OVERALL RATING
STRONG

Capital Series Protect120

STANDARD &POOR'S

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Standard & Poor's View

Standard & Poor's Fund Services rates Capital Series Protect120 as 'STRONG' based partly on our view that the capital growth lock-in feature generates an attractive expected risk-return profile with a higher degree of downside protection than alternative capital protection structures.

The product comprises two 5.5-year term strategies which provide the safeguard of either 100% capital protection or a 120% growth lock-in feature at maturity.

Strategy 1 provides exposure to Australian equities via the S&P/ASX 200 Price Index. Potential capital growth is limited to 80% above the initial reference level at maturity, equating to 11.3% p.a. over the term.

Strategy 2 provides exposure to the Chinese equities market via the Hang Seng Index, the European market via the Eurostoxx 50 Index, and the U.S. market via the S&P 500 index. The three indices are equally weighted at inception. Potential for capital growth of the basket is limited to 80% above the average initial reference level at the maturity date.

With both strategies, if the underlying portfolio exceeds the initial reference level by more than 20% at any six-monthly observation date, the guaranteed amount at maturity is increased to 120% (an effective return of 3.3% p.a. at maturity).

Returns are in the form of capital only, with no income during the term. As alluded, the minimum and maximum returns are 0% and 11.3% p.a. assuming 100% capital protection. However, if the 120% growth lock-in is triggered, the minimum return equates to 3.3% p.a.

Simulated back-testing generates different results for both strategies. However, in both strategies, there was a significant frequency in which the growth lock-in was triggered, indicating the effectiveness of the feature.

Based on a Monte Carlo analysis, strategy 1 exhibited expected returns of approximately 7.0%, with significant probabilities of the maximum 11.3% p.a. and the 3.3% p.a. return outcome. When compared with the "risk-free'" return of a five-year term deposit (competitive rates at 6% p.a.), we regard the expected returns profile as sufficient in the context of the high likelihood of a minimum return of 3.3% p.a.

We regard the product as sufficiently strong in the majority of the determinants of a structured product rating. But the standout feature, and a key contributor to the 'STRONG' rating, is the growth lock-in feature in a ZCB structure. More specifically, it is the high frequency at which the growth lock-in is expected to be activated. This generates a superior downside profile to alternative capital protected structures.

Investor Suitability

- S&P considers the product as only suitable to highly risk intolerant investors, especially strategy 1, who are concerned about ongoing high volatility and, relative to alternative capital protection structures, are prepared to forgo some capital upside in exchange for better downside protection.
- From a market outlook and relative performance perspective, the product is best suited to investors who believe high volatility will persist and do not expect strong appreciation.
- The product is not suitable for those seeking income during the term.

Key Strengths

- The capital growth lock-in is effective in all market environments, with a high probability of increasing the minimum return to the equivalent of 3.3% p.a. at maturity.
- The ZCB capital protection structure does not subject investors to market risks (volatility) to the same degree as some alternative capital protection structures in which participation levels are variable.
- The product may outperform some alternative capital protected structures in lower growth, higher volatility environments.
- On a back-tested basis, strategy 2 returns frequently exceeded returns of the international indices. The protection / growth lock-in provided a significant benefit.
- On a back-tested basis, there were very few occasions in strategy 1 in which returns were 'capped out'. The cost of the cap was low.

Key Weaknesses

- As a derivatives-based product, investors do not receive dividends from the underlying securities. Historically, this equates to around 4% p.a. for Australian equities and 2.8% for the international indices.
- Historically, the minimum return from being directly invested in Australian equities, and receiving dividends, would have always exceeded the minimum return for strategy 1. That is, the direct financial benefit of the capital protection was significantly less than the costs. S&P consider strategy 1 as only suitable for highly risk intolerant investors that place a high value on the knowledge that they will not incur a loss.
- The cost of the growth lock-in structure is the cap on potential capital returns. This cost is likely to be higher for strategy 2 than 1.
- The product will likely underperform some alternative capital protected structures in higher growth, lower volatility environments.

Risks

- Investors are reliant on CBA to meet its obligations under the product. In the unlikely event it cannot, investors may incur a loss.

