

Chapter 7: Unfunded liabilities

- 7.1 The unfunded liabilities are the liabilities for superannuation entitlements in respect of service already rendered to the ADF for which no assets are held. These liabilities do not fall due until the rules of the schemes provide for benefits to be payable, which is generally when members retire, and so they are spread over many years into the future. They have been calculated as the present value of all of the liabilities accrued in respect of past service less the value of the assets held in the MSBS Fund.
- 7.2 The net present value of unfunded liabilities was calculated to be \$37.9 billion as at 30 June 2008. This is 3.4 per cent of GDP. The net present value of unfunded liabilities reported as at 30 June 2005 was \$32.1 billion or 3.6 per cent of GDP.
- 7.3 Note that in previous reviews, the accrual methodology has differed slightly from that required under AASB 119. For the current review, the accrual methodology has been aligned with the AASB 119 approach. This has increased the MSBS unfunded liability by around \$150 million relative to what it would otherwise have been.
- 7.4 The 2005 Report projected that unfunded liabilities would be \$35.7 billion as at 30 June 2008, or 3.4 per cent of GDP for 2008. Liabilities are therefore somewhat higher than was projected at the last report in dollar terms, but as projected in GDP terms. The main reason for the increase in dollar terms is the change in the contributory membership base, both in terms of increased numbers of personnel and higher salaries. A number of other factors also acted to increase the unfunded liability. These include the adverse scheme experience over the three years in terms of higher than expected numbers of invalidity retirements and the consequent change in the actuarial assumptions regarding invalidity rates. The higher than expected GDP negated the impact of these changes when the figure is expressed as a percentage of GDP. Had the previous assumptions and accrual methodology used for the 2005 Report been retained for this Report the unfunded liabilities would have been approximately \$37.4 billion.
- 7.5 The unfunded liability for the DFRDB is \$25.1 billion and the equivalent figure for the MSBS is \$12.8 billion. These figures are higher than the estimates used for the Financial Statements for the Department of Defence as at 30 June 2008 of \$22.9 billion for the DFRDB and \$10.7 billion for MSBS. The major contributor to this result is the discount rate which is required to be used under the relevant AASB 119 to value the liabilities for Financial Statement purposes. The discount rate used for AASB 119 reporting was 6.6 per cent compared with the 6 per cent

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used for this report. The higher the discount rate used, the lower the unfunded liability. The issues associated with reporting under AASB 119 are discussed further, later in this chapter.

- 7.6 A breakdown of the unfunded liabilities between contributors, pensioners and preserved members by scheme is shown in the following table.

Estimate of unfunded liabilities as at 30 June 2008

Category of members	DFRDB (\$b)	MSBS (\$b)
Contributors	4.3	6.4
Pensioners	20.8	2.7
Preserved members	0.0	3.7
Total	25.1	12.8

- 7.7 The table below shows the projected unfunded liability for the DFRDB, the MSBS and for the two schemes combined. The projections are in nominal dollars and have **not** been adjusted to 2008 dollars. To enable a proper comparison of the projected liabilities with the position in 2008, projections of the combined unfunded liability as a percentage of GDP are also shown. Note that the projections assume that the MSBS remains open to new ADF personnel.

