



STATE SUPER
SAS Trustee Corporation

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ANNUAL REPORT

2005/06

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Report to the Minister

October 2006

The Hon. Michael Costa, MP
Treasurer
Governor Macquarie Tower
Level 39
1 Farrer Place
SYDNEY NSW 2000

Dear Minister

We have pleasure in submitting to you for presentation to Parliament the annual report of the SAS Trustee Corporation, covering the period 1 July 2005 to 30 June 2006.

The annual report contains the report for the SAS Trustee Corporation, the SAS Trustee Corporation Division of the Government Service of NSW and the Pooled Fund. These have been prepared in accordance with the provisions of the *Annual Reports (Statutory Bodies) Act 1984*, the *Public Finance and Audit Act 1983*, associated regulations and Treasurer's Directions.

We look forward to working with you during the coming year and wish to note our appreciation for the support and interest that your predecessor has shown in our activities.

Yours sincerely



Michael Cole
Chairperson
SAS Trustee Corporation



Ian Blair
Board Member and Chairperson of the
Audit and Compliance Committee
SAS Trustee Corporation

Part A – About the SAS Trustee Corporation

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Charter

SAS Trustee Corporation is a body corporate constituted by the *Superannuation Administration Act 1996*.

It is trustee of the STC Schemes which are:

- the State Authorities Superannuation Scheme (SASS),
- the State Superannuation Scheme (SSS),
- the Police Superannuation Scheme (PSS), and
- the State Authorities Non-contributory Superannuation Scheme (SANCS).

Its principal functions are to:

- administer the STC Schemes,
- invest and manage the fund of the STC Schemes,
- provide for the custody of the assets and securities of the STC Schemes,
- ensure Scheme benefits are properly paid, and
- determine disputes under the Schemes.

Mission

To support the future well being of NSW Government employees and their families by the productive delivery of superannuation benefits with optimal investment returns and member service.

Glossary:

Board means the Trustee Board of the SAS Trustee Corporation, appointed under the *Superannuation Administration Act 1996* and comprising an independent chairperson, four employee representatives and four employer representatives.

Executive means the executive staff of the SAS Trustee Corporation.

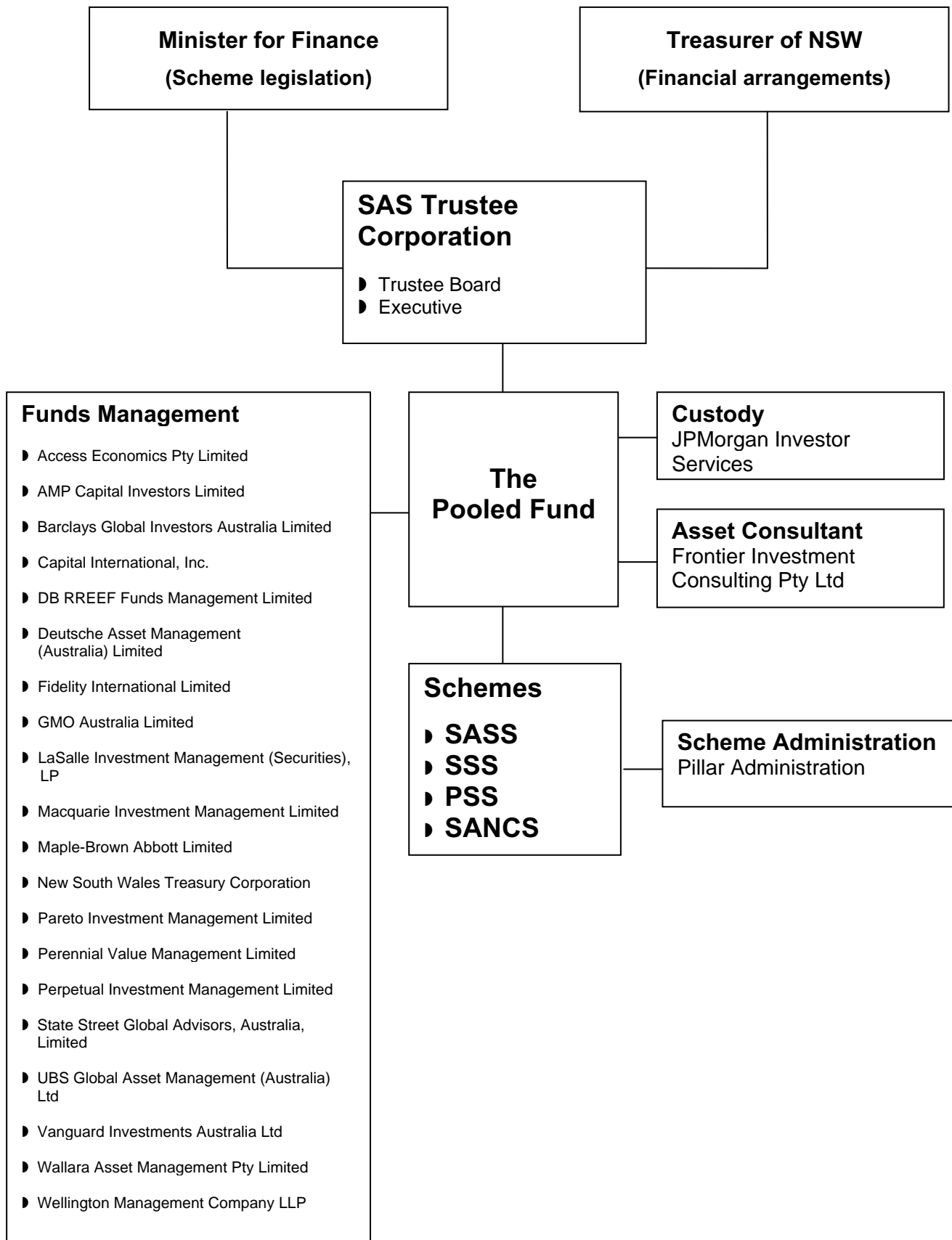
Pooled Fund or **Fund** means the Pooled Fund of the STC Schemes.

STC means the SAS Trustee Corporation.

This STC *Annual Report 2005–06* is on our website, www.statesuper.nsw.gov.au The accounts of the Pooled Fund's Controlled Entities may be obtained on request from the STC (see outside back cover for contact details). The accounts of the Controlled Entities have been separately tabled in the NSW Parliament.

Organisation structure

at 30 June 2006



Chairperson's report

The 2006 financial year was another busy year with activity across all areas of the fund, including investment, member services and legislative change.

