

MSBS 96-97

ANNUAL REPORT to members

FROM THE MILITARY SUPERANNUATION AND BENEFITS BOARD OF TRUSTEES

MSBS MEMBERS EARN 20% IN 1996-97

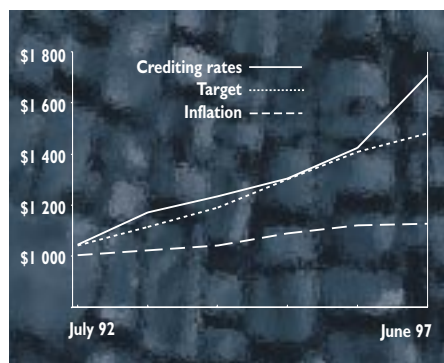
The MSBS Fund recorded its best-ever performance in 1996-97, earning a 20.6% return on its investments. As a result, we have declared a crediting rate (the interest rate applied to your account) of 20% for the year.

The Fund's pleasing performance supports our decision last year to move to a more growth-oriented investment policy. As a result of that move, we increased our share holdings considerably at the start of the year, which put us in a good position to take advantage of the world-wide increase in share prices that began in late 1996.

Our international share holdings, which make up almost a quarter of the fund, returned 31.4% for the year. Australian shares also did well, with a 27.8% return. All other sectors performed close to their benchmarks, except for the Fund's minor investment in direct property.

The MSBS Fund has continued to grow steadily since its inception in October 1991. Following last year's strong result, the value of assets under management in the Fund has risen to over \$580 million.

The graph on the right shows how Fund returns have stayed well ahead of inflation, and of the earnings target we set. An investment of \$1000 in the Fund in July 1992 would have grown to around \$1650 by June 1997. By comparison, if it had grown at the MSBS investment earnings target of inflation plus 5%, it would have been worth just over \$1400.



HOW IT AFFECTS YOU . . .

Put simply, the performance of the Fund affects you directly when you leave the Defence Force. The better the Fund performs while you're in the Defence Force, the bigger your lump-sum member benefit will be when you leave.

Naturally, there will always be fluctuations from one year to the next—we don't expect to earn 20% plus every year.

While we strive to remain very competitive with comparable superannuation funds, our primary objective is to achieve or surpass our long-term investment target without incurring too much risk. If we can do that, then the contributions you pay each fortnight will continue to build into a valuable refund when you finish your military career.

The MSB Board

1996-97

AT A GLANCE

EARNING RATE

20.6%

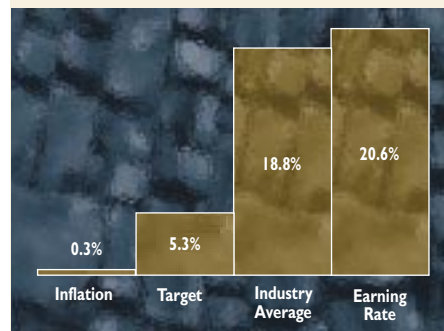
This is the Fund's investment earnings after taxes and fees are deducted.

CREDITING RATE

20.0%

This is the rate applied to your superannuation account. Its method of calculation is different from the Earning Rate method, as it takes account of Fund growth and cash flows throughout the year.

FUND PERFORMANCE



KEY

INFLATION is the rate of increase of the June-to-June Consumer Price Index (CPI).

TARGET is the Fund's investment earnings target, which is inflation plus 5%.

INDUSTRY AVERAGE is a measure of the performance of similar investment funds, and is drawn from the Intech Performance Survey of Market-Linked Pooled Funds, June 1997.

MSBS

MILITARY SUPERANNUATION AND BENEFITS SCHEME

OUR INVESTMENT *policy*

As Trustees, we have a responsibility to ensure that the money you pay in super contributions while you're in the Defence Force works hard to generate good investment returns—because the better the returns, the better off you'll be when you leave.

Our investment policy is aimed at increasing Fund returns while closely controlling risk. This primarily involves:

- balancing the mix between growth and defensive assets;
- maintaining an effective blend of specialist sector mandates; and
- ensuring our portfolio managers remain effective and competitive.

