Australian Government
Commonwealth Superannuation Corporation

Investment options and risk

Issued 6 December 2019

The information in this document forms part of the Product Disclosure Statement for the Military Superannuation and Benefits Scheme (MilitarySuper), seventh edition, issued on 6 December 2019.

The decisions you make now about your super can help you reach your retirement goals. Take the time to understand your options, taking your personal objectives, financial situation and needs into account. For example, you should consider the:

- impact investment performance has on your account
- amount of time your money will be invested before you need it for retirement
- level of investment performance that you are expecting
- level of risk and fluctuation in the value of your investment that you can tolerate.

Commonwealth Superannuation Corporation (referred to as CSC, we or us) offers, and is responsible for, all aspects of MilitarySuper, including the investment strategy. CSC pools your super with that of other members in a pooled super trust and invests it according to the investment options you choose.

You have the choice of investing your member benefit and any ancillary benefit in one or more of four investment options – **Cash**, **Income Focused**, **Balanced** and **Aggressive**. If you do not choose an investment option, your super will be invested in the default option, **Balanced.**

Investment choice is only available in respect of your member benefit and any ancillary benefit. If you require further information on the different components of your benefit, please visit our website at **csc.gov.au**

CSC — Military Super

Military Superannuation & Benefits Scheme

Commonwealth Superannuation Corporation (CSC) ABN: 48 882 817 243 AFSL: 238069 RSEL: L0001397
Trustee of the Military Superannuation and Benefits Scheme (MilitarySuper) ABN: 50 925 523 120 RSE: R1000306

CSC's framework for portfolio construction

CSC constructs a portfolio for each investment option by categorising assets according to their risk profile and their role in diversifying portfolio-level risk. To this end, investments rest within one of five broad asset categories, classified by their diversifying role in the portfolio. The five broad asset categories (corporate equities, debt, real assets, sovereign assets and alternative strategies) are described below:

- **corporate equities** comprise Australian shares, international shares, and private equity (investment in a company not listed on a stock exchange) investments. These investments earn a real return (i.e. return above inflation) by financing corporations through public and private equity markets.
- **debt** comprises corporate credit investments in developed and emerging countries. These investments earn a real return (i.e. return above inflation) by financing corporations through public and private debt markets.
- **real assets** comprise property and infrastructure investments. These investments earn a real return (i.e. return above inflation) by financing the building, maintenance, management and trading of real assets, accessed through public and private equity and debt markets.
- **sovereign assets** comprise government bonds and cash investments. These investments earn a return by financing sovereigns and banks, through the holding of government bonds and Australian cash, respectively.
- **alternative strategies** comprise investments not included in the traditional asset classes listed above, often targeting an absolute return. Examples include investments in hedge funds and multi-asset diversified funds. These investments can have differing levels of risk depending on the actual strategy employed.

Each of the asset classes that make up the above categories are described in more detail below.

Description of asset classes

The following is a general description of asset classes that make up the investment options.

Cash

Cash investments comprise deposits with banks and Australian-dollar-denominated money market securities (such as bank bills and promissory notes) that are issued or guaranteed by a government, bank or corporate entity. These securities must have a minimum credit rating of A1 (or its floating rate equivalent) for short-term securities and a minimum credit rating of A1 for long-term securities. Standard & Poor's (or the equivalent from Moody's or Fitch if no Standard & Poor's rating is available) determine these ratings. Interest rate futures, swaps and repurchase agreements are also investible securities in this sector.

Unlike bank deposits, these short-term money market securities can experience negative returns on a particular day if there are large unusual movements in interest rates.

Fixed interest

Government bonds

Investing in government bonds means your money is lent to governments wishing to raise funds. Generally, in return, you receive a fixed rate of interest until the bond matures and the amount invested is repayable.

CSC invests in both Australian and international government bonds (such as inflation-linked and nominal, government and semi-government bonds issued by developed and emerging country sovereigns). This is generally considered a moderate risk investment as the predominant exposure is to sovereign credit risk (the risk that a government cannot or will not honour its existing obligations) and interest rate risk.