Investment

Driven by strongly performing global equity markets, the Pooled Fund again posted strong investment returns for the year in all investment options, resulting in the following declared rates:

Growth	15.8%pa.
Balanced	11.4%pa.
Conservative Growth	8.1%pa.
Cash	4.9%pa.

For the Growth strategy, where over 99% of the Pooled Fund's accounts are invested, this result marked the third consecutive year of double digit returns and an above median investment performance for the three year period.

Following a period of strong investment returns, it is timely to encourage SASS members who have a choice of investment strategy for the accumulation part of their benefit to seek professional investment advice so that their investment portfolio selection best meets their retirement needs.

Member Services

Services to members continue to be improved with a number of major initiatives introduced during the year:

- a new website was implemented, with an updated design and improved navigation to make the site easier for members to use;
- in conjunction with Pillar Administration, administrative procedures continue to be streamlined to provide a higher level of service to members; and
- 20% of contributing members had a Commonwealth Co-contribution payment credited to their benefit.

Legislative Changes

While the Pooled Fund Schemes are closed and membership numbers are declining, there continues to be significant legislative change that impacts on the Schemes. The State legislative changes are outlined later in this report and primarily affect SASS and PSS members.

In addition, the Commonwealth Budget in May proposed sweeping changes to the taxation of superannuation especially for members of taxed funds, such as the STC Schemes. While these proposals have not yet been enshrined in legislation, members are strongly encouraged to seek professional financial planning advice on the impact of these changes on their personal situations and planning.

In conclusion, I extend my thanks to both the Board Members and the Executive for their support in the management of the Pooled Fund and the STC Schemes. In particular, I would like to acknowledge the outstanding service of Mr Rod Macleod, who announced his retirement after 30 years service in the investment management of the State's superannuation funds.

I also welcome to the Board Ms Anne De Salis, who replaces Ms Ouma Sananikone. Ouma made a strong contribution as a Trustee but has now relocated overseas.



Michael Cole
Chairperson
October 2006

Board members' profiles

Michael Cole, Chairperson, had a 17 year career with Bankers Trust Australia as a Director/Executive Vice-president in both the Investment Bank and Funds Management divisions. At various times executive responsibilities included Head of Fixed Interest/Capital Markets/Structured Finance, Credit, Stockbroking and Retail Funds Management. In September 2001, he was appointed a Director of the New South Wales Treasury Corporation. Michael is a member of the General Government Liability Management Fund, Ministerial Corporation, Management Committee. He is also the Chairman of Ironbark Capital Limited and a Board Member of IMB Ltd.

Ian Blair (Employer Representative) is a Chartered Accountant and a Company Director, holding a Master of Management degree from Macquarie University. Before joining the Trustee Board, Ian completed a long career with accounting firm Deloitte Touche Tohmatsu, including a five year term as CEO of the firm. He is also a Director of IOOF Holdings Ltd, Melbourne Business School Ltd, Sisters of Charity Health Service Ltd and Capral Aluminium Ltd. Ian has been active in local government and community organisations and received an Order of Australia Medal in 1987 for his services to the community.

Ron Davis (Employee Representative) is the full-time employee representative on the Trustee Board, a position he has held since 1 January 2002. Ron was previously a Valuation Manager with the State Valuation Office. He is a Central Councillor with the Public Service Association and immediate past president of the Professional Officers' Association. He also represents members as a delegate to Unions NSW's Public Sector Employees' Superannuation Committee. Ron is a member of the Australian Institute of Superannuation Trustees, a Fellow of the Association of Superannuation Funds of Australia (ASFA), and the Chair of ASFA's NSW Division Executive Committee. He is also a Director of State Super Financial Services Australia Limited.

Anne De Salis* (Employer Representative) is on the boards of the NSW TAFE Commission, the Superannuation Funds Management Corporation of South Australia, as well as the Council of the University of Canberra and the Vet Science Foundation of Sydney University. Anne has a diverse career spanning both the public and private sectors, which has included experience as a non-executive director since 1996. For more than 12 years, Anne worked in senior executive/director positions with AMP Limited and MBF Australia Limited. Prior to this, she enjoyed several years as Senior Adviser to the then Prime Minister, Rt Hon Paul Keating. She joined the Keating office from the Commonwealth Treasury, where she worked as an economic adviser in Canberra.

Rod Harty (Employee Representative) is an Advocate and Legal Advisory Officer for the Police Association of NSW and a consultant to the Police Federation of Australia. Rod also represents Police as a delegate to Unions NSW's Public Sector Employees' Superannuation Committee. Rod has post-graduate qualifications in Workplace Relations and Labor Law and has a broad public sector background in human resource management and business services.

Michael Lambert (Employer Representative) is an Executive Director in the Corporate Finance Department of the global investment bank, ABN AMRO. Previous to that Michael was the Secretary of the New South Wales Treasury and held various other senior positions. He has extensive experience and expertise in financial analysis and advising governments and clients on financial and strategic issues. In addition Michael is a non-executive Director of Energy Australia and Queensland Racing. Michael has a Bachelor of Economics (Honours) and Master of Economics from Sydney University.

Nick Lewocki (Employee Representative) is Secretary of the Rail, Tram and Bus Union. Nick spent his early career with the NSW Railways Department before being elected to a full-time union official's position in 1979. From 1990 he worked with Unions NSW for 6 years as an Industrial Officer responsible for a range of industries. Nick is a Director of the NSW Trades Hall Association and Australian Industrial Skills Futures Pty Ltd. As Secretary of the Union, he has overall responsibility for industrial agreements and their certification before the industrial tribunals which affect over 15,000 members.

Board members' profiles continued

Maree O'Halloran (Employee Representative) is the President of the NSW Teachers Federation and was appointed to the Trustee Board on 1 September 2002. Her union experience includes numerous roles in the Teachers Federation as well as being an Executive member of Unions NSW. Her teaching career spans city and country schools as well as TAFE and Corrective Services. She is admitted as a legal practitioner in NSW and has practised as a solicitor. She is currently a Board Member of the legal firm, MacMahon Associates and of Teachers Federation Health. She was previously a Board Member of the Blue Mountains Community Legal Centre. Maree is also a contributing author of an HSC Legal Studies textbook.

Paul Scully (Employer Representative) is a Director of Decision Horizons, a consulting enterprise through which he offers his services based on 30 years of experience in financial services and investment management. Paul is an actuary by training and was until July 2003 Chief Executive Officer for the Asia Pacific region of ING Investment Management and a member of its global board. Paul has held executive positions in life insurance and retail funds management. He now maintains a portfolio of non-executive directorships and consulting assignments.

