

PSS

94 ~ 95

annual report to members



from the PSS Board • Issued September 1995

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THE YEAR IN BRIEF

- **SCHEME TITLE:** With effect from 1 July 1995, the name of the Commonwealth Superannuation Board of Trustees No. 1 was changed to the PSS Board, and the name of the Public Sector Superannuation Fund was changed to the PSS Fund.
- **NEW TECHNOLOGY:** The project to redevelop ComSuper's computer system, ComSAS, was approved by Government and commenced in early 1994. The ComSAS system is designed to improve client service and the maintenance of contributor records. It is expected to be in operation by 1 July 1996.
- **ANNUAL CREDITING RATE:** The Board declared an annual crediting rate (the rate of interest credited to members' accounts) for 1994-95 of 7.2%, which is 1% higher than last year's rate.
- **CHANGED INVESTMENT ARRANGEMENTS:** The arrangement whereby Commonwealth Funds Management Limited (CFM) was the sole investment manager for the PSS expired on 30 June 1995. A new approach called **Total Risk Management** has been developed in conjunction with CFM and will be implemented throughout 1995-96.

In order to protect against losses, liabilities, actions, claims or demands arising from the performance of functions under the Scheme's legislation, the Board has taken out indemnity insurance with AMP General Insurance Limited.
- **FUND INVESTMENT:** Although there was considerable fluctuation in financial market returns during the year, the PSS Fund returned 7.4% after fees and taxes, and so exceeded inflation by 2.9 percentage points.
- **CONTRIBUTIONS AND BENEFITS:** Superannuation contributions totalling \$267.8m were received into the Fund during the year, comprising \$173.3m in member contributions and \$94.5m in productivity contributions. Benefits amounting to \$135.8m were paid from the Fund to members who left the PSS during the course of the financial year. The PSS pension liability at 30 June 1995 was \$12.2m per annum.
- **NEW LEGISLATION:** With the lodgement of an election under section 19 of the *Superannuation Industry (Supervision) Act 1993* (SIS), the Fund became a SIS regulated Fund for the 1994-95 financial year.

Many aspects of the Scheme design and administration have been modified in order for the PSS to fully satisfy the SIS Regulations. These changes are outlined in the following article.

NEW SUPER LEGISLATION

On 30 November 1993, a package of seven bills, known collectively as the Superannuation Industry (Supervision) legislation (SIS), became law. The SIS Regulations have been designed to safeguard superannuation investments and to ensure that the superannuation industry operates in a fair, honest and open manner.

CHANGES TO THE SCHEME

With the lodgement of an election under section 19 of the SIS Act, the PSS became a SIS regulated Fund for the 1994–95 financial year. This means that the Scheme must comply with all the standards set out in the SIS Regulations from the date of the election, on 29 June 1995.

In order to receive favourable tax concessions for 1994–95, the Fund must have satisfied the fund conditions under the *Superannuation Entities (Taxation) Act 1987* (formerly known as the *Occupational Superannuation Standards Act 1987*) up until the date of election to become a regulated superannuation fund under SIS, on 29 June 1995. In future years the Fund will have to comply with SIS requirements. The Board has received a compliance certificate from the Insurance and Superannuation Commission for the 1993–94 financial year. It anticipates receiving a compliance certificate for the 1994–95 financial year.

There are some aspects of scheme design and administration that must be modified in order for the PSS to fully satisfy the SIS Regulations. Some of the changes have already been made, while others will be brought in at later dates.

NAME CHANGES

With effect from 1 July 1995, the name of the Fund under the 1990 Act was changed to the PSS Fund, and the name of the Commonwealth Superannuation Board of Trustees No. 1 changed to the PSS Board.

The PSS Trust Deed has been reformatted to make it easier to read and the PSS Rules have been extensively rewritten in a 'plain English' style.

PRESERVED BENEFITS

Changes have been made to the PSS Rules to ensure compliance with the *Superannuation Industry (Supervision) Act 1993* (SIS) and Regulations.

