

# Understanding CBA/Bankwest Benefits

---

Document Version	Date
V3.3	4 <sup>st</sup> Jun 2013

## Abstract

We now know from the recent senate inquiry that Bankwest was in financial difficulty at the time the Commonwealth Bank of Australia (CBA) purchased the business. Since that takeover, CBA has faced growing allegations of unconscionable conduct and an unusual spike in court actions relating to foreclosures.

This document focuses predominantly on the potential motive for the CBA to act unconscionably towards customers using only publicly available documentation with the view to assist government and regulators understand this complex matter. It also addresses some questionable claims made by the CBA, in their efforts to obfuscate the true facts.

It is hypothesised that the CBA were over extending themselves financially to purchase Bankwest and its funding obligations. The purchase was only made possible by defaulting large numbers of productive customers in a number of ways, but the most troubling was blaming the GFC environment and problems with commercial loan security valuations.

Ultimately, it appears over two billion dollars worth of Bankwest commercial loan customers were lumped into an impaired loan category, and then sent to the wall in a ruthless scheme amortised over time to reduce the levels of anomaly.

CBA have then used carefully constructed PR spin, extremely aggressive tactics to any victims who pursued court action and avoiding the matter as much as possible, despite growing levels of concern and scrutiny by the Australian community. The human toll is devastating on both victims and the wider community.

## Executive Summary

In 2008 the HBOS book value of Bankwest was (AUD) \$4.25B. There was an agreement of upfront impairments. Some of these impairments were already induced by Bankwest to cover up their own financial difficulties. Some of these impairments were provisioned to later be induced by CBA after the sale so that CBA could still remain within APRA capital reserve requirements. Using various price adjustment mechanisms these allowances for impairments were discounted from the price to a final agreed cash purchase price of (AUD)\$2.1b.

There is a dispute between HBOS and CBA about impairments. The two parties can't agree so the purchase goes ahead on 19<sup>th</sup> Dec 08 with this figure still outstanding. The purchase agreement is for CBA to pay "no more than \$2.1b consideration" so CBA hand over \$2.1b cash consideration whilst withholding \$348m of the agreed purchase consideration. (Note: CBA actually only handed over \$1.8b because Bankwest had approximately \$300m cash at hand on 19<sup>th</sup> Dec 08). This triggered a dispute mechanism contained in the sale agreement.

Ernst & Young are engaged as independent arbitrators and work from late Dec 2008 to 9<sup>th</sup> July 2009. E&Y adjudicate that there are a further \$304m impairments pursuant to the agreed price adjustment mechanism. Note that this audit was completed 9 days after the new tax year begins meaning that any impairments and residual payments would now fall in the subsequent 2010 financial year.

Concurrently, from 19<sup>th</sup> Dec 2008, the CBA begin impairing the impairment allowances originally agreed on in the upfront price adjustment discount ( $\$4.25B - \$2.438B = \$1.812m$ ). As these loans were not wanted and not paid for due to the upfront discount, CBA would gain from the tax deduction, 18% penalty interest, asset sales and personal guarantees.

The audit is delivered 9<sup>th</sup> Jul 2009. E&Y adjudicate that there are a further \$304m impairments pursuant to the agreed price adjustment mechanism. CBA need only pay a further \$26m rather than \$328m. This provides CBA with a convenient 'clawback alibi' as they can tell the public that they actually paid extra money rather than revealing the full story that they were supposed to pay more but instead 'clawed back' more impairments.

The CBA 'get away plan' PR pin story would be that after 19-Dec-2008 CBA were dealing with 'bad customers' and CBA had to bear the loss. Note that the 2007 impairment total was \$88m. An increase to \$2b in 2008 would be a staggering 2000% (two thousand per cent) increase. Even CBA's PR team would find it difficult to justify this dramatic increase. Consequently, the Bankwest customer's allegations that Bankwest defaulted them because Bankwest was broke would start to sound more plausible.

Ian Narev goes on TV to say "the problems we are dealing with are problems from when we originally bought the bank" and "imprudent lending" implying the customers were at fault.

It was pre-decided that \$2.153Bm would be impaired, including the disputed amount from the audit, so there was a "mad panic" until June 2010 to make sure the impairment totals reached this figure otherwise it would be need to be reported in 2011 that there were unrealised Bankwest provisioned impairments. This would raise questions of why there are unrealised Bankwest provisions for

impairments in 2011. Then people would realise that CBA are lying and that the impairments were not finalised on 19<sup>th</sup> Dec 09 as they reported to the markets.

### Motive for aggressive impairments of Bankwest customers:

For CBA: To maintain the Commonwealth Bank Group's APRA Tier 1 Capital at 7.6% following the acquisition

In the original notice of 8 October 2008, the Commonwealth Bank stated:

The Group is determined to continue to carry substantial surplus capital due to the current volatile market conditions. It intends to fully fund the purchase price by undertaking a \$2 billion accelerated institutional placement which will maintain APRA Tier 1 capital at 7.6% and Tier 1 capital under UK FSA rules at 10.1%.

Figure 1 - CBA Media Release 8th Oct 2008

Maintaining the capital objective whilst facilitating the \$17 billion needed to meet BankWest's funding liabilities may have been a sufficient motivation for officers that the Commonwealth placed into the management of Bankwest to identify and pursue unfairly means by which Bankwest could reduce the funding burden and the acquisition price by eliminating loans that it otherwise may not have. Commercial loans are easier to impair and default as there are more default covenants available to the bank (e.g. LVR, anniversary dates etc).

For Bankwest: To account for the realisation by the bank that it would not be able to meet its funding obligations to its customers and to provide Bankwest with a legal argument that the customer defaulted first.