*Appointed to the Trustee Board as from 1 February 2006.

Not included: Ouma Sananikone (Employer Representative), who retired from the Trustee Board on 31 January 2006.

Executive management team

Up to December 2005, STC had a commercial arrangement with the FSS Trustee Corporation to share the costs of investment personnel. This arrangement was terminated in January 2006. STC now operates autonomously and there are no longer any cost sharing arrangements with FSS Trustee Corporation.

Details of STC's senior management team as at 30 June 2006 are set out below:

Don McLean – Chief Executive Officer

Mr McLean's main focus is to ensure that the Trustee Board receives expert professional advice on which to make its decisions. He joined STC as Chief Executive Officer in January 2003. Before that, he worked in the financial services industry for over 30 years, both as a senior executive in major retail fund management organisations and in consulting roles.

Lyn Collingridge – General Counsel and Company Secretary

Ms Collingridge joined STC in October 1998. Having worked in the industry since 1989, she is a superannuation lawyer with extensive experience in both the public sector and private practice. She is responsible for the delivery of secretarial services as well as advice on legal and compliance to the Trustee Board and the Executive.

Martin Drew – Chief Investment Officer

Mr Drew manages STC's investment advisory team that monitors all aspects of the investment management and performance of the Pooled Fund. This includes liaison with investment service providers, such as the asset consultant, investment managers and the custodian. Martin has a diverse career both in the public and private sectors spanning almost 10 years.

Karen Faulconbridge – Operations Manager

Ms Faulconbridge joined STC in March 2000 as Manager, Policy Advice. She took on the broader role of Operations Manager in July 2004 following a restructure of the Executive. Prior to her appointment to STC, she worked in the superannuation industry in the private and public sector for over 17 years. She is responsible for the management of operational areas, including administration and member communication.

Andrew Grice – Accounting and Administration Manager

Mr Grice joined STC in August 2004. He is a Chartered Accountant and has more than 10 years of superannuation work experience. Prior to joining STC, Andrew was an external auditor involved in the audit of several large entities, including superannuation funds. He is responsible for the accounting, actuarial and taxation functions within STC.

Review of 2005–06 year

STC's Objectives and Achievements for 2005–06

The objectives set for the 2005-06 financial year are set out below along with a summary of actions taken in pursuit of these objectives:

- *Review investment strategies in order to achieve the overall return and risk objectives of the Fund.*

The Board formally reviews the strategic asset allocation on an annual basis but it is constantly monitored throughout the year.

During the year, STC made a number of changes to the portfolio and managers, including:

- the implementation of a more flexible management of the currency position of overseas equities;
- the introduction of exposure to global listed property securities;
- a number of new mandates were awarded including share managers using long/short equity strategies. This provides diversification in both managers and management styles;
- a regular reporting of risk measures is being introduced;
- STC put to tender its asset consulting service. As a result of the tender process, Frontier Asset Consulting was appointed as the asset consultant.

Overall, STC has continued to increase the diversification of the Pooled Fund, both in asset sectors and management styles, with the objective of improving the overall risk/return characteristics of the portfolio.

- *Work with the Fund's Administrator to effectively and efficiently manage and improve services to members.*

Early in the financial year, STC negotiated new terms for an extension of the administration agreement with Pillar Administration. The new contract provides a better balance in the fixed and variable fee components.

Pillar Administration continues to exceed the service standards set out in the agreement. At the same time, Pillar, in conjunction with STC, is working on a range of initiatives that will further streamline processes and improve overall services to members.

In recent years, STC has introduced investment choice for SASS members and put in place the systems required to receive Co-contribution payments from the Commonwealth Government. Currently, STC and Pillar are working on the changes necessary to introduce salary sacrifice for SASS members following recent changes to the SASS Scheme's legislation.

- *Provide members with access to information on their benefit entitlements.*

STC offers to members a range of sources of information on their entitlements and the Scheme's benefits. These include:

- annual statements;
- a website, providing both general information on the Schemes and secure access to a member's details;
- seminars targeted at members approaching retirement. These are run in both metropolitan and regional centres and have been very well attended;
- personal interviews;
- Fact Sheets on the Schemes' Rules. These are available on the website or alternatively from Customer Service;
- SuperViews, which is a quarterly newsletter distributed to employers and unions;
- information in selected union publications.

In late May 2006, STC implemented a new website, which has a better design and significantly improved navigation around the site.

- *Ensure that the Board and the Executive operate both efficiently and in accordance with best practice governance principles.*

While the Pooled Fund Schemes are “exempt” funds regulated by NSW State legislation and not directly by Commonwealth superannuation legislation, STC endeavours to comply, where appropriate, with Commonwealth legislation. Consequently, developments in superannuation fund governance are monitored and incorporated, as appropriate, into STC’s governance and compliance procedures.

During the year, STC either reviewed its policies or documented its procedures in a wide range of areas, including Codes of Conduct and its Occupational Health and Safety Plan.

In 2005, STC undertook a comprehensive review of processes and procedures relating to claims for “Hurt-on-Duty” benefits in the Police Superannuation Scheme. The recommendations of the external consultant are now being implemented, involving working groups including representatives of the Police Service and Police Association.

- *Maintain strong working relationships with key stakeholders, including NSW Treasury and Premier’s Department.*

STC continues to work with both Treasury and Premier’s Department on key superannuation issues.

The introduction of the new accounting standards has been an area of frequent consultation with Treasury, as has reporting on investment issues. The Board has also made recommendations on legislative amendments that would improve the STC’s effectiveness in managing the Fund.

STC maintains a strong dialogue with Premier’s Department in relation to proposed legislative amendments that impact on members’ entitlements.

STC also maintains close relationships with its key service providers, notably its administrator, Pillar Administration and its custodian, JPMorgan Investor Services.

Scheme Membership

The STC Schemes are closed to new members. Consequently, the trends in membership numbers are highlighted by:

- active members, who contribute to the Schemes, declined from 93,075 to 87,062;
- relative stability in deferred members, as new deferrals are closely matched by deferred members taking their benefits;
- the number of pensioners continues to rise reflecting the aging of the active membership, with members in SSS reaching retirement age and taking their benefit in the form of a pension. Over the year, the number of pensioners increased from 48,937 to 50,061.