In particular, with effect from 1 July 1996, the amount that may be paid immediately as a cash lump sum on any form of exit other than on age grounds, is the greater of:

- the member's contributions to the Fund (without interest);
- the amount that would have been paid to the member if he or she had resigned on 1 July 1996, indexed according to changes in average weekly ordinary time earnings; or
- the amount that would have been paid to the member if he or she had been retrenched from employment on 1 July 1996, indexed according to changes in average weekly ordinary time earnings.

The balance of the benefit will have to be preserved in the Fund. Special provisions for the earlier release of funds will still operate if hardship can be demonstrated.

The age on which a member may claim the preserved employer-financed lump-sum benefit may be extended. Although the relevant legislation has not yet been introduced into Parliament, the Government proposes that, from 1 July 1996, the preservation age for employer-financed superannuation benefits will be gradually increased, so that by 2025 most benefits will be preserved in the Fund until the member reaches the age of 60—instead of age 55, as the current rules provide. These proposed preservation changes would not affect anyone born before 1 July 1960. Those members would still be able to claim employer-financed lump-sum benefits on retirement from the workforce on or after age 55.

STATE SUPER MEMBERS AND THE 'TEN YEAR RULE'

The service of all state public sector superannuation scheme members, compulsorily transferred to the Commonwealth, will count towards the 'ten year rule'.

The 'ten year rule' states that for a 10-year period of membership (not necessarily a continuous period or the first 10 years of membership) the employer's maximum share of the benefit is based on the member contributing an average 5% each year.

So, if a member contributes (on average) more than 5% of salary for that 10-year period, he or she will not receive any employer-financed benefits for those contributions made above 5%.

Rules have also been made to deal with the maintenance of salary for superannuation purposes where workplace bargaining supplements exist.

TRANSFER VALUES

In a further change to the Rules, amounts transferred into the Fund after 31 December 1995 will be payable, together with interest, solely as a lump sum on cessation of membership.

No longer will there be an option to take the amount transferred as additional PSS pension. Also, a transfer amount will not be taken into account in establishing when the member reaches his or her maximum benefits in the Scheme (at which time employer-financed benefits cease to accrue).

An amount transferred to the PSS will thus be treated in the same manner as an amount preserved outside the PSS—for example, in an Approved Deposit Fund, and it will not affect other PSS benefits.

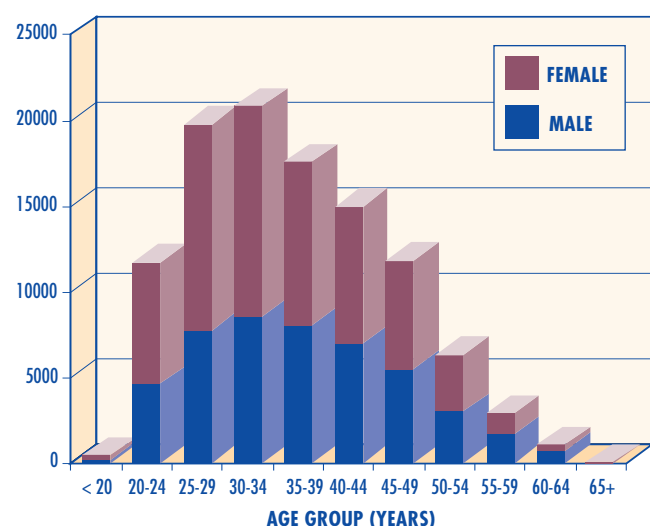
SCHEME ADMINISTRATION

MEMBERSHIP

At 30 June 1995, there were 107 434 members of the Public Sector Superannuation (PSS) Scheme—60 426 females and 47 008 males. The age and gender profile is shown in Chart 1.

During the year there were 11 743 new entrants to the PSS, and 8888 members left the Scheme, resulting in a net population increase of 2855 (2.6%).