GROWTH ASSETS AND DEFENSIVE ASSETS

All investment funds must balance risk against returns. That is, they must determine the mix of growth assets and defensive assets that best suits their members' long-term needs.

Growth assets are investment vehicles (such as shares and property) that are very responsive to market fluctuations. They therefore involve a higher degree of risk, but have the potential to provide a higher return. On the other hand, **defensive assets** (such as cash and bonds) are less susceptible to market fluctuations, and are therefore less risky investments. However, with this reduction in risk comes a reduced potential for growth.

About three-quarters of MSBS members are younger than 30—and as a general rule, the younger you are, the higher the proportion of growth assets you should have. Therefore, a fund like ours, with a lot of young contributors, will best serve its

members' long-term interests by holding a fairly high proportion of growth assets.

In previous years, about 60% of the Fund comprised growth assets. Our new policy increases that to around 75%. But increasing our growth holdings doesn't necessarily mean we've increased our risk exposure. By changing from balanced fund managers to specialist sectoral managers (see p.3), we have contained the Fund's risk profile at around the same level as it was under our previous policy.

MEETING OUR INVESTMENT OBJECTIVES

We believe that our investment strategy represents the best way of achieving our primary long-term earning objective—to exceed inflation by at least five percentage points over rolling five- to seven-year periods.

That is, if inflation runs at 2% p.a. over the five-year period between 1994–95 and 1998–99, then (after taxes, fees and charges have been deducted) the Fund should earn at least 7% p.a. over the same period.

Our other long-term objectives are:

- to ensure that the chance of not achieving a better-than-inflation return over a period of ten years is no greater than one in 18; and
- to ensure that the chance of a negative return in any one year is no greater than one in six.

In some years the Fund may have a negative return on its investments. But if that happens, the thing to remember is that superannuation is a long-term investment. Losses incurred in one year will be more than offset by the gains achieved in other years over the long term.

fund investment

A SUMMARY

- The Fund is managed by sectoral specialist managers over the full range of major asset classes.
- We have increased our growth assets to around 75% of total Fund value.
- Our holdings in shares (both domestic and international) and our fixed-interest holdings have been sub-divided into core and active components (see *Fund management and performance*, p.3).
- There is no Reserve Account. Therefore, all Fund earnings (after tax, fees and expenses—see *Other Investment Information*, below) will be distributed to members. The down-side of this is that Fund losses will also be passed on to members. However, under our risk management policy, the probability of this happening is less than one in six.
- The focus of risk control is the total Fund, not individual sectors. The overall Fund risk will be kept within a specified range, so the Fund can neither be too aggressive (thus creating an excessive possibility of losses), nor too defensive (which would reduce our growth potential).
- Derivatives (e.g. options and futures) may be used to manage the risk profile of the Fund and transaction costs (including market impact), and to implement investment positions. However, they may not be used for speculative purposes, or for gearing the portfolio.
- No single asset can exceed 7.5% of the Fund's total value. For example, we can't hold more than 7.5% of our assets in BHP shares.
- Our exposure to a single economic entity cannot exceed 10% of the total Fund value. For example, if we hold 7.5% of our assets in BHP shares, then we can't hold more than 2.5% of Fund value in BHP debentures.

OTHER INVESTMENT *information*

MASTER CUSTODIAN

The Fund's Master Custodian is Morgan Stanley Australia Ltd. They perform various 'housekeeping' functions in relation to investment management, including settlement of trades, physical custody and safekeeping of securities, collection of dividends, and preparation of accounts.

They allocate all available monies to the investment managers in accordance with the mandates set down by the Board.

They also hold (but do not own) the assets which comprise the Fund. They collect and disburse dividends, maintain consolidated accounts and tax records for the Fund, and report to the Board on individual fund

manager performance and investment returns.

INVESTMENTS COMPRISING OVER 5% OF TOTAL FUND ASSETS

At 30 June 1997 there were no single investments comprising more than 5% of total Fund assets; nor did any combination of investments in a single entity comprise more than 5% of total assets.

