

STANDARD
& POOR'S

Guide To S&P Qualitative Fund Ratings



Introduction

This document is designed to be read in conjunction with Standard & Poor's *Fact Sheet—Fund Ratings*, which describes S&P's value proposition to fund managers and wealth-management businesses. This *Guide to S&P Qualitative Fund Ratings* provides further information about our ratings methodology for assessing managed-fund products and the ratings process we follow to deliver research and rating outcomes.

Background

S&P launched its current managed-fund-rating service in August 2005 after the acquisition of the Assirt business from St. George Bank. S&P and Assirt had been providing managed-fund ratings in different guises for many years previously.

Ratings Approach

Figure 1 outlines S&P's fund-rating peer-group classification system. This diagram represents the highest levels of our classification system, but it does not show additional levels of sectorisation applied to the managed-investment space. The aim is to create sufficient granularity in the classification system to differentiate investment products properly, while ensuring that there is enough equivalence among products in the same peer

Figure 1: Fund Rating Peer Groups

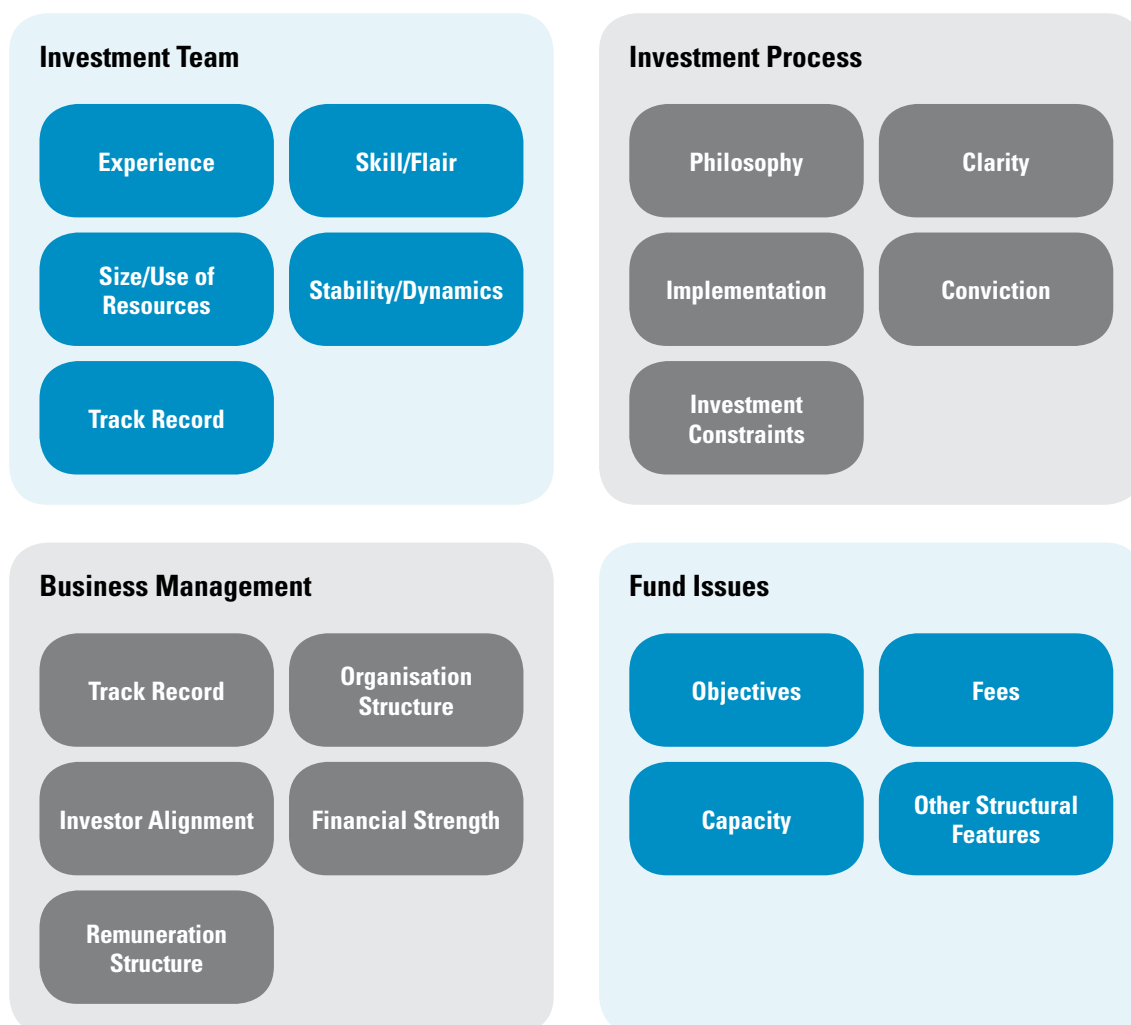
		ASSET CLASS / SECTOR					
		Equities	Fixed Income	Property	Alternative Strategies	Alternative Assets	Multisector
RATING PEER GROUPS	Large Cap	Credit	Listed	Single Strategy	Commodities	Conservative	
	Small Cap	High Yield	Direct*	Multi Strategy	Private Equity	Balanced	
	Emerging Markets	Fixed Interest	Diversified	Long/Short	Infrastructure	Growth	
	Regional	Mortgages			Currency		
	Specialist	Diversified					
	Diversified						

