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10 November 2015

Ms Toni Matulick
Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra
ACT 2600

Dear Ms Matulick,

Re: inquiry into the impairment of customer loans Questions on Notice

I refer to our letter to the Committee of 8 October 2015 in which we provided responses to Questions on Notice 1 to 4 and Question 6, but advised that further time would be required to respond to Question 5. I now attach our response to Question on Notice 5.

In our previous response of 8 October 2015 we committed to providing “a split of the loan impairment expense between the pre and post-acquisition Bankwest loan portfolio”.

The total Bankwest loan impairment expense on the commercial loan portfolio recognised after acquisition was $1,866 million[1]. Of this, $1,656 million is attributable to the pre-acquisition commercial loan book, with the majority of the expense being incurred from acquisition to 30 June 2010.

An explanation of the difference between loan impairment provisions and write-offs is provided at the end of our response to Question on Notice 5.

We categorically reject accusations that Commonwealth Bank manufactured customer defaults in order to reduce the purchase price of Bankwest. We would be pleased to provide further information which might assist the Committee.

Yours sincerely,

David Cohen
Group Executive Group Corporate Affairs
Commonwealth Bank of Australia

[1] This figure is derived by adding together figures from commercial loans post acquisition in the chart under ‘Bankwest loan impairment expense’ provided in our previous response to the Committee

Question 5. For each financial year from 30 June 2008 to 30 June 2015, the number of loans and financial details of any losses that Bankwest and the Commonwealth Bank have subsequently incurred from loans that were established prior to 19 December 2008 and were not assessed to be impaired or in default as at 19 December 2008.

In reviewing the response below it is important to note that:

(a) The information covers both commercial and retail loans existing as at the acquisition date of 19 December 2008; and

(b) Losses incurred in relation to those loans (known as write offs) are not the same as loan impairment provisions. A summary of the differences is provided at the end of this response.

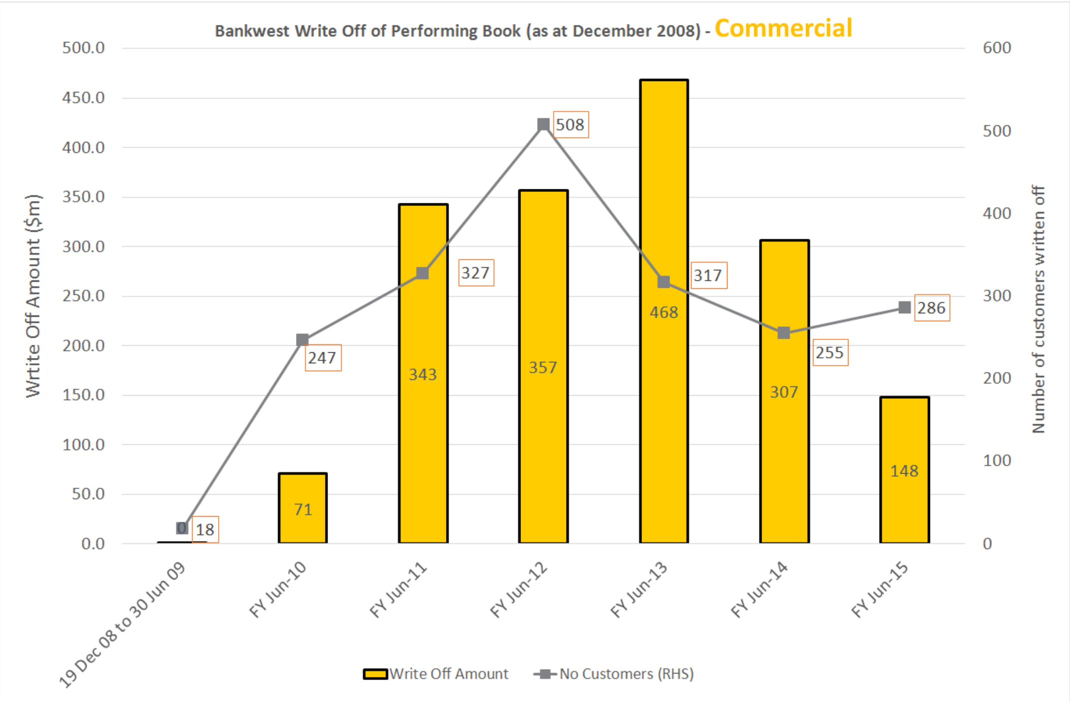
Prior to the acquisition date, Commonwealth Bank did not have the ability to set, nor did it set, the level of impairment provisions held in connection with the Bankwest loan portfolio. HBOS was solely responsible for setting the level of provisions against Bankwest's loan portfolio. As a result, the response to this question only considers the period from which Commonwealth Bank controlled Bankwest; that is, from 19 December 2008 onwards.