INDEMNITY INSURANCE

The Board is insured with AMP General Insurance Ltd against losses, liabilities, actions, claims or demands arising from the performance of its functions.

FEES AND CHARGES

The amount available for distribution to members represents the net income after allowances for tax and other expenses directly related to the operation of the Fund. The administrative costs in respect of the operations of the Scheme administrator, ComSuper, are met from Budget appropriations and are not charged against the Fund.

All fund managers are paid a fee which is generally based on the value of assets under their control. The fee reflects the investment costs applicable to each particular sector, and the investment style (i.e., active or passive) employed by each manager.

FUND MANAGEMENT *and performance*

We employ a 'core/active' approach to Fund investment, in order to control risk and keep costs down. We considered that at this stage of the Fund's development it was appropriate to introduce active management components as a means of adding value to the Fund.

Over the long term, this approach should bring better returns, and these returns will compound to provide substantial increases in the Fund's value. And that will improve the financial position of every MSBS member.

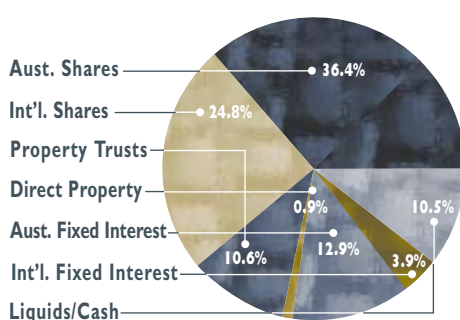
The Fund managers table below lists the managers for each asset sector, and shows the target ranges for each sector. It also describes the investment 'style' of each manager, that is, whether the manager has control of 'core' or 'active' assets.

CORE AND ACTIVE HOLDINGS

One way to reduce a fund's exposure to economic and market 'shocks' is to combine managers that have different approaches to outperforming their investment benchmarks.

Core managers stay very close to their benchmark. They take hundreds of small actions to add value, and pay very close attention to managing their costs. Good active managers also place a lot of emphasis on risk control, but they are more willing to back their judgment by holding a smaller number of stocks that are significantly different to the sectoral index.

PHYSICAL ALLOCATION AT 30 JUNE 1997



PHYSICAL EXPOSURE V. EFFECTIVE EXPOSURE

In the Fund managers table below, the Fund's physical exposure—the actual asset holdings of each investment manager—is listed. Some amounts here differ from the effective exposure amounts in the Fund performance table below it.

Our effective exposure in international shares is lower than our physical exposure because we were concerned about the very significant rise in value of international assets during the year, particularly in the US. That concern led us to implement an 'insurance' strategy to protect the Fund against a fall in the US share market. Among other things, that strategy involves the purchase of options (which provide a guaranteed future sale price). The effect of this strategy is to reduce the Fund's effective exposure in international shares.

The MSB Board's Investment Adviser is:
IPAC Portfolio Management Ltd
 Level 28, Grosvenor Place
 225 George St, Sydney NSW 2001

FUND *managers*

SECTOR	TYPE	FUND MANAGER	PHYSICAL EXPOSURE AT 30/6/97		RANGE	BENCHMARK
			\$M	%		
Aust. Shares	Core Active	Macquarie Investment Management Ltd	113.9	19.6%	} 27%-47%	ASX All-Ordinaries Accumulation Index
		Portfolio Partners Ltd	97.6	16.8%		
Int'l Shares	Core Active	Barclays Global Investors N.A.	73.8	12.7%	} 15%-35%	Morgan Stanley Capital International (MSCI) World Equity Index (excluding Australia)
		Wellington Management Company	70.0	12.1%		
Property Trusts Direct Property	Active Active	Paladin Australia Ltd	61.4	10.6%	} 5%-18%	ASX Property Trust Accumulation Index MSCI Property Trust Accumulation Index
		Commonwealth Funds Management Ltd	5.4	0.9%		
Aust. Fixed-Interest	Core Active	Westpac Investment Management Ltd	26.1	4.5%	} 5%-25%	SEC Composite Bond Index
		BT Funds Management Ltd	48.7	8.4%		
Int'l Fixed-Interest	Active	Credit Suisse Investment Management (Australia)	22.3	3.9%	1%-15%	JP Morgan World Government Bond Index in local currency
Liquids/Cash	Core	Morgan Stanley Australia Ltd	61.0	10.5%	0.5%-15%	SBC Australia Bank Bill Accumulation Index
Total			580.2	100.0%		