**Explanation:**

On the 8<sup>th</sup> Oct 2008 CBA released an investor pack. Its' indicative price for Bankwest was \$2.72m. The only think that was known was that the purchase price was to be \$2.1B.

**Estimate**

**Financial Impact of Acquisition<sup>1</sup>**

	Net Assets \$m	Pre-tax Profit / (Loss) \$m
Indicative fair value of net assets acquired	2,720	
Consideration paid	(2,100)	
Discount on acquisition		620
Transaction costs		(20)
Day 1 gain through P&L		600
Integration & restructuring provision	(330)	(330)
Comprising:		
▪ Restructuring costs		
▪ Technology integration expenditure		
▪ Other transition costs		

- Fair value of acquired net assets to be finalised
- Gain on acquisition and Integration provision to be excluded from Cash NPAT
- Year 1 (2009) CBA P&L/EPS positive
- Integration provision 150% of maintainable cost savings

<sup>1</sup> Subject to finalisation of completion accounts.

26

Determined by Deloitte

Figure 2 - CBA Investor Pack, 8th Oct 08, Page 26

The investor pack also noted that Bankwest impairment levels were low and normal.

**BankWest Financial Overview**

	2005 \$m	2006 \$m	2007 \$m	Unaudited 6 months to June 2008
Net interest income	609	716	857	487
Non interest income	213	208	279	176
Net operating income	822	924	1,136	663
Administrative expenses	(509)	(555)	(728)	N/A
Depreciation, amortisation and impairment	(27)	(34)	(40)	N/A
Operating expenses	(536)	(589)	(768)	(458)
Share of profits of associated undertakings	6	3	2	(0)
Impairment losses on loans and advances	(15)	(58)	(88)	(83)
Profit before income tax	277	280	282	122
Income tax expense	(84)	(87)	(78)	N/A
Profit for the period	193	193	204	N/A
NIM	1.79%	1.76%	1.66%	1.61%
Cost/Income	65.2%	63.8%	67.6%	69.1%
Impairment/average loans	0.05%	0.16%	0.19%	0.28%

Source: BankWest financial reports for the years ended 31 December 2005, 2006 and 2007.

Figure 3 CBA Investor Pack 8th Oct 2008, Page 22

After the purchase CBA do a full assessment and realise the Fair value of net assets of the bank is actually \$3.676b, not the previously estimated \$2.72b. CBA made a Day 1 asset gain of \$983m on the acquisition

The \$2.1B purchase price remains fixed.

## Understanding CBA/Bankwest benefits in induced defaults

<b>Purchase consideration</b>	<b>\$M</b>	
Cash paid		2,126
Direct costs relating to the acquisition		37
<b>Total purchase consideration</b>		<b>2,163</b>
Fair value of net identifiable assets acquired (see below)		3,676
Less: Preference share placement		(530)
<b>Gain on acquisition before tax</b>		<b>983</b>
<p>The gain on acquisition has arisen after the Group's reassessment of the fair value of the acquired entities' identifiable assets, liabilities and contingent liabilities and the cost of the acquisition, and has been recognised in the Group's statutory net profit in the current period.</p> <p>The assets and liabilities arising from the acquisition, reported in aggregate for the acquired entities, are as follows:</p>		
	<b>Pre-acquisition carrying amount</b>	<b>Recognised values on acquisition</b>
	<b>\$M</b>	<b>\$M</b>
Cash and liquid assets	422	422
Receivables due from other financial institutions	283	283
Assets at fair value through Income Statement:		
Trading	5,907	5,907
Insurance	212	212
Derivative assets	1,014	1,014
Available-for-sale investments	3	3
Loans, bills discounted and other receivables	58,153	57,351
Property, plant and equipment	177	226
Intangible assets	98	806
Deferred tax assets	255	610
Other assets	289	288
<b>Total assets</b>	<b>66,813</b>	<b>67,121</b>
Deposits and other public borrowings	50,401	50,677
Payables due to other financial institutions	4,673	4,673
Liabilities at fair value through Income Statement	250	250
Derivative liabilities	512	512
Deferred tax liabilities	54	258
Other provisions	84	84
Insurance policy liabilities	202	202
Debt issues	5,221	5,221
Bills payable and other liabilities	357	357
Loan capital	1,211	1,211
<b>Total liabilities</b>	<b>62,965</b>	<b>63,445</b>
<b>Net assets</b>	<b>3,848</b>	<b>3,676</b>
<p><b>Outflow of cash to to acquire business, net of cash acquired:</b></p>		
Cash consideration	n/a	2,126
Direct costs relating to acquisition	n/a	37
Cash and cash equivalents in subsidiaries acquired	n/a	(422)
<b>Cash outflow on acquisition</b>	<b>n/a</b>	<b>1,741</b>

Figure 4 - CBA Annual Report 2009, Page 223

## Understanding CBA/Bankwest benefits in induced defaults

Adjustment	Original Price	Discounted price	Price Change	Price Adjustment Mechanism's
#1	AUD \$4.25 BN	AUD \$2.428 BN – revised consideration price agreed	Minus AUD \$1.822B	CBA Increased the upfront classification of “distressed” loans.
#2	AUD \$2.428 BN	AUD \$2.1 BN – cash consideration paid	Minus \$328m	E&Y dispute
#3	AUD \$2.1 BN	AUD \$2,126	Plus AUD \$26m	Remaining sale consideration after E & Y indemnity dispute.

At time of the sale to CBA, the Bankwest book value had dropped to (AUD)\$4.25B. This number is derived by reverse engineering the provisions for “Loss on sale” entry in the HBOS 2008 Annual Report.

The agreed consideration price to HBOS for Bankwest was (AUD)\$2.4 B.

Loss on sale of BankWest and St. Andrews - On 19 December 2008, BankWest and St. Andrew's Australia were sold to Commonwealth Bank of Australia for a total consideration of **A\$2.4bn.** The sale generated a loss of **£845m** including the write off of £240m of goodwill.