Name:	Capital Series Protect120	**Open date:**	Oct. 18, 2010
Responsible entity:	Commonwealth Bank of Australia	**Close date:**	Nov. 26, 2010
Investment manager:	N/A	**Start date:**	Dec. 6, 2010
Liquidity	Daily	**Maturity date:**	June 14, 2016
Minimum investment:	$10,000	**Term:**	5.5 years

Capital Series Protect120

Product Structure

The product is structured as a deferred purchase agreement (DPA). Under the DPA, at maturity, investors will receive the delivery assets or may choose to receive the cash equivalent by using the sale facility. The delivery asset will be the SPDR S&P/ASX 200 Fund.

Counterparty risk lies with the Commonwealth Bank of Australia (CBA). If CBA fails to meet its obligation under the DPA on the maturity date, investors may not be able to recoup the value of their investment.

The investment process works in the following way. For $100 invested, 70.5% is allocated to the ZCB (the capital protection component). This pricing is based on a 5-year swap rate of approximately 5.5% currently.

Of the residual 29.5%, 23.2% is used to purchase the underlying options. The option structure is summarised in the Payoff Structure section. An amount of 11.8% is used to buy the 120% - 180% call spread and 11.4% is used to purchase an at-the-money up-and-out call option with a 120% barrier and 20% rebate (the capital growth lock-in component). Of the residual 6.2%, 2.2% is paid as commissions to advisors (which may be rebated to investors) and 4.0% to CBA as fees (<1% p.a.). The above pricing is for strategy 2. Strategy 1 is less expensive and, consequently, the implicit fee to CBA slightly higher.

For investors that exit early, the determination of the capital return is not straightforward – it is a function of all the standard determinants of derivative value – most notably volatility and term to maturity. For most investors, the determination of value prior to maturity is not transparent.

⇨ Taxation

Returns to investors are on exit and on capital account only. There are no income returns during the term. Consequently, all returns are expected to be on capital account and may be eligible for the 50% CGT discount if the investment has been held for more than 12 months.

We note 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.

⇨ Fees

Fees are detailed below. When S&P refers to costs, this relates to the pricing of the options that underpin the product.

We have estimated the pricing of the underlying options (see "Payoff Structure") and compared this with the pricing CBA has applied. If, for example, the pricing/charge levied by CBA is more expensive than that generated by the relevant option pricing model, then theoretically investors incur an indirect cost associated with a lower capped return than may otherwise have been the case.

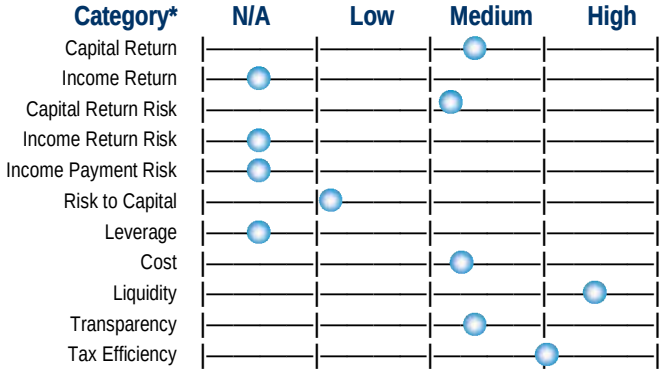
We use our pricing estimates as a reasonability test. On this basis, the CBA pricing appears fair and reasonable.

Fees And Costs

Type	Amount
Brokerage fee	Up to 0.55% of maturity value
Upfront commissions	Subject to investor-advisor commercial terms
Trailing commissions	Up to 0.55% per year
MER	1% to 1.5% p.a. (estimate)
Early exit fee	Up to $500

Source: S&P Fund Services.

Risk-Return Profile



**Refer to Glossary of Terms for certain definitions.*

Payoff Structure

The payout structure is based on three components:

- An at-the-money up-and-out call option with a barrier of 120%. This provides both the capital growth lock-in feature and the potential for capital gains from 0% to 20%;
- An out-of-the-money call spread with a 120 – 180 strike price. The call spread provides the prospect of the capital gain from 20% to 80%;
- A 5.5-year ZCB which provides the 100% capital protection.