FUND *performance*

SECTOR	EFFECTIVE EXPOSURE AT 30/6/96		EFFECTIVE EXPOSURE AT 30/6/97		PERFORMANCE, 1996-97	
	\$M	%	\$M	%	FUND	BENCHMARK
Australian shares	107.5	26.5%	211.2	36.4%	27.8%	26.6%
International shares	64.5	15.9%	117.8	20.3%	31.4%	28.6%
Property Trusts	8.7	2.1%	61.4	10.6%	27.7%	28.5%
Direct Property	5.5	1.4%	5.4	0.9%	3.3%	8.2%
Aust Fixed-interest	114.5	28.2%	74.8	12.9%	15.0%	16.8%
International Fixed-interest	7.0	1.7%	22.6	3.9%	11.6%	12.1%
Liquids/Cash	98.4	24.2%	87.0	15.0%	8.8%	6.8%
Total Fund	406.1	100.0%	580.2	100.0%	20.6%	18.8%*

* Intech Performance Survey, Market-linked Pooled Funds, June 1997

FINANCIAL *summary*

VALUE OF FUND AT 1 JULY 1996	\$402.0M
Inflow	
Contributions	\$121.6m
Investment Earnings	\$111.3m
Outflow	
Benefits Paid	(\$33.6m)
Investment and other expenses	(\$3.7m)
Taxation	(\$20.3m)
VALUE OF FUND AT 30 JUNE 1997	\$577.3M
ASSETS & LIABILITIES AT 30 JUNE 1997	
Assets	
Investments	\$580.8m
Other Assets	\$17.8m
Liabilities	
Liabilities	(\$21.3m)

Notes

- 1 The value of the Fund in this table includes all investment and non-investment assets, and is net of all fund liabilities.
- 2 These figures are taken from the annual financial statements prepared by ComSuper in respect of the operations of the Fund. Fully audited financial statements will be included in the MSB Board's 1996-97 Annual Report to Parliament, and are available on request from ComSuper. (See back page for contact details.)

LONG-TERM *performance*

EARNING RATE AND CREDITING RATE

The Earning Rate reflects the Fund's investment performance for the year, after taxes and management fees have been deducted. The Crediting Rate reflects how much of those investment earnings can be credited to members' accounts, taking into account the size of the Fund and its cash flows (benefits paid and contributions received) throughout the year.

INTEREST RATES SINCE 1992-93

Year	Earning Rate	Crediting Rate	Inflation Rate
1992-93	12.5%	12.1%	1.9%
1993-94	7.2%	5.4%	1.7%
1994-95	6.4%	5.8%	4.5%
1995-96	9.5%	9.0%	3.1%
1996-97	20.6%	20.0%	0.3%
5-year average	11.1%	10.3%	2.3%

MSBS *benefits*

No matter how you leave the Defence Force, you (or your dependants) will be entitled to receive an MSBS superannuation benefit. That benefit will consist of two parts:

- a *member benefit*, made up of your fortnightly contributions plus the interest they earn; and
- an *employer benefit*, which is the government's contribution to your superannuation.

YOUR MEMBER BENEFIT

Your contributions are paid into the MSB Investment Fund, and your member benefit grows in accordance with the returns achieved by the Fund. You can take it as a lump sum when you leave, or preserve it in the Fund for as long as you like, up to age 65.

YOUR EMPLOYER BENEFIT

This will make up the majority of your total MSBS benefit. It is calculated by multiplying your Final Average Salary (FAS) by a factor derived from your length of service. It is then divided into two parts, as follows:

- a 3% productivity benefit. This is called the *funded component*, because the government actually pays this money into the Fund on your behalf each fortnight.
- The balance of your employer benefit is called the *unfunded component*. Access to this is phased-in over the first seven years of your service.