Figure 5 - HBOS Annual Report 2008, Page 4

We don't know when this (AUD)\$2.4B was decided on so we don't know the exact exchange rate. I will assume it was as of 19<sup>th</sup> Dec 2008 when the sale was finalised making the exchange rate 0.4567 GBP to the AUD. This is the assumed exchange rate day because at the time the sale was announced all the purchase price figures given to the media/shareholders were “indicative”. CBA wouldn't have known exact figures till the final sale date.

By reverse engineering these numbers we can work out the HBOS book value of Bankwest at the time.

(£845m loss x **.4567** exchange rate= AUD \$1.85 HBOS loss on Bankwest sale)

The HBOS 2008 loss on sale = £845m loss

BW book value (AUD) at time of purchase = (AUD) \$2.4B + \$1.85B HBOS loss expressed in (\$)

BW book value (AUD) at time of purchase = approx. AUD \$4.25B \*

(\*depending on exchange rate used)

CBA annual reports admit CBA got a “significant discount on book value” down to \$2.4B. This created an immediate provision for a loss to HBOS of £845B which is shown in the HBOS Annual

## Understanding CBA/Bankwest benefits in induced defaults

Report of 2008. I believe based on these calculations that Bankwest's book value at the time of purchase was \$4.25B and CBA got an upfront purchase discount due to allowances made for \$2.153B of future impairments CBA would create by manufacturing defaults.

### Side Note: £240m "goodwill" price adjustment

The HBOS 2008 report shows a £240m "goodwill" reduction. Consistent with this, the SMH report below reports a \$525m goodwill reduction.

<http://www.smh.com.au/business/bankwest-costs-hbos-dearly-20090301-8lfi.html>

However the Bankwest 2007 Annual Report (pre-acquisition) shows goodwill at that time to be valued at \$57.5m and the Bankwest 2008 Annual Report (post-acquisition) shows goodwill to be \$72.1m. The Bankwest 2009 Annual report shows goodwill to be valued at \$32.7m.

Based upon these figures, how can there be a reduction of £240m of goodwill from the Bankwest balance sheet?

THEORY: I believe this "goodwill" reduction is another price adjustment mechanism to hide the allowance given for future induced impairment CBA would later create through manufactured defaults. CBA at no stage mention this goodwill reduction. It may have been a way of HBOS making their book value reduction seem less damaging.

### \$304m price adjustment

The consideration price to be paid was \$2.428B which was split up as:

\$2.1 billion	Cash consideration
\$328 million	Provision for remaining consideration

On 19 December 2008, the Group acquired 100% of the share capital of Bank of Western Australia Ltd (consisting of retail and business banking), St Andrew's Australia Pty Ltd (consisting of insurance and wealth management services businesses) and HBOSA Group (Services) Pty Ltd (an internal administrative support entity) for cash consideration of \$2.1 billion.

Details of net assets acquired and the provisional discount arising on acquisition are as follows:

Purchase consideration	\$M
Cash paid	2,100
Provision for remaining consideration	328
Direct costs relating to the acquisition	31
Total purchase consideration	2,459
Provisional fair value of net identifiable assets acquired (see below)	3,771
Less: Preference share placement	(530)
Provisional discount on acquisition before tax	782

Figure 6 - CBA 2009 Half Yearly Report ending Dec 2008, page 47

CBA's effective tax rate is 25.6% so using this rate as an average we can calculate that CBA paid tax on this \$328 provision for remaining consideration (i.e. \$328m \*.256 = \$76m approx.)

## Understanding CBA/Bankwest benefits in induced defaults

Effective Tax Rate	%	%	%
Total – corporate	25.6	20.9	27.5
Retail Banking Services – corporate	29.9	30.1	29.9
Premium Business Services – corporate	(12.0)	17.3	25.9
Wealth Management – corporate	26.4	27.6	29.5
International Financial Services – corporate	13.5	24.5	19.7

Figure 7 - CBA 2009 Half Yearly Report ending Dec 2008, page 34

(Does this mean CBA had no intention of paying withheld component so declared it as a taxable benefit?)

Tax effect of expenses that are non-deductible/income non-assessable in determining taxable profit:					
Current period					
Taxation offsets and other dividend adjustments	(59)	(85)	(55)	(249)	(479)
Tax adjustment referable to policyholder income	(115)	(81)	186	-	-
Bankwest - Discount on acquisition	76	-	-	-	-
Tax losses recognised	-	(89)	(24)	-	(87)
Tax losses assumed by the Bank under UIG 1052	-	-	-	(14)	(72)
Difference in overseas tax rates	(55)	(35)	(27)	(19)	(21)
Offshore banking unit	(56)	(16)	(16)	(56)	(16)
Investment allowance	(28)	-	-	(14)	-
Other	(7)	(38)	35	44	76
	(244)	(322)	89	(308)	(599)

Figure 8 - CBA Annual Report, year ending Jun 2009, page 118

CBA admit that they had to ultimately pay an extra \$26 million. This represents the remaining component of the \$328m “provision for remaining consideration” after all impairments were calculated by Ernst & Young. I believe they were indemnified from paying the remaining \$328m based on pre-acquisition impairments.

The amount of provisioned impairments that could be offset against the “provision for remaining discount” of the consideration price was being disputed. This dispute wasn’t resolved until 9<sup>th</sup> July 2009 (the next tax year, 2010). CBA’s submission states the audit was complete in “early June 2009”. The exact date can be confirmed through discovery.