CHART 1. PSS MEMBERSHIP, BY AGE AND GENDER, 30 JUNE 1995



CONTRIBUTIONS

Contributions received during the year \$267.8m

less:

Benefits paid from the Fund during the year (\$135.8m)

Net contributions flow, 1994–95 \$132.0m

SCHEME EXITS

Most (59.5%) of the 8888 members who left the PSS in 1994–95 did so through resignation, while 35.7% of the Scheme's members exited by involuntary retirement. The invalidity retirement rate remained low with only one in every hundred exiting members leaving for this reason.

REASON FOR EXIT	NUMBER	%
Age retirement	268	3.0%
Involuntary retirement (retrenchment)	3 171	35.7%
Resignation (including preservation)	5 290	59.5%
Invalidity retirement	109	1.2%
Death	50	0.6%
Total	8 888	100.0%

PENSIONS IN FORCE

At 30 June 1995, there were 1050 pensions in force, incurring an annual pension liability of \$12.2m. These pensions are paid from Consolidated Revenue.

TYPE OF PENSION	NUMBER	ANNUAL LIABILITY (\$'000)
Age	250	2 995.5
Invalidity	218	3 358.0
Involuntary retirement (retrenchment)	423	4 796.5
Spouses & orphans	159	1 013.2
Total	1 050	12 163.2

FUND INVESTMENT

CHANGED INVESTMENT ARRANGEMENTS

The arrangement whereby Commonwealth Funds Management Limited (CFM) was the sole investment manager for the PSS expired on 30 June 1995.

The Board and CFM, with the assistance of specialist consultants, have been reviewing the PSS investment policy since early 1993. A result of the review has been the development of an innovative approach to investment management called Total Risk Management. This approach, which includes overall risk management, portfolio structure, manager selection, and client reporting for the Board, will be provided by a subsidiary company of CFM called Total Risk Management Pty Ltd which will serve as the agent of the Board.

The Total Risk Manager's role is to establish an active link between all elements of the investment disciplines, from setting objectives to asset and income allocation. This approach enables the Total Risk Manager to comprehensively monitor, assess and manage investment risks being undertaken by the PSS Board.

The Total Risk Manager ensures that only appropriate risk is taken to enhance returns. This simply means that the Fund has a better chance of achieving its investment objectives.

In general terms, core investment will be undertaken by CFM and will be determined by the Total Risk Manager. Non-core investment, including risk management overlays, will be undertaken by external specialist active managers.

Core portfolios (which make up, on average, around 60% of the moneys in the Fund) are those invested with the intention of earning at least the market return in a risk controlled approach.

Non-core investments (the rest of the moneys in the Fund) are those managed by several specialist managers who are expected to produce better than average market returns. The non-core investments will be subject to higher levels of risk from time to time.

The address of the Fund's Investment Manager is:
CFM Ltd, 12 Moore St, Civic, ACT 2600

PSS INVESTMENT POLICY

INVESTMENT OBJECTIVES

The Board's objective for the Fund is to provide members with a satisfactory level of retirement benefits by maximising real returns on the accumulation fund subject to a tolerable level of shorter-term volatility.

The investment objective is to achieve the Fund objective through the maximisation of long-term real returns subject to:

- a requirement that annual crediting (and exit) rates are not negative;
- less than a 20% probability that nominal Fund returns will be negative in any year;
- more than a 60% probability that the rate of interest credited to members' accumulated contributions will exceed the rate of increase in the Consumer Price Index by 3% in any given year; and
- at least a 70% probability that the rate of interest credited to members' accumulated contributions will exceed the rate of increase in the Consumer Price Index in any given year.