Your employer benefit must be preserved in the Scheme (except in exceptional circumstances) when you leave the Defence Force. Generally, it is not available until you retire from the workforce at or after age 55. Once the employer benefit becomes payable, you can take it as a lump sum, or as a CPI-indexed pension, or as a mixture of both (as long as you take at least half of it as a pension).

don't lose touch...

We don't want you to become 'lost' when you leave the Defence Force. A lost member is someone who leaves the scheme without claiming their benefit, or someone with a preserved benefit entitlement whose Annual Information Statement is returned to us without a forwarding address.

If you become a lost member because you don't claim your benefit, we'll treat your benefit as if you had elected to preserve it. It will stay in the Fund, and you can claim it at any time.

Every year we send out important information about your super, in the form of this Annual Report and its accompanying information statement. This information helps you to plan your financial affairs—but if you are a 'lost' member, you will receive none of it.

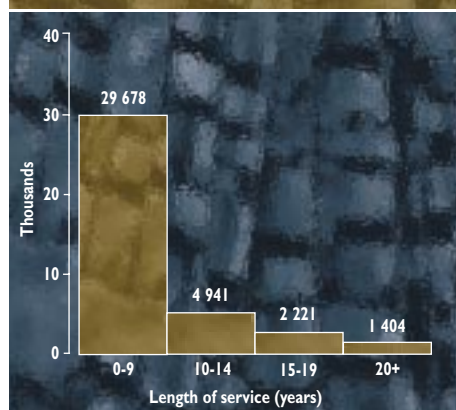
*So, when you leave the Defence Force,
please let us know
when you change your address.*

MSBS membership

MEMBERS AT 30 JUNE 1997

Service	Men	Women	Total
Army	13 861	2 323	16 184
Air Force	9 572	2 461	12 033
Navy	8 033	1 994	10 027
Total	31 466	6 778	38 244

MSBS MEMBERSHIP, BY LENGTH OF SERVICE



CONTRIBUTOR EXITS IN 1996-97

Reason	Number	%
Age	80	1.7%
Retrenchment	4	0.1%
Resignation	4 065	84.7%
Invalidity	366	7.6%
Death	19	0.4%
Other	267	5.5%
Total	4 801	100.0%

PENSIONS IN FORCE AT 30 JUNE 1997

Type of Pension	Number	Annual Liability (\$m)
Age	349	8.4
Retrenchment	1 609	10.9
Invalidity	830	12.6
Preserved	54	1.2
Dependants	26	0.4
Total	2 868	33.5

PRESERVED BENEFITS AT 30 JUNE 1997

Type	Number	Value(\$m)
Member Benefit	1 213	14.3
Employer Benefit	24 343	679.5
Total	25 556	693.8

the 1997 Budget

NO MAJOR CHANGES TO SUPERANNUATION POLICIES, BUT A FEW MINOR ONES THAT MAY AFFECT YOU IN THE FUTURE

INCREASE IN PRESERVATION AGE

If you were born on or after 1 July 1960, your preservation age (the age at which you can access your employer component) will increase incrementally to age 60, as per the following table. The process will be fully phased-in by 2025.

Date of Birth	Preservation age
Before 1/7/60	55
Between 1/7/60 and 30/6/61	56
Between 1/7/61 and 30/6/62	57
Between 1/7/62 and 30/6/63	58
Between 1/7/63 and 30/6/64	59
After 30/6/64	60

If you were born before 1 July 1960, your preservation age remains at age 55.

ACCESS TO MEMBER COMPONENT

As from 1 July 1999, when you leave the MSBS you will not be able to take your member component *in full* as a lump sum.

From then on, all contributions you make (and any interest accrued) must remain in the Fund until you reach your preservation age.

Contributions made and interest accrued before that date will still be available as a lump sum on exit.

CHOICE OF FUND

From 1 July 1998, employers will be required to give new employees 28 days to choose between five (or more) complying super funds or Retirement Savings Accounts (RSAs) nominated by the employer.

For existing employees, employers must provide a similar choice within two years of the date of effect of the legislation.

