

THE MSB FUND



Annual Report to Members

STEADY PERFORMANCE CONSOLIDATES GAINS

The MSB Fund earned a 7.7% return on its investments in 1997-98.

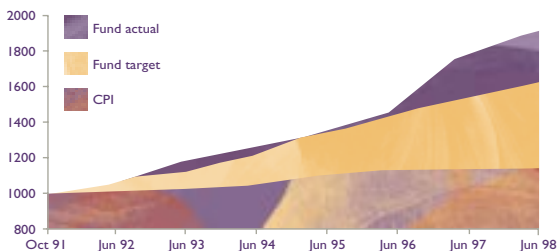
Returns reflect a year notable for the varied performance of financial markets around the world. Compared to a very strong year in 1996-97 which saw the Fund earn 20.6%, investment performance over the 1997-98 year was hampered by a number of factors. The financial crisis in Asia triggered falls in most Asian sharemarkets and currencies. Commodity prices such as gold and oil were similarly affected. Between Australia's strong trade links to the region and falling commodity prices, the Australian sharemarket returned only 1.6% - its lowest for ten years.

The Fund's relatively low allocation to the Australian sharemarket helped contain negative effects. Other investment markets fared better, including the

property sector and the Australian bond market. The Fund's high proportion of property allocation helped offset the poor results in Australian shares.

International shares delivered the strongest result with the Fund returning 40% in this sector. Again, the Fund was well positioned to take advantage of this with a comparatively high allocation of resources to this sector.

The Fund has maintained its high level of returns over the rolling five year period. For the past five years the Fund has averaged a crediting rate of 10.2%, compared to an inflation rate of 2.0% and a Fund target rate of 7.0% (inflation plus 5%). An investment of \$1,000 in the Fund in October 1991 when it opened would have grown to around \$1,882 by June 1998. By comparison, if it had grown at the MSBS earning target of inflation plus 5%, it would be worth \$1,596.



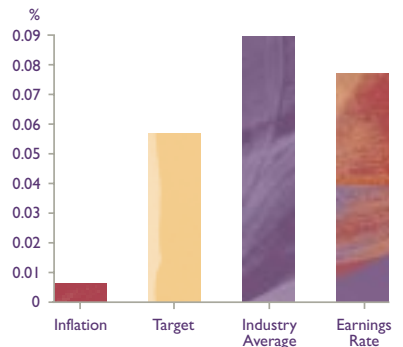
This graph shows how an investment of \$1,000 placed in the Fund when it opened in October 1991 would have grown until the present day.

AT A GLANCE

CREDITING RATE 8.7%

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

The Earning Rate is the Fund's investment earnings after taxes and fees are deducted. The earning rate for 1997-98 was 7.7%. Please see page 6 for a complete explanation of crediting and earning rates.



Fund performance

Inflation is the increase in the cost of living as measured by the 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, drawn from the Intech Performance Survey of Market-Linked Pooled Funds, June 1998.

IMPORTANT CHANGES TO YOUR SUPER

Changes have been made by the Government to legislation affecting all superannuation funds. Please see page 2 for full details.

IMPORTANT CHANGES TO YOUR SUPER

SCHEME CHOICE

You may have heard of the Government's choice of fund provision, announced in the 1997 Budget. These provisions require employers to give staff a choice of four or more funded superannuation schemes. At the time of the announcement it was unsure how this would affect the MSBS, a largely unfunded scheme. It has since been established that as an unfunded defined benefit scheme which exceeds current Superannuation Guarantee requirements, the MSBS is not currently required to meet the fund choice requirements.

PRESERVATION CHANGES

As previously announced, the minimum age from which you can access your superannuation benefits without restriction is to be increased for those born after 1 July 1960. This change applies to all Australian superannuation schemes. The table below shows how the change is being phased in. You will not be able to access your productivity benefit or the employer component of your MSBS benefits lump sum until you have reached at least your preservation age, previously age 55 for those affected by this change.

Member benefit preservation

Changes to the Superannuation Industry (Supervision) regulations have now been made to implement the enhanced preservation requirements announced in the 1997 Budget.