## Understanding CBA/Bankwest benefits in induced defaults

- Under the sale agreement, CBA would review the draft financial accounts and raise any issues with HBOS Australia Pty Ltd.
- If the parties could not agree the final accounts between themselves, the sale agreement provided for a final determination by an independent expert to assist them resolve any outstanding issues.
- Ultimately, the parties were unable to agree on a number of items, including that the level of individual provisions reflected in the 19 December 2008 accounts were appropriate in all cases.
- Ernst and Young was appointed as the independent expert to determine these disputed items. Ernst and Young's determination was final and binding.
- We are aware of speculation that HBOS plc paid CBA some \$200 million as a result of the price adjustment process. This is not correct. The purchase price adjustment process was finalised by early July 2009 and resulted in a small increase in the purchase price for Bankwest.
- The price adjustment process was designed to achieve a 'zero sum' outcome. It could not, and did not, deliver any windfall gains. If the financial accounts finalised by Ernst and Young reflected an increase in value, CBA was to pay more and vice versa.
- CBA paid for the independently determined value it acquired in Bankwest, and Bankwest, under CBA ownership, has borne any losses it has subsequently incurred from loans that were not assessed to be impaired or in default as at 19 December 2008.

Figure 9 - CBA senate submission, page 21

HBOS were expecting to receive a further AUD \$328m for the "provision for remaining consideration" but had to wait until the dispute was adjudicated by independent arbiter Ernst & Young. The adjudication arrived on 9<sup>th</sup> July 2009 stating that there was an extra \$304m of impaired loans during the warrantee period so CBA do not have to pay the provision for remaining consideration of \$328m, they only need to pay \$26m. This event must now appear in the following tax year for HBOS (i.e. April 2009 to Mar 2010). I believe the E & Y audit will show, \$328m - \$304m = \$26m (includes assumed rounding error of \$2m) to be paid by CBA.

14 Profit (loss) on sale of businesses	2009 £m	2008 £m
Loss on the sale of Bank of Western Australia Limited and St. Andrews Australia Pty Limited	(100)	(845)
Profit on the sale of Insight Investment Management Limited	126	-
	<u>26</u>	<u>(845)</u>

On 12 August 2009 the Group announced the sale of Insight Investment Management Limited. The sale completed on 8 November 2009 and resulted in an estimated pre-tax profit on disposal of £126 million.

On 8 October 2008, the Group agreed the sale of part of its Australian operations, principally Bank of Western Australia Limited and St. Andrews Australia Pty Limited, to Commonwealth Bank of Australia Limited. The sale completed on 19 December 2008 and resulted in an estimated pre-tax loss on disposal of £845 million (including goodwill written-off of £240 million). The agreement provided for adjustments to the consideration received in certain circumstances and as a result a further loss of £100 million has been recognised in the current year.

The exchange rate as of 9<sup>th</sup> July 2009 was 0.487 which makes the AUD \$302 loss equivalent to £148m. (Need to investigate why it is different to £100m).

The figure of \$302m of pre-acquisition impairments is confirmed by the CBA Annual Report 2010, year ending Jun 2010. It refers to a figure of \$304m ( I assume there is a \$2M rounding error).

There is also another "pre-acquisition" impairment expense of \$212m in the Annual Report 2010. This number matches up with the \$200m that is discussed in the media. This figure when converted to British pounds matches up with £100m pounds from the HBOS 09 report. (Exchange rate approx. 0.41).

These two impairment figures (\$212m and \$304m) match up with media reports at the time that CBA required mediation for possible clawback.

[http://www.bankingday.com/nl06\\_news\\_selected.php?act=2&selkey=8682&stream=1](http://www.bankingday.com/nl06_news_selected.php?act=2&selkey=8682&stream=1)

## Understanding CBA/Bankwest benefits in induced defaults

It appears as if the \$304m was “offset” against the \$328m purchase price held back and the \$212 was recorded in HBOS 09 report as a provision for a loss. (Need to investigate. I would have thought both should be offset and both would be provisioned for a loss).

Bankwest loan impairment expense has also increased as a result of deterioration of the pre-acquisition business lending portfolio.

Since the initial review of the Bankwest portfolio, further detailed work has been undertaken into the Bankwest business banking portfolio. This comprehensive review identified pre-acquisition loans reflecting poor asset quality, high loan to value ratios and insufficient covenant coverage. This resulted in significant risk grade reassessments and security revaluations with provisioning increasing \$304 million. These loans are confined to the pre-acquisition business banking portfolio.

Given the one off nature of the impairment and the fact it relates to an understatement of provisioning in the pre-acquisition portfolio, this additional amount of loan impairment expense has been recorded as a non-cash item. This is consistent with the treatment of the gain on acquisition of Bankwest.

Figure 10 - CBA Annual Report year end Jun 2010, pg 15

**Impairment Expense**

Impairment expense for the year was \$754 million, up 65% from the prior year. The increase in impairment expense was mainly due to property related exposures, primarily in Queensland and New South Wales.

Arrears levels have improved during the year, with greater than 90 day rates declining across the entire retail portfolio, in particular credit cards.

The Group has also included \$304 million of loan impairment expense as a non-cash item which relates specifically to the Bankwest pre-acquisition loan portfolio.

Figure 11 - CBA Annual Report year end Jun 2010, pg 34

**Loan impairment:** In the year ended 30 June 2010, a \$212 million after tax loan impairment expense was recognised relating to pre-acquisition loans. Refer to impairment expense commentary on page 15 for further details.

Figure 12 - CBA Annual Report ending Jun 2010, pg 16

This meant that the CBA had until 30<sup>th</sup> Jun 2010 to realise these provisions. If not they would have to declare these unrealised provisions in the 2011 tax year as a profit which would potentially red-flag that something was amiss as CBA's story has always been that these provisions were dealt with as of 19<sup>th</sup> Dec 2008.