This requirement only applies to funded schemes (i.e., those where the employer contributions are paid at the same time as the member contributions). The Government is yet to decide how this

arrangement will apply to the largely unfunded MSBS.

TAX REBATE ON SUPER CONTRIBUTIONS

The Government announced a tax rebate on savings, which also applies to super contributions.

The rebate will be available to people who make personal (undeducted) member superannuation contributions and/or who earn net personal income from savings and investments. It will be available in respect of super contributions and/or income up to an annual cap of \$3000. It will be phased in at a rate of 7.5% on income earned from 1 July 1998 (maximum \$225), rising to 15% from 1 July 1999 (maximum \$450).

For more details, call the Tax Office, on 13 28 60.

EARLY RELEASE OF BENEFITS

If you resign and go overseas to live, you cannot withdraw your employer component before reaching your preservation age.

The Government also announced changes concerning early release of employer benefits on financial hardship or compassionate grounds.

The test for *financial hardship* is now a simple, objective one, based on evidence that you have received specified Commonwealth income support payments for a continuous period of 12 months (or 9 months if you're aged 55 or over). For MSBS members, this is administered by ComSuper under delegation from the Board.

Defined criteria for the release of benefits on *compassionate* grounds have also been introduced. This is administered by the Insurance and Superannuation Commission (ISC).

If you want more information on the 1997 Budget changes, ask your pay office for a copy of **Military Super News No.18.**

THE MSB *Board*

The Military Superannuation and Benefits Board No. 1 consists of five Trustees appointed by the Minister for Defence Industry, Science and Personnel. The Minister nominates two members, two are nominated by the Chief of the Defence Force (CDF), and there is an independent chairperson.

The current Board membership is:

Chairperson: **Mr Charles Kiefel**¹
Mr Kiefel is a director of ANZ Securities Limited, and is experienced in providing advice to a number of multinational corporations and governments.

Minister's Nominees: **Mr Patrick Gourley**
Mr Gourley is First Assistant Secretary, Defence Personnel Executive, Dept of Defence.

Mr Peter Skinner²
Mr Skinner is Deputy Commissioner for Superannuation.

CDF Nominees: AIRCDRE **Nick Ford**³
AIRCDRE Ford is Director General Financial Conditions, Defence Personnel Executive

WOFF **Robert Swanwick**⁴
WOFF Swanwick is a RAAF Loadmaster currently working in the Directorate of Workforce Planning (Air Force).

Notes

- 1 Mr Kiefel was appointed to the Board as Chairman on 11 July 1997. The previous Chairman, Sir William Cole, resigned in April 1997.
- 2 Mr Skinner was alternate to Mr Ken Searson, who resigned from the Board in February 1997. He is an acting member of the Board pending the appointment of a permanent replacement for Mr Searson.
- 3 AIRCDRE Ford replaced AVM Frank Cox, who resigned in July 1997.
- 4 WOFF Swanwick has been nominated to replace wo David Sutherland RAN, whose appointment ended in September 1997.

ADMINISTRATIVE STRUCTURE



need more information?

If you want to know more about your super scheme, read *The MSBS Book*, which has just been updated and reprinted. If you'd like a copy, ask at your pay office. They should also be able to help you with any general information about your super that you need to know about.

If you need specific information regarding your super entitlements, call ComSuper's Information Line:

(02) 6252 6178

or send a fax to: **(02) 6252 6878**

or write to: **The Secretary**
MSB Board
PO Box 22
Belconnen ACT 2616

If you are unhappy with any decision or action by the Board or its administrator (ComSuper), you may write to:

The Complaints Officer
ComSuper
PO Box 22
Belconnen ACT 2616

The *Superannuation Industry (Supervision) Act 1993* requires us to resolve your complaint within 90 days of receiving it.

Generally, if we can't sort out your complaint in 90 days, or if you're not satisfied with the outcome of our reconsideration, you can lodge a complaint with the Superannuation Complaints Tribunal, an independent tribunal set up by the Commonwealth Government. The address is:

Locked Bag 30360
GPO Melbourne VIC 3001
phone: 13 14 34
or fax: (03) 9248 5170