Complementary changes are to be made to the MSBS Rules. Once implemented

these changes will mean that from 1 July 1999 if you leave the ADF before your preservation age, access to the member component of your MSBS benefit before that age will be restricted to the value of member benefit available at 30 June 1999.

Any contributions you make to the scheme after that date, any interest earned on those contributions and any interest earned on the value of your member component as at 30 June 1999 are required to be preserved in a fund of your choice and cannot be accessed as a lump sum until you have reached your preservation age.

If you leave the ADF on or after age 55 and have not reached your preservation age, you will be able to take your benefit in the form of a full pension or part pension with the lump sum portion of the benefit being preserved in a fund of your choice until you reach your preservation age. Similar conditions apply to members who have chosen to preserve their benefits in the MBS Fund.

This change was announced by the Government in the 1997 Budget. It affects all superannuation schemes in Australia, not just the MSBS.

Early release provisions

There have been a number of changes to early release provisions during the year. MSBS preserved benefit members may be able to access some of their preserved employer benefit provided the circumstances are consistent with a number of guidelines developed by the Australian Prudential Regulation

Authority (formerly the Insurance and Superannuation Commission).

Financial hardship

An MSBS preserved benefit member, but not a contributor, can now apply to the Trustees for access to part of his or her preserved employer benefit on financial hardship grounds, provided that:

- the member has been in receipt of prescribed income support payments for a continuous period of over six months; and
- the member is unable to meet reasonable and immediate family living expenses; and
- the amounts being released do not exceed \$10,000 in any 12 month period.

Compassionate grounds

Separate conditions apply to release of superannuation benefits on compassionate grounds, generally in situations where substantial medical expenses are involved.

In some circumstances early release of a limited amount of preserved benefit may also be granted on compassionate grounds to allow a member to make a payment on a loan to prevent loss of his or her principal place of residence.

Applications for benefits on compassionate grounds are received and processed by the Australian Prudential Regulation Authority.

Permanent relocation overseas

Until 30 June 1998, it was possible for superannuation benefits to be released

ACCESS TO LUMP SUM BENEFITS

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

where a person had taken up residence overseas on a permanent basis. This provision has now been removed.

TAX SURCHARGE FOR HIGHER INCOME EARNERS

You will be aware that from 20 August 1996 the Government introduced a Tax Surcharge on superannuation accruals for higher income earners. The MSBS Rules have now been altered to allow affected members to choose to have a surcharge debt discharged by way of a deduction from the final benefit. Members also have the option to make payments from their own resources at the time the debt is incurred.

The surcharge is administered by the Australian Taxation Office (ATO). If you are affected by it you will receive separate advice from the ATO. ComSuper will also contact affected members with information about their surcharge debt. Further information about the operation of the surcharge can be found at ComSuper's internet site, www.comsuper.gov.au

Important note: If you have not supplied your Tax File Number (TFN) in connection with the surcharge or related superannuation matters, you may incur a surcharge debt until your number is provided regardless of your level of income. Please contact ComSuper or your unit pay office if you haven't already authorised the release of your TFN.

TAX REBATE ON SUPER CONTRIBUTIONS

In the 1997 Budget, the Government announced a rebate of up to \$225 for members for the financial year 1998-99 in respect of undeducted contributions made to the MSBS and/or personal income derived from savings and investments. For 1998-99 it is proposed the rebate will be phased in at the rate of 7.5% of the first \$3,000 of contributions and income so earned. From 1 July 1999 it is proposed the maximum rebate will be \$450.

INTEREST RATES FOR MEMBERS LEAVING THE SCHEME

During each year the Board sets a rate of interest to apply to the accounts of members who exit the Scheme. This rate of interest is used to calculate total interest from the previous 1 July to the date of exit. This is called the exit rate.

In 1998 the Board decided that with effect from 1 July 1998 the exit rate would be calculated each month rather than every three to four months as was previously the case.