*Refer to Guide to Direct Property Fund Ratings

group in terms of allowable investment universe, risk/return objectives, management style, and product structure. Importantly, our ratings exist within the context of these peer groups only, so ratings between peer groups are not comparable. For a full breakdown of our classification system, and to map our qualitative fund-rating peer groups to Morningstar data categories, please contact Client Services.

In conducting our ratings process, we examine a wide range of factors, including fund-management experience, performance consistency, and portfolio-management discipline. Experience has shown us that these factors are critical when determining which funds are likely to outperform their peers. *Figure 2* summarises the key areas formally scored as part of the ratings evaluation. Most of the assessment is weighted toward investment team and process, but business management and fund-specific issues have the potential to affect rating outcomes materially.

Figure 2: Key Areas Assessed



Ratings Definitions

S&P has designed its fund-rating definitions, as outlined in *Figure 3*, to be clear and unambiguous. We consider that a fund must meet minimum standards for an investor to consider it, such as being true to label and having the ability to achieve its stated investment objectives. Meeting these minimum standards is a necessary precondition for a fund to achieve three stars on our rating scale. We apply our higher four- and five-star ratings to those funds we have the most confidence in relative to other rated funds within that peer group. By definition, we expect the higher-rated funds to outperform the median fund in the peer group.

Importantly, our ratings do not incorporate a judgment about the future absolute performance of that sector or peer group as a whole. As a result, we look through investment cycles to determine the best-performing funds over the long term. This approach also means that we do not make distinctions in ratings quality based on the investment style applied by the investment manager, although we do recognise that styles will perform differently in the near and medium term.

With our forward-looking approach, we are able to rate new funds provided that the funds are open, have seed funding, are fully invested, and a relevant and demonstrable track record can be shown on similar funds. Funds meeting these conditions, or where significant change has occurred in a long-standing fund, are assigned the 'NEW' subscript.

Figure 3: Ratings Definitions



Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers.



Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers.



Standard & Poor's has conviction that the manager can generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.



Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.



Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.



Issues potentially affecting the management of the fund have emerged, and the fund rating is temporarily suspended, pending clarification.



A manager with significant issues that have the potential to adversely impact performance. Existing investors should consider obtaining advice regarding switching or redemption.

Fund-Rating Subscript



Where the investment process, fund manager or analytical team has changed significantly, or where the fund has a relatively short history, but a relevant and demonstrable track record can be shown on similar funds.

