

CAPITAL PROTECTED FUNDS

Rating Methodology

Since the establishment of the mutual fund industry, asset management companies have seen considerable development, including increasing investor awareness, bringing about enhancement in products, offering diversified investment options. One such product that has been on the offer is Capital Protected Funds (CPF). In order to address the evolving investor needs, JCR-VIS Credit Rating Company Limited (JCR-VIS) has also designed a rating mechanism to assess the risk profile of such funds.

Ratings of capital protected funds, issued by JCR-VIS indicate the probability of timely repayment of principal investment to the unit holders of the fund on the predefined maturity date.

CPFs, by way of their structure, guarantee capital protection or

return of principal at the time of the fund's maturity. Protected funds can offer investors a way to invest in

capital markets while having the security of retaining their initial investment. Local regulatory definition of CPFs mandates that:

such scheme shall make investment in such a manner that the original amount of investment is protected whilst having the potential to yield positive returns, with such conditions as to tenure of investment and any other conditions that are disclosed in the offering document; the offering document of such scheme shall clearly demonstrate how this capital protection is intended to be achieved; and

in the event that such scheme is protecting the investment capital by placing a term deposit with a bank or DFI, the rating of such bank or DFI at the time of offering the scheme shall not be lower than 'AA-' (Double A Minus).

CPFs call for protection of principal, through investment of a portion of the fund in fixed income portfolio, which will allow for value at maturity to match initial consideration. The remainder of the fund is invested in the equities market, allowing investors to capitalize on potential upside movement.

Investments are made secure with deployment in fixed income instruments of very high credit quality. Where these fixed income instruments are marked-to-market, the fund's Net Asset Value may also be

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subject to price risk during the life of the fund. The fund manager must also manage maturities of assets vis-à-vis the life of the fund. Assets with longer duration than the life of the fund can give rise to liquidity risk while short term assets may be exposed to re-investment risk.

Liquidity risks may arise in the backdrop of an underdeveloped debt market. There may also be an impact cost in case of selling equities. If the fund is structured as a closed end scheme, liquidity risks may be of less consequence during the life of the fund.

With investments of the capital protection segment restricted to highly rated bank deposits as per the regulations governing these funds in the local market, these funds are likely to maintain a conservative risk profile.

CPF's are in their design, structured as closed end funds. Alternatively, the fund may have a very high back-end load to discourage redemption prior to maturity. Investors who may need ready access to their funds may need to be cautious when considering investing in a protected fund. Depending on how the fund is structured, early withdrawal may mean losing the principal guarantee and facing early withdrawal fees. However, assigned ratings only comment on value of principal at the time of maturity.

CPF's can be structured in many ways to ensure protection of principal to investors; however these structures are modifications of two basic types; Funds can either be Basic Hedge Funds or Aggressive Hedge Funds.

Basic Hedge Funds ensure capital protection entirely through the fixed

income portfolio, or in other words, the fixed income portfolio invested in matures to the principal at the end of the term. The remaining portion is invested in equities, providing a possibility of additional returns to the investor.

An Aggressive Hedge Fund, is structured such that capital protection is reliant on both fixed income and equity investments made by the fund. A fusion of both equity and fixed income instruments invested in are required to provide for the invested principal at the time of maturity of the fund.

Despite the advantages of this type of fund they will nonetheless be exposed to counter party risk, therefore credit worthiness of the issuer of fixed income instrument plays a vital role in the rating assessment of this fund.

Quantum of the investment in one counter party may also lead to con-

centration related risks, with the counter party not being able to service its obligations at the time of maturity. Risk of default can be countered by investing in high credit quality instruments. In case of an Aggressive Hedge Fund, price risk of equities is an added source of risk that needs to be monitored while evaluating the fund's ability to meet capital protection.

Given the nature of the fund, close monitoring of its fundamental structure is of importance. Analysis of the probability of the fund value falling below the initially contracted principal value, and of investors not retrieving their invested capital in full is the focus of the assigned ratings **JCR-VIS**

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CAPITAL PROTECTED FUNDS RATING SCALE

AAA(cpf)

Highest probability of timely repayment of principal investment. Risk is negligible with very low sensitivity to changing economic conditions.

AA(cpf)

Very high probability of timely repayment of principal investment. Risk is modest but may vary slightly from time to time because of changing economic conditions.

A(cpf)

High probability of timely repayment of principal investment. Risk factors may vary with possible changes in the economy.

BBB(cpf)

Adequate probability of timely repayment of principal investment. Risk factors are considered variable if changes occur in the economy.

BB(cpf)

Low probability of timely repayment of principal investment. Risk factors are sensitive to changes in the economy.

B(cpf)

Very low probability of timely repayment of principal investment. Risk factors are capable of fluctuating widely if changes occur in the economy.

CCC(cpf)

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC(cpf)

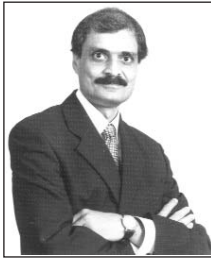
Weak capacity to make timely repayment of principal investment.

C(cpf)

Very weak capacity to make timely repayment of principal investment.

A **plus (+)** or **minus (-)** sign may be added to the rating symbols **from AA(cpf) to B(cpf)**, to indicate relative standing within each of those rating categories.

While no Outlook is assigned to ratings of Capital Protected Funds, ratings may be placed under Rating Watch if JCR-VIS views that the status of the assigned rating is uncertain and there are conditions present that necessitate re-evaluation of the assigned rating. Developments in factors other than those that necessitated the 'Rating Watch' may result in a rating change, while the rating continues to be under 'Rating Watch'.



Faheem Ahmad
President & CEO, JCR-VIS
Founder, VIS Group

Faheem Ahmad has diverse experience with international consulting agencies in USA & Middle East. He has also held senior positions with local industrial and financial groups. In 1994, he established Vital Information Services (Pvt.) Limited, which is a leading capital market research house. VIS has the largest data bank of corporate Pakistan. His major research work includes copy-righted F&J financial strength rankings, Musharaka Variable Income Securities and stock market indices. VIS group includes JCR-VIS Credit Rating Company Limited and News-VIS Credit Information Services (Pvt.) Limited, the first private credit bureau of Pakistan. The majority of shareholders in group companies include the largest publication house in Pakistan and major financial institutions.

He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters degrees in Engineering and Business Administration from USA. His research work has been published in various international journals.



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Senior Manager

Sobia Maqbool leads ratings of Financial Institutions. She holds a Masters degree in Business Administration from the Institute of Business Administration, Karachi in 2003.



Amna Rahman
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Amna Rahman has been involved in the ratings of Financial Institutions. She has completed her Masters in Professional Accounting from The University of Wisconsin- Milwaukee.

Jahangir Kothari Parade (Lady Lloyd Pier)
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari
Parade

National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

JCR-VIS Credit Rating Company Limited

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