Generally, the movements in member numbers have been broadly in line with expectations. However, the number of members receiving Hurt-on-Duty benefits from the Police Superannuation Scheme continues at a high level, despite the rapidly reducing number of members. The number of applications received for these benefits in the 2006 financial year was 344, compared to 486 in the 2005 year and 217 in the 2004 year. In the 2006 year, this represented around 9% of the active membership.

Membership movements will be analysed in detail by the Scheme Actuary as part of the Triennial Actuarial Valuation, which is being carried out as at 30 June 2006.

Administration

STC's administration of member records is outsourced to Pillar Administration. During the year, STC negotiated an extension of this contract on terms which provide a better balance between fixed and variable fees.

The administration agreement sets out a range of service levels for the provision of the agreed services. Key service standards and the performance of the administrator under the new agreement from October 2005 to June 2006 are summarised below:

Service	Standard	2006 Achieved
Telephone Calls		
- answered within standard	90%	90%
- calls abandoned	<3%	1%
Correspondence		
- response within 15 days	95%	98%
Benefit Payments		
- lump sum payments within five days of receipt of all information	95%	96%
- payment of pensions on due date	100%	100%
Member Record Adjustments		
- within 5 days	95%	98%
Contribution Processing		
- within 5 days	95%	100%

Overall, the service levels achieved continue to exceed agreed standards.

Pillar Administration has embarked on a major project to streamline and improve business processes and procedures. During the 2006 financial year, a number of processes were streamlined and further improvements are scheduled for the 2006-07 year. A significant area of improvement has been the receipt of contributions from employers, where the new arrangements have been beneficial to both the administrator and employers.

Member Services

STC continues to provide a range of services, whereby members can obtain information on the Schemes or on their personal benefit entitlements. The trends in members' use of these services is set out in the table below:

Service	Member Contacts			
	2003	2004	2005	2006
Telephone Calls	142,437	130,344	126,885	126,683
Personal Interviews	4,698	4,691	4,540	4,276
Seminar Attendance	1,519	5,377	4,745	5,429
Correspondence				
- postal	8,259	6,916	7,821	6,404
- email	5,215	7,647	9,744	10,418
Total Contacts	162,128	154,975	153,735	153,210

While total membership has dropped by over 20% over the last four years, total member contacts have fallen by less than 6%, reflecting the increasing interest in superannuation issues as members approach retirement.

Since December 2003, active and deferred SASS members have a range of investment strategies available for the accumulation part of their benefit. The table below indicates the take-up of these strategies:

Investment Strategy	SASS Member Accounts as at 30 June	
	2005	2006
	\$m	\$m
Growth (default)	4,692.0	5,384.6
Balanced	74.4	89.3
Conservative Growth	32.0	31.4
Cash	19.2	17.0
Total	4,817.6	5,522.3

At this stage, only a small minority of members have made an investment election, with 2.5% of available funds outside of the default Growth strategy. However, since the new strategies were made available, the investment markets have been particularly strong, which is reflected in the strong performance of the default Growth strategy. In a lower return environment, a higher usage of the alternative strategies may be expected.

In the 2005 year, Commonwealth Government Co-contributions became payable. As members of the STC Schemes have paid contributions from their after-tax income, members with taxable incomes of less than \$58,000 qualify for this Commonwealth payment. Commonwealth Government Co-contributions received by the Fund have been:

Financial Year End 30 June	Amounts Received \$m	Members	Average Per Member \$
2005	4.578	9,514	481
2006	13.548	22,312	607

The significant increases in 2006 arose from the increases in the qualifying income threshold from \$40,000 to \$58,000 and in the maximum payment from \$1,000 to \$1,500. Overall, more than 20% of contributing members received a payment from the Commonwealth in the 2006 year.

Staff

At 30 June 2006, STC employed 21 staff.

Early in the year, STC shared its investment personnel, on a commercial arrangement, with FSS Trustee Corporation. However, from January 2006, all STC personnel have been engaged solely on STC business.

STC has continued its staff training program which is aimed at ensuring that relevant staff maintain up to date knowledge on superannuation issues and maintain competency levels in line with ASIC's PS146 requirements.

During the year, STC staff were offered the opportunity to have free influenza immunisations and 14 staff members accepted.

Corporate Governance

Compliance Framework

STC's formal compliance framework has been in operation since late 2005 and the Plans and Policies are documented. The STC Board receives ongoing reporting and actively participates in the monitoring process to ensure the adequacy of the Plans and Policies.

All the Plans and Policies are reviewed on a two year rolling basis or sooner if required.

STC's compliance requirements include:

- Policies and Plans that are required by NSW legislation for public sector agencies to develop and maintain;
- Plans and Statements that comply with APRA and ASIC requirements for regulated and licensed superannuation funds, the spirit of which STC attempts to conform with in order to ensure best practice;
- A comprehensive compliance checklist that identifies all STC's legislative (both Commonwealth and NSW) and contractual obligations is completed by the relevant responsible STC manager once a year and the results are reported to the Board;
- Formal annual verification from STC's outsourced service providers that they have complied with their contractual and legislative obligations during the year in relation to their services to STC.

Prudential Governance

The Pooled Fund is an exempt public sector superannuation scheme under the Commonwealth *Superannuation Industry (Supervision) Act 1993* (SIS). The SIS legislation treats exempt public sector superannuation funds as complying funds for concessional taxation and superannuation guarantee purposes.

In May 1996, the NSW Premier and the Commonwealth Treasurer signed a Heads of Government Agreement. Under that Agreement, the NSW Government undertakes to ensure that the Pooled Fund schemes will conform with the principles of the Commonwealth retirement incomes policy related to preservation, vesting and reporting to members and that members' benefits are adequately protected.

Amendments made to the Pooled Fund legislation in March 2004 enable the NSW Government to prudentially monitor and audit the Pooled Fund and the Trustee Board activities in a manner consistent with the prudential controls of the SIS legislation. These provisions are in addition to other legislative obligations on the Trustee Board and internal processes that monitor the Trustee Board's adherence to the principles of the Commonwealth's retirement incomes policy.

Investment Governance

The Trustee Board has formally adopted a Proxy Voting Policy in relation to its Australian shareholdings. This policy acknowledges that, in view of the limitation of STC's investment powers contained in the *Superannuation Administration Act 1996*, STC must delegate the voting function to its active Australian equities managers. Under the policy, managers are required to:

- vote on all resolutions at all meetings;
- lodge a copy of their voting policy with STC at least annually;
- report quarterly to STC on how they voted;
- where required, explain the reasons for the way they voted; and
- consult with STC when a potentially sensitive or controversial issue arises.

