

Chapter 2: The MSBS and the DFRDB

The MSBS

- 2.1 The Military Superannuation and Benefits Scheme was introduced on 1 October 1991. The documents setting out the provisions of the MSBS are the *Military Superannuation and Benefits Act 1991* and the Trust Deed and Rules of the Scheme. Membership is compulsory for those joining the ADF as permanent employees.

The DFRDB (and the DFRB)

- 2.2 The Defence Force Retirement and Death Benefits Scheme came into existence on 1 October 1972 when it replaced the Defence Forces Retirement Benefits Scheme (DFRB). All contributory members of the DFRB transferred to the DFRDB at that time. While DFRB pensioners continue to receive pensions payable under the DFRB legislation, their costs are shown under the DFRDB. The DFRDB was itself closed to new entrants from 1 October 1991. The documents setting out the provisions of the DFRDB are the *Defence Force Retirement and Death Benefits Act 1973* as amended, together with the associated Regulations and the Defence Force (Superannuation) (Productivity Benefit) Determination made under the *Defence Act 1903*. The DFRDB covers all members of the DFRDB as at 30 September 1991, with the exception of those contributory members who transferred to the MSBS under the transitional arrangements associated with the introduction of the new scheme.

Benefits

- 2.3 Summaries of the benefits payable under the MSBS and the DFRDB are set out in Appendices A and B respectively. They can be described briefly as follows:

MSBS A member financed benefit equal to member contributions accumulated with fund earnings plus an employer financed lump sum benefit based on a multiple of final average salary and total service. On age retirement, the employer financed lump sum may be wholly or partially converted to an indexed pension.

DFRDB An indexed pension benefit based on a multiple of final salary and total service. Part commutation of the pension to a lump sum is permitted on age retirement.

Changes to military superannuation over the review period

- 2.4 There have been a number of relatively minor changes to military superannuation arrangements since the last report. The most significant, from a financial perspective, flowed from the change in the method of determining employer's Superannuation Guarantee obligations. Since 1 July 2008, defined benefit schemes have been required to assess their obligations against ordinary time earnings (OTE). Previously such schemes had been assessed against what were known as protected earnings bases. In the case of the DFRDB and the MSBS the protected earnings bases were essentially the superannuation salaries defined in the schemes' governing documents.
- 2.5 OTE for ADF personnel includes allowances which are not included in the schemes' definitions of superannuation salary. In order to ensure compliance with Superannuation Guarantee obligations, employer superannuation contributions of up to 9 per cent of certain allowances which do not form part of superannuation salary will be paid into the ancillary section of the MSBS. In determining the amount of employer superannuation contributions for an individual, the maximum earnings base for Superannuation Guarantee purposes is taken into account. The additional employer contributions will apply for both DFRDB and MSBS members and are expected to amount to approximately \$45 million in 2008-09.
- 2.6 The anticipated additional cash expenditure involved has been included in the projected cash outlays in this report. There is no impact on the projected unfunded liability as the additional employer contributions are paid into a fully funded accumulation arrangement. The notional employer contribution rates for the MSBS and the DFRDB do not include any allowance for these additional contributions. However, the approximate total cash cost has been reported as a percentage of superannuation salary to allow comparison with the cost of the defined benefit schemes.
- 2.7 Other minor amendments have been made to remove the loss of spouse benefit entitlements on remarriage; incorporate the Qualification and Skills (Q & S) component of certain allowances into superannuation salary; and correct an unintended anomaly in the provisions relating to adjustment of DFRDB benefits to take account of Family Law settlements. There were also a number of technical changes to the MSBS as a result of the 'Better Super' taxation changes that came into effect from 1 July 2007.

- 2.8 A more significant change, but one which does not impact on employer costs or the unfunded liabilities of the scheme, is the introduction of a new class of benefits under the MSBS; ancillary benefits provide a vehicle for DFRDB and MSBS members to accumulate spouse contributions, Government co-contributions, voluntary salary sacrifice or personal contributions and amounts transferred from other schemes. Ancillary benefits are fully funded accumulation benefits. The cost of ancillary benefits is not included in this report.
- 2.9 In 2007, the compulsory retirement ages for most ADF personnel were increased with the intention of providing greater employment flexibility. The change had an unintended flow-on effect on the calculation of death and invalidity benefits paid under the MSBS. At the time of writing this report, no death or invalidity benefits had been paid using the higher retirement age and steps were being taken to clarify in the MSBS Rules that the change in compulsory retirement age did not flow through to the calculation of these benefits. We have assumed that death and invalidity benefits will not be impacted by the change in compulsory retirement age. Should this assumption turn out to be wrong, the results presented in this report may need to be revised.

Funding and payment of benefits

- 2.10 Member contributions and productivity superannuation contributions to the MSBS are invested by the Military Superannuation and Benefits Board of Trustees No 1 (the trustees). Contributions are accumulated with interest at the actual investment earnings rates of the MSBS Fund. When benefits commence to be paid to a member, the accumulated productivity contributions are transferred to the CRF and the employer benefit is financed from the CRF on an unfunded basis. In any given year, the unfunded benefits paid from CRF will be the total amount of benefits paid less the transfers from the MSBS Fund relating to members who have exited in that year.
- 2.11 Member contributions to the DFRDB are paid direct to the CRF and not accumulated in a fund. All benefits from the DFRDB (and DFRB pensions) are provided from the CRF on an unfunded basis.
- 2.12 The OTE contributions discussed above are funded as they accrue through contributions to the ancillary benefits section of the MSBS Fund.
- 2.13 Other contributions to the MSBS ancillary benefits section are payable in addition to the above contributions. Government co-contributions for all superannuation schemes are made via the Australian Taxation Office (ATO) and accounted for via that program. Accordingly, no allowance has been made in the projections for the Commonwealth cash expenditure associated with government co-contributions (for reference, these co-contributions amounted to \$33 million in 2007-08). Transfer amounts, personal, spouse and salary sacrifice

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contributions paid to the ancillary benefits section are made at an individual's discretion, rather than determined under scheme rules. They have not been included in the projections.

2.14 The estimates in Chapter 6 of this report relate to the actual employer cost payable by the Commonwealth, with the cost in each year being calculated as follows:

(i) **MSBS**

Funded productivity superannuation contributions paid to the MSBS Fund

plus

Unfunded benefits paid from the CRF

(ii) **DFRDB**

Benefits (entirely unfunded) paid from the CRF

less

Member contributions paid to the CRF

(iii) **DFRB**

Pensions paid from CRF

(iv) **Superannuation Guarantee Contributions**

Funded contributions paid to the ancillary section of the MSBS Fund

2.15 For simplicity, DFRB is treated as being part of DFRDB in this report.

Retention benefit

2.16 The *Military Superannuation and Benefits Act 1991* also provides for a retention benefit which is payable to eligible personnel who, on completion of 15 years service, undertake to complete a further five years service. The benefit is a lump sum of one times salary which is paid directly to the individual at the time he or she commits to the additional service and is taxed as assessable income in the hands of the individual. As the retention benefit is not a superannuation benefit (being payable prior to exit from service), the benefit outgo and associated employer costs have not been included in this report.

2.17 Access to the retention benefit ceased on 5 October 2005; the last payments will be 15 years after this date. Since 2005, there have been a number of retention initiatives introduced, including more targeted completion bonus payments. As with the retention benefit, these payments do not form part of superannuation salary for the purposes of the defined benefits payable under the MSBS or the

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DFRDB and are not superannuation benefits. They do, however, form part of OTE and, as such, give rise to Superannuation Guarantee contributions which have been included in the cashflows reported in Chapter 6.