The new policy ensures the exit rate more accurately reflects the exiting member's share of actual investment performance earnings for the period from the previous 1 July to the date of exit.

A monthly setting of exit rates means that fluctuations (both positive and negative) in the exit rate will tend to be greater at the beginning of the year than with quarterly changes. In times of low investment performance there is a chance a negative rate of interest could be set. However the Board's investment policy is geared to minimise this risk and the rate would still reflect the exiting member's share of actual investment performance earnings.

PHASING IN

Prior to 1 July 1998, if you resigned from the ADF before completing seven years of service, your entitlement to the unfunded component of your employer benefit was phased in according to your length of service. The funded component, your 3% productivity benefit, was not subject to the phase-in provision.

The phase-in provision has now been removed. Members exiting on or after 1 July 1998 with less than seven years' service will now be entitled to receive the full amount of employer benefit.

ADDITIONAL CHANGES

Other changes to the Scheme rules include:

- a provision to ensure that a member's benefit is preserved by default where

he or she has failed to make an election to either claim the member benefit or preserve it in the MSBS Fund within three months of leaving the ADF;

- a change to allow invalidity classifications to be determined prior to retirement as well as after;
- an amendment to enable full recovery of the employer contribution where a member is on leave without pay for the purposes of engaging in employment outside the ADF.

FUTURE CHANGES

A discussion paper has recently been circulated by the Government on the treatment of superannuation following dissolution of marriage. The paper explores the options for the division of superannuation and puts forward proposals to establish a regime for the division to operate from 2000. No decisions have yet been taken. Changes to the MSB legislation will be needed to give effect to any decision reached.

QUICK SUMMARY OF CHANGES TO YOUR SUPERANNUATION

- Superannuation surcharge for higher income earners
- Tax rebate on superannuation contributions by members
- MSBS not required to meet scheme choice arrangements
- New rules governing the age at which members have access to components of their superannuation
- New rules on early release of preserved benefits
- Phase-in of accrual of full employer benefit for members with less than seven years' service removed
- Exit rates to be set on a monthly basis to accurately reflect members' share of actual investment earnings

MANAGEMENT AND PERFORMANCE

The Fund's investment policy is geared to produce good growth returns over the long term. For a Fund with a large proportion of young members, this strategy of long term gain is the best way to maximise returns over the years you spend in the Defence Force. The better the Fund performs while you are in the Defence Force, the larger your member benefit is when you leave.

The unsettled market is expected to continue into the 1998-99 financial year as the full extent of the economic slow down in Asia emerges. The most important investment strategy in the current environment is one of long term discipline and a broadly diversified portfolio of investments. While the Fund strives to remain competitive with comparable superannuation funds, our primary objective is to achieve or surpass our long term investment target without incurring excessive risk.

In an investment market such as this, it is tempting to follow the short term flows into particular markets. However these flows can push prices up significantly, and investing too much in a small number of markets, even if they have performed well recently, is risky. The best way to achieve good returns over time is with a spread of investments. This method also offers protection against markets which, having moved strongly in the past, may retrace their steps in the future. For a comprehensive description of the Board's investment policy, please see the Investment Policy booklet, which is available from the ComSuper office or internet site.

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

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

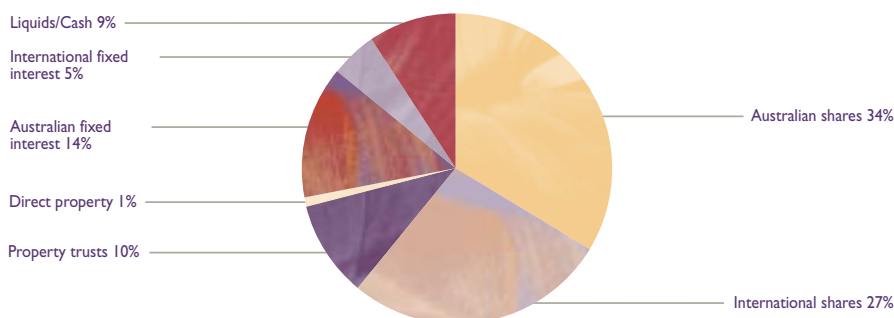
Following its January investment review, the Board opted to make certain changes to its fund managers. We terminated our arrangements with BT, Paladin and Macquarie. New contracts were signed with Tower and Axiom with effect from the beginning of March 1998. These decisions were made to take advantage of current market trends and maximise our returns.