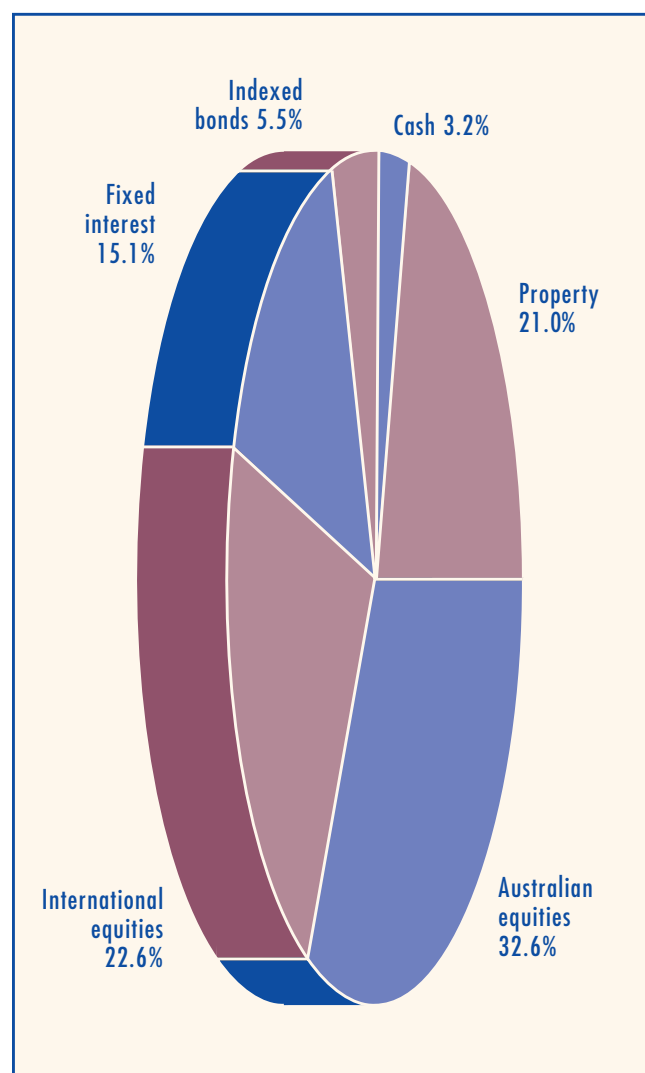
THE BENCHMARK PORTFOLIO

The Board's investment policy nominates a strategic benchmark investment portfolio against which the Fund's performance can be measured. The benchmark portfolio assumes that fixed proportions of the Fund are invested in the major asset classes, with the investment performance of each asset class being compared to market indices. The benchmark portfolio was reviewed early in the year. The benchmark portfolio and the sectoral indexes are shown in Tables 1 and 2.

INVESTMENT STRATEGY

The investment strategy has been developed based on a long-term view of the expected behaviour of asset sectors. The Board considers that the Fund should continue to follow a long-term investment strategy and not be unduly influenced by short-term performance results. Observing the return of the Fund over a one-year period may give a misleading indication of the Fund's performance. Observing the Fund performance over two and three years gives a much more realistic view.

CHART 2. FUND COMPOSITION, AT 30 JUNE 1995



The Board will continue with its policy of broad diversification of investments to lessen the impact of short-term movements, while still capturing growth from these markets. Fund managers will carry out the day-to-day investment decisions, and provide a further level of diversification. They will be closely monitored by the Board and the Total Risk Manager to ensure investment objectives are met.

The Board's investment policy is still being refined and a new Investment Policy Statement will be available once finalised.

INVESTMENT PERFORMANCE

The performance of financial markets during the financial year can be characterised in two distinct periods. In the first six months, market returns were predominantly hampered by rises in short-term interest rates both in Australia and the United States.

Strong consumer demand and surging economic activity resulted in monetary policy being tightened in an attempt to moderate the rate of growth towards a more sustainable level. This impacted negatively on both equity and bond markets which recorded weaker returns during this period.