Ratings Process

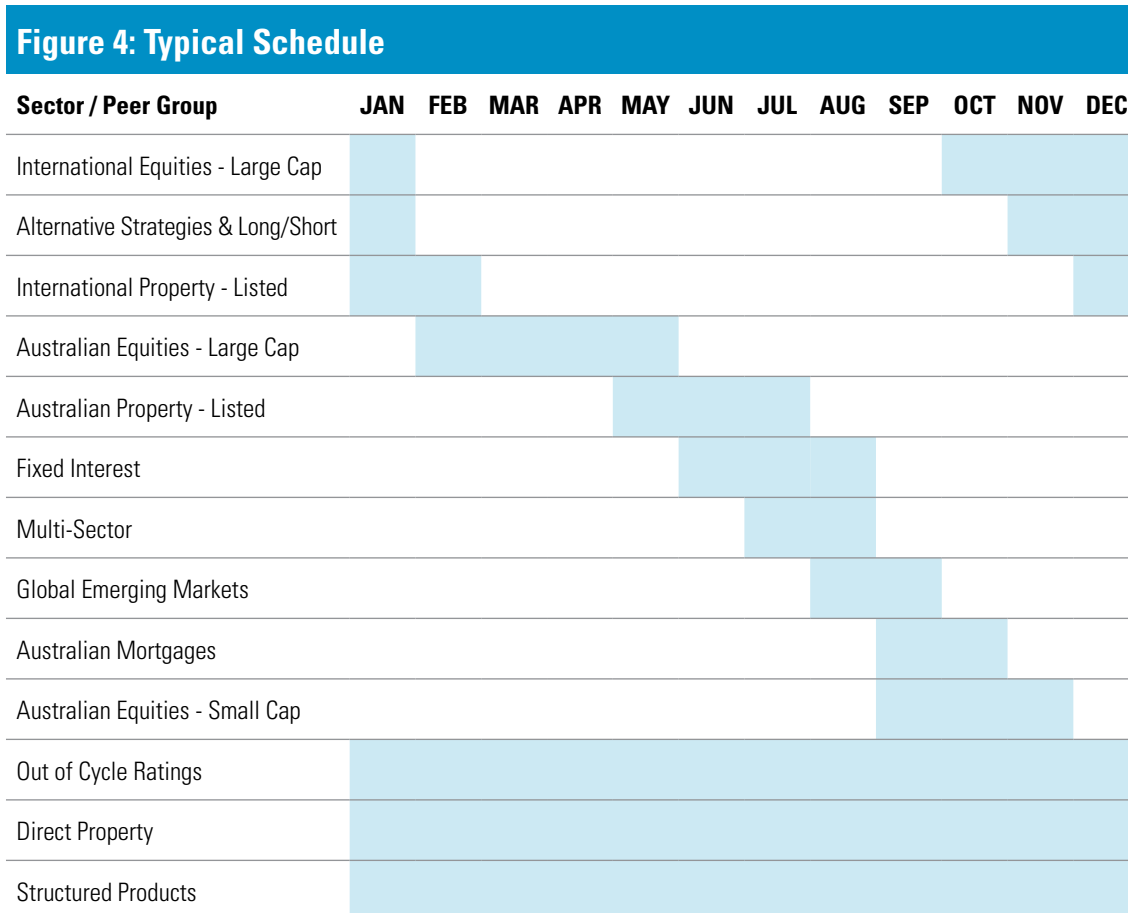
Sector Reviews

A critical objective for S&P is to maintain an appropriate and continuous oversight over all rated funds. We do this through a continuous scheduled sector-review program combined with regular remote surveillance, additional reviews when material fund or personnel changes occur, and other regular engagements with fund managers.

We have designed the scheduled sector-review program to be conducted on a rolling 12-month basis, with multiple reviews often running concurrently. *Figure 4* shows a typical calendar of peer reviews.

Fund Coverage and Selection

S&P is committed to increasing its ratings coverage across all asset classes. Our primary focus is to ensure that we rate all funds in demand from financial planners. Our approach for identifying funds to include in upcoming peer reviews involves a comprehensive sweep of the market, including consideration of funds carried on various administrative platforms, dealer-group-approved lists, and direct requests from financial planners and fund managers. So long as the fund manager is prepared to engage S&P to rate the identified products, we will incorporate the new funds into our planning and preparation for the associated upcoming peer review.



'Out of Cycle' Reviews

S&P has the ability to conduct ratings on funds outside the normal scheduled peer-review process, or out of cycle (OOC), where requested. Typically, an OOC review may last six weeks from the initial manager meeting, depending on the complexity of the product and the ready access to key investment staff and other information required from the manager. Fund managers and financial-planning clients highly value this OOC capacity, so we prioritise requests, with the highest priority given to funds meeting the following criteria:

- Strong demonstrable demand from financial-planning groups;
- Products offered by a manager new to S&P; and
- Demonstrably different products.

Ratings Process

Figures 5 and 6 outline the typical sequence of steps required for getting a fund rating, beginning with the contracting process through to public release of the rating.