The up-and-out call option works in the following way. If the 20% barrier is hit the option terminates. The option includes a rebate of 20%, which is fixed at inception and remains constant for the term. If the barrier is hit the value of the option is 20%. Once knocked out, and regardless of how the underlying performs thereafter, the value of the option is 20% at maturity. This, therefore, provides the 120% capital growth lock-in. If the barrier is not hit, then the option functions as a call option over the index, providing capital upside potential from 0% to 20%.

The call spread is implemented by buying an out-the-money call option with a 120% strike price while simultaneously writing an out-of-the-money call option with a 180% strike price over the same underlying indices with the same expiration date. By selling the out-of-the-money call, the net cost of establishing the position is reduced. This, however, is at the cost of capping potential capital returns.

Pricing of the ZCB is based on the applicable five-year bank bill swap rate shortly before the issue date.

The price investors pay for the growth lock-in feature is essentially a cap on potential capital gains. In our view, however, the costs are outweighed by the benefits of lower downside risk given the frequency in which the growth lock-in is expected to be triggered. To "cap out", the Australian equities market would need to record total returns in the 15% to 15.5% p.a. range over the 5.5-year term (i.e. 11.3% plus an approximate 4.0% yield). Based on historical experience, such an outcome is unlikely.

Capital Series Protect120

Simulated Back-Tested Performance

We have conducted a simulated back-tested analysis based on the historical performance of the index from 1992. The analysis serves as a guide to the performance risks of the product over a full market cycle.

⇨ Strategy 1

The first chart illustrates the simulated back-tested performance of strategy 1 since 1992. The table details the key performance outcomes.

The analysis is based on rolling 5.5-year performance and consists of 155 discrete periods.

The key points from the analysis include:

- The capital growth lock-in was activated 100% of occasions, reinforcing our view of the effectiveness of the feature;
- On 11% of occasions capital returns were capped out. However, the degree of forgone returns was low, specifically 1.0% p.a.
- On 13.5% of occasions returns equalled the capital protected amount of 3.3% p.a. The minimum return of the S&P/ASX price index was 0.8% p.a. but this would equate to around 5% p.a. if directly invested in the Australian equities market (the impact of dividends).
- Given this last point, S&P considers strategy 1 as only appropriate for highly risk intolerant investors that place a high value on the capital protection – growth lock-in as an insurance policy.

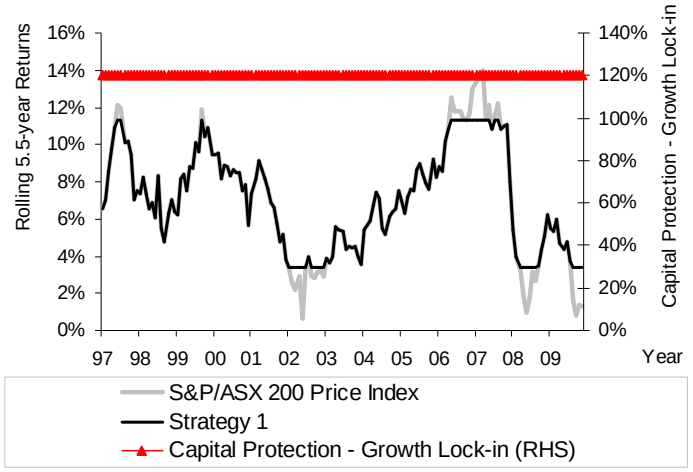
⇨ Strategy 2

The first chart illustrates the simulated back-tested performance of strategy 2 since 1992. The table details the key performance outcomes.

The key points from the analysis include:

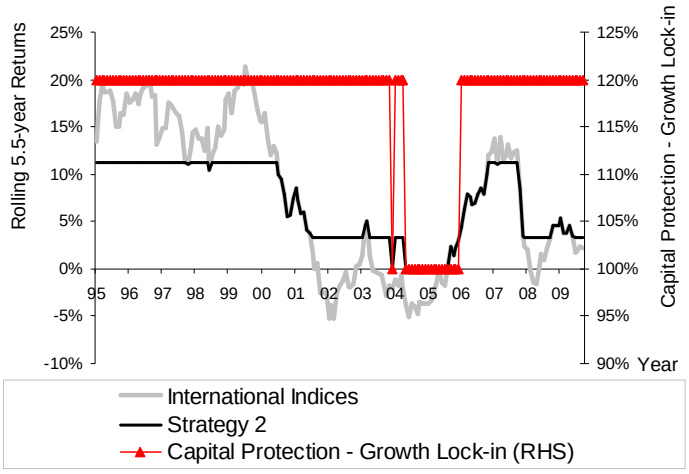
- The capital growth lock-in was activated 88% of occasions. We regard the feature as effective;
- On 42% of occasions capital returns were capped out. On such occasions, strategy 2 underperformed the international indices by a material average 4.6% p.a.
- On 35% of occasions returns equalled the capital protected – growth lock-in amount. On such occasions, strategy 2 outperformed the international indices by an average 3.7% p.a.
- The minimum return of the international indices was -5.3% p.a. but this would equate to around -2.5% p.a. if directly invested in the international indices (the impact of dividends).
- The international indices clearly have a higher risk-return profile relative to the S&P/ASX 200 index, with greater downside and upside. Consequently, the inherent value of the capital protection is greater than strategy 1 but so too is the inherent opportunity cost – forgone returns when 'capped out'. S&P considers strategy 2 as suitable to a broader spectrum of investors in terms of risk-return profile relative to only the highly risk intolerant for strategy 1.

Strategy 1—Simulated Back-Tested Performance



Source: S&P Fund Services

Strategy 2—Simulated Back-Tested Performance



Source: S&P Fund Services.

Strategy 1--Simulated Back-Tested Performance Metrics

Outcome	Measure
Average returns	7.0% p.a.
Frequency growth lock-in triggered	100%
Frequency returns "capped out"	11.0%
Frequency of capital protected – lock-in returns	13.5%
Minimum return Strategy 1	3.4% p.a.
Minimum return S&P/ASX 200 price index	0.6% p.a.
Maximum return S&P/ASX 200 price index	14.0% p.a.

Source: S&P Fund Services.

Strategy 2--Simulated Back-Tested Performance Metrics

Outcome	Measure
Average returns (% p.a.)	7.0% p.a.
Frequency growth lock-in triggered (%)	88%
Frequency returns "capped out" (%)	41.8%
Frequency of capital protected – lock-in returns	34.5%
Minimum return Strategy 2	0.0% p.a.
Minimum return International indices	-5.3% p.a.
Maximum return International indices	21.4% p.a.

Source: S&P Fund Services.

Capital Series Protect120

Simulated Performance Analysis

We have conducted a Monte Carlo analysis to assess expected performance characteristics of the two strategies under various market risk-return scenarios. The scenarios are detailed below.

Risk–Return Scenarios Strategy 1 (% p.a.)

Scenario	Return	Risk
Average	7.1	12.1
Good	8.9	10.5
Poor	4.8	13.5
95th Percentile	2.1	14.9

Source: S&P Fund Services.

Risk–Return Scenarios Strategy 2 (% p.a.)

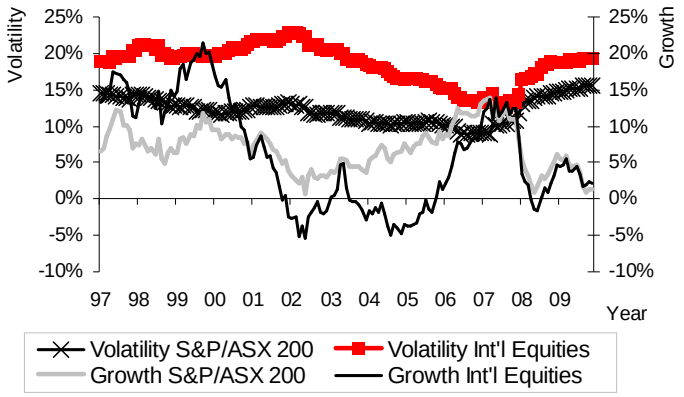
Scenario	Return	Risk
Average	7.4	18.9
Good	14.8	16.2
Poor	0.3	20.0
95th Percentile	-3.6	21.9

Source: S&P Fund Services.

The scenarios are based on the rolling 5.5-year performance of the underlying portfolios (see charts below). Consequently, there are separate scenarios for both strategies. Three scenarios are based on quartile performance, with "poor" based on quartile 1 performance, "average" quartile 2, and "good" quartile 3. Additionally, high volatility has been grouped with low returns, and vice versa, reflecting historical patterns in which periods of poor market performance are also characterised by higher volatility.