In the second half of the financial year, economic growth in Australia and internationally, particularly in the United States, has slowed down noticeably due to the impact of rises in short-term interest rates. This slowdown in growth has been particularly positive for bonds and equities which have produced stronger returns over this period.

Although there was considerable fluctuation in the financial markets during the year, the Fund returned 7.4% after tax and fees. All investment sectors recorded a positive result.

International equities and Australian fixed interest were the best performing sectors for the year. A weaker Australian dollar accounted for half of the return from overseas equities.

The Australian dollar declined due to slowing economic growth, uncertainty about the Federal Budget's passage through the Senate, and poor current account deficit outcomes.

The Australian bond market posted a strong return for the year. Positive factors for the market were a low underlying inflation environment, slower economic growth, declining global bond yields (particularly in the US) and an improving Federal Government fiscal position.

SECTORAL PERFORMANCE

TABLE 1. SECTORAL PERFORMANCE

ASSET CLASS	VALUE OF ASSETS				TARGET PORTFOLIO	BENCHMARK 1994-95 PERFORM- ANCE (AFTER TAX) %	PSS FUND 1994-95 PERFORM- ANCE (AFTER TAX) %
	at 30/06/94		at 30/06/95		Current target		
	\$m	% of Fund	\$m	% of Fund	%		
Property ¹	319.6	21.1	365.5	21.0	22.0	9.5	6.9
Australian equities	443.2	29.3	569.5	32.6	33.0	5.0	4.6
International equities	313.2	20.7	393.5	22.6	22.0	12.0	10.3
Fixed interest	319.8	21.1	263.1	15.1	16.0	10.0	9.5
Indexed bonds	88.2	5.8	96.4	5.5	5.5	8.9	7.5
Cash	30.0	2.0	55.8	3.2	1.5	6.0	5.8
Total Fund	1 514.0	100.0	1 743.8	100.0	100.0	8.8	7.4

1. The PSS direct property strategic exposure is expected to be reduced to 15% in a staged manner by 1998-99.

TABLE 2. THE INDEXES AGAINST WHICH THE FUND'S SECTORAL PERFORMANCE IS MEASURED ARE:

Australian equities	Australian Stock Exchange All Ordinaries Accumulation Index
International equities	Morgan Stanley Capital International World Index (ex Australia) in \$A with net dividends reinvested
Property	Unweighted average of AMP and National Mutual property returns
Fixed interest	SBC Composite Bond Index (All Maturities)
Indexed bonds	SBC Inflation Linked Bond Index
Cash	SBC Bank Bill Index

THE BOTTOM LINE...

The Board's primary investment objective (outlined on page 4) seeks to maximise the return on investments within a context of exceeding inflation and maintaining positive crediting rates.

Key results for 1994-95 are:

- the annual crediting rate is 7.2% which exceeded the inflation rate by 2.7%;
- the exit rate from 1/7/95 is 7.2%; and
- at the end of the year the balance in the Reserve Account was approximately \$10m.

These results demonstrate the solid achievements of the Fund in exceeding the parameters set down in the Board's investment policy. That policy is a long-term one, and is continually being monitored and fine-tuned in response to market conditions and the long-term needs of PSS members.

INTEREST RATES

IMPORTANT NOTE ON INTEREST RATES

The earnings rate and the annual crediting rate differ because they reflect different aspects of the Fund. The earnings rate reflects Fund investment performance for the year (after tax and management fees); while the annual crediting rate reflects how much can be credited to members' accounts, given Fund size, growth from investment and cash flows, such as benefits paid and contributions received.

ANNUAL CREDITING RATE

With every superannuation contribution you make, your stake in the Fund grows—and that stake grows further every year as it earns interest. Each year, the Board declares an **annual crediting rate** of interest that is credited to your accumulated

contributions for the financial year just completed.

