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3 July 2012

LASF Defined Benefit Plan Funding – Status Report

On 15 December last year I provided an update to the chief executives of employers with members in the LASF Defined Benefit Plan, and alerting them to be prepared for a funding call following the actuarial review required at 31 December 2011.

While there has been media speculation about the size of the unfunded liability, the actuarial review and funding plan was only finalised by the Trustee at its board meeting on 29 June 2012.

This has been a complex review because the government regulations that apply to the Plan ordinarily require that any shortfall in funding be made up within 5 years. This would have been catastrophic for many authorities. Therefore, before the review could be completed, it was necessary for the Trustee, in consultation with the regulator (APRA), to arrange a special 15-year funding plan.

The unfunded liability is expected to be $453 million, spread across all sectors.

No payments will be required before 1 July 2013.

The Federal Government tax on superannuation contributions, currently 15%, will apply to the above amounts.

There are now a number of important governance steps to be undertaken before the final funding plan and individual liabilities can be advised to employers. The actuarial review and the apportionment methodology will be externally audited. The review will be discussed with the Victorian Auditor-General's Office.

The Municipal Association of Victoria is also discussing with the Treasury Corporation of Victoria whether special borrowing arrangements can be arranged for employers. This work is still in progress.

In summary, this is a complex actuarial review. To minimize the potential impact on authorities, a special 15-year funding plan has been agreed with the regulator. Subject to compliance with appropriate due diligence and governance procedures, Vision Super expects to be able to advise authorities of the funding arrangements and their individual liabilities by the end of July.

Yours sincerely

Rob Brooks
Chief Executive Officer

For more information, contact:

David Moxon
Fund Development Manager
Ph: 03 9911 3132
Vision Super Mob: 0418 541 003
Email: dmoxon@visionsuper.com.au

LOCAL AUTHORITIES SUPERANNUATION FUND DEFINED BENEFIT PLAN

Investment Briefing June 2012

Vision Super Pty Ltd
Trustee of the Local Authorities Superannuation Fund
ABN: 50 082 924 561
RSE Licence No: L0000239

Introduction

As the Trustee of the Local Authorities Superannuation Fund (LASF) Defined Benefit Plan, one of Vision Super's roles is to invest the assets of the Plan. When an unfunded liability arises, it is appropriate for people to ask how the investments have been managed. This paper describes:

- our investment structure
- our investment objectives
- how we construct a portfolio
- how we have performed in relative terms
- how we have performed in absolute terms.

Investment structure

As Trustee, the Vision Super Board is responsible for investment decisions and has a formal governance structure for managing investments. It has established an Investment Committee that makes recommendations to the Board.

Specialist consultants provide independent expert advice on legal, taxation, audit and compliance and investment issues. Frontier Investment Consulting provides advice on investment strategy, portfolio construction, selecting and monitoring investment managers. Sovereign Investment Research and JG Service provide specialist advice about private equity and property investment respectively.

The Vision Super investment team is responsible for implementing the Board's investment strategy, monitoring fund manager performance and reporting through to the Trustee on all investment matters.

All assets are held in the name of a custodian, NAB Asset Servicing, on behalf of the Trustee. The Custodian is responsible for settling trades instructed by investment managers, collecting investment income, accounting, taxation and compliance reporting. This provides security for the safekeeping of assets.

All money held in respect of Vision Super members, including Defined Benefit money, is invested in the Vision Pooled Superannuation Trust. While Defined Benefit assets were $1.69 billion at 31 December 2011, they were invested in a pool of assets totalling $5 billion. This provides greater economies of scale than would be available if the assets were managed independently.

Vision Super invests in a range of different asset classes; Australian and international equities, property, infrastructure, absolute return strategies, private equity, opportunistic property, fixed interest and cash. Separate investment pools are maintained for each asset class.

Specialist investment management companies are appointed to invest a proportion of assets in each pool. All assets are managed externally, with the exception of cash.