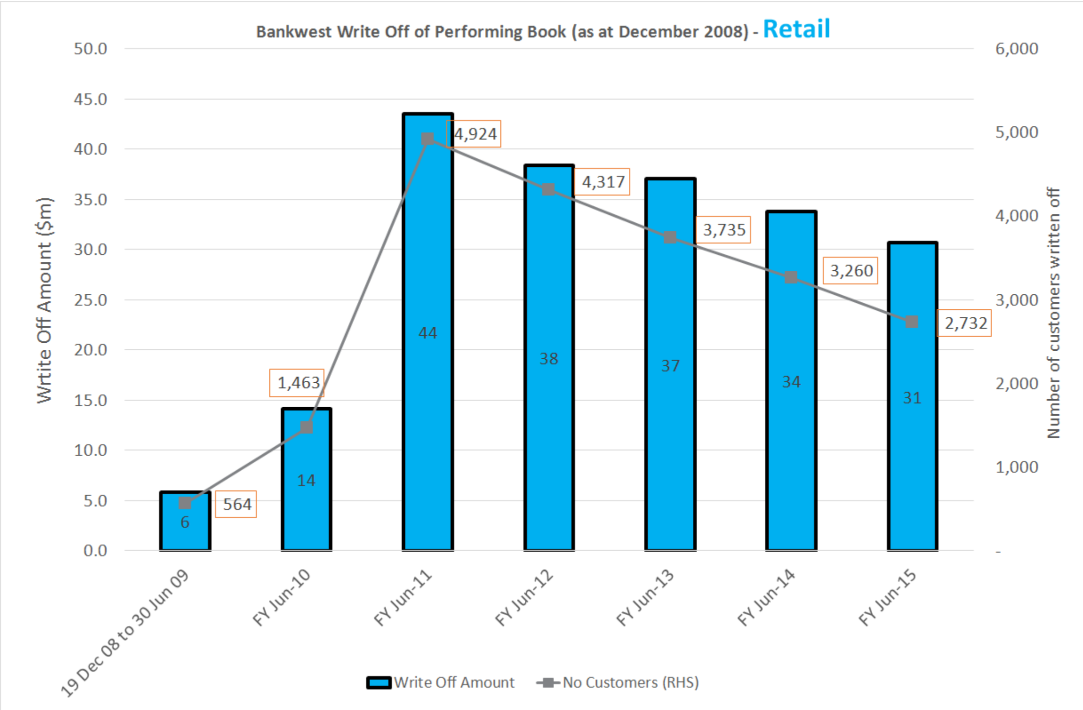
Performing Loans

The Bankwest Commercial and Retail Loans existing as at 19 December 2008, excluding loans in default and impaired loans, ('performing book') were as follows:

Portfolio	Amount $ million
Commercial	22,869
Retail	34,566
Total	**57,435**

Of this performing book, write-offs incurred for the period 19 December 2008 to 30 June 2015 totalled $1,898 million (22,953 in number). This has been illustrated for the commercial ($1,694 million and 1,958 in number) and retail ($204 million and 20,995 in number) loan portfolios in the graphs that follow:





Impaired Loans

The total loan impairment provision, after the Independent Expert's determination, for both retail and commercial loan portfolios held at 19 December 2008, was $630 million ($250 million collective provision, $380 million individual provision).

Total Losses

The losses incurred subsequent to acquisition date on the performing retail and commercial loan portfolios and on the defaulted and impaired portfolio are shown below:

	Amount $ million
Write-offs incurred on the performing loan portfolio	1,898
Write-offs incurred on the defaulted and impaired portfolio	872
Total write-offs incurred	**2,770**
Less: loan impairment provision as at 19 December 2008	(630)
Write-offs in excess of the loan impairment provision	**2,140**

Therefore total write-offs exceeded the loan impairment provision by $2,140 million. This had no impact on the purchase price paid for Bankwest, and was recorded in Bankwest's post acquisition income statement.

Difference between Write Offs and Loan Impairment Provisions

Our previous responses to the Committee referred to loan impairment provisions. Write-offs differ to loan impairment provisions.

Accounting standards require loan impairment provisions to be recognised as soon as there is objective evidence that a loan (either individually or collectively) is considered to be impaired. Under Bankwest's accounting policies individually assessed provisions were recognised against impaired loans. Loans that did not fall into this category (i.e. performing loans) were assessed for impairment on a collective basis. These provisions represented an estimate of the losses that were anticipated to be incurred.

The creation of an accounting loan impairment provision does not necessarily indicate that the customer is in legal default. As we outlined in our original submission, if a customer appears to be in difficultly we first determine whether there is a strategy to enable the customer to meet their obligations and improve their credit position. If this is not possible, we determine a strategy to minimise any losses following the legal default of the customer. This may include selling secured assets, the appointment of a receiver or company liquidation.

It is not until other efforts have been exhausted that the final write-off is recorded.