The annual crediting rate for 1992–93 was 8.3%

The annual crediting rate for 1993–94 was 6.2%

The annual crediting rate for 1994–95 was 7.2%

In brief, the annual crediting rate is calculated after determining the investment earnings of the Fund for the year. Necessary adjustments for taxes, fees and transfers to or from the Reserve Account are made in accordance with a predetermined formula. The balance of Fund earnings is then converted into a percentage, which becomes the **annual crediting rate**.

The methodology for the calculation of the annual crediting rate and exit rate has changed as a part of the review of the Board's investment policy. Further details will be included in the new Investment Policy Statement which is currently being refined. Members will be informed once it becomes available.

THE RESERVE ACCOUNT

The Board is prevented by legislation from declaring negative annual crediting rates, which means that members are guaranteed a return of their contributions plus interest, if interest is payable. One way for the Board to ensure the maintenance of this guarantee would be to pursue a conservative investment policy with no risk of capital losses. However, the Board would prefer to be able to credit members' accounts over the long term with higher rates than are available under such a policy.

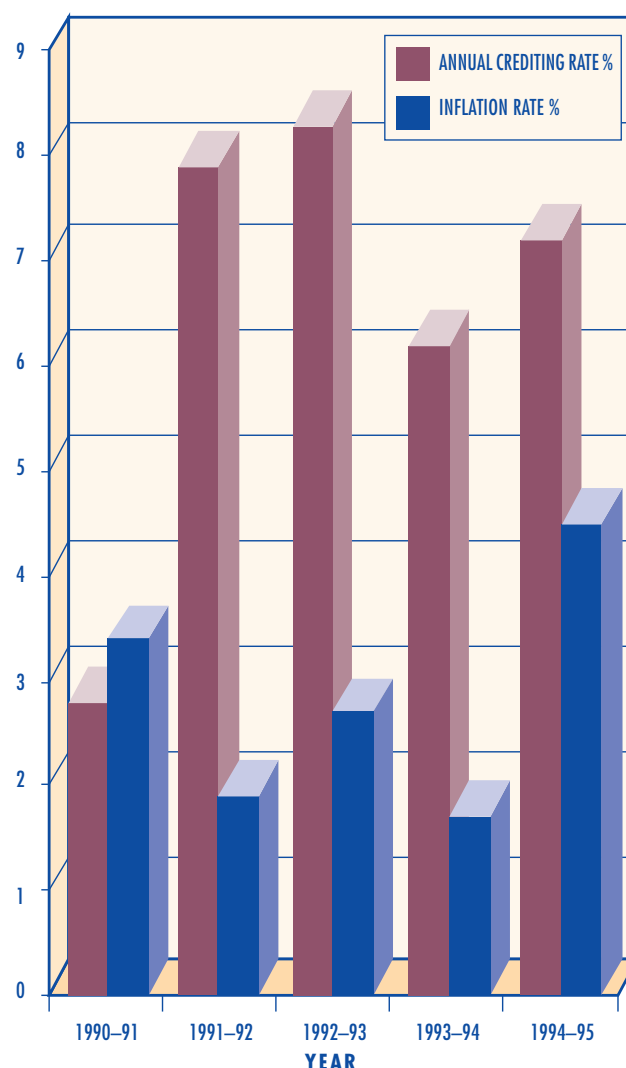
Accordingly, the Board has adopted a more growth oriented investment strategy, implying a higher probability of short-term fluctuations in asset values (including the possibility of negative earnings) linked with a Reserve Account. Such a policy enables annual crediting rates to be smoothed by transfers to and from the Reserve Account. Independent actuarial advice indicated that this approach could generally be expected to produce long-term annual crediting rates around 2% per annum higher than if a more conservative investment policy was pursued.

Chart 3 shows that Fund annual crediting rates have consistently exceeded the inflation rate over the years. (The inflation rate is the percentage change in the June-to-June CPI indexes).

BUT REMEMBER...

The annual crediting rate only affects the member-financed component of your superannuation benefit and the productivity component. The benefit payable at retirement is a defined amount which grows in accordance with your length of service, salary and your contribution rate, and consequently is not dependent on the investment earnings of the Fund.