Legislative and policy review

2006 Commonwealth Budget

The 2006 Commonwealth Budget included significant changes to the Australian superannuation system. At the date of writing, the proposals have not been legislated. However, some of the announced changes have been amended following Commonwealth Government consideration of industry feedback. Unless otherwise noted, the proposals will take effect from 1 July 2007.

State Super Schemes are Taxed Schemes

It is important to note that SASS, SSS, PSS and SANCS are taxed superannuation schemes. The Commonwealth Budget proposals differentiate in treatment between taxed and untaxed schemes.

Undeducted Contributions

- If the Trustee does not have a member's **Tax File Number** on record by 30 June 2008, deductible contributions (employer and salary sacrifice) may be taxed at the highest marginal tax rate and the member's after-tax contributions may not be able to be accepted by the Fund.
- Between 10 May 2006 and 30 June 2007, a member can make up to \$1 million of after-tax superannuation contributions.
- From 1 July 2007, after-tax (undeducted) superannuation contributions will be limited to \$150,000 per annum – *there will be provision for a maximum contribution of \$450,000 every three years. Contribution caps will be indexed to Average Weekly Ordinary Time Earnings, subject to minimum increments of \$5,000.*

Employer (before tax) Contributions

- The current age based limits on employer superannuation contributions will be replaced with a universal limit of \$50,000 per annum per member. Employer contributions above \$50,000 per annum will be taxed at the highest marginal tax rate instead of the concessional rate of 15%. *(However, for Defined Benefit Schemes such as SASS, SSS, PSS and SANCS, discussions continue on how the notional employer contributions are to be calculated.)*
- Pre-tax contributions can be made until the age of 75 years – *the member must meet a work test when making a contribution after age 65 years.*
- **Salary sacrifice contributions are treated as employer contributions for the purpose of determining whether the employer contribution limit has been reached.**
- A five year transitional period will apply to members aged 50 and over to allow members planning for retirement to make pre-tax contributions of \$100,000 a year.

Benefits

- **Reasonable Benefit Limits** will be removed – this means that there will be no limit on the amount of superannuation a member can receive on a concessional tax basis.
- **From age 60 onwards**, superannuation benefits paid from a taxed fund (such as State Super Schemes) will not attract any tax – irrespective of whether the member takes a pension or a lump sum. *(Benefits accessed prior to age 60 remain taxable.)*
- **From 10 May 2006**, superannuation benefits can remain in a superannuation scheme even when the member is over age 65 years and not working.

Legislative and policy review continued

2006 NSW Legislative Amendments

The *Superannuation Legislation Amendment Act 2006* which was proclaimed on 30 June 2006 included the following minor amendments:

- ability for members of SASS, SSS and PSS, who are entitled to a pension, to nominate the date on which the pension payment is to commence. *(This is for Reasonable Benefit Limit reporting purposes. If the announcements in the 2006 Commonwealth Budget are legislated, this provision will not be necessary from 1 July 2007, as Reasonable Benefit Limits will be abolished.)*
- amends the SASS, SSS and SANCS legislation to enable Regulations to provide that the salary of an employee or class of employees is to be determined in the manner prescribed by the Regulations where the basis on which their remuneration is determined has been changed to an annualised basis.

Family Law Provisions

On 28 December 2002, Commonwealth legislation took effect allowing superannuation interests to be divided following the breakdown of a marriage. Commonwealth legislation provides the basis for valuing a member's superannuation entitlement for this purpose. However, trustees had the right to apply for an alternate valuation method. STC sought approval for alternative valuation methods.

The alternative valuation methods for SASS, PSS and SANCS were approved by the Commonwealth Attorney-General on 20 April 2006.

The SSS application is still under consideration. Once this application has been approved, Regulations to allow benefits to be split will be drafted.

SASS Salary Sacrifice

The *Superannuation Legislation Amendment Act 2006* included amendments to the SASS legislation to enable SASS members to pay their compulsory personal contributions as Salary Sacrifice contributions.

Salary Sacrifice contributions can be accepted from 1 April 2007. However, the member must make the Salary Sacrifice arrangements with his/her Employer.

If the Employer agrees, the member can choose to pay the personal contributions from:

- after-tax salary; or
- before-tax salary; or
- a combination of before-tax and after-tax salary.

Salary Sacrifice contributions are **subject to the 15% contributions tax** on entry to the Fund. This means that the contribution rate needs to be increased to cover the contributions tax, so that the member makes the same net contribution that the member would have made through after-tax contributions. For example, if the member elected to contribute at 6%, the member would need to contribute an additional 1.06% of salary on a pre-tax basis. (Formula: Contribution Rate ÷ 0.85).

Salary Sacrifice contributions:

- count towards the member's Reasonable Benefit Limit (*2006 Commonwealth Budget proposals include abolishing the Reasonable Benefit Limits from 1 July 2007*);
- are subject to tax on benefit payment (*2006 Commonwealth Budget announcements included a proposal to remove the tax on benefit payments if taken after age 60*);
- do not affect the salary used to calculate the member's superannuation benefits; and
- are counted in full towards the employer contribution limit (*2006 Commonwealth Budget proposals include removing the age based employer contribution limit*.)

Legislative and policy review continued

2006 Amendments to PSS Legislation

On 30 June 2006, amendments were made to the *Police Regulation (Superannuation) Act 1906* - this is the legislation which governs the Police Superannuation Scheme (PSS) which is the superannuation scheme applicable to Police Officers who joined the Police Force prior to 1 April 1988. The amendments were contained in the *Superannuation Legislation Amendment Act 2006*.

These amendments generally apply to events occurring on and from 30 June 2006.

1. Age and time limits for applications for Hurt on Duty pensions

A Hurt on Duty pension is not payable to a former PSS member who retired or resigned unless the former member's application for this benefit is received by Pillar Administration before the later of:

- the date on which the member reaches age 60; or
- 5 years after the member retired or resigned.

2. Age and time limits for increases in Hurt on Duty pensions

An increase in a Hurt on Duty pension is not payable unless the member's application for the increase is received by Pillar Administration PSS before the later of:

- the date on which the member reaches age 60; or
- 5 years after the member retired or resigned.

3. Amendments to Commutation Rights

(a) *Early and Normal Retirement pensions*

Prior to the 30 June 2006 amendments, a member's right to commute their retirement pension was confined to the date of retirement. There was also a requirement for the entire pension to be commuted.

The amendments now enable a member to choose how much pension to commute (i.e. all or part).