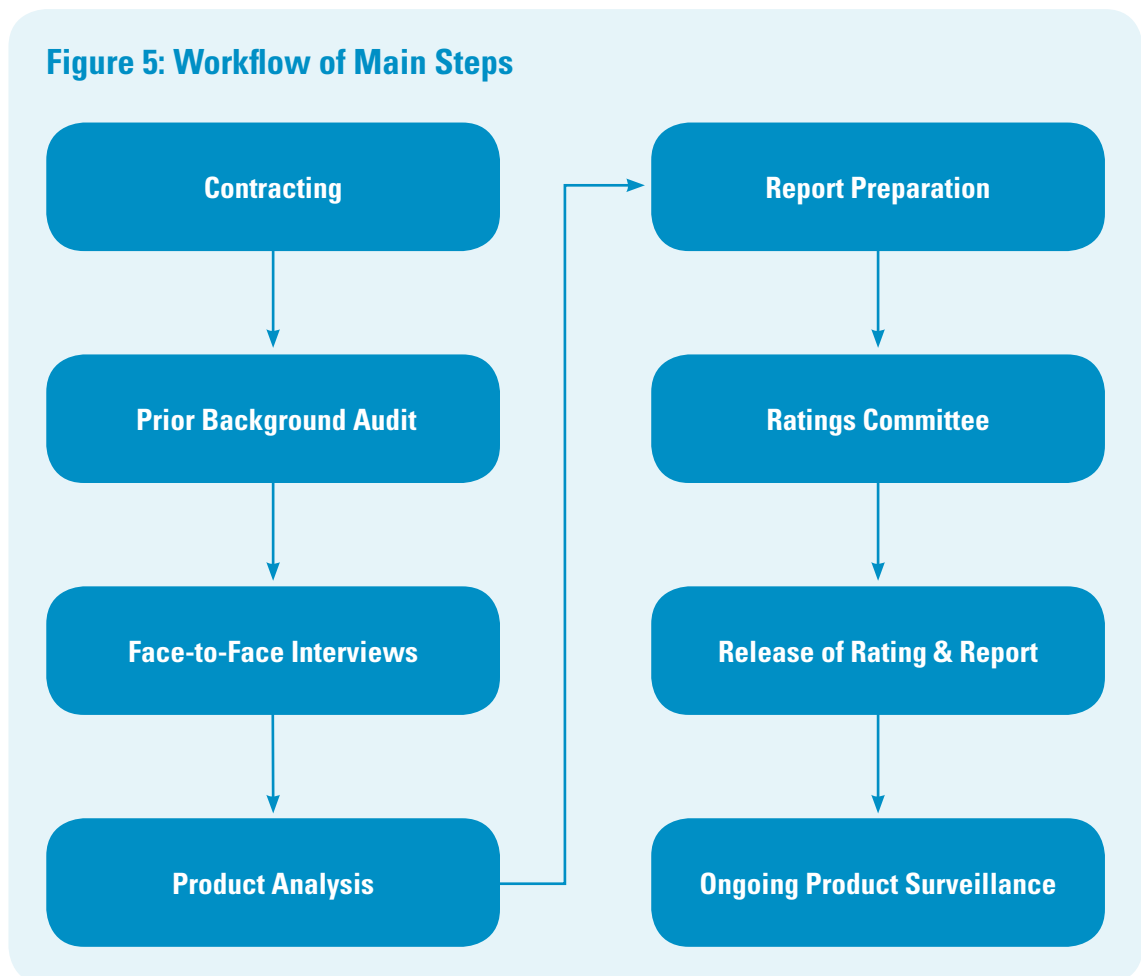


Figure 6: Fund-Rating Sequence

Stage	Activity
Ratings agreement signed	Defines the terms and conditions of the commercial engagement and the full scope of work to be conducted, including if any work will be performed out-of-cycle.
Ratings schedule	S&P routinely communicates to fund managers the anticipated schedule of peer reviews, although this schedule is subject to change. For upcoming peer reviews, participating fund managers are contacted several weeks in advance to arrange suitable meeting times..
Information requests	The fund-ratings team requests the information required of fund managers as early as possible in the preparatory period. This information typically includes IFSA documents, Product Disclosure Statements (PDS), and other quantitative and qualitative information as specified by S&P.
New fund additions	Where new funds are contracted, the fund manager needs to provide additional information to S&P's fund-data supplier (currently Morningstar) to ensure that these funds are registered on its system and accessible to the S&P analysts at the commencement of the ratings process.
Fund-manager meetings	S&P generally meets the fund manager at the fund manager's premises. S&P always assigns two analysts to cover each fund review. It discusses appropriate attendees beforehand, so the most suitable experts are available to outline and discuss the features and nuances of the product offering. To ensure appropriate continuity, S&P will plan for at least one analyst to be involved in the subsequent rating of the fund the following year. S&P provides the fund manager a customized agenda before the meeting to ensure its key focus areas are addressed.
Report preparation	S&P will produce a premium rated fund report for each headline fund only.
Draft report review	S&P will supply the fund manager with a draft of the premium rated fund report. The draft report will not contain the STAR rating or final opinion. It is the responsibility of the fund manager within five working days, to: <ul style="list-style-type: none"> • Identify and help correct any factual errors or misrepresentations, or any confidential or commercially sensitive information; and • Make any necessary comments on the statements contained within the rating report. These comments may not necessarily be incorporated into the final rating report.
Scoring	S&P scores all funds to be rated according to S&P's internal assessment process.
Rating committee	The reviewing analysts present all funds to be rated to the S&P fund-rating committee for determination of the final rating.
Results release	S&P issues all rating outcomes publicly by media release. Ratings are either released together at the completion of a peer review, or selectively upon completion through the course of a peer review, depending on circumstances. Individual out-of-cycle ratings are released upon completion..
Distribution of ratings and reports	S&P will distribute the final ratings and reports to fund managers and subscribers. Standard & Poor's also distributes ratings and ratings-related information to the media and to publicly accessible internet sites. The fund manager has certain rights to distribute its rating reports according to the terms and conditions of the ratings agreement.
Fund-manager survey	At the completion of the fund review, Standard & Poor's may survey the fund manager to determine the quality and satisfaction with the ratings-engagement process.