Both the Actuary and Frontier consult with the Board about the expected returns and liability profile of the Defined Benefit Plan. The assets of the Defined Benefit Plan are managed as a separate portfolio.

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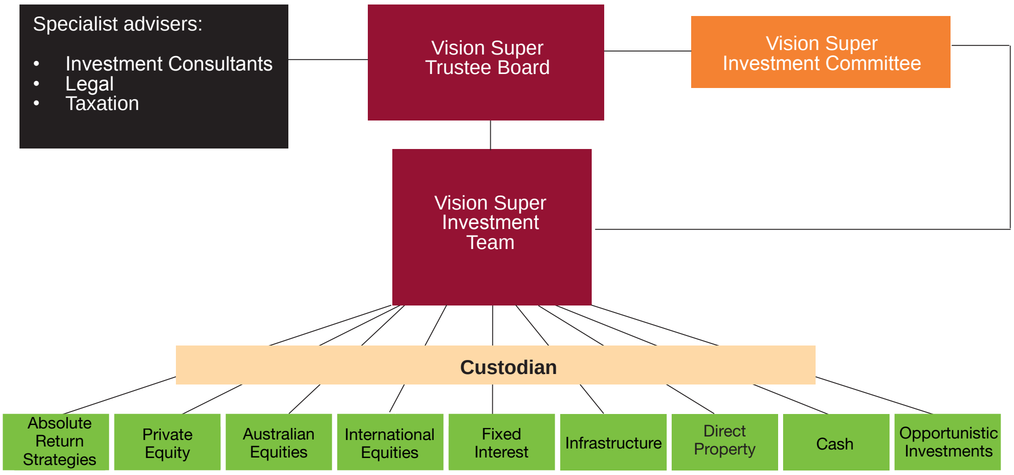
Vision Super Investment Structure

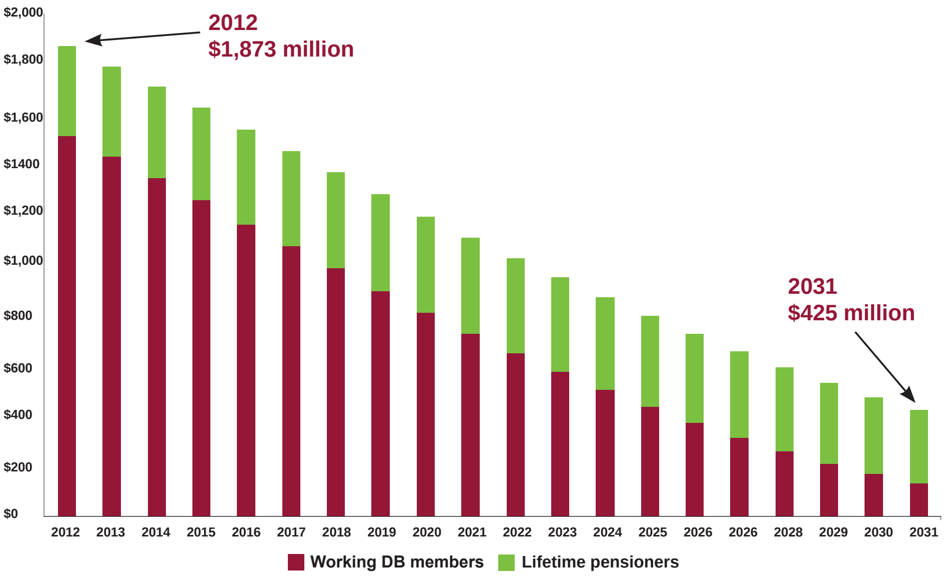


It is important to understand that Vision Super has a robust process for managing the assets of the Defined Benefit Plan.

Investment objectives

In a Defined Benefit fund, the assets are invested in a way that will provide the greatest likelihood that monies will be available to pay benefits to members and pensioners as they fall due. The following chart shows the amount expected to be required to pay benefits to members (in red) and pensioners (in green) in the years ahead.