The 95th percentile scenario represents something of a "long-tail" event. We have been included it partly for illustrative purposes, as well as to highlight some of the comparative performance characteristics of various capital protected structures currently in the Australian market (see "Comparative Analysis").

Rolling 5.5-Year Performance—Underlying Portfolios



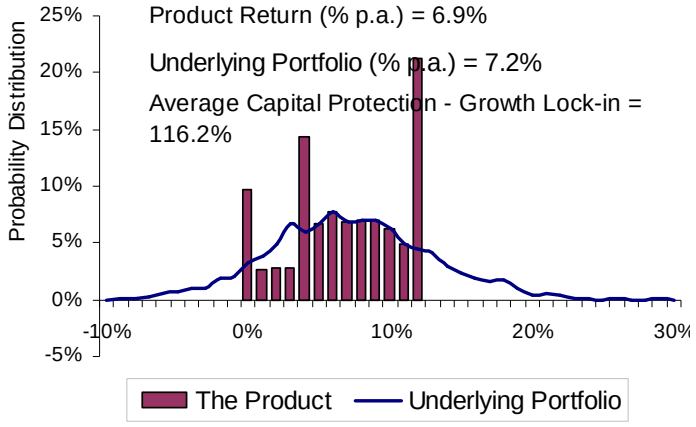
Source: S&P Fund Services.

⇨ Strategy 1

The chart below illustrates the probability distribution of returns. The scale of the vertical axis has been truncated so that the probability distribution of returns below the maximum return amount is obvious.

The table details the key metrics. The underlying portfolio refers to the performance of the price index. For Australian equities, an additional approximately 4% would need to be added for a total returns measure, based on the historical dividend yield of the Australian equities market.

Strategy 1—Distribution Of Expected Returns



Source: S&P Fund Services.

Strategy 1—Expected Performance Metrics (% p.a.)

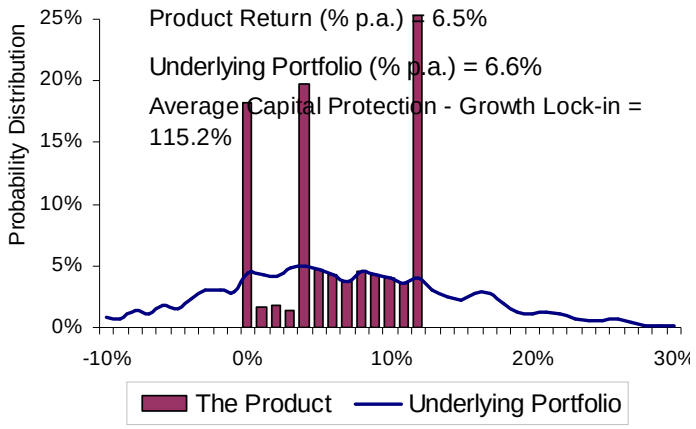
Scenario	Product	Avg. Protection - Growth lock-in	Underlying Portfolio
Average	6.9	116	7.2
Good	8.5	118	9.3
Poor	5.3	114	4.8
95th Percentile	3.9	111	1.8

Source: S&P Fund Services.

⇨ Strategy 2

The chart below shows the probability distribution of returns. The scale of the vertical axis has been truncated so that the probability distribution of returns below the maximum return amount is obvious.

Strategy 2—Distribution Of Expected Returns



Source: S&P Fund Services.

Strategy 2—Expected Performance Metrics (% p.a.)

Scenario	Product	Avg. Protection – Growth Lock-in	Underlying Portfolio
Average	6.5	115	6.6
Good	10.3	119	15.1
Poor	3.5	110	-0.4
95th Percentile	2.2	108	-2.4

Source: S&P Fund Services.

