2005

MILITARY SUPERANNUATION AND BENEFITS SCHEME

AND

DEFENCE FORCE RETIREMENT AND DEATH BENEFITS SCHEME

(MSBS AND DFRDB)

A report on long term costs
carried out by the
Australian Government Actuary
using data to 30 June 2005

ISBN 0 642 74354 1

Publication enquiries
Australian Government Actuary
The Treasury Building
Langton Crescent
PARKES ACT 2600

Printed by Canprint Communications Pty Ltd

CONTENTS

SUMMARY

This report sets out estimates as at 30 June 2005 of the long term costs of superannuation benefits payable in respect of the members of the major superannuation schemes covering the vast majority of Australian Defence Force (ADF) personnel. The previous report was prepared using data as at 30 June 2002.

The schemes covered in this report are:

- the Military Superannuation and Benefits Scheme (MSBS) which commenced on 1 October 1991; and

- the Defence Force Retirement and Death Benefits Scheme (DFRDB) which has been closed to new members since the commencement of the MSBS.

Changes to military superannuation since the previous report

There have been two significant changes to the superannuation regime applying to ADF personnel over the period under review. The first was to allow the splitting of superannuation entitlements following the changes to the Family Law Act. The other significant change during the period was the inclusion of certain Qualifications and Skills allowances into superannuation salary. The first of these measures had a negligible impact on scheme costs and the second resulted in a minor increase in costs.

Scheme membership

Contributory membership has been stable over the past six years at around 51,500, with declines in DFRDB serving members being offset by increased numbers of MSBS serving members. The number of pensioner members in both schemes has continued to increase with almost 62,000 pensioners in total being valued for the current review. The number of MSBS members with a preserved benefit increased by 13,000 over the three years from 2002 to 2005, to over 57,000.

Changes in assumptions since the previous report

The assumptions adopted and changes since the previous report are discussed in Chapter 4. For the most part, each of the changes in the experience assumptions since the previous report is of a relatively minor nature but cumulatively they result in a noticeable increase in the dollar value of reported costs. The assumed growth in GDP is higher than for the previous report.

Notional employer contribution rates

The notional employer contribution rate is the contribution rate that would be required to fund the benefits accruing to serving members over the next three years on the basis that superannuation benefits are accrued uniformly over a member's period of service. The following table shows the contribution rates for each scheme as calculated for this report and the previous report as at 30 June 2002.

Notional employer contribution rate as a percentage of superannuation salary

Report as at	MSBS	DFRDB	Combined
30 June 2002	23.2%	33.9%	25.3%
30 June 2005	24.7%	33.5%	26.0%

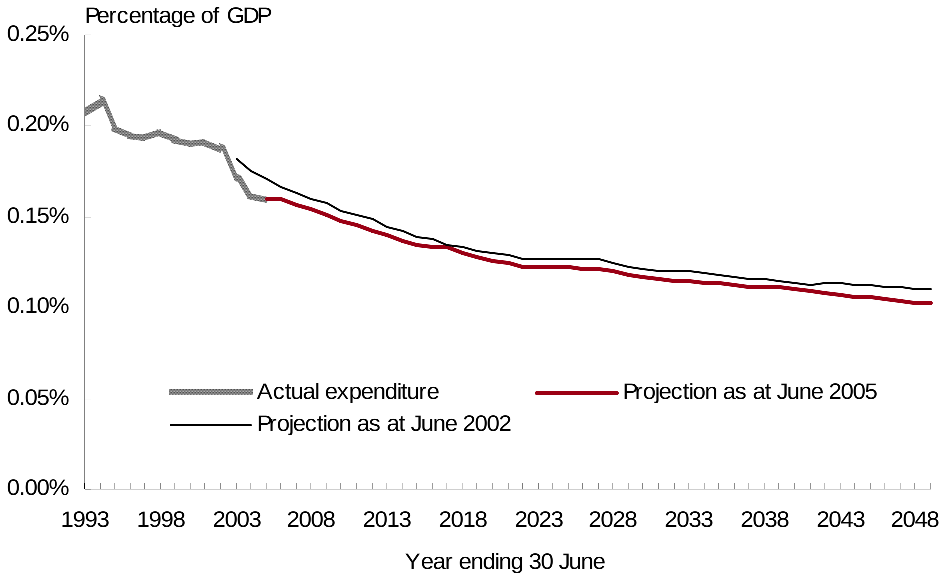
Notes:

1. The MSBS rates exclude the cost of the retention benefit.
2. The 2002 and 2005 combined rates are weighted average rates based on salaries of the members of the two schemes projected over the three years following the review date.
3. Attention is drawn to the changes in assumptions between 2002 and 2005. Details are given in Chapter 4.
4. These rates include the 3 per cent productivity benefit.

Projection of employer costs

The cashflows that will be required under the current method of funding benefits have been projected for the next 40 years and expressed as a percentage of Gross Domestic Product (GDP) so that the relativities of annual Government superannuation cash outlays can be matched against a relevant base. The following chart shows actual costs since 1993 and projected costs for the next 40 years, together with the costs that were projected in the 2002 Report.

Actual and projected employer costs as a percentage of GDP



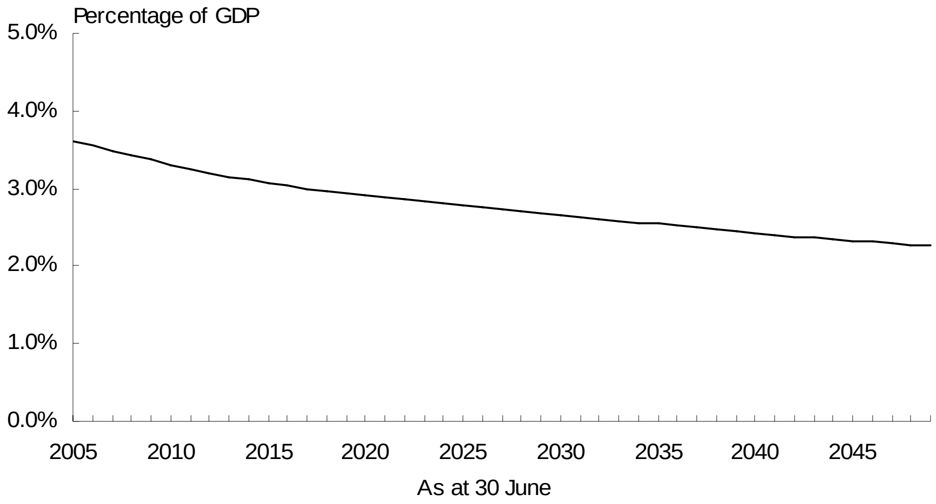
Annual costs represent approximately 0.16 per cent of GDP at present, falling to around 0.11 per cent of GDP in the long term. The current projections are slightly lower than the projections in the 2002 Report due to higher projected GDP.

Present value of unfunded liabilities

The direct unfunded liability in respect of benefits that have already accrued for current employees, former employees and pensioners has been calculated to be $32.1 billion as at 30 June 2005 of which $23.3 billion relates to the DFRDB and $8.8 billion to the MSBS. This is 3.6 per cent of GDP. This compares with the figures appearing in the last report of $27.1 billion or 3.8 per cent of GDP as at 30 June 2002.

The following graph illustrates the projected fall off in the total unfunded liabilities as a percentage of GDP. The trend is clearly favourable with liabilities at the end of the period being around 70 per cent of their current level.

Projected unfunded liabilities as a percentage of GDP



AASB 119

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 AASB 119 requirement to use a Government bond rate at the reporting date as the interest rate 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.

The current report is focussed on the financial implications of the military superannuation arrangements over the long term and, in my view, is a more appropriate document for this purpose than the Department of Defence Financial Statements.

Future Fund

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.