Corporate credit

Investing in corporate credit means your money is lent to corporate organisations wishing to raise capital through the issue of corporate bonds.

Generally, in return, you receive a fixed rate of interest until the bond matures and the amount invested is repayable. CSC invests in Australian and international corporate credit. This is generally considered a moderate risk investment as the predominant exposure is to credit risk (the risk that a borrower cannot or will not honour its existing obligations) and interest rate risk.

Equities

Australian shares

Investing in Australian shares means you are investing in companies listed on the ASX (Australian Stock Exchange). The return on your share investments is your part of the companies' profits which is paid to shareholders in the form of dividends, and any capital gains or losses from share price fluctuations. As the companies' fortunes fluctuate, so will the value of any shares. Share prices are affected by market forces and are considered to be one of the more risky investments, but over the longer term they may offer relatively higher returns.

International shares

Investing in international shares is like investing in Australian shares except that the companies are listed on international stock market exchanges rather than the ASX. In addition to being exposed to global stock market fluctuations, investment returns can also be influenced by foreign currency exchange movements. Foreign currency exposure is managed through hedging against Australian dollars. The level of hedging is determined by CSC and may vary from time to time.

Private equities

Investing in private equities means you are investing in companies that are not listed on a stock exchange. These companies are located both in Australia and internationally. They provide access to sectors or segments of economic growth that may not be accessed as efficiently through listed markets (eg information technology and health care sectors). The private companies are managed by teams with operational expertise in the industries in which these companies operate.

Property

Property includes investments in established buildings and properties, for example shopping centres, or buildings under construction. We also invest money in property trusts and property companies, which means we pool your money together with other investors, in order to have the scale to purchase a share of very large properties. The investment returns on property come from rent and changes to property values over time. Our property portfolio generally has lower returns than Australian shares as its risk profile is more moderate.

Infrastructure

Infrastructure includes investments in essential public works facilities and services in Australia and overseas, for example, toll roads, airports, schools, water systems and power supply including renewable energy. We also invest money in trusts and infrastructure companies, which means we pool your money together with that of other investors, in order to have the scale to purchase a share of very large infrastructure assets.

Alternatives

CSC also allocates capital to investment strategies that exploit price discrepancies opportunities between markets and between securities. These strategies provide a stream of returns that are less dependent on the actual direction of equity markets. In this way, these returns generally hedge the portfolio against episodes of negative equity market returns.

Investment options

Cash

Objective

To preserve its capital and earn a pre-tax return close to that of the Bloomberg AusBond bank bill index by investing 100% in cash assets.

Risk profile and investor suitability

This investment option may be suitable for those who prefer less risk. The minimum suggested time-frame for holding this option is one year or more. With a very low risk rating (band one), it is estimated that the option will have a negative return (i.e. will lose value) in less than six months over any 20 year period.

Bloomberg AusBond bank bill index

The Bloomberg AusBond bank bill index is a market accepted index that is commonly used to benchmark the performance of short-term cash investment portfolios. The index comprises a basket of 13 generic bank bills that range in maturity from one week to 13 weeks. Each week the shortest-dated bank bill matures and is replaced by a new 13 week bank bill. In this way, the index has an average maturity of 45 days and is turned over every 90 days.

Income Focused

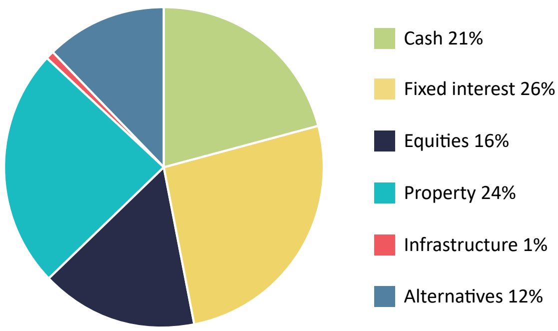
Objective

To outperform the Consumer Price Index (CPI) by 2% per annum, after fees and taxes, over 10 years.

