STANDARD & POOR'S

Capital Series Aussie Blue Chips

Analyst(s): Rodney Lay, Michael Armitage, Tom Mills

OVERALL RATING	
STRONG	
COMPONENT ASSESSMENT	
UNDERLYING	STRUCTURE
UN ASSESSABLE	DELIVERS

Product Facts

Name:	Capital Series Aussie Blue Chips	**Opening date:**	Aug. 23 2010	**Issue price:**	A$1.00
Issuer:	Commonwealth Bank of Australia	**Closing date:**	Oct. 1, 2010	**Min. investment:**	A$10,000
Portfolio manager:	Not Applicable	**Start date:**	Oct. 11, 2010	**Multiples:**	A$1,000
Protection provider:	Commonwealth Bank of Australia	**Maturity date:**	April 18, 2016 (5.5 years)		

Standard & Poor's View

Standard & Poor's has rated Capital Series Aussie Blue Chips as 'STRONG' reflecting our view that the product provides a competitive expected risk-return profile, a clear investment proposition, and is based on an efficient and relatively simple-to-understand structure.

The Capital Series Aussie Blue Chips (the product) comprises an equity-linked investment strategy that provides a fixed guaranteed annual income amount plus the potential for capital growth upon exit. The product provides the safeguard of 100% capital protection at the end of the 5.5-year investment term (the maturity date). The product is based on a zero coupon bond (ZCB) plus call option structure.

The product provides a fixed income amount of 4% per year (after 1.5 years) plus the potential for capital gains. Capital gains are contingent upon the price performance of the 20 largest ASX-listed companies by market capitalisation (the underlying portfolio).

Capital gains are only generated if the value of the underlying portfolio at the maturity date is greater than 20% above the initial value at the issue date. The value of the underlying portfolio is equal to the sum of the performance of each individual security. In turn, the performance of each security is capped at 80% above the initial value of the security at the issue date. Consequently, when combined with the 20% threshold noted above, the maximum capital return is 60% over the 5.5 years, a compound annual growth rate (CAGR) of 9%.

When combined with the capital protection and fixed income, the minimum and maximum total return is 3.6% and 12.6% per year, if the product is held for the 5.5 years to the maturity date.

Investors should note that the capital return formula incorporates an asymmetry of risk to the downside. That is, the performance formula fully incorporates the negative price performance of each individual security but incorporates positive price performance up to 80% only over the 5.5-year period. As a consequence, the product is essentially "long correlation"; for any given market return environment, the higher the correlation in price performance across the 20 stocks, the higher the expected capital return of the product, and vice versa.

Based on our Monte Carlo analysis, the expected annual total return for the product is 8.6%. The result is based on a risk-and-return environment consistent with the long-term performance (price returns, volatility, and correlations) of the relevant underlying equities.

The product is a hybrid fixed income and equities investment. Investors are provided a guaranteed fixed minimum amount annually. However, by taking on equity market risk they may earn an additional return that may generate a total return materially in excess of the most competitive five-year term deposit offering (7.25% per year). S&P characterises the product as low-to-moderate risk, moderate return.

The product may be suitable for investors who would like to maintain a certain income rate on funds with the potential of participating in a positive equity market environment. It may complement existing fixed income and equity investments in an overall portfolio, or it may more represent a more directional play on equity markets for either the risk-averse investor who has a positive view on equities or those who see the likelihood for only moderate gains with the persistence of high volatility.

SWOT Analysis

Strengths

- A competitive relative risk-return profile of an expected return of 8.6% per year based on S&P Monte Carlo analysis and a 70% probability of exceeding the most competitive five-year term deposit.
- On an after-tax basis, the potential capital return may be taxed on capital account. Therefore it may be subject to the 50% capital gains tax (CGT) discount in contrast to interest paid on a term deposit, which is on income account only.
- A relatively simple, easy-to-understand structure in which the capital protection mechanism does not incorporate deleverage risk (albeit at the opportunity cost of capital returns exposure capped at 80% of positive performance in each underlying security).

Weaknesses

- With the asymmetry of downside risk performance calculation (long correlation), an increase in sector-specific risk and idiosyncratic company risk will reduce expected returns, all other things being equal. This is more a feature than a weakness.
- As it is based on a call option structure, capital returns performance does not capture dividends paid by the underlying securities. That is, performance is based on price returns only rather than total returns. Again, this is more a feature than a weakness.
- As the capital returns formula captures limited upside but unlimited downside in the performance of each security, an increase in volatility will reduce expected returns (for any given level of correlations).

Opportunities

- The strategy presents a relatively attractive alternative to a five-year term deposit, and even more on an after-tax basis, for those with a positive outlook on domestic equities.
- Exposure to the price performance of the underlying securities is limited to an 80% gain.

Threats

- A period of low correlation in the underlying portfolio securities will adversely affect the strategy. Such an environment might arise from a period of higher sector-specific and company-idiosyncratic risk.
- Break costs associated with early termination by investor. Investors should not use this product if funds are needed prior to maturity date. Investors and advisers should read the offering product disclosure statement (PDS) to understand the related break costs of the investment.