Projection of Vested Benefits at 1 January (in today's dollars)



Source: Russell Investments

It is expected that $1.87 billion is required now, and that this amount will progressively decrease as members retire and lifetime pensioners pass away. However, it is expected that in 20 years time $425 million will still be needed.

The long-term liabilities of the Defined Benefits portfolio require Vision Super to adopt a longer-term investment strategy, while maintaining sufficient liquidity to pay benefits as they fall due.

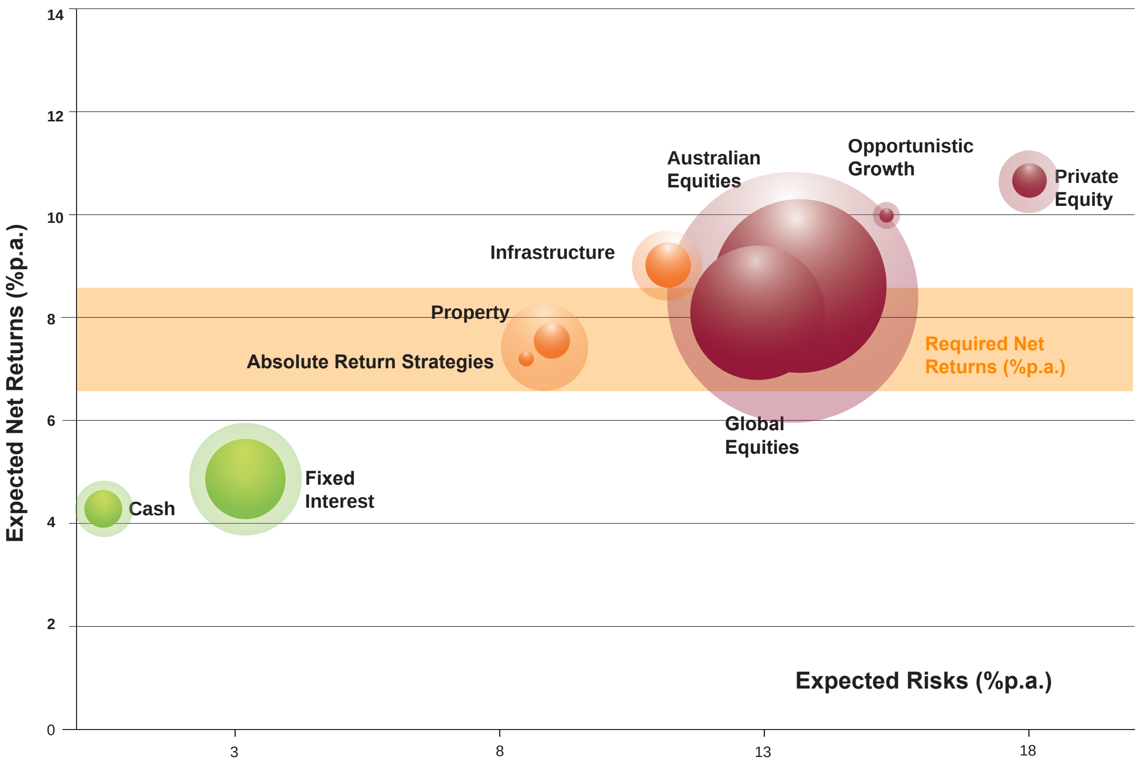
How we construct the portfolio

Constructing the portfolio involves investing in a mix of asset classes that is expected to meet the long-term investment objectives of the Defined Benefit Plan. Investments are also spread across a range of asset classes for diversification. We do not 'put all our eggs in one basket'.