CHART 3. ANNUAL CREDITING RATES COMPARED WITH INFLATION



EXIT RATES

The exit rate is the rate of interest that is applied to your accumulated contributions if you leave the Scheme before the next annual crediting rate is declared and take your accumulated contributions out of the Fund. The current exit rate is 7.2%, which is the interest rate that would apply if you were to leave the PSS in the immediate future. It would apply to your accumulated contributions between 1 July 1995 and your date of exit.

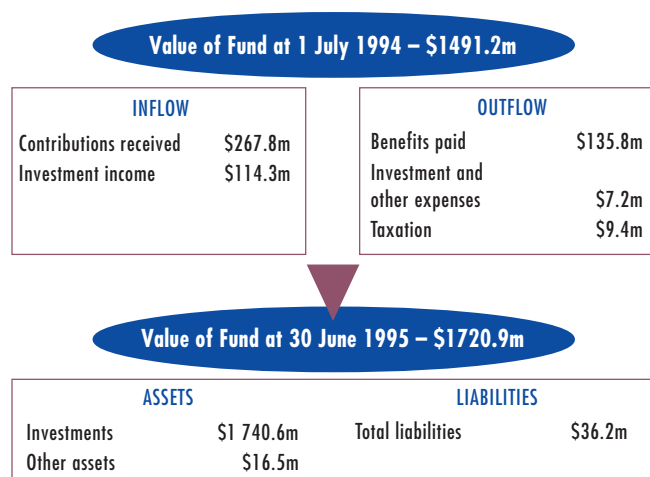
The exit rate is adjusted throughout the year to reflect changing investment conditions, and each new exit rate applies from 1 July 1995 to your date of exit.

FEES AND CHARGES

The amount available for distribution to members represents the net income from investment activities less Fund management fees, income tax and other expenses directly related to the operation of the Fund. The administrative costs in respect of the operations of ComSuper are met from Budget appropriations and are not a charge against the Fund.

FINANCIAL NOTES

CHART 4. FINANCIAL SUMMARY



The 'Value of the Fund' shown in Chart 4 includes all investment and non-investment assets, and is net of total Fund liabilities. Therefore it differs from the 'Value of Assets' shown in the table on page 5.

INVESTMENT EARNINGS FOR THE LAST THREE YEARS (AFTER TAX, INVESTMENT FEES AND OTHER EXPENSES)

1992–93	(combined PSS/CSS Fund) \$89.5m
1993–94	\$60.5m
1994–95	\$97.7m

IMPORTANT NOTE

The above figures are taken from the annual financial statements currently being prepared by ComSuper in respect of the operations of the Fund. Those financial statements have not yet been audited. Fully audited financial statements will be included in the Board's 1994–95 annual report to Parliament and will be available from ComSuper in November.

Copies of that report will also be available in your organisation's library, or at AGPS bookshops.

AUDIT QUALIFICATIONS

In previous annual reports the Board has reported on the major project to redevelop the computer systems used by ComSuper.

The computer systems in question are outdated and unable to cope with the demands placed on them by superannuation in the 1990s. In the past these shortcomings have resulted in the Board having its financial statements qualified by the Auditor-General.

The project to redevelop ComSuper's computer systems was approved by Government and commenced in early 1994. This is an enormous undertaking and the project is still proceeding, with completion expected early in 1996.

However, to minimise the risk of audit qualifications during the

redevelopment phase, ComSuper has implemented a highly detailed and structured process for undertaking the work required for the preparation and audit of financial statements and for monitoring progress against set milestones. This process was initiated with the assistance of officers of the Australian National Audit Office and has been successful during the past two years in removing all major areas of audit concern.

A major objective of the Board's Audit Committee was to monitor this process progressively during the year and to assure itself that all reasonable efforts were made by the administrator to minimise the risk of qualifications pending the completion of the computer systems redevelopment project.