This explains why John Sutton was said to be in a panic late in June 2010, under pressure from CBA head office to significantly increase Bankwest impairments. He needed to make sure that the \$302m in provisioned impairments were realised and so they could be declared in the 2010 period as an “impairment expense” and CBA could continue with their story that these were all bad customer's whose losses are born by the bank.

CBA organised a project called Project Magellan (date to be confirmed) to impair as many loans as were required to fill the provisions (from mid-09 to Jun 2010). Otherwise CBA would lose the related tax deduction and consequently have to report this accordingly.

## Understanding CBA/Bankwest benefits in induced defaults

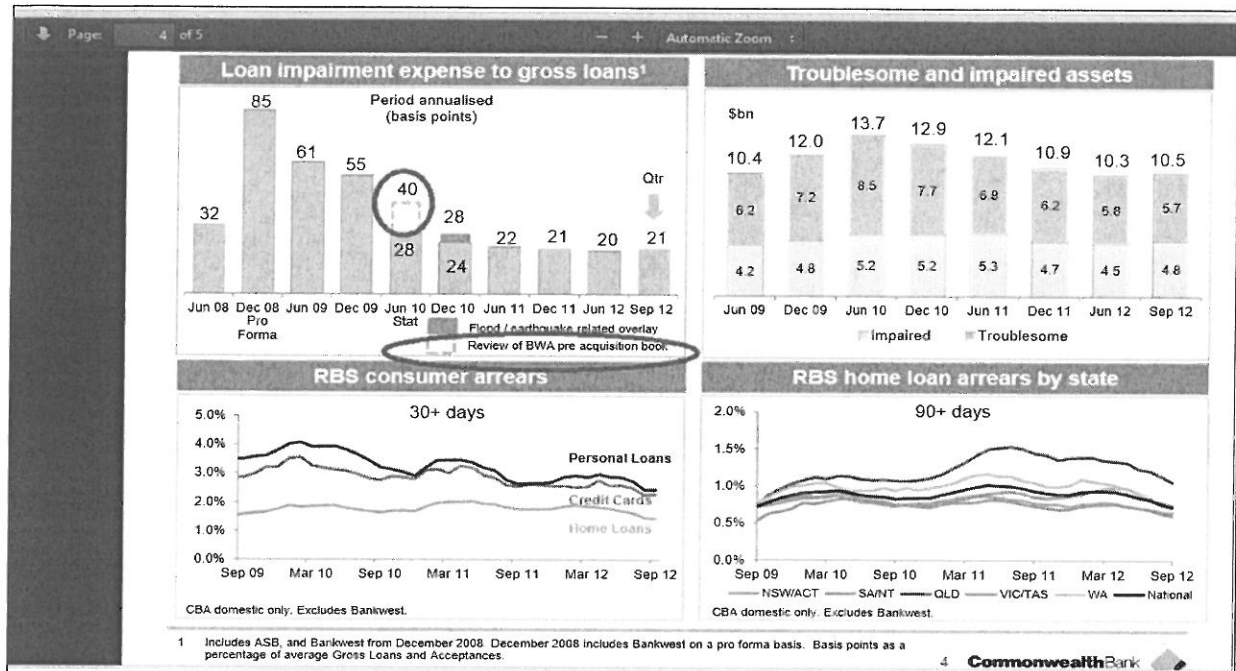


Figure 13 - CBA Quarterly Report, 7 Nov, 2012, Page 4

The CBA 'alibi' story has always been (David Cohen, Senate Inquiry, CBA Chief Counsel)

"The so-called 'claw-back' arrangement is straightforward. Simply put, the purchase price paid by CBA could increase or decrease, depending on the number of **distressed** loans at the time CBA completed the acquisition on 18 December 2008. CBA could only reduce the purchase price for loans that were **distressed** at the time of sale on 18 December 2008. Any loans that became **distressed** after that purchase date became a liability that Bankwest and CBA had to bear. CBA had no right to recoup any of those losses from HBOS."

We don't know what the term "distressed" means as it is not defined in any CBA report, IFRS Reporting Standards or AAPS Accounting Standards (need to check?). CBA could define what ever loan they wanted to be "distressed". He also stresses that they all had to be declared as distressed before 18<sup>th</sup> Dec 2008.

The June 2009 Annual report mentions the "Additional purchase price adjustment" of \$26m which gives CBA an 'alibi' to debunk the existence of this "so-called clawback". Mr Cohen can simply say "At the end of the day, we paid about a further \$26 million."

## Understanding CBA/Bankwest benefits in induced defaults

The screenshot shows page 18 of the Commonwealth Bank Annual Report 2009. The page is titled 'Acquisition Accounting' and contains two tables. The first table, 'Integration Expenditure for the year ended 30 June 2009', shows a total of \$112 million. The second table, 'Purchase Consideration as at 30 June 2009', shows a total of \$2,163 million. The text on the page discusses the acquisition of BankWest and the resulting gain on acquisition of \$983 million before tax, which is significantly higher than the \$660 million indicated at the time of the acquisition. It also mentions that the amount of integration expenditure for the six months to 30 June 2009 was \$112 million.

	\$M
Restructuring	16
Property	7
Operations	24
IT expenditure	60
Other	5
<b>Total</b>	<b>112</b>

	\$M
Original purchase price	2,100
Additional purchase price adjustment	26
Costs relating to acquisition	37
<b>Purchase consideration</b>	<b>2,163</b>
Fair value of net identifiable assets acquired	3,876
Less: preference shares placement	(530)
<b>Gain on acquisition</b>	<b>983</b>
Income tax expense	(371)
<b>Gain on acquisition after tax</b>	<b>612</b>

Figure 14 - CBA Annual Report year ending Jun 2009, Page 18

This can then be understandably misinterpreted by anyone including Senator Williams who replies “So you paid \$2.1 billion for it, and, when you went to the loan book, there was \$26 million worth more value because of the loans. Was there an estimation first of some impaired loans, a percentage or something? How did you have to pay an extra \$26 million?”