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Product Structure

Capital Series Aussie Blue Chips is structured as a deferred purchase agreement (DPA) and is based on three separate components: a ZCB (capital protection component), a deposit (the fixed income component), and a call option (the capital return component).

Commonwealth Bank of Australia (CBA) does not charge an explicit fee. Rather, it bases its fees on the pricing of the ZCB and the loan interest rate. We approximate the fee at around 0.7% per year. There is counterparty risk associated with all three components of the strategy: capital protection, fixed income, and capital returns. That risk lies with CBA. We regard the counterparty risk as low given the entity's strong credit rating.

Investors should refer to the PDS for a list of the 20 constituent stocks of the strategy. The 20 stocks are equally weighted at inception but not subsequently rebalanced during the investment term.

For every $1.00 invested approximately 75% is allocated to the ZCB, 17% to the fixed income component, and 8% to the call option component.

There is a 100% investment loan option, but CBA is not expected to market the option for this particular product. S&P does not regard the product as suitable for an investment loan given expected returns do not adequately exceed likely interest costs on a loan.

As a call option-based product, and as noted above, potential capital returns do not capture dividends paid by the 20 underlying securities. The capital returns performance calculation is a function of price returns only, rather than total returns.

For investors who exit prior to the maturity date, the redemption value will be determined by a range of market variables at the time, including interest rates, market volatility, and time to maturity. The value of the investment prior to the maturity date may be less than the invested amount as 100% capital protection only applies at the maturity date. Investors may track the value of the product during the term by contacting CBA.

From a taxation perspective, the fixed income component may be on income account in the year earned, whereas capital returns upon exit are likely to be on capital account and may be eligible for the 50% CGT discount if the investment is held for in excess of 12 months.

At maturity, investors may elect to receive a delivery asset consisting of units in the SPDR S&P/ASX 200 Fund. Irrespective, a CGT event will occur at the maturity of the product.

S&P advises that tax consequences depend on individual circumstances and investors should seek their own taxation advice. The above comments regarding taxation treatment are based on S&P's understanding, but cannot be considered tax advice.

Product fees and adviser commissions are detailed below. Commission payments are subject to the commercial agreement between investor and adviser. S&P regards such commissions as exogenous to the product itself and therefore outside the rating process.

Fees And Costs

Type	Amount
Brokerage fee	Up to 0.55% of the maturity value
Upfront commissions	Subject to that agreed between investor and adviser
Trailing commissions	Up to 0.55% per year on the loan balance
MER	Approximately 0.7% p.a.
Early exit fee	An amount up to $500

Payoff Profile

Investors should note that the payout profile as described below assumes the investment is held to maturity. To reiterate, for investors who redeem early, the return may be less than the capital-protected amount and will be determined partly according to an option-based pricing method and the market value of the ZCB. Investors should not use this product if funds are needed prior to maturity date.

Investors should also note that they have no entitlement to any dividend income or franking credits that may be paid by the underlying securities or constituent stocks of an index.

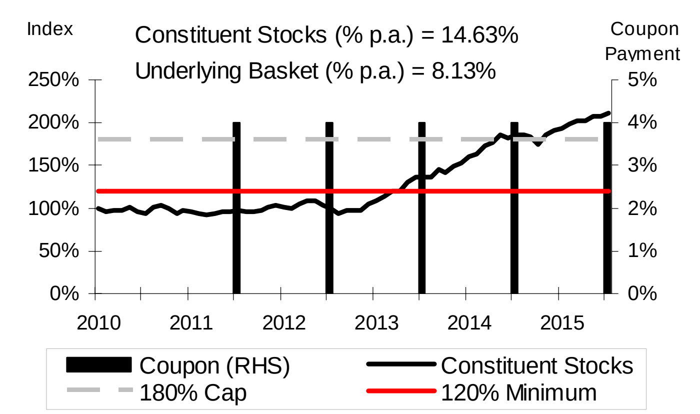
Five annual income amounts of 4% are paid to investors on the coupon payment dates, which fall on April 18, 2012 and 2013, April 22 2014, April 20 2015 and April 18 2016. The first payment is made 1.5 years after the issue date. With a 5.5-year investment term, the five 4% coupon payments equate to an effective payment of 3.6% per year over the full term. The income payment is not contingent upon the performance of the underlying basket of the 20 stocks. It is fixed and guaranteed, subject to the credit risk of CBA.

For capital returns the performance of the basket is based on the average performance of each of the 20 stocks. The exposure to each stock is limited to 80% above the initial level of each stock at the maturity date. The performance of the underlying basket is then reduced by 20%, reflecting the sum of all fixed annual income paid over the term. Consequently, the maximum capital return of the underlying basket over the 5.5 years is 60%, and capital growth is only achieved if the performance of the underlying portfolio is greater than 20% over the full term. With a 20% income return, the maximum total return is 80% over the 5.5-year term.