Ratings Release

The public release of our ratings depends on the terms of engagement with the manager. OOC ratings, which by definition involve the review of a single fund, are released as soon as we complete the work. We handle peer reviews, comprising many different funds, differently. Traditionally, we issued all fund ratings associated with a peer review at the completion of the full review. However, we have transitioned to a “release as we go” approach, in which we release fund families in different style subgroups within the peer group as soon as they are completed. For the larger peer groups, such as Australian Equities—Large Caps, there may be several mini-releases during the course of the full peer review. In this way, rating outcomes are known sooner and can be applied by advisers and investors, which is particularly important if ratings change.

Surveillance

S&P maintains surveillance on all rated funds, and we consider ratings to be current at all times, notwithstanding when we conducted the most recent formal scheduled review. When material changes occur, we will investigate to determine whether the rating should change. Changes may include additions or losses of investment staff, strategic redirection of the business, investment-mandate changes, investment-process changes, and adjustments to fund structure, including fee changes. In many cases, there is not full clarity around the changes, or the manager has not determined how it intends to respond to them, particularly when they involve the unexpected loss of key staff. In these situations, we will place the fund ‘On Hold’ pending further information. ‘On Hold’ ratings are a signal to advisers and investors that something material has occurred, and although S&P is investigating, they should exercise caution if considering investing in or redeeming from the fund. We remove ‘On Hold’ ratings as fast as possible, although this often depends highly on the fund manager. When we remove ‘On Hold’ ratings, we may affirm the rating at the previous level, raise it, lower it, or withdraw it, depending on the circumstances.

Research Reports

S&P’s premium rated-fund reports and rated-fund reports summarise our qualitative views on a product, together with our rating. These reports should be read in conjunction with product-disclosure statements to understand the investment opportunity fully. In addition, concise sector reports, produced at the completion of each peer review, summarise views accumulated during our scheduled peer reviews. *Fact Sheet—S&P Research Reports* contains a fuller outline of the different research outputs.

Research Team

S&P is a leading global authority in funds research. Our qualitative fund ratings are the true measure of excellence in managed investment, relied on by fund managers, investment advisers, wealth managers, and individual investors around the world.

In Australia, S&P’s Fund Ratings team rates more than 1,200 funds, and our coverage is growing. We have an experienced team of analysts, with the group structured along sector lines. However, we manage our resources flexibly; most analysts work across sectors, and are not dedicated to any one area. The size of the peer review, analyst experience, the need at times for continuity with certain fund managers, and the speed at which it chooses to complete the review dictate the number and identity of analysts assigned to any particular peer review. In addition to the local Australian team, we can draw on the collective experience of S&P’s Fund Research team in London.

Communicating Ratings

We aim to make our fund ratings as accessible as possible, and to ensure that we communicate changes to fund ratings to the market in a timely manner. In short, we:

- Communicate fund ratings and rating changes to the market by press release to the media and our subscriber client base;
- Distribute fund ratings through multiple channels including our subscription Web site, direct feeds into client organisations, leading platforms, and third-party software providers and content aggregators;
- Widely publish fund ratings in Australia's leading newspapers and magazines;
- Communicate the status of fund ratings placed 'On Hold' through dedicated reports on our subscription Web site; and
- Routinely hold seminars with market participants to describe the key rating outcomes from major sector reviews.

Further Information

S&P Fund Services produces a number of documents outlining our rating methodologies, including:

- Guide to S&P Qualitative Fund Ratings;
- Guide to S&P Direct Property Fund Ratings;
- Guide to S&P Structured Product Ratings; and

We also produce a range of educational publications targeting the retail market, including our popular **Understanding Indices**, **Understanding Fixed Income**, and **Understanding Hedge Funds** publications.

A range of Reader's Roadmaps to help users understand our research reports are also available.

For further information, contact

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