In addition, if the member retires between age 55 and 60, and does not commute any part of the pension at the time of retiring, a second opportunity to commute is provided at age 60.

Such elections to commute can be made between the age of 59 years 6 months and 60 years 6 months. The date of effect of the commutation is the day the member reaches age 60.

Notes:

Spouse pension entitlements are affected when a member commutes all or part of the retirement pension. The entitlement reduces in the same proportion as the member commutes the pension eg if 50% of the pension is commuted, the spouse is entitled to 50% of the spouse pension.

(b) *Incapacity pensions*

Age 55

Prior to 30 June 2006, members, in receipt of an incapacity pension, had the right to commute **all** of that pension at age 60.

The amendments now allow a member to commute **all or part** of the pension at the later of **age 55** or the date of commencement of the pension. (*The date of effect of the election is the date the member attains the age of 55 years or the date of commencement of the pension, whichever is the later.*)

Where a member does not commute any portion of the pension at those times, the member has a second right to commute at age 60.

Legislative and policy review continued

Age 60

Where the incapacity pension commences prior to age 60 and the member has not commuted any part of the pension at the first opportunity (age 55 or the pension commencement date, if later), the member again has a second right to elect to commute that pension between the age of 59 years 6 months and 60 years 6 months. *(The date of effect of the election is the day on which the member attains age 60.)*

Notes:

- 1. Spouse pension entitlements are affected when a member commutes all or part of the incapacity pension. The entitlement reduces in the same proportion as the member commutes the pension eg if 50% of the pension is commuted, the spouse is entitled to 50% of the spouse pension.*
- 2. If a member commutes the entire incapacity pension, the member does not have the right to apply for any pension increase.*

Transitional Arrangements

The legislative amendments also included transitional arrangements for members receiving an incapacity pension and aged between 55 and 60 years on 29 June 2006.

These members will have the right to elect to commute the whole or part of the incapacity pension with effect from 30 June 2006. This election must be received by the Administrator on or before 28 February 2007. **All such members were sent a letter from the Trustee in September 2006.** This provided details of the commutation rights.

Notes:

- 1. A member retains the right to elect to commute the incapacity pension at age 60 if no portion of the pension is commuted under the transitional arrangements.*
- 2. If a member commutes the entire incapacity pension, the member does not have the right to apply for any pension increase.*
- 3. Spouse pension entitlements are affected when a member commutes all or part of the retirement pension. The entitlement reduces in the same proportion as the member commutes the pension eg if 50% of the pension is commuted, the spouse is entitled to 50% of the spouse pension.*

4. Rehabilitation obligations where discharged after being Hurt on Duty

From 30 June 2006, if a member applies for a Hurt on Duty incapacity pension, the pension will not be paid if the Commissioner of Police decides that the member has not complied with a reasonable direction about participation in an injury management program approved by the Commissioner.

The legislation does not give the Trustee any discretion in relation to this matter.

5. Application for Incapacity Pension after resignation or retirement

From 30 June 2006, if a member applies for a Hurt on Duty incapacity pension after retiring or resigning from the Police Force:

- the member must demonstrate that the member was incapacitated at the date of exit from the Police Force; and
- the Hurt on Duty pension is payable from the date of application unless exceptional circumstances support payment from an earlier date.

Review of investments

(i) Investment Overview

Economic Environment:

The world economy has continued to expand at above average pace over the course of 2005–06 with contributions coming from the U.S., Europe, Japan and Asia. China and India continued to experience very strong growth, which has been reflected in strong prices for oil and base metals. This has created very favourable conditions for the Australian economy, which now appears to be operating with limited spare capacity. Both Western Australia and Queensland are experiencing boom conditions, whereas growth is more moderate in NSW and Victoria. The economic expansion has resulted in the jobless rate being at a 30 year low at 4.9%, which compares to 4.6% in the U.S and 7.9% among the 12 nations in the Euro Zone.

Limited spare capacity has raised concerns about inflation. In Australia, the Consumer Price Index rose by 4% for the year ended June 2006, which is above the target range of 2 – 3% used by the Reserve Bank of Australia. Similar concerns are evident across the world. To combat rising inflation, most central banks have been increasing interest rates over the past year. The US Federal Reserve has increased interest rates 17 times since mid 2004 from 1.0% pa. to 5.25% pa., with eight of these increases taking place during financial 2005–06. The Bank of Japan has also made a slight increase in interest rates (in July 2006), which was the first interest rate increase in over a decade. In Australia, there was only one interest rates rise in the financial year, when rates were increased from 5.5% pa. to 5.75% pa. in May 2006.

Australian Equities:

The Australian stock market experienced another strong year with the S&P/ASX300 Accumulation Index up by 24.0% for the year ended June 2006, which is the third year in a row that the investment return from Australian listed equities has exceeded 20%. Strong commodity prices boosted the returns from the Materials and Energy sectors, which were up by 49.8% and 34.9% respectively. The only sector to record a negative return for the year was the telecom sector.

International Equities:

Despite a weak fourth quarter, the year to 30 June 2006 was good for investments in international equities. The MSCI World index, which is used as a benchmark for international equities returned 15% on a fully hedged basis and 19.9% on an unhedged basis for the year. Although there was plenty of unfavourable news during the year, corporate earnings growth remained strong in the US, Europe and Japan, which underpinned business and consumer confidence. In addition, there was a surge in global merger and acquisition activity, which provided a boost to returns. On an unhedged basis the best returns during the 12 months ended 30 June 2006, were sourced from Europe ex UK (39.4%), emerging markets (30.2%) and the US (24.0%).

Property:

In the Australian market, the difference between listed and unlisted property returns was minimal. Unlisted property returned around 17% and listed property trusts returned 18.0% for the year. Globally it was an even stronger year for listed property trusts, which returned 21.6%, which was surprising given an environment of rising interest rates.

Fixed Interest:

It was not a good year for fixed interest investments, as fear of inflation and rising interest rates eroded returns. Both Australian and international fixed interest under-performed cash, which returned 5.8% for the year. Australian government bonds generated a return of 3.0% for the year, whilst international government bonds, fully hedged, just managed to generate a positive return of 0.9% for the year.

(ii) Investment Returns

SASS

Part of the benefits payable to SASS members are accumulation benefits, which are directly affected by the investment returns. These benefits include the Personal Account Balance and Commonwealth Government Co-contributions Account of SASS contributing members and the whole benefit of Deferred SASS members.