How we construct a portfolio is explained in the picture on the next page, where:

- The orange horizontal bar shows the required long-term return from the portfolio, in this case a return of between 6.5% and 8.5% a year. The required investment return from the portfolio is currently 7.5% p.a.
- Each ball represents a different asset class, the size of each ball represents how much is typically invested in that asset class.
- The colouring outside of each circle reflects its liquidity.
- The scale on the left of the chart shows the expected long-term return from each asset class.
- The scale on the bottom of the chart shows the expected volatility of the asset class i.e. how risky it is. The further to the right, the more volatile the asset class it is likely to be.

Vision Super Defined Benefit Portfolio Mix



Source: Frontier Investment Consulting

This picture demonstrates that to achieve the required long-term return, it is:

- Not possible to invest only in cash or fixed interest; they do not return enough.
- Necessary to invest in both Australian and international equities (shares), even though they are more volatile, and
- Possible to reduce the risk of shares by investing in a range of other asset classes such as property, infrastructure and private equity.

A long-term investment strategy requires investment in asset classes other than cash and fixed interest.

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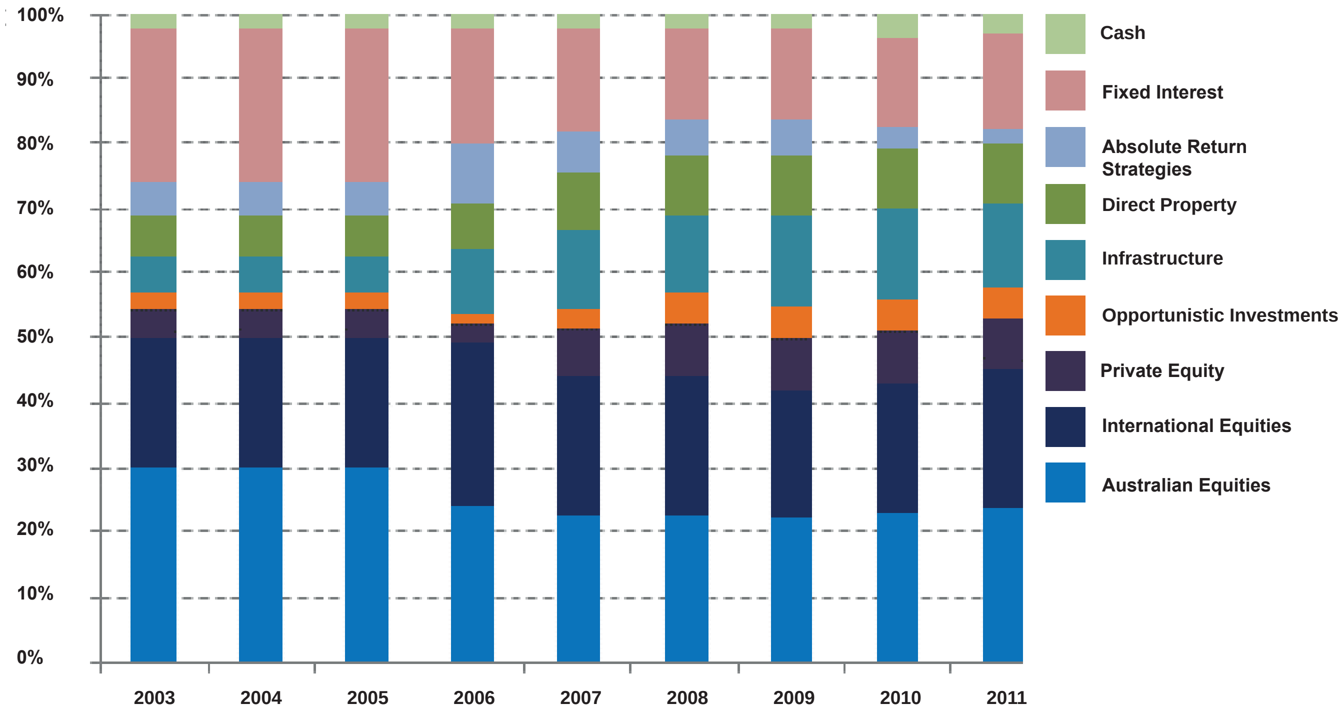
Putting this long-term investment strategy into practice, the table below shows the current strategic asset allocation for the Defined Benefit portfolio.