Now note the next carefully worded statement by Mr Cohen in reply. “We purchased the assets on a **certain price basis**, and that was simply applied to the value of the assets that existed as a result of that examination.”

Mr. Cohen wants us to think he’s saying “we **paid \$2.1b** and **added \$26m** to it”. But he is being intentionally vague and is really saying “we purchased the assets at **\$2.428m**, **held back \$328m** and then **claimed (“ie. Clawed-back”) \$302m** more impairments which left CBA with a **\$26m** residual to pay”. In fact, Mr. Cohen has intentionally misled the senate.

### Impairment Totals

All these price adjustments based on “impairment provisions” must have corresponding “impairment expenses”. (need to verify this)

Gross impaired assets increased by \$2,031 million over the prior half to \$2,714 million as at 31 December 2008. This includes \$770 million relating to BankWest.
The Group remains well provisioned, with total provisions for impairment losses at 31 December 2008 of \$3,608 million, \$803 million of which relates to BankWest. This represents a \$2,228 million increase since December 2007 and \$1,863 million increase since June 2008. The current level reflects:

Figure 15 - CBA 2009 Half Year Report ending Dec 2008, page 8

## Understanding CBA/Bankwest benefits in induced defaults

Movement in Impaired Asset Balances					
	2009	2008	2007	2006	Group 2005
Gross Impaired Assets	\$M	\$M	\$M	\$M	\$M
Gross impaired assets - opening balance	683	421	326	395	393
Acquisitions	770	-	-	-	-
New and increased	4,374	1,104	928	745	769
Balances written off	(1,056)	(470)	(482)	(450)	(350)
Returned to performing or repaid	(564)	(372)	(351)	(384)	(387)
<b>Gross impaired assets - closing balance</b>	<b>4,210</b>	<b>683</b>	<b>421</b>	<b>326</b>	<b>395</b>

Figure 16 - CBA 2009 Annual Report

Additional Information								
Intangible asset amortisation	8	44	7	1	22	49	45	179
Impairment expense	606	309	1,708	-	202	113	17	3,048
Depreciation	11	24	36	5	41	19	164	302
Defined benefit superannuation expense	-	-	-	-	-	-	14	14
Gain on acquisition	-	-	-	-	-	-	983	983
Bankwest integration	-	-	-	-	-	78	35	112
Other	27	9	36	9	5	1	52	125

Figure 17 - CBA 2009 Annual Report, Page 184

Note that the Impairment expense in Figure 19 - CBA Annual Report year ending Jun 2010, Page 34 mentions large impairments recognised due to a “small number of exposures”. Could it be that these are the Rory O’Brien, Luke Saraceni etc. provisions finally being recognised as impairment expenses.

- Bankwest performing well, twelve months since the acquisition.
- Impairment expense for the half was \$313 million, 9% lower than the prior comparative period, however, remained at an elevated level due to provisions recognised in relation to a small number of exposures.

Figure 18 - CBA Dec 2010 Half Yearly Report, page 30

This impairment figure was then offset against the operating income of Bankwest. Note: This impairment loss was in fact already discounted off the purchase price meaning CBA benefitted from the tax offset as well as sale proceeds from assets and suing personal guarantors.

Total impairment expense for 2010 is \$754m (\$313m for Jul-Dec 2009, \$441m for Jan-Jun 2010).

- The expense to income ratio decreased from 66% to 51%. The cash net profit after tax was unfavourably impacted by loan impairment expense of \$754 million, up 65% on the prior year. The increase in impairment expense was mainly due to property related exposures, primarily in Queensland and New South Wales.
- Deposit balances increased 9% over the prior year in a highly competitive market, with more pronounced growth in the second half driven by attractive product offerings and a strong focus on sales.

Figure 19 - CBA Annual Report year ending Jun 2010, Page 34

## Understanding CBA/Bankwest benefits in induced defaults

**Bankwest non-cash items**  
**Loan impairment:** In the half year ended 30 June 2010, a \$212 million after tax loan impairment expense was recognised relating to pre-acquisition loans. This non-cash treatment was consistent with the treatment of the gain on acquisition of Bankwest.

Figure 20 - CBA 2011 Half yearly report ending Dec 2010, page 10

Bankwest loan impairment expense has also increased as a result of deterioration of the pre-acquisition business lending portfolio.

Since the initial review of the Bankwest portfolio, further detailed work has been undertaken into the Bankwest business banking portfolio. This comprehensive review identified pre-acquisition loans reflecting poor asset quality, high loan to value ratios and insufficient covenant coverage. This resulted in significant risk grade reassessments and security revaluations with provisioning increasing \$304 million. These loans are confined to the pre-acquisition business banking portfolio.

Given the one off nature of the impairment and the fact it relates to an understatement of provisioning in the pre-acquisition portfolio, this additional amount of loan impairment expense has been recorded as a non-cash item. This is consistent with the treatment of the gain on acquisition of Bankwest.

Figure 21 - CBA 2011 Half Yearly Report ending Dec 2010, page 15

The CBA 2011 Half Yearly report suggests that there are no more pre-acquisition impairment expenses (ie. "non-recurrence").

- Impairment expense for the half was \$49 million, 84% lower than the prior comparative period, mainly due to the non-recurrence of property related impairments.