The key points from the analysis include:

- The charts clearly show three high probability outcomes—the 0% p.a., 100% capital protected outcome; the 3.3% p.a., 120% capital growth lock-in outcome; and the maximum capped return outcome of 11.3% p.a. In the "average" scenario, there is a 45% probability of one of these three outcomes.
- The material incidence of the 120% growth lock-in outcome indicates that it was triggered often and also resulted in a higher return outcome than would have otherwise been the case. In the "average" scenario, on 7.5% of occasions, the 120% growth lock-in was triggered, but the underlying portfolio recorded less than the 20% return at maturity. In effect, the growth lock-in was effective in increasing the overall return profile and, in particular, reducing the likelihood of particularly low return outcomes (less than 3.3% p.a.). It is also effective in all market environments.
- The expected return is 6.9% and the protection - growth lock-in level 116% in the "average" scenario (6.5% and 115% for strategy 2). In assessing the attractiveness of this, competitive five-year term deposit rates are currently around the 6% p.a. level (although after-tax returns are on income account not capital account, which is eligible for the 50% CGT discount). There is a slightly greater than 50% probability of a return above 6% p.a. with the product and slightly less than 50% for a return of 6% or less. However, the bulk of higher returns are for the maximum return outcome of 11.3% p.a., whereas the bulk of returns equal to and below 6% are in the 4% to 6% range. S&P regards this relative returns probability distribution as adequately competitive but not compellingly so. Ultimately, however, the perceived attractiveness will depend on an investor's market outlook.

Comparative Analysis

The product provides capital protected long-equities exposure to an underlying portfolio. There are various other structures on the market that do something similar, including constant proportion portfolio insurance (CPPI), several "ZCB-like" structures, and the ZCB-plus uncapped call structures. The first two provide exposure to total returns; similar to this product, the latter provides exposure to price returns only.

While the CPPI and ZCB-like structures are exposed to total returns, the direct and indirect costs can be high, and more than offset the dividend effect.

With CPPI, the indirect cost is possible forgone returns, by being less than 100% exposed to the underlying asset (de-leverage). In extreme cases, exposure may go down to zero (cash lock). The ZCB-like structures retain 100% exposure, but fees are typically high due to the issuer's hedging activities.

In the case of the uncapped call, participation may be slightly less than 100%, depending on interest rates (ZCB pricing) and market volatility (call option pricing).

The various structures will perform differently in different market environments. The perception of which structure is more suitable will partly depend on an investor's market outlook.

The results of the comparative analysis are detailed below. In summary, in all but very strong market environments, we expect the product to very marginally outperform the uncapped call structure due to the positive effect of the capital growth lock-in feature and the low incidence of being capped out.

The product is unlikely to outperform the ZCB-like structure, but the product does have the benefit of materially lower downside risk due to the growth lock-in mechanism. If the option of the two structures presented itself, investors should consider their risk-return profile.

The product is also unlikely to outperform a CPPI structure. Additionally, the higher the growth and the lower the volatility of the market, the stronger the relative performance of the CPPI structure.

However, this may not be the case in an environment where there is a strong spike in volatility or a sharp drawdown in equities, as was seen during the GFC. Furthermore, due to the issue of de-leverage, CPPI essentially imposes certain market risks on investors—notably volatility and the path-dependent nature of performance—that an option based structure does not. These costs are unknown before investing—they are only known on exit. Many advisors are wary of the CPPI structure after the events of the GFC. Consequently, if the option of the two structures presented itself, factors other than expected risk-return may need to be considered.

A key point to note regarding the product is that the growth lock-in structure generates a lower expected downside risk profile than the other structures. This may be an important consideration for more risk-averse investors.

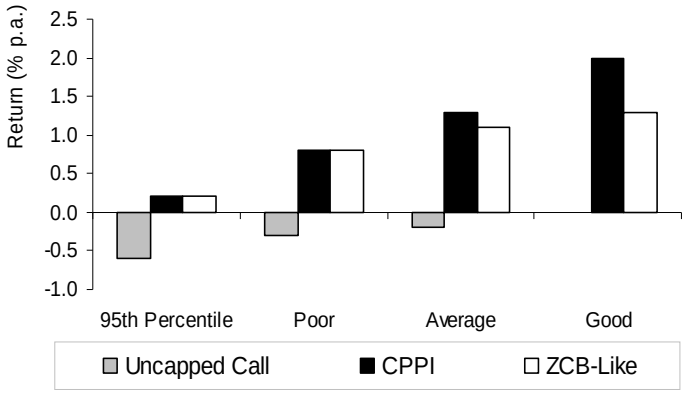
Comparative Assessment – Strategy 1

Strategy 1	Return (%)	Avg. Protection – Growth Lock-in (%)
Average	6.9	116
Good	8.5	118
Poor	5.3	114
95th Percentile	3.9	111
CPPI		
Average	8.2	110
Good	10.5	114
Poor	6.1	106
95th Percentile	4.1	105
ZCB-like		
Average	8.0	100
Good	9.8	100
Poor	6.1	100
95th Percentile	4.1	100
Uncapped Call		
Average	6.7	100
Good	8.5	100
Poor	5.0	100
95th Percentile	3.3	100

Source: S&P Fund Services

Capital Series Protect120

Capital Protected Structures—Comparative Analysis Strategy 1



Source: S&P Fund Services.