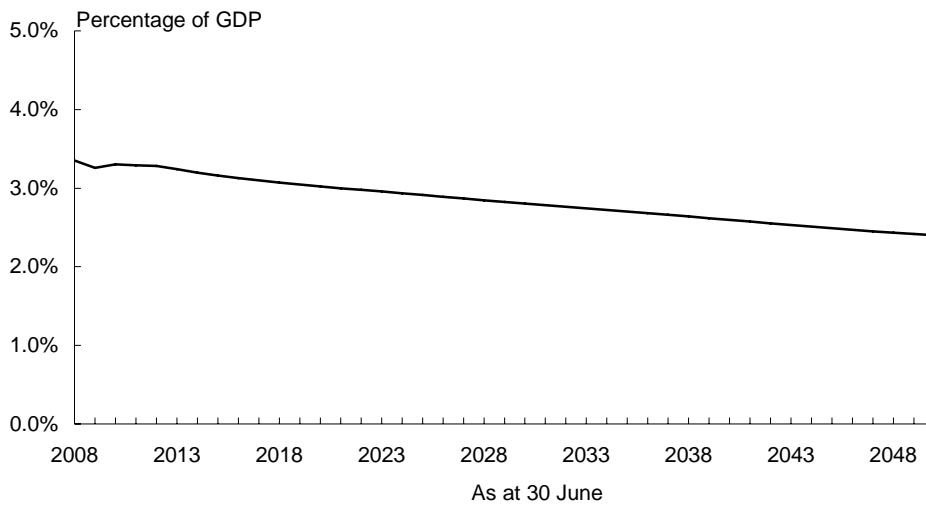
Projected Unfunded Liabilities

Year ending 30 June	DFRDB (\$b)	MSBS (\$b)	Total (\$b)	As a percentage of GDP
2008	25.1	12.8	37.9	3.4
2009	25.2	14.2	39.3	3.3
2010	25.3	15.6	40.8	3.3
2015	25.2	24.4	49.6	3.3
2020	24.4	36.3	60.7	3.2
2025	22.9	51.4	74.3	3.0
2030	20.9	69.9	90.8	2.9
2035	18.2	92.8	111.1	2.8
2040	15.1	120.3	135.4	2.7
2045	11.7	152.5	164.2	2.6
2050	8.3	190.8	199.1	2.5

Note: Totals may differ from the sum of DFRDB and MSBS due to rounding.

- 7.8 The graph below shows the projected unfunded liabilities as a percentage of GDP.

Projected unfunded liabilities as a percentage of GDP



7.9 The initial kink in the series is attributable to the short term volatility in the projected GDP series. Over the longer term, the main feature of the projection is the steady fall in unfunded liabilities relative to GDP. There are three main reasons for this:

- it is assumed that the total number of ADF personnel will stay at the same level as at 30 June 2008, that is, that the number of ADF personnel as a percentage of the population will fall;
- the MSBS is a less expensive scheme than the DFRDB; and
- the MSBS is partially funded whereas the DFRDB is wholly unfunded.

7.10 The general trend is clearly favourable with liabilities at the end of the period being around 75 per cent of their current level relative to GDP.

AASB 119

7.11 Since the 2005-06 financial year, the Department of Defence has been required to comply with Australian Accounting Standard AASB 119 — Employee Benefits in reporting on superannuation obligations in its financial statements. The discount rate assumption assumptions required under AASB 119 differs from the assumption used in this report. The requirement for the AASB 119 discount rate to be based on the Government bond rate at the reporting date is likely to result in changes in economic assumptions from year to year. All else being equal, movements in interest rates will lead to volatility in reported liabilities under AASB 119. Over the period for which unfunded liabilities have been calculated

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for financial statements under this Standard, the interest rates used in the calculations have all been within one percentage point of the interest rate used for this report.

- 7.12 The current report is focussed on the financial implications of the military superannuation arrangements over the long term. As noted earlier, it is important in a long term cost report not to introduce unnecessary volatility which might mask genuine effects. Accordingly, in my view, this is a more appropriate document for considering liabilities in a long term context than the Department of Defence Financial Statements.

Future Fund

- 7.13 In 2006, the Government established a Future Fund to meet unfunded superannuation liabilities, contribute to national savings and increase net worth. It is intended that the unfunded liabilities of all Commonwealth superannuation schemes, including the military superannuation schemes, would eventually be covered by the assets of the Future Fund. However, since the assets of the Future Fund are not held by the schemes, the unfunded liabilities projected in this report have not been reduced to take account of the assets which may be held by the Future Fund. Similarly, the projected outlays have not been reduced to take account of any drawdowns from the Future Fund.



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