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

FUND PERFORMANCE

SECTOR	EFFECTIVE EXPOSURE AT 30/6/97		EFFECTIVE EXPOSURE AT 30/6/98		PERFORMANCE 1997/98	
	SM	%	SM	%	FUND	BENCHMARK
Australian shares	211.2	36.4	242.5	33.9	-1.9	1.6
International shares	117.8	20.3	149.6	20.9	40.0	42.1
Property trusts	61.4	10.6	73.0	10.2	9.2	10.0
Direct property	5.4	0.9	6.2	0.9	9.0	10.2
Australian fixed interest	74.8	12.9	100.6	14.1	10.4	10.9
International fixed interest	22.6	3.9	36.0	5.0	10.9	11.2
Liquids/cash	87.0	15.0	107.3	15.0	3.8	5.1
Total fund	580.2	100.0	715.2	100.0	7.7	8.9

EXPOSURE AS A PERCENTAGE OF THE FUND



FUND PERFORMANCE

SECTOR	TYPE	FUND MANAGER	PHYSICAL EXPOSURE AT 30/6/98		RANGE	BENCHMARK 1997/98
			SM	%		
Australian shares	Active	Portfolio Partners	105.7	14.8%	27%-47%	ASX All Ordinaries Accumulation
	Active	Tower	136.8	19.1%		
International shares	Active	Wellington	108.1	11.9%	15%-35%	MSCI World ex Australia
	Core	Barclays Global Investors	107.3	15.0%		
		Currency Hedge	-9.8			
		Option Overlay	-13.3			
Property trusts	Active	Axiom	73.0	10.2%	5%-18%	ASX Property Trust Accumulation
Direct property	Direct	Commonwealth Funds Mgt	6.2	0.9%	0%-18%	AMP P Unit
Australian fixed	Core	Westpac	100.6	14.1%	5%-25%	SBC WDR Composite Bond
International fixed interest	Active	Credit Suisse	35.9	5.0%	1%-15%	JP Morgan Hedged Global Bond
Liquids/cash	Core	Morgan Stanley	64.7	9.0%	0.5%-20%	SBC WDR Bank Bill
Total			715.2	100.0%		

NB: New Managers – Tower (Macquarie) and Axiom (Paladin)
 NB: Currency Hedge & Option Overlay included in the International Equity

FURTHER INVESTMENT

INFORMATION

MASTER CUSTODIAN

The Fund's Master Custodian is Morgan Stanley Australia Limited. 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 FUND ASSETS

At 30 June 1998 there were no single investments comprising more than 5% of total Fund assets; nor did any combination of assets in a single entity comprise more than 5% of total assets.

INDEMNITY INSURANCE

The Board is insured with AMP General Insurance Limited 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 paid by the Department of Defence 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 sector, and the investment style (i.e. active or passive) employed by each manager.



FINANCIAL

SUMMARY

VALUE OF FUND AT 1 JULY 1997		\$576.9M
Inflow		
Contributions		\$124.6M
Investment earnings		\$56.9M
Outflow		
Benefits paid		\$46.8M
Investment and other expenses		\$3.7M
Taxation		\$11.0M
Value of Fund at 1 July 1998		\$696.9M
ASSETS AND LIABILITIES AT 30 JUNE 1998		
Assets		
Investment		\$710.8M
Other		\$15.0M
Liabilities		
Liabilities		(\$28.9M)

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 unaudited annual financial statements prepared by ComSuper in respect of the operations of the Fund. Fully audited financial statements will be included in the MSBS 1997-98 Annual Report to Parliament and are available on request from ComSuper, or from the ComSuper internet site, www.comsuper.gov.au.



