



# Australian Defence Force Retirees Association Inc.

No. A0108026R

We represent the interests of Defence Force Retirees regarding their Superannuation

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The Hon Matt Keogh MP

Minister for Defence Personnel

Minister for Veterans' Affairs

Dear Minister,

Your letter is inconsistent with the facts. Many of the statements have been seen countless times before in other correspondence to Parliamentary Members and Senators, and in personally shared correspondence from your office to DFRDB recipients.

Your letter **mistakenly asserts** that:

- DFRDB retirement benefits are updated in the same way as Age Pensions;
- Commutation is a separate component of the DFRDB scheme;
- The expectation of life factor determines a member's commutation lump sum;
- Contemporizing the expectation of life factors will leave most members worse off; and
- The commutation provisions in the Act reflect the recommendations of the 1972 Joint Selection Committee on Defence Force Retirement Benefits Legislation.

Your letter **overlooks** that:

- Part XA of the DFRDB Act significantly depreciates recipient members' and Spouse's benefits, discriminating by the members' age and gender; and
- Commutation reduces recipient members' statutory entitlements beyond life expectancy.

You letter quotes the findings of two investigations which "*recognized the beneficial nature of the scheme*" and recommended no changes after **your department misinformed those inquiries** on the operation of the DFRDB Act.

ADFRA's annotations in the attached copy of your letter address these matters in greater detail.

Yours faithfully,

***Herb Ellerbeck***

Secretary, Australian Defence Force Retirees Association (ADFRA) Inc.

6 March 2023



THE HON MATT KEOGH MP  
MINISTER FOR VETERANS' AFFAIRS  
MINISTER FOR DEFENCE PERSONNEL

Ref No: MC22-002536

**Herb Ellerbock**

herbell@bigpond.net.au

Dear Mr Ellerbock,

**DEFENCE FORCE RETIREMENT AND DEATH BENEFITS SCHEME ~~COMMUTED PENSION~~**

Thank you for sharing your presentation regarding the Defence Force Retirement and Death Benefits (DFRDB) scheme following our meeting on 6 September 2022.

I note that the DFRDB scheme has been reviewed a number of times since its introduction in 1973. The most recent reviews were completed by the Commonwealth Ombudsman in 2019 and by the Senate Foreign Affairs, Defence and Trade ([FADT](#)) Reference Committee in 2021.

If this implies that those reviews fully addressed the matters of concern to DFRDB members. Then **that is not the case**.

DFRDB members were not consulted on the **Terms of Reference** for those reviews, which have **ensured** that members' primary **concerns would not be addressed**.

The Commonwealth Ombudsman's conducted an **Own Motion** investigation, the scope for which was determined after consultation with Commonwealth Superannuation Corporation and Department of Defence (Personnel).

When questioned by the FADT Reference Committee's about the DFRDB scheme design issues raised with him, he replied, "**those matters were outside the scope of my functions**".

The FADT Reference Committee's Report quoted from submissions and testimony, and echoed the Commonwealth Ombudsman's findings, but made no specific comment regarding the scheme's design.

Yet, the effects of that design **are the very matters members want to be investigated**.

I have addressed the issues raised in your presentation in detail below.

## Indexation

As noted above, there has been a range of reviews to consider the most appropriate method of indexation for DFRDB pensions. While some reviews differ in the exact methods recommended, they broadly agree that a fair method of indexation allows for pension recipients to maintain the purchasing power of the pension over time.

The way indexation is calculated is set out in the *Defence Force Retirement and Death Benefits Act 1973* (the Act) under Part XA, which includes section 98B that you have referenced in your presentation.

There are two methods for measuring purchase power set out in the DFRDB legislation: Consumer Price Index (CPI) and Pensioner and Beneficiary Living Cost Index (PBLCI). Information about how these are calculated is available at: [www.abs.gov.au](http://www.abs.gov.au).

DFRDB pensioners under the age of 55 receive twice yearly adjustments in line with CPI. Since 2014, DFRDB pensioners over the age of 55 receive twice yearly adjustments using the higher of the CPI or the PBLCI. This is the same way that the Age pension is paid by Services Australia and the Service pension paid by the Department of Veterans' Affairs are indexed.

In comparison, the majority of the other Commonwealth funded superannuation scheme pensions and pensions payable from the state and territory governments are indexed in line with upwards movements in CPI only.

No additional changes to indexation methods for the DFRDB scheme are being considered.

