

## **CHAPTER 7: UNFUNDED LIABILITIES**

- 7.1 The unfunded liabilities are the liabilities for superannuation entitlements in respect of service already rendered to the ADF and 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. Since the DFRDB holds no assets, the latter term refers in practice to member contributions and productivity superannuation contributions in the MSBS, together with the investment return on them.
- 7.2 The net present value of unfunded liabilities was calculated to be \$32.1 billion as at 30 June 2005. This is 3.6 per cent of GDP. The net present value of unfunded liabilities reported as at 30 June 2002 was \$27.1 billion or 3.8 per cent of GDP.
- 7.3 The 2002 Report projected that unfunded liabilities would be \$29.7 billion as at 30 June 2005, or 3.5 per cent of GDP for 2005. Liabilities are therefore somewhat higher than was projected at the last report. The main reason for this outcome is the changes in the actuarial assumptions, particularly the higher rates of pension take up and lower pensioner mortality. A number of other factors also acted to increase the unfunded liability. These include the adverse scheme experience over the three years and the additional cost of including some Qualification and Skills allowances into superannuation salary. The higher than expected GDP has reduced the impact of these changes when the figure is expressed as a percentage of GDP.
- 7.4 The unfunded liability for the DFRDB is \$23.3 billion and the equivalent figure for the MSBS is \$8.8 billion. These figures are higher than the approximate updated estimates used for the Financial Statements for the Department of Defence as at 30 June 2005 of \$22.3 billion for the DFRDB and \$8.2 billion for MSBS. In both cases, the new valuation assumptions being used have played a significant role in the increase relative to the Financial Statements.
- 7.5 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 2005

Category of Members	DFRDB (\$billion)	MSBS (\$billion)
Contributors	4.4	4.5
Pensioners	19.0	1.9
Preserved Members	0.0	2.4
<b>TOTAL</b>	<b>23.3</b>	<b>8.8</b>

Note: Total may be different from the sum of the components due to rounding.

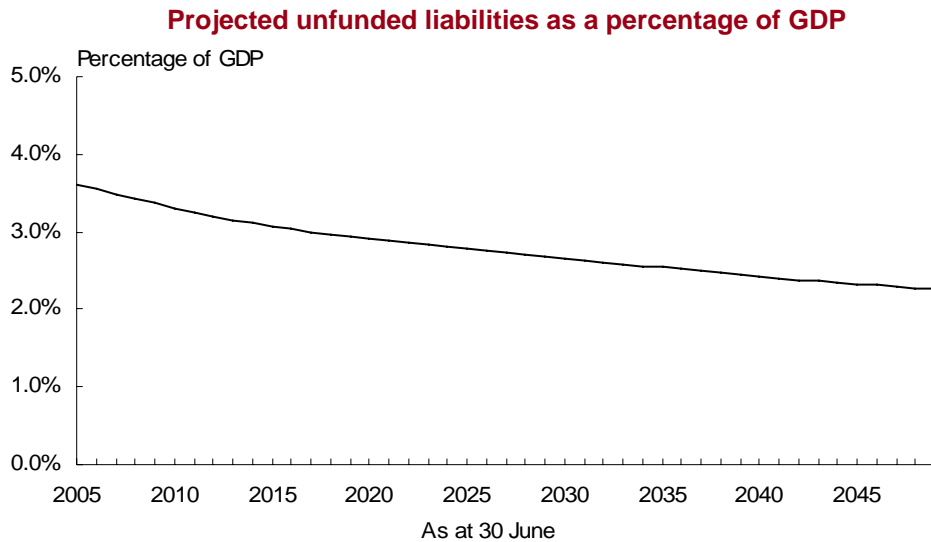
7.6 The table below shows the projected unfunded liability for the DFRDB, the MSBS and for the two schemes combined. The projections are in nominal dollars and have not been adjusted to 2005 dollars. To enable a proper comparison of the projected liabilities with the position in 2005, projections of the combined unfunded liability as a percentage of GDP are also shown.

### Projected Unfunded Liabilities

Year Ending 30 June	DFRDB (\$billion)	MSBS (\$billion)	TOTAL (\$billion)	As a percentage of GDP
2005	23.3	8.8	32.1	3.6
2010	24.2	14.0	38.3	3.3
2015	24.2	21.5	45.7	3.1
2020	23.4	31.4	54.8	2.9
2025	21.9	44.0	65.8	2.8
2030	19.8	59.1	78.9	2.7
2035	17.2	77.6	94.8	2.5
2040	14.1	99.3	113.5	2.4
2045	10.9	125.1	136.0	2.3

Note: Total may be different from the sum of DFRDB and MSBS due to rounding.

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



7.8 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 2005, 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.

7.9 The general trend is clearly favourable with liabilities at the end of the period being around 70 per cent of their current level relative to GDP.

### **AASB 119**

7.10 From the 2005/06 financial year, the Department of Defence will be required to comply with Australian Accounting Standard AASB 119 — Employee Benefits in reporting on superannuation obligations in its financial statements. The valuation methodology and assumptions required under AASB 119 differ in some respects from the methodology and assumptions used in this report. In particular, the requirement to use the Government bond rate at the reporting date as the interest rate is likely to result in changes in economic assumptions from year to

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year. All else being equal, movements in interest rates will lead to volatility in reported liabilities under AASB 119.

- 7.11 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 the purpose than the Department of Defence Financial Statements.

### ***Future Fund***

- 7.12 The Australian Government announced during the 2004 federal election that it would establish a Future Fund to meet unfunded superannuation liabilities, contribute to national savings and increase net worth. It is intended that the unfunded liabilities of 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.