THE BOARD OF TRUSTEES



The PSS Board consists of five members—two ACTU nominees, two employer nominees, and an independent chairperson. All are appointed to the Board by the Minister for Finance. The ACTU nominees and the chairperson are appointed for three-year terms, but are eligible for reappointment. The employer nominees hold office 'at the Minister's pleasure'. The Minister may terminate an appointment of a Trustee. However, a Trustee appointed by the Australian Council of Trade Unions can only be terminated with the ACTU's consent.

(standing) Pat Barrett, David Leaver, Ken Searson (seated) John Flitcroft, Ron Brown, Michele Dawson (Secretary)

MR RON BROWN (Independent Chairperson)

Appointed 25 July 1990; reappointed from 1 July 1993 to 30 June 1996. Mr Brown is a consultant to both State and Federal governments, and is currently a member of several government and semi-government boards and commissions. He is also Chairperson of the CSS Board.

MR KEN SEARSON (Employer Nominee)

Appointed 8 April 1992. Mr Searson is the Commissioner for Superannuation and Chief Executive Officer of ComSuper. He is Chairman of the DFRDB Authority, a member of the CSS and the MSB Boards, and a member of the Federal Council of the Association of Superannuation Funds of Australia (ASFA).

MR JOHN FLITCROFT (ACTU Nominee)

Appointed 1 July 1990; reappointed from 1 July 1993 to 30 June 1996. Mr Flitcroft is a member of the CPSU, and is employed by the Department of Veterans' Affairs. He is also a member of the CSS Board.

MR DAVID LEAVER (ACTU Nominee)

Appointed 1 July 1990; reappointed from 1 July 1993 to 30 June 1996. Mr Leaver is manager of the Australian Bureau of Statistics Microsimulation project. He is a member of the CPSU, and is also a member of the CSS Board. He is also the Chairperson of the Audit Committee and a member of the Reconsideration Advisory Committee.

MR MICHAEL HUTCHINSON (Employer Nominee)

Appointed 22 June 1995. Mr Hutchinson is a newly appointed Deputy Secretary of the Department of Finance and a member of the CSS Board. He is also a member of the Audit Committee.

MR PAT BARRETT AM (Employer Nominee)

Appointed 1 July 1990; resigned 2 May 1995
Mr Barrett resigned in May 1995 and was replaced by Mr Michael Hutchinson.
The Board Secretary is Ms Michele Dawson, Director of ComSuper's Secretariat Section.

KNOW YOUR SUPER SCHEME

Superannuation is a major element of your employment package. The benefits you receive when you leave the Scheme will largely determine your lifestyle in retirement. So, the more you know about your super, the better equipped you will be to make the important decisions about your future.

With that in mind, the Board is keen to ensure that you have full access to information about your contributions, your prospective benefits, the management of Fund investments, and anything else that affects your super entitlements.

YOUR PSS ENTITLEMENTS

If you want to know more about your PSS entitlements, read *The Super Book* which is available from your Personnel Section and is given to all new members when they join the PSS Scheme.

ComSuper also issues monthly superannuation newsletters and has distributed leaflets on a variety of topics related to your superannuation benefits to Personnel Sections. Personnel also have a Ready Reckoner computer disk which you can use to calculate prospective benefits using your Information Statement details.

If Personnel can't answer your questions, call ComSuper's Telephone Information Service on (06) 252 7708, or send a fax to (06) 253 1116.

BOARD ISSUES

For information on the management and performance of the Fund, or for copies of:

- the 1994-95 audited financial statements (including the Auditor-General's report);
- OSSA compliance notices for the last three years; and/or
- the PSS Trust Deed and Rules—

write to:

Michele Dawson
The Secretary
PSS Board of Trustees
PO Box 22
Belconnen ACT 2616

Phone: (06) 252 6698 or (06) 252 5268
Fax: (06) 252 6948