**Contrary to your assertion, DFRDB benefits are not updated in the same way as Age Pensions.**

Regardless of whether the CPI or the higher of the CPI or PBLCI is used, **s.98B(5)** of the DFRDB Act excludes from adjustment, a part of *retired pay* and *invalidity pay*. Depending on age, the part excluded, which is determined by the Expectation of Life Factors in Schedule 3 of the Act, ranges from:

- 8.6% to 25.51%, for female members; and
- 9.74% to 32.08% for male members.

That **partial indexation** method can only have one effect. That is to erode, no, to **reduce the value of the retired pay and invalidity pay entitlements**.

Your acknowledgement: "**...that a fair method of indexation allows for pension recipients to maintain the purchasing power of the pension over time**", also appeared in your department's submission to the FADT Senate inquiry.

However, that submission failed to mention the **benefit depreciation** method incorporated in Part XA of the DFRDB Act, which **excludes up to more than 30% of retired pay and invalidity pay from indexation**, the effect of which is to do the very opposite of maintaining purchasing power over time.

As you have observed, the other superannuation schemes you referred to are ‘**funded**’. In those schemes, member contributions and Government co-contributions are paid into a Fund, the assets of which are invested and generate a compounded return for the members.

Typically, the rate of return from those investments far exceeds the upwards movements in the CPI. As an example, according to the Commonwealth Superannuation Corporation’s (CSC) annual Report of 2016-17, the **7-year rate of return**, net of fees and taxes, **was**:

- **8.3%** for the Commonwealth Superannuation Scheme; and
- **8.2%** for the Public Sector Superannuation Scheme.

**Over the same period**, the average **increase in the CPI was 2.1%**.

The 2021-22 CSC Report to Government states that the default investment objective, after fees and taxes, is “**To outperform the CPI by 3.5% per annum over 10 years**”.

On the other hand, **DFRDB** is an ‘**unfunded**’ scheme in which **member contributions** are paid directly into the Consolidated Revenue Fund, where they are **not invested and generate no return** for the members or the Commonwealth. Under the Constitution, the Commonwealth may use the funds for any legitimate purpose.

That significant detail was omitted from your department’s submission to the FADT Senate inquiry.

The Reference Committee could rightly have expected your department, as the department responsible for DFRDB policy, to inform the FADT Senate inquiry of the operation of the benefit adjustment (indexation) provisions. But your department’s submission **withheld vital details**, which could only be seen to **mislead the Committee** in forming an understanding of the DFRDB indexation methodology.

Furthermore, in its testimony at the FADT Senate inquiry Hearing on 20 May 2021, your department explained that:

**“[w]hen the DFRDB Act 1973 was legislated, the commutation provisions were mirrored off the DFRB scheme”.**

I have also seen **similar words** in House of Representatives **Hansard, 05 Feb 2018**, in a Background paper produced by your department in support of the Minister’s response to **Petition No. PN0063**.

That statement is **factually incorrect** and **misleading**. ADFRA member, Mr Clinton McKenzie, has already addressed that matter to you separately in his letter dated 20 January 2023.

When the Hon John McLeay moved that the *Defence Force (Retirement and Death Benefits Amendments) Bill 1977* be read a second time, he knowingly or otherwise misled the Parliament about the DFRDB benefit adjustment method when he said:

***“those updating arrangements achieved consistency with those currently applying to comparable classes of pensioners under the Commonwealth Public Service superannuation schemes”.***

**This is not true.**

**The nature of military service is unique.** There were **no comparable classes of pensioners in the Commonwealth Public Service.** The ‘**unfunded**’ DFRDB scheme was designed to be unique to satisfy Defence Force capability factors. There are **no comparable ‘funded’ Commonwealth Public Service superannuation schemes.**

### **Commutation and Life Expectancy factors**

The DFRDB scheme, like all Commonwealth defined benefit schemes, was developed as a structured benefits scheme. All aspects of the scheme should be considered together in order to recognise the overall benefits provided. It is important to note that amendments in isolation to one component of the scheme would have secondary effects on the calculation and operation of other benefits provided, and would not necessarily increase the beneficial nature of the scheme overall.

**Commutation is not a separate component** of the DFRDB scheme. It is an option for members to receive an advance payment of a **part of their benefit entitlement**, defined in s.23 of the DFRDB Act, **as a lump sum**.

Members are not asking for an “**increase in the beneficial nature of the scheme**”. They only **want their benefit entitlements**, as defined in s.23 of the Act, **to be paid in full**.

The expectation of life factor is an actuarially based element of the commutation calculation undertaken to determine a DFRDB scheme member’s lump sum and resultant pension benefit. Commutation is the early payment of part of a member’s retirement pay in the form of a lump sum.

