Purpose
The Morningstar Stewardship Grade for mutual funds is designed to help investors further research, identify, and compare fund managers and fund companies that do a good job—or a poor job—of aligning their interests with those of fund shareholders.

The Stewardship Grade goes beyond the usual analysis of strategy, risk, and return. It helps investors to assess funds based on:
- The manner in which funds are run;
- The degree to which the management company’s and fund board’s interests are aligned with those of fund shareholders;
- The degree to which shareholders can expect their interests to be protected from potentially conflicting interests of the management company.

The Stewardship Grade tries to capture some of the intangibles associated with making an investment decision. While the grades are not intended to serve as buy/sell signals in isolation, when combined with other Morningstar analyst commentary—such as an assessment of a fund’s strategy and management—they can help determine the difference between a great investment and one to avoid.

The new grades are based on information compiled from public filings, responses to a detailed survey Morningstar sent to each fund company, and the expertise of Morningstar’s fund analysts.

Scope
Initially, Morningstar analysts are grading 500 of the largest funds. In the coming months, we will assign Stewardship Grades to all the funds we cover—approximately 2,000 funds.

Scoring
Scale
Each fund is assigned a letter grade from A (best) to F (worst). All funds are graded on an absolute basis. There is no “curve.”

Components
Morningstar analysts’ evaluation of the following five components determines the grade for each fund:
- Regulatory Issues
- Board Quality
- Manager Incentives
- Fees
- Corporate Culture

Each component is worth a maximum of 2 points, for a total, overall score of 10 possible points. Points for each component are awarded in increments as small as 0.5. With the exception of Regulatory Issues, the minimum score a fund can receive in each component is zero. For Regulatory Issues, the lowest possible score is −2.

Each component score corresponds to one of the following qualitative terms:
Excellent = 2 points
Good = 1.5 points
Fair = 1 point
Poor = 0.5 points
Very Poor = 0 points or fewer

The overall Stewardship Grade is based on the sum of the five component scores:
A: 9 - 10 points
B: 7 - 8.5 points
C: 5 - 6.5 points
D: 3 - 4.5 points
F: 2.5 points or fewer
Stewardship Grade Components

Regulatory Issues (Score range: -2 to +2)
We examine any regulatory issues at the fund company in the past three years. Serious breaches of fiduciary duty can result in a score of -2; funds with no regulatory concerns receive 2 points. In the event of any breaches, we review the remedies in place and the scope of, and commitment to, reform.

Board Quality (Score range: 0 to +2)
We assess the quality of a fund's board, looking at the following factors; each is worth 0.5 points:
- Has the board taken action in cases where the fund clearly hasn't served investors well?
- Do the independent directors have meaningful investments in the fund? To earn the maximum score, at least 75 percent of a board's independent directors must have more money invested in the funds they oversee than they receive in aggregate annual compensation for serving on the board. However, the Securities and Exchange Commission requires directors to report investments in dollar ranges, with the top range being "more than $100,000." As a result, we will assume that directors with more than $100,000 invested in the funds they oversee meet the above criterion.
- Is the board overseeing so many funds that it may compromise the ability to diligently protect the interests of shareholders at this specific fund?
- Does the fund meet the maximum SEC requirement for the proportion of independent directors, regardless of whether or not it is subject to the requirement? (Former fund company employees, family members, and current or former employees of fund service providers are not considered independent by Morningstar.)

Manager Incentives (Score range: 0 to +2)
We assess two distinct aspects; each is worth 1 point:
- Fund Ownership: Does the manager have a significant investment in the fund(s) he or she oversees? Managers with more than $1 million or more than one third of their liquid net worth in the funds they run receive full credit. Managers with at least $500,000 in the funds they run receive partial credit. If the funds overseen by the manager are inappropriate for a large investment, the manager may receive partial or full credit for investing in other funds at the same firm, if that information is provided to Morningstar. Similarly, if other reasonable circumstances prevent a manager from investing in his or her fund, we will consider those situations on a case-by-case basis.
- Compensation Structure: Do the compensation plans reward long-term performance or emphasize asset growth? Incentive programs that encourage a focus on short-term performance or asset growth are viewed less favorably.

Fees (Score range: 0 to +2)
We assess two aspects; each is worth 1 point:
- Fee Comparison: A fund receives 0.5 points if its expense ratio is lower than the median for its type of share class within its comparison group (see Appendix A: Stewardship Grade Fee Score Methodology and Comparison Groups, below). A fund receives an additional 0.5 points, for a total of 1 point, if its expense ratio falls below the 25th percentile for its type of share class within its comparison group.
- Fee Trends: A fund receives up to 1 point if its expense ratio has declined materially as assets have grown or if there is evidence that it will do so, such as a management contract with significant fee “breakpoints.”

Corporate Culture (Score range: 0 to +2)
This component looks at a wide range of factors to assess how seriously a firm takes its fiduciary duty to its fund shareholders. Morningstar analysts may consider the following:
- Has the firm launched "trendy" funds in an attempt to gather assets?
- Has the firm closed funds at an appropriate size, or has it allowed fund assets to grow too large?
- Does the firm implement redemption fees or otherwise discourage rapid trading of its funds?
- Has the firm done a good job of retaining key personnel?
- How strong are the firm's shareholder communications?
- Has the firm used soft dollars?

Where to Find the Stewardship Grade
- Morningstar.com. Each fund report displays the scores of each of the five components, as well as the final grade.
- Morningstar® Mutual Funds™
- Morningstar® FundInvestor™
Appendix A: Stewardship Grade Fee Score Methodology and Comparison Groups

Until September 2005, for the purposes of the Stewardship Grade, Morningstar compared funds’ expense ratios with those of other funds within their Morningstar categories and share-class types. Under the previous scoring methodology, for the fee-comparison segment of the score (worth up to 1 point) funds received full credit if their expense ratios were below the average expense ratio for their comparison group, and no credit if their expense ratios were above the average for their comparison group. In September 2005, the scoring methodology for the fee-comparison segment changed as described above. (The fee-trends segment remains the same.) In addition, the comparison group definitions changed as follows:

Old comparison group methodology: Each Morningstar category (e.g., large growth, small value, etc.) constituted a distinct comparison group.

New comparison group methodology: Morningstar categories have been combined where appropriate to form 32 comparison groups of funds that invest in similar asset types. The new groups are as follows:

- Moderate Allocation
- Multisector Bond
- Muni FL + Muni MA + Muni MN + Muni NJ + Muni OH + Muni PA
- Muni National Intermediate + Muni Single State Intermediate + Muni CA Int/Sh, + Muni NY Int/Sh
- Muni National Long + Muni Single State Long + Muni CA Long + Muni NY Long
- Muni National Short + Muni Single State Short
- Short Bond
- Short Government
- Small Growth + Small Blend + Small Value
- Specialty: Communications + Financials + Health Care + Natural Resources + Precious Metals + Real Estate + Technology + Utilities
- Ultrashort Bond
- World Allocation
- World Bond
- World Stock

Bank Loan
Bear Market
Conservative Allocation
Convertibles
Diversified Emerging Markets + Pacific/Asia ex-Japan + Latin America Stock
Diversified Pacific/Asia + Japan Stock
Emerging Markets Bond
Europe Stock
Foreign Large Value + Foreign Large Blend + Foreign Large Growth
Foreign Small/Mid-Value + Foreign Small/Mid-Growth
High Yield Bond
High Yield Muni
Intermediate Bond
Intermediate Government
Large Growth + Large Blend + Large Value
Long Bond
Long Government
Mid Growth + Mid Blend + Mid Value