Risk profile and investor suitability

This investment option may be suitable for those who prefer less risk. The minimum suggested timeframe for holding this option is five years. With a low-to-medium risk rating (band three), it is estimated that the option will have a negative return (i.e. will lose value) in one to two years over any 20 year period.

Target asset allocations



Balanced – the default option

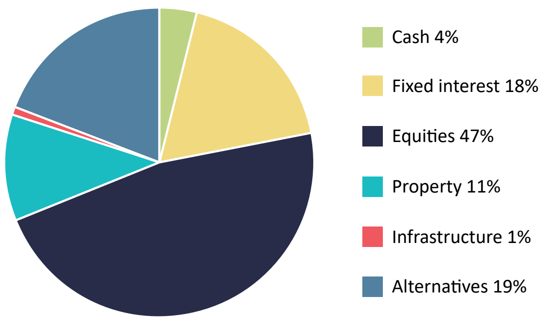
Objective

To outperform the Consumer Price Index (CPI) by 3.5% per annum, after fees and taxes, over 10 years.

Risk profile and investor suitability

This investment option may be suitable for those prepared to take more risk in exchange for potentially higher returns on their investment over the medium-to-long term. The minimum suggested timeframe for holding this option is 10 years. With a medium-to-high risk rating (band five), it is estimated that the option will have a negative return (i.e. will lose value) in three to four years over any 20 year period.

Target asset allocations



Aggressive

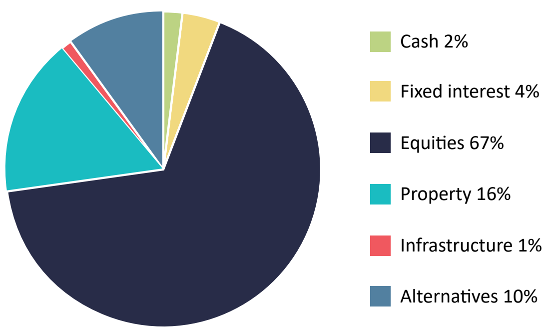
Objective

To outperform the Consumer Price Index (CPI) by 4.5% per annum, after fees and taxes, over 10 years.

Risk profile and investor suitability

This investment option may be suitable for those prepared to take more risk in exchange for potentially higher returns on their investment over the long term. The minimum suggested timeframe for holding this option is 15 years. With a high risk rating (band six), it is estimated that the option will have a negative return (i.e. will lose value) in four to six years over any 20 year period.

Target asset allocations



Target asset allocations

The **Income Focused**, **Balanced** and **Aggressive** investment options have a specific target asset allocation to each asset class which are monitored for market movements within the following target asset allocation ranges.

Investment	Income Focused	Balanced	Aggressive
Cash	10–100%	0–65%	0–35%
Fixed Interest	10–100%	0–65%	0–35%
Equities	0–40%	15–75%	20–95%
Property	0–35%	5–25%	0–50%
Infrastructure	0–35%	0–20%	0–50%
Alternatives	0–70%	0–30%	0–70%
Foreign currency hedge ratio	0–100%	0–100%	0–100%

Target asset allocation ranges show, on average, the allocations each investment option is expected to hold over the long-term. These allocations may be changed by CSC without notice, for example in periods of extreme market conditions, and this may affect the amount of fees you pay.

Investment risk and Standard Risk Measure (SRM)

Investment risk is determined using the SRM. The SRM is a guide as to the likely number of negative annual returns expected over any 20 year period. The purpose of the SRM is to provide members with a label to assist in comparing investment options.

The SRM is not a complete assessment of all forms of investment risk, for instance it does not detail what the size of a negative return could be or the potential for a positive return to be less than you may require to meet your objectives. Further, it does not take into account the impact of tax on the likelihood of a negative return.

You should ensure that you are comfortable with the risks and potential losses associated with your chosen investment option(s).

The following table demonstrates the estimated number of negative annual returns over a 20-year period applied to determine the risk band and label.