Vision Super 2012 Defined Benefit Portfolio Strategic Asset Allocation	
Asset Class	Asset Allocation (%)
Cash	5.5
Fixed Interest	10
Absolute Return Strategies	2
Direct Property	9
Infrastructure	13
International Equities	21
Australian Equities	26.5
Opportunistic Investments	5
Private Equity	8
Total	**100**

The following picture shows how the mix of asset classes in the Defined Benefit portfolio has changed over time.

Vision Super Defined Benefit Portfolio Mix Over Time



Source: Frontier Investment Consulting

In 2005 it was decided to invest less in listed Australian and international equities and more in unlisted growth assets such as infrastructure, property and private equity. While the allocation to listed equities was lowered, they still make up a significant part of the portfolio because they are liquid; they can easily be traded on the stock market. This was expected to result in lower risk over time, while still achieving the required return.

How we have performed in absolute terms

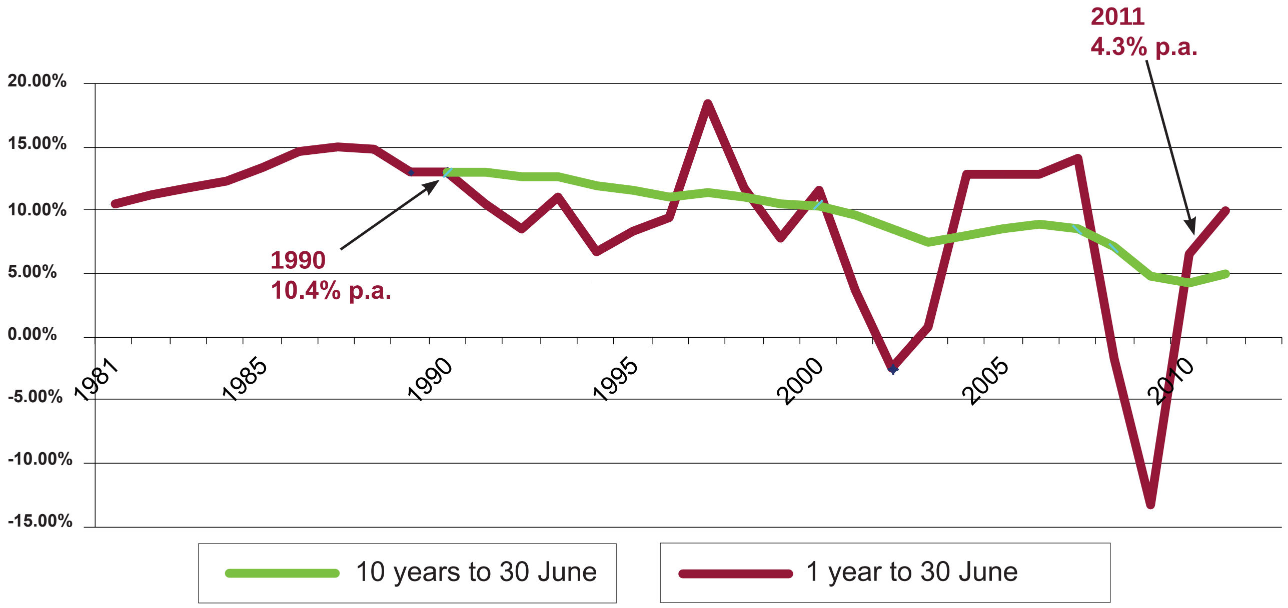
No individual investor can control either the world economy or global investment markets. When these go down every long-term investor is caught in the downturn. Vision Super has likewise been affected. The table below shows the returns of the Defined Benefit portfolio since 1981.