SASS members have a range of investment strategies which they may select for their accumulation benefit. These strategies are Growth, Balanced, Conservative Growth and Cash. The Growth strategy is the default strategy that applies if a SASS member does not make a choice. Earnings credited reflect the investment returns on the investment portfolio and consequently may be positive or negative.

For both SASS and Deferred SASS members, investment choice does not apply to the lump sum SANCS Basic Benefit, the Commonwealth Government Co-contributions Account and any superannuation guarantee shortfall amount.

SSS and PSS

Most benefits paid from SSS and PSS are defined benefits, which are not directly affected by the Fund's investment earnings. All moneys received in respect of SSS and PSS benefits are invested in the Growth Investment Strategy. This includes Deferred SSS and Deferred PSS benefits, as well as the lump sum SANCS Basic Benefit (including Commonwealth Government Co-contributions Account) and any superannuation guarantee shortfall amount. Member investment choice does not apply to any portion of SSS and PSS benefits.

The declared rates in recent times are set out in the table below:

Year Ended 30 June	Growth	Balanced	Conservative Growth	Cash	CPI
	% pa.	% pa.	% pa.	% pa.	% pa.
2002	-7.0	These strategies were introduced in December 2003. Consequently there are no declared rates for the full year ended 30 June 2004 or earlier.			2.8
2003	-1.7				2.7
2004	13.5				2.5
2005	13.0	11.6	9.3	4.9	2.5
2006	15.8	11.4	8.1	4.9	4.0
Average 2 Years	14.4	11.5	8.7	4.9	3.2
Average 3 Years	14.1	These strategies were introduced in December 2003. Consequently there are no declared rates for the 3, 5 or 10 year periods.			3.0
Average 5 Years	6.3				2.9
Average 10 Years	8.8				2.6

Note: The figures above are after allowance for tax and investment management expenses. Past returns are no guarantee of future returns. The Personal Account Balance and Commonwealth Government Co-contributions Account portion of a SASS member's benefit or the benefit of a Deferred SASS member is not guaranteed and the value of such accounts can go up or down with investment returns. SASS members are encouraged to seek professional advice before selecting an investment strategy to suit their personal circumstances.

(iii) Asset Allocation

The Strategic Asset Allocation is the percentage of Growth Assets and Defensive Assets for each Investment Strategy, as set out below:

Strategic Asset Allocation for Investment Strategies

Strategy	Growth Assets %	Defensive Assets %
Growth	74.5	25.5
Balanced	50.0	50.0
Conservative Growth	30.0	70.0
Cash	0.0	100.0

Note: Growth Assets include equities, property and 50% of mature infrastructure assets, and Defensive Assets include cash deposits, fixed interest and 50% of mature infrastructure assets.

(iii) Asset Allocation continued

The proportions allocated to each strategy remain within a margin of plus or minus 5% of the percentages shown. However, the allocation to the asset sectors that make up these broader categories may change. The Fund's asset allocations are reviewed formally at least once a year and are constantly monitored throughout the year.

	Asset Sector Allocation							
	Growth		Balanced		Conservative Growth		Cash	
	2005 %	2006 %	2005 %	2006 %	2005 %	2006 %	2005 %	2006 %
Australian Equities	34.0	37.5	25.6	25.1	13.6	13.1	0.0	0.0
International Equities	25.9	27.9	18.1	18.0	10.0	10.2	0.0	0.0
Unlisted Equities	3.2	1.9	0.0	0.0	0.0	0.0	0.0	0.0
Mature Infrastructure	2.6	2.6	0.0	0.0	0.0	0.0	0.0	0.0
Property								
- direct	5.1	5.5	4.3	4.6	4.3	4.7	0.0	0.0
- listed property trusts	3.5	1.3	2.8	1.1	2.8	1.1	0.0	0.0
- global listed property securities	0.0	2.0	0.0	1.7	0.0	1.7	0.0	0.0
Australian Fixed Interest	11.1	9.7	19.7	20.0	19.8	20.3	0.0	0.0
International Fixed Interest	7.4	6.7	19.8	20.0	19.9	20.3	0.0	0.0
Cash	7.2	4.9	9.7	9.5	29.6	28.6	100.0	100.0
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(iv) Investment Return Objectives

The long-term investment objectives for each of the strategies are;

Strategy	Investment Return Objective
Growth	Change in CPI + 4.5% p.a. over rolling 10-year periods
Balanced	Change in CPI + 3.0% p.a. over rolling 7-year periods.
Conservative Growth	Change in CPI + 2.0% p.a. over rolling 4-year periods.
Cash	Change in CPI + 1.5% p.a. over rolling 3-year periods.

The Growth strategy's 10-year return at 30 June 2006 was 8.8% pa which exceeded the 10-year target of 7.1% pa. The other strategies were only introduced in December 2003 and therefore have not been in place long enough to be measured against the longer-term investment objectives. In addition, short-term performance up to three years is monitored against comparable funds as measured by the appropriate universe of managers in the Intech Super Survey. At 30 June 2006, the returns achieved in each strategy have been competitive with the peers on this measure.

(v) Investment Expenses

Investment management expenses include funds management fees, custodial fees and the costs of managing the investment portfolio. These expenses are deducted from investment earnings, before the declared rates are determined.

Year Ended 30 June	Investment Expenses as a % of Average Total Assets			
	Growth % pa	Balanced % pa	Conservative Growth % pa	Cash % pa
2002	0.27	These strategies were introduced in December 2003.		
2003	0.22			
2004	0.31	0.19*	0.18*	0.11*
2005	0.29	0.20	0.22	0.12
2006	0.32	0.21	0.22	0.15

*Annualised for the seven months from 1 December 2003 to 30 June 2004.

(vi) Investment Managers

All of the Pooled Fund's assets are managed by external fund managers who are appointed by the Trustee Board, on the advice of the asset consultant. The performance of the various fund managers is monitored throughout the year and managers may be added or replaced. At 30 June 2006, the Fund's investment managers were:

Australian Shares

- AMP Capital Investors Limited
- Barclays Global Investors Australia Limited
- Deutsche Asset Management (Australia) Limited
- GMO Australia Limited
- Macquarie Investment Management Limited
- Maple-Brown Abbott Limited
- New South Wales Treasury Corporation
- Perennial Value Management Limited
- Perpetual Investment Management Limited
- State Street Global Advisors, Australia, Limited
- UBS Global Asset Management (Australia) Ltd
- Wallara Asset Management Pty Limited

International Shares & Currency

- Barclays Global Investors Australia Limited
- Capital International, Inc.
- Fidelity International Limited
- New South Wales Treasury Corporation
- Pareto Investment Management Limited
- State Street Global Advisors, Australia, Limited
- Wellington International Management LLP

Alternative Assets

- Access Economics Pty Limited
- Deutsche Asset Management (Australia) Limited

Australian Property (including listed property trusts)

- DB RREEF Funds Management Limited
- Vanguard Investments Australia Ltd

International Property (including listed property securities)

- LaSalle Investment Management (Securities), LP
- Vanguard Investments Australia Ltd

Australian Fixed Interest and Cash

- Deutsche Asset Management (Australia) Limited
- State Street Global Advisors, Australia, Limited

International Fixed Interest

- State Street Global Advisors, Australia, Limited

(vii) Asset Consultant

The Trustee Board has appointed Frontier Investment Consulting Pty Ltd as its investment consultant to advise on strategic asset allocation and fund manager selection.