Risk band	Risk label	Estimated number of negative annual returns over a 20–year period
1	Very low	Less than 0.5
2	Low	0.5 to less than 1
3	Low to medium	1 to less than 2
4	Medium	2 to less than 3
5	Medium to high	3 to less than 4
6	High	4 to less than 6
7	Very high	6 or greater

For more information on the methodology applied to calculate the standard risk measure, go to **csc.gov.au**

Significant risks

Super, like any investment, has risks. Significant risks include:

Risk	Description
Inflation	Inflation may exceed the return on investment.
Asset investment risk	Individual assets we buy may fall in value for many reasons, such as changes in the internal operations or management of a fund or company we invest in, or in its business environment.
Market risk	Economic, technological, political or legal conditions, and even market sentiment, can change, and this can affect the value of investments.
Interest rate risk	Changes in interest rates can have a positive or negative impact directly or indirectly on investment value or returns.
Currency risk	We invest in assets located in other countries and if their currencies change in value relative to the Australian dollar, the value of the investments can change.
Derivatives risk	We may use derivatives to reduce risk or gain exposure to investment markets when we think it appropriate. Risks associated with these derivatives include the value of the derivative failing to move in line with the underlying asset, market or index.

Counterparty risk	Counterparty risk is the risk that the other party to a contract cannot meet its obligations under the contract. This may have a negative effect on the value of the investments.
Fund risk	Risks particular to the fund include that it could cease operation, fraud against CSC could occur, Board restructure and that our investment professionals could change.
Liquidity risk	Assets that we invest in can become difficult to trade under certain market conditions.
Super laws*	Changes are frequently made to superannuation law and may affect your investment and your ability to access it.
Changes to tax*	Changes can occur to taxes on investments or super generally, which may affect the value of your investment.

* These risks also apply to the defined benefit component of MilitarySuper.

Investment risk management

Investment risk can be managed and even minimised, but cannot be eliminated. No matter how skilled the investment manager, or how strong performance has been in the past, there is always a chance you could receive less than you invested.

Ways we manage investment risk include:

- diversification across asset classes, individual assets, investment styles and investment managers;
- a focus on understanding the inherent risks of any particular type of investment;
- systematic compliance and fraud control programs;
- a continuous program of research and analysis, including environmental, social and governance (ESG) analysis; and
- continuous monitoring of market performance, investment manager performance and relevant legislation.

Our investment governance focuses on managing risk and is driven by our primary investment objective, which is to maximise long-term real returns (i.e. return above inflation) within strictly defined risk limits. Professional investment managers make day-to-day investment decisions, within agreed investment parameters, which are regularly reviewed.

We use a number of corporate engagement and governance advisory services to support our proxy votes in the Australian and international companies in which we invest.

Environmental, social or governance considerations

We take a wide frame to risks and integrate analysis of environmental, social and governance (ESG) considerations into our investment and portfolio management processes. ESG considerations cover the range of risks that relate to the management of the factors of production including human capital (labour practices); natural capital (ecosystem inputs and externalities); technology capital; and organisational capital (how all of these factors are overseen; decisions about their management controlled; and their interactions managed).

Transparency: The availability of robust and consistent data on ESG risks across global companies has improved over the last decade but remains below that of financial data. We support continued improvement and transparency on these measures because we consider ESG risks as potential future financial risks. Our internal risk analysis explicitly incorporates ESG scores on all public companies in our portfolio. All of our active external investment managers incorporate ESG risk analysis into their investment process and security valuations, and include this in their regular reporting to us.

We recognised early on the impact that ESG risks could have on our members' investments both directly as they revealed themselves in franchise value or indirectly through regulation or changing customer preferences. As a result, we were the first Australian superannuation fund to invest in building a robust database measuring the environmental, social and governance risks associated with the operating activities of Australian companies more than a decade ago.

We were also the first Australian super fund to measure our climate footprint (undertaken independently by the Climate Institute in 2009), with the intention of understanding how and where we could support long-term thinking and robust transitions in our material public companies.