The green line represents rolling 10-year returns i.e. what the return of the portfolio has been over the previous 10 years at any particular point in time. The red line shows rolling 1-year returns i.e. the return of the portfolio over the previous 12 months at any point in time.

In June 1990 the Defined Benefit portfolio had returned 10.4% p.a, net of fees and tax over the previous 10 years (the green line). By June 2011 this had reduced to 4.3% p.a.

While this looks like a steady decline over 20 years, the red line shows the volatility of returns over that time. This demonstrates that investment returns have not only fallen since the global financial crisis, they have also become significantly more volatile.

Vision Super Defined Benefit portfolio Rolling returns to 30 June 2011



As a prudent long-term investor, Vision Super's Defined Benefit portfolio has been caught up in the global financial crisis and its aftermath.

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How we have performed in relative terms

Have we done better or worse than other super funds?

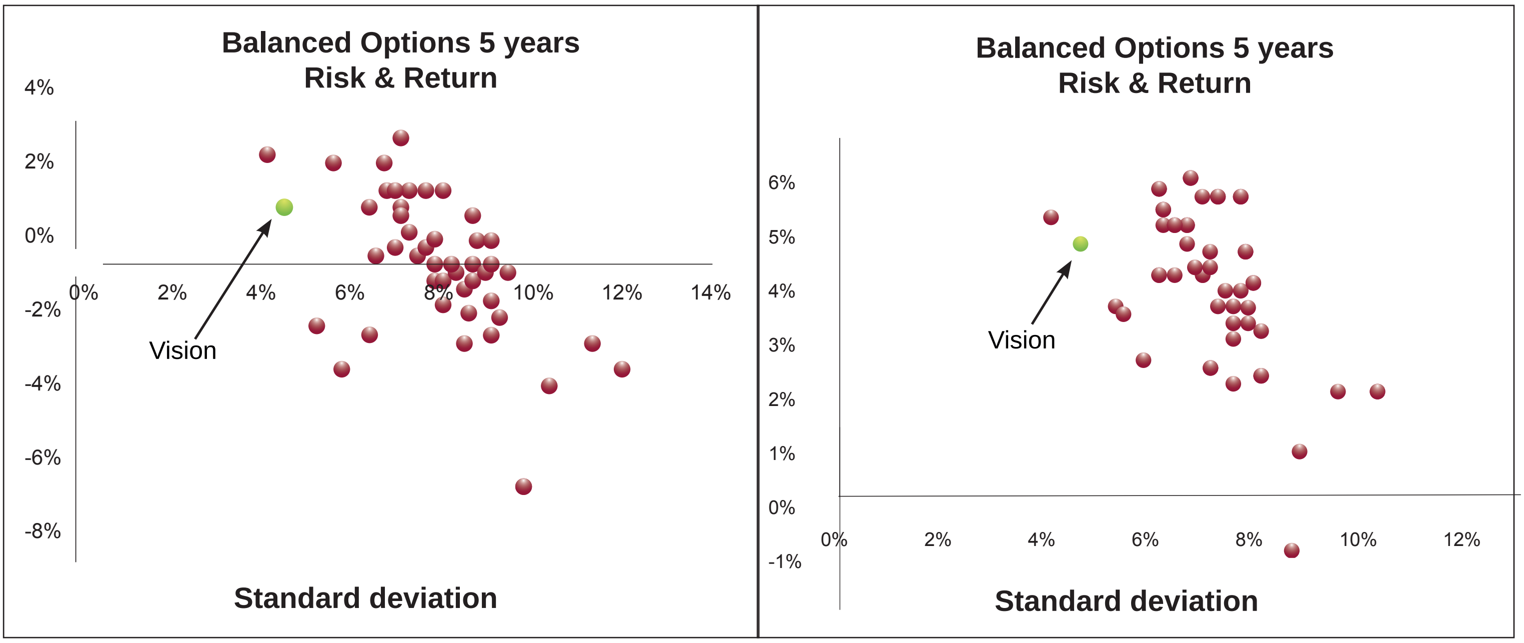
There is no survey of Defined Benefit portfolios. No two funds have the same mix of assets and liabilities, so the mix of assets in their portfolios will vary. Therefore we compare our performance against other super funds with a similar mix of assets.