For strategy 2 relative performance is generally better (see chart overleaf) for two main reasons:

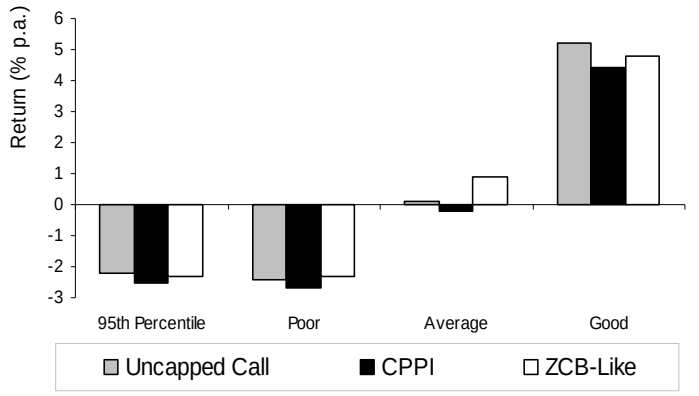
- Investors forgo a lower level of dividends (the weighted-average dividend for the three indices is approximately 2.8% vs. 4%– 4.5% for Australian equities); and
- Volatility is materially higher, which is particularly adverse for the CPPI structure.

Comparative Assessment—Strategy 2

Strategy 2	Return (%)	Avg. Protection – Growth Lock-in (%)
Average	6.5	115
Good	10.3	119
Poor	3.5	110
95th Percentile	2.2	108
CPPI		
Average	6.7	110
Good	12.9	118
Poor	2.6	104
95th Percentile	1.4	102
ZCB-like		
Average	7.8	100
Good	13.3	100
Poor	3.0	100
95th Percentile	1.6	100
Uncapped Call		
Average	7.0	100
Good	13.7	100
Poor	2.9	100
95th Percentile	1.7	100

Source: S&P Fund Services.

Capital Protected Structures—Comparative Analysis Strategy 2



Source: S&P Fund Services.

Capital Series Protect120

Structured Product Rating Philosophy

The performance of a structured product is a function of the interaction of the two separate components. Importantly, the performance will not match that of the underlying growth asset. Consequently, the rating is a product of the assessment of the two underlying components in isolation to each other plus the expected performance based on the interaction of those two components.

Structured Product Rating Definitions

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.

Structured Product Rating Process

The evaluation of a structured product addresses: the underlying growth asset; the structural component; strengths and weaknesses; component complementarities; investment philosophy; fees and costs; expected absolute and relative risk-adjusted performance; and exogenous risks.

Glossary of Terms

Expected Risk-Return	Expected risk and return measures are based on an output of the Monte Carlo analysis using a risk-return scenario consistent with the historical performance of the underlying asset class. Returns relate to both capital and income. Risk represents the annualised standard deviation.
Income Payment Risk	The risk income is not paid on a payment date as a contingency test is not met.
Risk To Capital	The risk of a loss on invested capital. Capital protected products, for example, can be regarded as having limited risk.
Counterparty Risk	The risk that a loss will be incurred if a counterparty to a transaction does not fulfil its financial obligations in a timely manner.
Management Expense Ratio (MER)	A calculation of investment management, marketing, trusteeship, legal, accounting, and auditing costs of a managed investment fund as a percentage of a fund's net asset value.
Monte Carlo Analysis	A probability distribution of (typically) risk-return outcomes using random samples. In most cases, the random sample represents performance of the broader asset class market or the investment strategy by which the performance of the investment structure is determined. The random samples are guided by particular market risk (volatility) and return assumptions scenarios.
Standard Deviation	Measure of the variability or volatility of the monthly returns of the fund.