The **expectation of life factor does not determine a “member’s lump sum and resultant pension benefit”**. *Retired pay and invalidity pay are determined by a percentage of final salary*, determined from Schedule 1 in the DFRDB Act, **based on completed years of service**.

Members with the **same final salary and completed years of service** receive **identical retired pay or invalidity pay**, regardless of their gender and age.

The Commonwealth Ombudsman concluded that some DFRDB members were led to believe incorrectly that their commuted pension would increase once they reached their life expectancy factor age. This was not correct and amounted to defective administration by Defence.

As a consequence, the Secretary of Defence and Chief of the Defence Force issued an apology on 3 December 2019, which was published in the Ombudsman's report on 11 December 2019.

The Senate Foreign Affairs, Defence and Trade Reference Committee recommended that the Australian Government consider providing more assistance to those members who wish to lodge a claim under the Compensation for Detriment caused by Defective Administration (CDDA) scheme in respect of the commuted pension under the DFRDB scheme, or to those wishing to appeal an adverse decision in relation to the scheme.

Members of the DFRDB scheme who believe they have suffered a financial detriment as a result of the provision of such erroneous information, are encouraged to lodge a claim under the CDDA scheme. Defence has tailored the claims process to help focus on the issues critical to the determination of the claim and provided members access to a case manager to assist with the process. A claim can be lodged under the CDDA scheme by completing the DFRDB CDDA Application Form found at [www.defence.gov.au/legal/Directories/dsfc.asp](http://www.defence.gov.au/legal/Directories/dsfc.asp) and submitting it to [dl.de1dc@defence.gov.au](mailto:dl.de1dc@defence.gov.au). Please note that the Commonwealth Ombudsman's report sets out criteria (Appendix F of the report) that should be considered prior to lodging a claim for CDDA. The report can be found [www.ombudsman.gov.au/publications?page=1&year=2019](http://www.ombudsman.gov.au/publications?page=1&year=2019).

You have requested that the Government consider updating the expectation of life factor as prescribed in Schedule 3 of the Act so that current serving men and women have what you view as a fairer scheme when they are given the option to commute on their retirement from the Australian Defence Force.

*Australian Defence Force Retirees Association Inc. (ADFRA) has not asked the Government to consider updating the expectation of life factors in Schedule 3. That request came from the Defence Force Welfare Association, an Ex-Service Organization your department partially funds.*

*As demonstrated in the ADFRA presentation, using the expectation of life factors results in a discriminatory reduction of benefits after commutation, which cannot be remedied by applying updated expectation of life factors.*

The purpose of commutation is to allow members the flexibility to receive a lump sum if required, depending on their financial situation at the time, and to assist the member in resettling into civilian life. Permanently reducing the pension recognises that members who elect to commute will obtain a long-term advantage from the immediate use of their lump sum, depending on what they choose to do with the amount. It is important to note that a decision to commute part of the pension is entirely voluntary.

The commutation provisions in the legislation reflect the recommendations of the 1972 Joint Selection Committee on Defence Force Retirement Benefits Legislation, and include the retention of a proportionate reduction to the pension to account for the commutation.

The Joint Select Committee on Defence Forces Retirement Benefits Legislation's May 1972 Report (*Jess Report*) includes no words which can be construed to mean:

***"Permanently reducing the pension recognises that members who elect to commute will obtain a long-term advantage from the immediate use of their lump sum".***

When the Hon Lance Barnard moved that *Defence Force Retirement and Death Benefits Bill* 1973 be read a second time, he said:

***"Commutation of retirement pay will be a right for members who retired after 1 October 1972, subject only (emphasis added) to applications for commutation being made within one year of retirement ..."***

**Commutation** was one of, if not **the most significant provision** in the DFRDB scheme. Yet, **the Minister's speech**, which would have been drafted by his department, **provided no details whatsoever**.

The **DFRDB Bill** was introduced concurrently with three other **Bills**, and the House of Representatives had just **three working days** to scrutinize and debate all four **Bills** which, according to Mr David Hamer MP, was "**grossly Inadequate**" for a Bill of such complexity.

**The omission** of relevant details the Minister's Second Reading speech **guaranteed** that the **Commutation** provision **would not be closely scrutinized**.

