grow and operate successfully.

Allegations relating to Bankwest

Commonwealth Bank is aware that specific allegations exist around the impairment of loans provided to customers of Bankwest in the years leading up to the GFC.

The broad form of these allegations is as follows:

- Commonwealth Bank agreed a purchase price of around \$2.1 billion for Bankwest, following its owner HBOS becoming financially distressed during the GFC;
- Built into the contract for this purchase were 'clawback' provisions, in which the purchase price would be reduced for every loan which Commonwealth Bank determined was 'bad'; and
- Commonwealth Bank subsequently commenced recovery action against a number of Bankwest customers who were 'good' customers because the purchase price would be reduced accordingly.

Commonwealth Bank has appeared before previous inquiries and rejected these accusations. Our position has not changed - these claims are without foundation.

In reality, the sale price could not be reduced for loans which Commonwealth Bank determined were 'bad'. Any price adjustment for impaired loans was required to be made by reference to provisions for loans which Bankwest had already determined were bad before it was owned by Commonwealth Bank.

The acquisition of Bankwest coincided with the height of the GFC and the credit profile of a number of customers changed, due to the resulting negative impact on the economy and property prices (in particular development properties) and the tighter credit positions adopted by all banks. Bankwest under Commonwealth Bank ownership met all existing contractual obligations and continued to provide credit if it was obliged to do so.

Unfortunately some existing highly leveraged or high risk developments and businesses failed or suffered a significant deterioration in their ability to service their loans. In these circumstances Bankwest had no alternative but to take steps to protect its position. The sale agreement had no influence on the decisions made in relation to the affected customers.

Price Adjustment Mechanism

An independently determined price adjustment mechanism was contained in the sale document between Commonwealth Bank and HBOS. The following section explains why Commonwealth Bank could not unilaterally determine the outcome of that process.

Commonwealth Bank and HBOS entered into a Share Sale Deed for the purchase of Bankwest, St Andrews and associated assets on 8 October 2008. The Share Sale Deed provided that the initial purchase price for the acquired companies was \$2.1b. The initial purchase price could be varied via the price adjustment mechanism set out in the Share Sale Deed. The application of the price adjustment mechanism could result in one of three possible scenarios, namely:

- no change in the initial purchase price;
- a price increase; or
- a price decrease.

Which of these three scenarios eventuated was to be determined by objective reference to the capital position of the acquired companies as reflected in the completion balance sheets as at 19 December 2008 (the date at which Commonwealth Bank became the new owner), which among other things included provisions against loans. This is a common feature of acquisition agreements whether the target company operates in the financial services sector or in other sectors of the economy.

An obligation of the parties to the Share Sale Deed was to resolve what the acquired provisions against loans were as at 19 December 2008. Failing agreement between the parties, they were compelled to refer any outstanding matters to an independent expert for a final and binding determination. A reference to an independent expert was ultimately made in relation to the level of acquired provisions. The independent expert process and the determination of the level of acquired provisions was completed by July 2009.

The expert determination resulted in a purchase price increase of \$26m.

Prior to 19 December 2008, Commonwealth Bank did not have the ability to, nor did it, set the level of provisions held in connection with the Bankwest loan portfolio. Prior to the date of completion, Bankwest under HBOS' ownership was entirely responsible for setting the level of provisions against Bankwest's loan portfolio.

Given that there was no 'clawback' in this context, it would be contrary to the interests of both the Group and customers to impair and raise provisions for otherwise performing loans.

Commonwealth Bank has answered questions in relation to these matters at a variety of Parliamentary forums, notably the Senate Inquiry into the post GFC banking sector in 2012. It has also provided evidence in response to these allegations in a number of legal cases. In those cases, no evidence providing credible foundation for these allegations has ever been put forward.

Indeed, where the substance of allegations has been tested in court it has been found in favour of Commonwealth Bank, including:

- *Commonwealth Bank of Australia v Geoffrey Anthony Shannon* in the Supreme Court of New South Wales

In this case the court concluded: "I am satisfied that there is simply no evidence whereby it could be suggested [Bankwest] did not have due regard to the interests of 33 Electra, C2C Investments or for that matter Mr Shannon. It clearly did all it could to assist Mr Shannon to deal with his difficulties both financial and personal."

- *International Skin Care Suppliers Pty Ltd v Commonwealth Bank of Australia* in the Supreme Court of New South Wales

In this case the court concluded that "unsupportable and indeed irresponsible allegations of dishonesty and misconduct on the part of the Bank and its officers were made and promoted, but then abandoned" and that "ISC's claim fails at every hurdle".

Commonwealth Bank stands by testimony provided in relation to Bankwest at these inquiries and in court proceedings.