CREDITING RATE AND PERFORMANCE

The annual crediting rate represents the rate at which fund earnings are attributed to members' accounts. It is determined at the end of the financial year and is based on the Fund's investment performance after allowance for fees, charges and administrative costs. Because of this allowance, the crediting rate can differ from the return on the Fund's investment performance.

It is industry practice to calculate the rate of return and the Fund's performance on a time weighted basis, which minimises the effect of the flow of money throughout the financial year in order to measure the performance of fund managers equitably. The Fund's accounting records and financial statements, on the other hand, are calculated on a money weighted basis, which takes into account the full impact of the amount and timing of cash flow during the year. This provides an accurate measure of the rate of growth.

Differences between the two methods will always occur, but these are usually insignificant. However, in 1997-98, the MSB Fund experienced low rates of return in the first half of the year, which were then countered by very strong performance and considerable inward cash flow in the second half. This unusual pattern of growth has enabled the Board to declare a crediting rate for 1997-98 which, at 8.7%, is higher than the return achieved on investment performance alone.

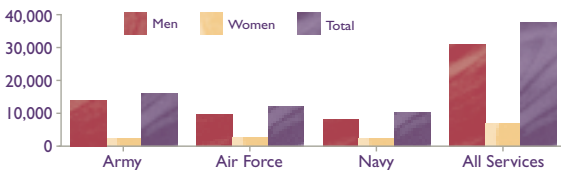
INTEREST RATES SINCE 1993-94

YEAR	EARNING RATE	CREDITING RATE	INFLATION
1993-94	9.0%	5.4%	1.7%
1994-95	6.3%	5.8%	4.5%
1995-96	9.0%	9.0%	3.1%
1996-97	20.6%	20.0%	0.3%
1997-98	7.7%	8.7%	0.7%
Five year average	10.4%	9.7%	2.0%

MEMBERSHIP

DETAILS

MEMBERS AT 30 JUNE 1998*



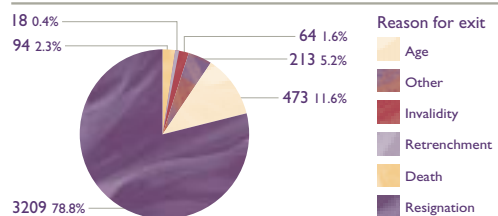
PENSIONS IN FORCE AT 30 JUNE 1998*



PRESERVED BENEFITS AT JUNE 1998*

TYPE	NUMBER	VALUE
Member Benefit	1,603	\$22.8M
Employer Benefit	27,260	\$829.1M
Total	28,863	\$851.9M

CONTRIBUTOR EXITS IN 1997/98*



* These figures are based on preliminary data subject to confirmation.

CHANGES TO THE SCHEME ADMINISTRATION

Change to ComSuper's funding base

As a Budget funded agency, ComSuper has been responsible for the provision of administration services for the MSBS.

ComSuper will in future contract with the Department of Defence for the provision of administration services. To give effect to these new arrangements ComSuper has been established from 1 July 1998 as a Business Unit operating under the Financial Management and Accountability Act.

Seamless transition

Throughout the changes to ComSuper, the MSBS and the superannuation industry as a whole, the MSB Board will maintain its high level of service to members.

New Client Service Charters, changes to our computer systems, surveys of client satisfaction and development of an Internet site are just some of the ways we will monitor service delivery and keep you informed and up to date.

Surcharge implementation

The Superannuation Contributions Tax (Assessment and Collection) Act 1997 requires superannuation providers to report surchargeable contributions for all MSBS members to the Australian Taxation Office (ATO) on an annual basis. The legislation applies a tax on employer financed contributions, specifically targeted at high income earners, and imposes a surcharge of up to 15 per cent on a member's surchargeable contributions, provided the member's adjusted taxable income is greater than the surcharge threshold.

Collection of Tax File Numbers

When reporting surchargeable contributions to the ATO ComSuper was required to include the member's Tax File Number (TFN). Members have been requested to authorise release of their TFN held on their employer's payroll system. Once authorised, the TFN was transmitted electronically to ComSuper as part of normal superannuation contribution transactions.