(viii) Investment Policies

(a) Investment Reserves

The Trustee Board has determined that investment earnings will not be placed in an investment reserve. Consequently, all available investment earnings or losses, after providing for tax and investment expenses, are distributed to employers and members, based on a declared rate which is determined monthly. Members exiting the Pooled Fund Schemes receive a daily declared rate applicable since the last monthly rate was struck.

(b) Derivatives

Derivatives, including futures and options, can be used by the Pooled Fund investment managers. However, the investment mandates clearly state that derivatives may only be used to facilitate efficient cash flow management or to hedge the portfolio against adverse market movements and cannot be used for speculative purposes or gearing the investment portfolio. During the year to 30 June 2006, the managers made limited use of derivatives.

(c) Hedging

STC's policies in regard to currency hedging as at 30 June 2006 are:

- international fixed interest: 100% hedged into Australian dollars;
- international equities: Specialist currency managers have been engaged to manage the currency exposure of international equities. Consequently, the level of hedging may vary from 0% to 68% depending on the managers' positions from time to time;

- international mature infrastructure: 100% hedged into Australian dollars.
- international listed property securities: 100% hedged into Australian dollars.

(d) Custodian

The Trustee Board has appointed JPMorgan Investor Services as custodian to hold the Pooled Fund's assets. In addition, the custodian values the Fund daily and monitors each investment manager's daily activity to ensure compliance with their investment mandate.

(e) Passive Rebalancing

The Pooled Fund passively rebalances the tradeable asset classes in the portfolio in a disciplined manner. Each day, after the portfolio is valued, the index manager, State Street Global Advisers, Australia, Limited reviews the asset allocation for each strategy. If a sector has deviated outside a set range relative to the target allocation, the manager reallocates funds between sectors to return allocations within the agreed range. This rebalancing process may involve the use of futures or derivatives.

(ix) Large Investments

During the year, there was no individual investment directly held by the Pooled Fund that exceeded 5% of the Fund's total investments.

However, the Pooled Fund held 6.3% of the Fund's total investments in the Emerging Managers Trust and 5.2% of the Fund's total investments in the Alpha International Managers Trust (both managed by New South Wales Treasury Corporation). These are unlisted unit trusts, which engage a range of managers to manage Australian Share and International Share portfolios respectively.

5 years at a glance — to 30 June

	2002	2003	2004	2005	2006
Member statistics					
Active Members — SASS	72,629	68,543	64,968	60,776	57,168
Active Members — SSS	35,661	33,465	31,151	28,593	26,614
Active Members — PSS	5,066	4,489	4,143	3,706	3,280
Total active members	113,356	106,497	100,262	93,075	87,062
Pensioners — SASS	6,072	5,615	5,312	5,012	4,569
Pensioners — SSS	34,136	35,378	36,872	38,548	39,795
Pensioners — PSS	4,459	4,877	5,096	5,377	5,697
Total pensioners	44,667	45,870	47,280	48,937	50,061
Deferred Benefits — SASS	13,703	12,216*	12,080	11,843	11,809
Deferred Benefits — SSS	4,812	4,753	4,638	4,539	4,347
Deferred Benefits — PSS	232	230	202	192	179
Basic Benefit only	1,211	-	-	-	-
Total deferred benefits	19,958	17,199	16,920	16,574	16,335
Gender ratios – active members					
Females — SASS	53%	53%	52%	53%	52%
Males — SASS	47%	47%	48%	47%	48%
Females — SSS	33%	32%	33%	33%	33%
Males — SSS	67%	68%	67%	67%	67%
Females — PSS	10%	11%	11%	11%	11%
Males — PSS	90%	89%	89%	89%	89%
Contributions — \$m					
Employer contributions	175	316	326	332	274
Employee contributions	464	464	474	494	507
Accelerated Crown Contribution	-	-	-	-	-
Total contributions	639	780	800	826	781
Benefits Paid — \$M	2,304	2,071	2,038	2,398	2,458
Net Contributions — \$M	-1,669	-1,291	-1,238	-1,572	-1,677
Investment Revenue — \$M	-2,175	-523	3,251	3,354	4,372
Assets/Liabilities — \$m					
Accrued Benefits — SASS	8,743	8,903	9,824	10,566	11,600
Net assets to pay benefits	5,712	5,278	5,779	6,105	8,590
Over/under funding	-3,031	-3,625	-4,045	-4,461	-3,010
Accrued Benefits — SSS	22,156	23,661	24,888	26,203	26,143
Net assets to pay benefits	16,428	15,431	16,866	18,409	17,881
Over/under funding	-5,728	-8,230	-8,022	-7,794	-8,262
Accrued Benefits — PSS	3,989	4,318	4,761	5,065	5,673
Net assets to pay benefits	1,328	1,126	1,096	1,020	963
Over/under funding	-2,661	-3,192	-3,665	-4,045	-4,710
Accrued Benefits — SANCS	1,848	1,888	2,097	2,231	2,354
Net assets to pay benefits	597	471	474	366	1,144
Over/under funding	-1,251	-1,417	-1,623	-1,865	-1,210
Total Accrued Benefits \$M	36,736	38,770	41,570	44,065	45,770
Total Net assets to pay benefits	24,065	22,306	24,215	25,900	28,578
Total Over/under funding	-12,671	-16,464	-17,355	-18,165	-17,192
Total Investments — \$M	23,829	22,092	24,231	25,980	28,699
Growth strategy annual crediting rates — %					
Net Returns – 1 year	-7.0%	-1.7%	13.5%	13.0%	15.8%

*In May 2003, 1,145 Deferred SASS accounts were transferred to the First State Superannuation Scheme.