Figure 22 - CBA 2011 Half Yearly Report ending Dec 2010, page 28

Pre-acquisition Bankwest Impairments	
Impairment Period	Impaired Amount
At time of Acquisition 19-Dec-08	
Reported in year-end Jun 2009	\$770m
Reported in half-end Dec 2010	\$212m
Reported in half-end Dec 2010	\$304m
<b>TOTAL</b>	<b>\$1,286m</b>
Pre-acquisition CBA Impairments	
Impairment Period	Impaired Amount
19-Dec-08 to 30-Jun-09	\$113m
01-Jul-09 to 30-Jun-10	\$754m
<b>TOTAL</b>	<b>\$867m</b>
<b>TOTAL IMPAIRMENTS</b>	<b>\$2,153m</b>

Note, the \$770m impairment figure is from the CBA 2009 half yearly report as the impairments at the time of the acquisition. The figure in the Bankwest year end Dec 2009 Report is \$825m. I am assuming the difference (\$825m-\$770m = \$55m) is from impairments from 19 Dec 2008 to 31 Dec

## Understanding CBA/Bankwest benefits in induced defaults

2008. Either way the \$825m allowed Bankwest to offset this against the \$610.9 operating profit they then declared that year (see page 7, Bankwest annual report Dec 2009). Keeping in mind that these impairments were already discounted in the purchase agreement CBA would benefit from the loss as a tax offset. Furthermore, they could then resell the assets and sue the guarantors as further benefit.

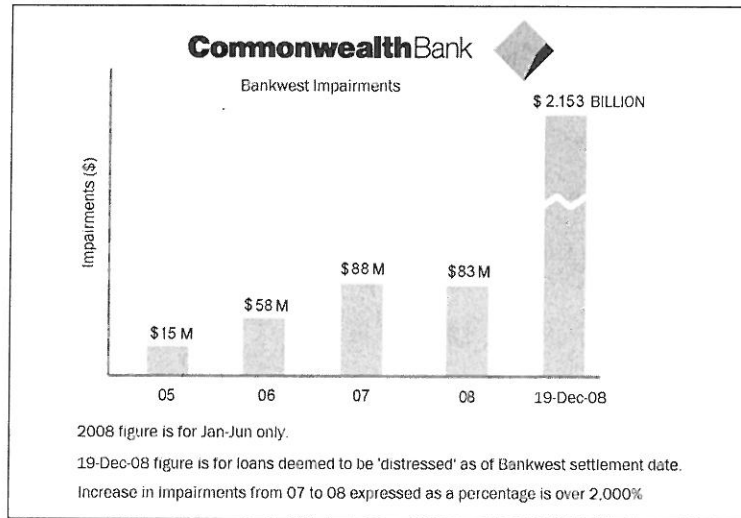


Figure 23 - Bankwest pre-acquisition impairments

Pre-acquisition Impairments			
Impairment Period	\$(AUD)		
Original Bankwest Book value at time of acquisition	\$4.25B		
(Minus) Ralph Norris's "considerable book discount"	\$2.153B	\$1.286B	Customers that Bankwest impaired to hide its own insolvency.
		\$867m	Customers that CBA decided prior to the sale would be impaired by CBA after the sale.
<b>Final cash consideration paid</b>	<b>\$2.1B</b>		

This "considerable book discount" was essentially an upfront agreement to impair loans that CBA did not want to buy, some of these were already impaired due the Bankwest insolvency (approx. \$1.286B). After the purchase CBA went about inducing defaults in these pre-agreed impairments.

### Tax Offset Benefits

As all impairment losses were in fact already discounted off the Bankwest purchase price CBA benefitted from the tax offset as well as sale proceeds from assets and suing personal guarantors.



## Understanding CBA/Bankwest benefits in induced defaults

	Half Year Ended		
	31/12/09	30/06/09	Pro forma 31/12/08
	\$M	\$M	\$M
Net interest income	727	591	530
Other banking income	121	168	83
<b>Total banking income</b>	<b>848</b>	759	613
Operating expenses	(443)	(483)	(426)
Impairment expense	(313)	(113)	(344)
Net profit before tax	92	163	(157)
Corporate tax expense	(28)	(50)	47
<b>Cash net profit after tax</b>	<b>64</b>	113	(110)

Figure 24 - CBA Half Year Dec 2010, Page ?

The impairment figure for full year-end Jul 2010 of \$754m (i.e. \$313 + \$441m) was then offset against the operating income of Bankwest for year-end Jun 2010 of \$1,720m. These impairments were for assets that CBA didn't pay for as these impairments formed part of the price adjustment mechanism used to get the Bankwest purchase price down from \$4.25B to \$2.438B.

	Full Year Ended		Half Year Ended	
	30/06/10	Pro forma 30/06/09	30/06/10	31/12/09
	\$M	\$M	\$M	\$M
Net interest income	1,487	1,121	760	727
Other banking income	233	251	112	121
<b>Total banking income</b>	<b>1,720</b>	1,372	872	848
Operating expenses	(880)	(909)	(437)	(443)
Impairment expense	(754)	(457)	(441)	(313)
Net profit before tax	66	6	(6)	92
Corporate tax expense	(26)	(3)	2	(25)
<b>Cash net profit after tax</b>	<b>60</b>	3	(4)	64