The **operation of the commutation provision in the predecessor DFRB scheme** is explained in the *Jess Report*:

***"The provision made for commutation in the existing legislation is designed to ensure that if the option is exercised the actuarial assumptions on which the scheme is based will not be affected. A retiree may not, therefore, commute more than he could be expected to draw as pension. The assessment of his individual life expectancy is designed to ensure this. The amount payable to the retiree is reduced to allow for expected loss to the fund of anticipated interest earnings. The commutation factors applied by the Actuary contain an element which makes this adjustment."***

**There is no Fund** in the DFRDB scheme, **and therefore, no justification** for permanently reducing *retired pay* or *invalidity pay* after commutation.

**After the DFRDB Bill was enacted**, then Secretary of the *Defence Force Retirement and Death Benefits Authority*, **Mr R. J. Perriman**, issued *DFRDB Circular 193/7*, dated 2 August 1973, in which paragraph 65 provides this explanation:

***"Although a life expectancy factor is used, full retirement pay is not restored should the member live beyond life expectancy. By the same token, should the member die before attaining the expected age, no attempt is made to recover the amount of the***

*lump sum outstanding from dependents or the estate.”*

Mr Perriman’s assertion implies that the **members who live beyond their life expectancy** must **compensate** the Commonwealth **for** an effective overpayment of entitlements to **those who die before** their life expectancy.

But life expectancy has increased and continues to rise. Currently, at least 80% of members will live beyond the age determined by their 1960-1962 expectation of life factor. Therefore, **80%** of members who commuted **will compensate** the Commonwealth **for** the **20%** who die prematurely—a **significant imbalance**.

On a recipient member’s premature death, the **Commonwealth’s liability** for the deceased member’s benefit entitlement **is significantly reduced**, and the **commutation arrangement is effectively terminated** by Recommendation (14)(c) in the *Jess Report*, which states:

*“That for the purpose of determining a widow’s entitlement commutation should be disregarded.”*

The Australian Government Actuary (the Actuary) has provided advice regarding commutation values for DFRDB members. The Australian Government Actuary noted that when the DFRDB scheme was introduced in 1973, the use of the 1960-62 Australian Life Tables as a commutation factor was favourable to members relative to the alternative pension.

When the Government Actuary referred to the “**alternative pension**”, did he mean a pension based on **1970-1972** Life Tables, which were the most current Life Tables in 1973?

The average differences in Expectation of Life Factors for the ages in Schedule 3 were:

Gender	1970-1972	1960-1962	Difference
Males	25.53	25.78	0.24
Females	30.65	30.46	-0.19

The 1960-1962 Life Tables were **unfavourable for female members**.

Some DFRDB retirees have proposed replacing the existing life expectancy tables with current tables, to improve their residual pension post-commutation. While doing so would have that effect, the life expectancy tables should not be amended in isolation as they are a foundation principle of the DFRDB scheme, upon which all other benefits flow. Updating the tables will require updates to the overall scheme to effectively contemporise how the DFRDB scheme would operate today.

Does this mean that the defined **benefits** recommended in the Jess Report were **derived from** the **1960-1962 life expectancy** tables when the recommendation clearly states; “**retired pay and invalid pay be expressed as a percentage of final pay**”?

You cannot contemporise one component without considering the rest of the scheme. Contemporising the overall scheme will leave most members worse off as commutation factors would also need to be updated, which would likely affect the pension amount an individual receives.

**Does this mean that contemporizing the expectation of life factors would result in an adjustment of the commutation factors which ensures most members will be left worse off?**

The Commonwealth Ombudsman made note of the life expectancy tables in his investigation into the administration of the DFRDB scheme. While the Ombudsman noted that if the commutation divisor increased, it would have a beneficial flow on to members, the Ombudsman concluded that as the scheme drafters did not include a provision to update the tables from time to time, it would suggest that the tables were meant to be used as a static commutation factor, consistent with the static commutation factors used in the civilian Commonwealth Superannuation Scheme.

**ADFRA's presentation demonstrated clearly that if members who commute live beyond the age determined by their expectation of life factor, their benefit entitlements, as defined in s.23, are reduced.**

**The Commonwealth Ombudsman's conjecture** that an increase in the expectation of life factors "*would have a beneficial flow on to members*" should more appropriately have been "*would have a less detrimental effect on members*".

Two extensive investigations into the DFRDB scheme found that member and dependant benefits are paid correctly in accordance with the legislation, and also recognised the beneficial nature of the scheme. No changes to the scheme were recommended. As such, the Australian Government has no plans to make further changes or conduct further reviews of the scheme at this time.

**That finding is not surprising, considering your department misinformed those inquiries on the operation of the DFRDB Act.**

I trust this clarifies matters concerning these issues for you.

Yours faithfully,



HON MATT KEOGH MP

(9) November 2022