Since 2005, the Defined Benefit portfolio has returned 4.5% p.a. This would have made it a top quartile performer i.e in the top 25% of super funds with a similar investment option (Source: SuperRatings Fund Crediting Rate Survey December 2011).

Using data from SuperRatings, Frontier has prepared the following "risk and return" charts, where:

- The scale on the left shows the actual return of each super fund's investment portfolio in the survey.
- The scale on the bottom shows the relative volatility of the asset class i.e. how volatile its returns have been. The further you are to the left, the lower your volatility has been.
- The green dot is the Vision Super Defined Benefit portfolio.
- The red dots are other super funds with a similar mix of assets.

Performance of Vision Defined Benefit portfolio compared to similar balanced options (to 31 December 2011)



Source: SuperRatings Fund Crediting Rate Survey December 2011 & Frontier Investment Consulting

The position of the green dot shows that, over both the previous 5 and 7 years, the Vision Super Defined Benefit portfolio has performed above the average of its competitors with below average volatility.

Relative to competitors, we have performed well and the strategy of investing more in unlisted growth assets has reduced volatility.

Conclusion

When there is an unfunded liability it is wholly reasonable and justifiable for stakeholders to ask how the investable assets of the Defined Benefit portfolio have been managed. The purpose of this paper has been to explain both our processes and performance.

The assets of the Defined Benefit portfolio are invested in accordance with a strict governance framework. The Defined Benefit Plan is a separate portfolio, with its assets invested in the larger, Vision Pooled Superannuation Trust; therefore gaining access to greater economies of scale.

The objective of investing a Defined Benefit portfolio is to match assets with liabilities. The liabilities of the Defined Benefit plan will exist long-term; so a longer-term investment strategy is required.

To meet the required longer-term performance necessitates investment in equities and growth assets. Investing solely in cash and fixed interest would not provide the required returns.

To lower volatility, the portfolio has been invested in a range of unlisted growth assets (e.g. property and infrastructure) designed to reduce exposure to Australian and international equities without reducing performance.

With a longer-term investment strategy, the returns of the Defined Benefit portfolio have been depressed by the global financial crisis and the downturn in world economies and markets that have followed it.

While all long-term investors have suffered lower returns, in relative terms the Vision Super Defined Benefit portfolio has produced above average returns with below average volatility.

Since 2005, the performance of the Defined Benefit portfolio would have placed it in the top 25% of funds with a similar asset allocation in the independent SuperRatings survey. As outlined in this investment briefing, Vision Super has managed the assets of the Defined Benefit plan in a prudent and responsible manner and will continue to do so.

Contribution and Repayment Plan

Nillumbik Shire Council

Authority # 958

	Total DB Plan	Nillumbik Shire Council	
Unfunded Pension Liability	$86,880,972	0.86885%	$754,870
Pre 30Jun1993 Service (active members)	$92,079,900	0.86885%	$800,041
Post 30Jun1993 Service (active members)	$274,039,128	0.81560%	$2,235,076
Unfunded Liability (excl cont. tax)	**$453,000,000**		**$3,789,986**
Contribution tax	$79,941,176		$668,821
Unfunded Liability (Inc cont. tax)	**$532,941,176**		**$4,458,807**

If you were.to choose to pay over 15 years, the annual instalment (including contribution tax) would be $469,885 payable on 1 July each year, with the first instalment due in July 2013. Over 15 years this amounts to a total repayment of $7,048,269 which is comprised of the unfunded liability (excluding contribution tax) of $3,789,986, interest costs of $2,201,043 and contribution tax of $1,057,240.

Note: all percentages quoted in the table above are rounded to five decimal places.