Client survey results

An extensive customer service survey was carried out by Orima Research during the year. Contributors, preserved benefit members and retired members were surveyed on ComSuper's performance and their level of satisfaction. A Quality Service Index (QSI) was developed to measure the results.

Over the four survey periods, ComSuper averaged 83 points out of a possible 100. Survey results have been incorporated into ComSuper's continuous improvement process and changes made to processes and procedures as a result. Additional surveys will be carried out next year as part of a regular program.

Year 2000 issues and management

You may have heard of the so-called 'millennium bug'. This refers to problems which can arise from some means of representing dates in computer systems.

The Trustees will be closely monitoring this activity to ensure that members' superannuation records and payments will not be affected.



MSBS BENEFITS

Regardless of how you leave the Defence Force, you or your dependants are 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 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. The better the Fund performs over your years in the Defence Force, the greater your lump sum member benefit will be when you leave.

Your employer benefit

This will make up the majority of your total MSBS benefit. It increases each year independently of the return achieved by the Fund. It is calculated by multiplying your Final Average Salary (FAS) by a factor derived from your length of service.

Your employer benefit must be preserved in the Scheme when you leave the Defence Force (except under exceptional circumstances). Generally, it is not available until you retire from the workforce at or after your preservation age. 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). Pensions payable are fully indexed and calculated using conversion factors that are very favourable compared to those generally available in the marketplace. For instance, an accrued MSBS benefit of \$150,000 can be converted to a fully indexed pension of \$12,500 per annum upon retirement at age 55 or \$13,600 pa at age 60. You would need approximately \$220,000 to purchase equivalent pension benefits in the general market.

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 Chairman, appointed after consultation with the Minister for Finance and Administration. Ministerial Trustees hold office at the Minister's pleasure, while other Trustees are appointed for a fixed period not exceeding three years.

Trustees Air Vice Marshall Frank Cox AO and WOFF Dave Sutherland left during the year and were replaced by AIRCDRE Nick Ford and WOFF Robert Swanwick. Mr Michael Sharpe AM was appointed in place of the Commissioner for Superannuation. The current Board membership comprises:

Chairman: Mr Charles Kiefel

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, Department of Defence.

Mr Michael Sharpe AM

Mr Sharpe is a retired partner with Coopers & Lybrand and has held many Government and professional appointments including Chairman of the International Accounting Standards Committee from 1995 to 1997.

CDF Nominees: AIRCDRE Nick Ford

AIRCDRE Ford is Director General, Financial Conditions, Defence Personnel Executive.

WOFF Robert Swanwick

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



From left to right: Mr Michael Sharpe, WOFF Robert Swanwick, Mr Charles Kiefel (seated), Mr Patrick Gourley and AIRCDRE Nick Ford.

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 whose Annual Member Statement is returned to us without a forwarding address.

If you have become a lost member because you don't claim your benefit, we will treat your benefit as if you had elected to preserve it. It will stay in the Scheme 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 Member 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.

NEED

MORE INFORMATION

If you would like to know more about your super scheme, read *The MSBS Book*, recently updated and reprinted. Your pay office can provide you with a copy.

They should also be able to help you with any general information about your super that you need to know. For specific information about our investment policy, please see the *MSB Fund Investment Policy* booklet, available from ComSuper.

If you need specific information regarding your superannuation entitlements, you can contact ComSuper:

Telephone: (02) 6252 6178

Facsimile: (02) 6252 6878

Post: The Secretary

MSB Board

PO Box 22

Belconnen ACT 2616

Internet: www.comsuper.gov.au

If you are unhappy with any decision or action of the Board or 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. If we can't sort out your complaint in 90 days, or if you're not satisfied with the outcome, you can lodge a complaint with the Superannuation Complaints Tribunal, an independent tribunal set up by the Commonwealth Government. Their address is:

Locked Bag 3060

GPO Melbourne VIC 3001

Telephone: 13 14 34

Facsimile: (03) 9248 5170