We have our own active owner policy which describes how we view our purpose; our comparative advantages and capacity to influence; our proxy voting principles; and our prioritisation of the material and consequential risks to our members. We draw on a wide variety of data and information sources including ratings agencies such as MSCI (ESG score providers); proxy voting advisors; our own active manager networks for deeper insights into idiosyncratic corporate risks; private asset operating partners and advisors; organisations such as the UNPRI; responsible investor network; TCFD; etc. Where information about environmental and social risks can lack robustness and consistency across international regions, we rely on governance insights as indicators of the quality of corporate management and their capacity for long-term thinking and strategic execution.

Integration and materiality: We take a portfolio approach to risk—respecting the extent to which risks are priced, and the potential interaction between individual risk factors as contributors to the sustainability of our members' incomes in retirement.

- Where CSC members are majority or control-interest shareholders, we directly mitigate ESG risks (eg. our directly-held private assets); we vote on ALL shareholder resolutions in all our public company investments.
- Where CSC members are minority shareholders but have a material exposure to a public company we take an active role to engage with those companies, either directly, or via our mandated external managers;
- Where CSC members are minority shareholders and have immaterial exposure to a public company, we support our active managers to engage on substantive issues;

- Our internal investment risk team monitors and assess all risks across the portfolio, ranking them according to the size of the potential impact on our members' income adequacy and sustainability in retirement.
- We identify and critically examine all factors relating to the future value and durability of returns from our investments.
- We use both internal and external tools to generate thematic research insights and measure specific risk exposures.
- We currently use MSCI ESG ratings in our portfolio analytics to measure, monitor and manage ESG exposures in our equity portfolios. Details can be found msci.com/esg-ratings
- We use scenario analysis to consider the distribution of potential outcomes regarding all risks, inclusive of those related to financial, environmental, social, governance, technological, regulatory etc.

Robust transitions: For us, divestment is a last resort. We believe that long-term investors have a responsibility to help the companies they invest in to transition to better practice, actively manage their ESG risks, along with the other strategic and cyclical risks they face, and to do this in an enduring way, with fit-for-purpose strategies, processes and controls.

That being said, we have divested from companies when our active engagement cannot effectively reduce franchise risks because governance risk can't be mitigated and/or our engagement efforts are grossly constrained. Examples of this have been in tobacco (which we divested in 2013) and Australian forestry company, Gunns, in which board governance risks were high and unmitigatable (which we divested in 2010). Of course, we don't invest in companies whose activities are contrary to Australian government regulations, sanctions, treaties or conventions. For example, we do not invest in cluster munitions.

Active-ownership: We seek to influence investee company behaviour by voting on all resolutions put forward by our public company management teams. We vote in the best interests of our members, not necessarily company management. We exercise ownership through our active manager's analysis of company-specific situations; engaging directly or indirectly, through our contracted active managers, with the material companies in which we invest; and direct governance rights across our directly held private assets.

Public reporting: We publish our public company voting record on our website, along with the key issues voted on, every 6 months.

Collaboration: We engage and work with a diverse group of investment managers, advisers and shareholder groups, to leverage scale in the promotion of ESG awareness, integration and continuous improvement.

- We were a founding signatory to the Principles for Responsible Investment—an initiative for global best practice in responsible investment. This membership includes a commitment to explicitly consider ESG issues in our investment policies and practices.
- We are a member of the Investor Group on Climate Change Australia/New Zealand, and an investor signatory to CDP (formerly the Carbon Disclosure Project). These collaborative industry initiatives address the business and shareholder value implications of climate change.
- As a signatory to the Montreal Carbon Pledge, we are committed to measuring and disclosing the carbon footprint of our public market equities portfolio. This information is regularly updated on our website.

We have been independently recognised as a leader in the management of ESG risks by:

  - UN PRI: receiving the inaugural innovation award for responsible investing in 2003
  - Bretton Woods Initiative: being named as one of the top 25 global leaders in responsible asset allocation in 2018 and recognised again in 2019.

For further information, refer to our **Stewardship Factsheet** online.