There is an inherent asymmetry of downside risk in the performance calculation. That is, the calculation method captures the full negative performance of each stock, but limits positive performance to 80% over the term. As such, the lower the average correlation, and the higher the volatility of the stocks, the lower the expected return of the underlying basket for any given market-return environment.

Chart 1 shows a randomly generated example of the payout profile of the strategy over the 5.5-year term. In the example, the constituent stocks generated a 112% gain over the term (14.6% per year). In contrast, the gain of the underlying portfolio is 74% minus the 20% threshold equalling 54% (8.1% per year). While the positive performance of the constituent stocks exceeded 80%, this does not mean the underlying portfolio captures the full 80% gain. This is because the performance calculation is based on the capped performance of each individual stock.

Chart 1: Strategy Payout Structure



The strategy may be suitable for investors seeking an enhanced, regular income stream but who are prepared to risk the income that

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would otherwise be available from a low-risk income-only alternative (up to 7.25% per year for a five-year term deposit). This is in exchange for capturing some of the equities' market upside risk but with the safeguard of 100% capital protection.

Simulated Risk-Return Analysis

We have conducted a Monte Carlo analysis to assess the simulated expected return profile of the product.

We based the scenario on the rolling five-year historical risk-and-return performance of the S&P/ASX 20 price index as a proxy.

Using this data, we based the market-environment scenario on first, second (historical median), and third percentile rolling five-year price returns while basing the level of risk on the second quartile level. The risk and return variables are detailed below.

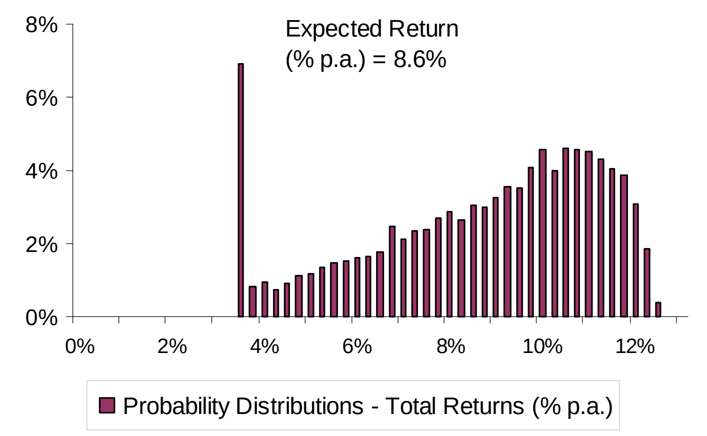
Market Risk-Return Scenarios

Scenario	S&P/ASX 20
Poor	3.8%
Historical	8.0%
Good	10.8%
Risk	12.9%

The table below summarises the expected performance of the product under the three scenarios and Chart 2 shows the probability distribution of expected returns. The key results include:

- In a risk-and-return environment consistent with the long-term average of the S&P/ASX 20 price index ("historical" scenario), there is roughly a 70% probability of a return that exceeds the most competitive five-year term deposit rates (7.25% per year). This may provide an attractive alternative/complement to a long-term term deposit for investors with a positive market outlook who are prepared to take on a degree of equity risk.
- Due to the cap-and-floor payout structure, the expected level of returns is narrow and investors forgo a degree of capital upside in exchange for a guaranteed income level.
- The strategy is long correlation and short volatility: the higher the average level of correlation between the 20 stocks the higher the expected returns, while the higher the volatility the lower the expected returns.

Chart 2: Strategy Simulated Expected Returns



Strategy Simulated Expected Returns

Scenario	Poor	Average	Good
Capital return	2.8%	5.0%	6.4%
Income return	3.6%	3.6%	3.6%
Total return	6.5%	8.6%	10.0%

Analyst(s): Rodney Lay, Michael Armitage, Tom Mills.
Release authorised by: Leanne Milton.

OVERALL RATING
STRONG

Rating Philosophy

A structured product rating combines a qualitative assessment of the structures ability to provide exposure to the underlying asset class(es) and a view on the management of the underlying exposure the product is replicating/delivering.

OVERALL RATING VERY STRONG	S&P has assigned a very strong rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has scored exceptionally in a number of categories but may not be suitable for all investors.
OVERALL RATING STRONG	S&P has assigned a strong rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has scored strongly in a number of categories but may not be suitable for all investors.
OVERALL RATING SOUND	S&P has assigned a sound rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has scored satisfactorily in a number of categories but may not be suitable for all investors.
OVERALL RATING PASS	S&P has assigned a pass rating to the product based on its conviction that it can meet its objectives over the stated time period. The product has passed a number of categories but may not be suitable for all investors.
OVERALL RATING WEAK	S&P has assigned a weak rating to the product based on its conviction that it can not meet its objectives over the stated time period. The product has scored weakly in a number of categories and may not be suitable for most investors.
OVERALL RATING ON HOLD	An On Hold designation is a suspension of a rating pending further analysis of a material change in the characteristics of a product.