<u>Report on Future Fund and Unfunded Liability by Geoff Henkel and Tom Hayes</u>

- **A recent article by John Kehoe, Senior Writer on economics etc., in the AFR had alerted Geoff Henkel on a major change in the calculation of the Unfunded Liability (UL) by Dep. of Finance (DOF). DOF had increased the UL for the Civil Superannuation schemes from $183B to $233B in its 30 June 2019 Report.**

- **On investigation, we found that this was caused by the adoption of a low discount rate for calculating the Present Worth (or UL) of all future annual outlays for superannuation over a 40 year period. (If the discount rate adopted is 6 %, then the first year outlay is reduced by 6 %, the second year outlay by a further 6% and so on to 40 years when the annual outlay is reduced by 6 % 40 times.) A low discount rate increases the Present Worth/UL value of all annual outlays. A high discount rate reduces the UL.**
- **The discount rate for determining the UL had used the usual Long Term Bond Rate, adopted as 6 %, for 5 of the Trienniums up to 2014, but it was reduced to 5 % for the last 2017 Triennium. Then in 2019, DOF had adopted 1.7/1.9 %, the current Short Term Bond Rate. Its lowered discount rate of course increased the UL markedly.**

- **Mercer is commissioned by DOF to do the Civil UL determination; The Australian Government Actuary (AGA) determines the Military UL on behalf of the Department of Defence. They both base their determination on common assumptions and appropriate similar estimates and undertake it for the same triennium date.**

- **Tom Hayes investigated the Military Superannuation and the UL is $181 B for 30 June 2019 with the AGA adopted discount rate of 1.9 %.**

- **The total UL of both Civil and Military schemes is $ 414 B, more than twice the value of the Future Fund, valued at $166 B on 30 September 2019. The Future Fund has returned 10 % pa over the last 10 years and will take a long time to reach the increased UL.**

- **The intention is apparently to let the Future Fund to continue to make 10 % pa and continue to fund DB superannuation out of the Budget, although the Government intends to credit the revenue side of the Budget with the Future Fund earnings after 2020.**

- **We also noted that Mercer had used a 5 % discount rate in it 30 June 1917 Triennial assessment, reported in 2018, but had separately advised DOF as its Designated Actuary/Advisor in July 2018 that the Target Asset Level of the Future Fund for the UL for the Government to cover (Civil + Military) for 30 June 2019 would be $194 B, <u>using</u> <u>a 6 % discount rate</u>. It based the advice on**

what return could be expected from the Future Fund; conservatively assuming it would be the Target Return of 6 %. The Future Fund has and could perform better and has actually achieved 10 % pa return over the last 10 years.

- **Tom Hayes and Geoff Henkel arranged a joint meeting with Andrew Leigh (Shadow Assist. Treasurer) and Katy Gallagher (Shadow Minister for Finance) in Parliament on 28 November 2019 to discuss the adoption of a low discount rate. Katy was busy on Senate divisions, so we spoke to only Andrew, but he promised to brief Katy. We said that the ALP might use the Future Fund on the basis of the performance and save on the Budget, when next in Government or perhaps for Katy to ask questions on the lows discount rate in Senate Estimates.**

- **Subsequently to the ACPSRO Meeting, Tom Hayes has undertaken UL calculations for discount rates of 6 %, 8 % and 10 %. He found that that the Future Fund worth could equate to the UL for discount rates above about 7 %.**

- **Tom Hayes has also investigated why DOF would use current bond returns, of under 2 %. It seems that accounting standards can justify the use of the low discount rates adopted.**

- **This seems silly as the Future Fund is to be the single source of financing DB Superannuation and it is likely to perform better than its Target Return of 6 %.**

- **It thus seems likely that the Future Fund also could pay fairer indexation, rather than a deficient CPI. We are hopeful of having an enquiry into the purpose of indexation and the adoption of a fair indexation rate for all Commonwealth beneficeries, such as the ASIC direction to Financial Advisors to adopt for retirement planning a CPI of 2 % plus 1.2 % for retirees to maintain a reasonable living standard.**

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