Figure 25 - CBA Jun 2010 Annual Report, page 35

	Full Year Ended 30 June 2010								
	Net profit after tax "cash basis"	Hedging and IFRS volatility	Bankwest non-cash Items <sup>(1)</sup>	Tax on New Zealand Structured Finance Transactions	Loss on disposal of controlled entities/ investments	Treasury shares valuation adjustment	Policyholder tax	Investment experience	Net profit after tax "statutory basis"
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
<b>Profit Reconciliation</b>									
<b>Group</b>									
Net interest income	11,868	(57)	111	-	-	-	-	-	11,922
Other banking income	4,112	119	-	-	(23)	-	-	-	4,208
<b>Total banking income</b>	<b>15,980</b>	<b>62</b>	<b>111</b>	<b>-</b>	<b>(23)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>16,130</b>
Funds management income	1,898	-	-	-	-	(51)	50	31	1,928
Insurance income	945	-	-	-	-	-	80	295	1,230
<b>Total operating income</b>	<b>18,823</b>	<b>62</b>	<b>111</b>	<b>-</b>	<b>(23)</b>	<b>(51)</b>	<b>130</b>	<b>236</b>	<b>19,288</b>
Investment experience	236	-	-	-	-	-	-	(236)	-
<b>Total income</b>	<b>19,059</b>	<b>62</b>	<b>111</b>	<b>-</b>	<b>(23)</b>	<b>(51)</b>	<b>130</b>	<b>-</b>	<b>19,288</b>
Operating expenses	(8,601)	-	(115)	-	-	-	-	-	(8,716)
Loan impairment expenses	(2,075)	-	(304)	-	-	-	-	-	(2,379)
Net profit before tax	8,363	62	(308)	-	(23)	(51)	130	-	8,193
Corporate tax expense	(2,266)	(45)	92	(171)	-	7	(130)	-	(2,513)
Non-controlling interests	(15)	-	-	-	-	-	-	-	(16)
<b>Net profit after tax</b>	<b>6,101</b>	<b>17</b>	<b>(216)</b>	<b>(171)</b>	<b>(23)</b>	<b>(44)</b>	<b>-</b>	<b>-</b>	<b>6,664</b>

(1) Includes merger related amortisation through net interest income of \$111 million; merger related amortisation through operating expense of \$24 million; integration expenses of \$40 million; Loan impairment expense of \$304 million and income tax benefit of \$62 million.

Figure 26 - CBA June 2010 Annual Report, page 82



## Total benefits for CBA

Summary of Day 1 Asset Gain	(AUD)	
Fair value of net identifiable assets acquired (Bankwest)	\$3,676 million	Figure 14 - CBA Annual Report year ending Jun 2009, Page 18
Original Consideration for Bankwest	\$2,100 million	Figure 14 - CBA Annual Report year ending Jun 2009, Page 18
Minus preference share placement???	\$530 million	What does this mean?
<b>TOTAL DAY 1 GAIN</b>	<b>\$983 million</b>	

Summary of Impairments (*discounted from purchase price)	(AUD)
Figure 21 - CBA 2011 Half Yearly Report ending Dec 2010, page 15	(AUD) \$304 million
Figure 20 - CBA 2011 Half yearly report ending Dec 2010, page 10	(AUD) \$212 million
Figure 16 - CBA 2009 Annual Report	(AUD) \$770 million
Figure 17 - CBA 2009 Annual Report, Page 184	(AUD) \$113 million
Figure 19 - CBA Annual Report year ending Jun 2010, Page 34	(AUD) \$754 million
<b>TOTAL IMPAIRMENT BENEFIT</b>	<b>(AUD) \$2.153 Billion</b>

Other benefits (from impairments after they were discounted from purchase price)		
Penalty Interest	CBA got to invoke concealed penalty interest clauses of up to 18%.	
Personal Guarantees	CBA get to sue guarantors for legal & additional costs. These rates are usually at high hourly rates (eg. Lawyers, receivers).	
Tax benefits	The initial \$825m loss in Dec 09 was offset against the \$610m operating profit (as were all other impairments). Note: This impairment loss was in fact already discounted off the purchase price meaning CBA benefitted from the tax offset as well as sale proceeds from assets and suing personal guarantors.	

## Conclusion

The increase in impairments caused a reduction in purchase price and loan book funding obligations for CBA, which may have been required to keep CBA within its APRA tier 1 capital reserve obligations.

Hypothetical Example 1. Without price adjustment mechanisms – outside APRA/FSA Tier 1 threshold

Bankwest Purchase price \$4.25B + Loan book funding \$19.15 B = \$23.4 B funding obligations

This may have put CBA over their Tier 1 threshold

Hypothetical Example 2. With price adjustment mechanisms - within APRA/FSA Tier 1 threshold

Induce defaults on \$2.15B worth of customer's loans.

Bankwest Purchase price \$2.1B + Loan book funding \$17 B = \$19.1B funding obligations

This may have put CBA under their Tier 1 threshold

By engaging in this conduct the Bankwest executives, most of whom were seconded from CBA, did not act in the best interests of Bankwest, rather they acted in the best interests of CBA. This breach of director's duties contravenes section 184 of the Corporations Act as well as the unconscionable conduct provisions of the ASIC Act and Corporations Act.

Bankwest's motivation for inducing defaults prior to CBA involvement is because they knew that the bank was about to renege on its contractual obligation to fund its customers so it was in the banks interest to default the customer first. This contravenes unconscionable conduct provisions of the ASIC Act and Corporations Act.

Consequences of a CBA Tier 1 Ratio breach

If CBA had have breached their Tier 1 ratio then this would cause their credit rating to drop. When all banks have a drop in credit rating together this usually does not affect their relative profitability to other banks, however if CBA's credit rating were to drop independently of other banks there would be a significant market impact and their share price would reflect this. In the panic of the GFC with an already tight wholesale lending market, a further drop in credit rating would increase CBA's own borrowing costs and profit margin.

Ramifications on inaction by Regulators

This explanation is effectively a model for banks to meet their capital adequacy requirements in difficult economic times. If this conduct is allowed to go unpunished and indeed allowed to continue then next time there is a credit crunch or if government's raise capital reserve ratio's in an attempt to be more prudent, the banks will simply respond by increasing the rates of foreclosures on productive customers.

Suggested Discovery Documents

At discovery, litigants should ask for (a) All documents that show that CBA were complying with its APRA Tier 1 capital adequacy requirement prior to the takeover, and (b) all documents that show how CBA planned on complying with APRA/FSA Tier 1 capital adequacy requirement after the takeover.