Keeping track of your investments

Once you have made your choice of investment options, you also need to keep an eye on your investments, particularly if you have created your own investment strategy combining different investment options. Market movements may take your individual asset class proportions away from the point at which you started. As this happens, your fees and risk level may change and you will need to decide if you want to rebalance them by changing the amounts you invest in your selected investment options. We rebalance the individual asset class allocations within the Income Focused, Balanced and Aggressive investment options regularly.

Switching between investment options

You can switch to a different investment option(s) any time, free of charge:

- log in to your **MilitarySuper Member Services Online** account, or
- send us your completed **Member Investment Choice (MIC1)** form. This form is available on our website at **csc.gov.au** or you can call us on **1300 006 727** for us to email or post you a copy.

You will receive written confirmation when we have processed your investment switch. Your choice will only apply to your member benefit (including your ancillary benefit, if any) – it does not apply to your employer benefit.

You do not have to make an investment choice. If you choose not to exercise your choice, your member benefit (including ancillary contributions) and future contributions will be invested in the Balanced option which is the default option.

If you submit a request to change investment options, it cannot be cancelled. Instead you will have to submit another request with your preferred investment options. If you send us your second request by mail or fax, it is important that you note on that request that it overrides any other request received by us for you before 3pm.

If we receive two or more investment choice requests on the one day, we will process the most recent one, if we can determine this. If we cannot determine which request is the most recent one, we will not process any of them and ask you to resubmit your request. This is necessary to avoid members sending in multiple switches for the one day and then choosing the one that gives them the best outcome.

MilitarySuper performance

Performance information of the MilitarySuper investment options can be found at **csc.gov.au**. Please note that super is a long-term investment and past performance is no indication of future performance – investment markets are volatile, and it is not possible to predict when they will go up or down or how quickly this will happen.

How your investment in MilitarySuper is valued

Your investment in MilitarySuper is valued in units. The unit price for an investment option reflects the total value of assets in the investment option (less expenses and taxes), divided by the number of all units issued in the investment option.

MilitarySuper uses units and daily unit prices to process transactions on your account, perform switches between investment options and track the value of your investment in the fund.

When contributions are paid into your account, that money buys a number of units and the value of each unit (in dollars) is known as the unit price. Each investment option has a different unit price that can change daily, due to changes in investment markets and the value of assets.

Generally we base our calculation of the value of assets in each investment option on the latest available market value at the end of each business day. Using these values, we will generally calculate the unit price for a given business day on the next business day. For example, we will generally calculate the unit price for 1 September (if a business day) and make it available on 2 September (if a business day).

If we are unable to determine a unit price for a business day on the following business day due to an unforeseeable event, such as a trading suspension in relevant markets, we will take all reasonable steps to recommence unit pricing as soon as possible.

When MilitarySuper members make contributions to the fund they are allocated units based on the unit price for their chosen investment option (and if no choice is made the Balanced (default) investment option), on the day the contributions are received. When members receive a benefit from the fund, they will be effectively 'cashing in' or redeeming their units at the unit price applicable in accordance with Scheme rules.

Operational risk reserve

All trustees of super funds are required to establish and maintain an operational risk reserve. The purpose of a risk reserve is to provide a source of financial resources to help protect members' interests should an operational risk event occur, such as the use of an inaccurate investment earning rate to process a transaction that results in losses to the Fund or to members.

A target amount of 0.35% of funds under management was set for the operational risk reserve for MilitarySuper. While the target amount has been reached, maintaining this will require an accrual rate which will result in a minor impact on investment earnings. The operational risk reserve is monitored on a quarterly basis.

Changes to investment options

You should note that we can add, change or remove an investment option. We will contact you should these events occur. If we are unable to contact you, or you do not nominate a new investment option, we will switch any funds you have in the investment option we are closing to our default option, **Balanced**.

Email
members@enq.militarysuper.gov.au

Phone
1300 006 727

Fax
(02) 6275 7010

Post
MilitarySuper
GPO Box 2252
Canberra ACT 2601

Web
csc.gov.au

Overseas Callers
+61 2 6192 9502