



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 Andrew Gee MP
Minister for Defence Personnel

Dear Minister,

Thank you for your letter of 7 October 2021, and advice that the Department of Defence (DoD) is reviewing the recommendations of the Senate Foreign Affairs, Defence and Trade (FADT) Committee's inquiry into "*Accuracy of information provided to Defence Force Retirement and Death Benefits (DFRDB) members*".

The Government's position on DFRDB and the plethora of responses to DFRDB members' concerns stems from DoD advice. But that advice is rarely challenged by the Ministers responsible.

In his 2019 investigation, the Commonwealth Ombudsman found that DFRDB members were misled by DoD, and the FADT Committee did not dispute that finding. But the terms of reference for both inquiries, in the main, confined the investigation to information provided to DFRDB members regarding their entitlement to commutation.

DoD provided the background information to the Ombudsman and the FADT Committee, and that information was taken at face value. An example is this statement by DoD in its [Submission \(No. 39\)](#) to the FADT Committee:

"When the DFRDB Act 1973 was legislated, 'the commutation provisions were mirrored off the DFRB scheme."

That statement is quoted twice in the [Committee's Report](#) (see paragraphs 1.13 and 3.21) without any reservation or qualification.

The same statement appears in House of Representatives Hansard, 5 February 2018, in a [Background Paper](#) to the [Minister's Response](#) to Petition PN0063.

That statement by DoD is **incorrect**. The commutation provisions of the DFRDB Act **do not** mirror those of the DFRB Act.

Under the old DFRB Scheme, commutation was not an entitlement. It was entirely at the discretion of the DFRB Authority (see s 74 of the [Defence Forces Retirement Benefits Act 1948](#)), subject to scrutiny of the member's intention in obtaining the commutation and, if required by the Authority, a medical examination (see reg 15 of the [Defence Forces Retirement Regulations](#)).

Under the DFRB scheme, a retiree could not commute more than he could be expected to draw as pension. The assessment of the retiree's individual life expectancy was designed to ensure

this. The amount payable to the retiree was reduced to ***allow for expected loss to the fund of anticipated interest earnings*** (see paragraph 109 of the Jess Report). But there is ***no fund*** in the DFRDB scheme.

There can be no doubt, that this statement by DoD, regarding the mirroring of the DFRB scheme, influenced the Committee's understanding and interpretation of the commutation provision in the DFRDB Act.

The effect of commutation is not the only concern which has long been raised by DFRDB members. The method of adjusting members' benefits, as is shown in [The Legislated Reduction of Superannuation Entitlements for Ex-service Personnel video presentation](#), has long been the other major concern. But the terms of reference for the Ombudsman's investigation and the FADT Senate Committee's inquiry ensured that the adjustment (indexation) of DFRDB benefits would not be addressed.

But this misleading information from DoD is not an isolated case.

In a recent [letter from the First Assistant Secretary People Policy & Culture](#), Mr. David Nockels, stated:

"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 may have unintended consequences to other benefits provided, and would not necessarily increase the beneficial nature of the scheme overall."

DFRDB is a statutory defined benefit scheme, under which members of the Defence Force were granted an entitlement to *retirement pay* or *Class C Invalidity Pay*, at a rate determined by their final salary and completed years of service. DFRDB is an ***unfunded*** scheme, where members' ***contributions bear no relationship to the benefits***, which are ***fully funded*** from the Consolidated Revenue Fund (CRF).

The question which should be put to DoD is:

"Was the ***discrimination*** against members of the DFRDB scheme because of their gender, age, or time of departure from the Defence Force, which results from:

- CPI-linked and partial adjustments;
- the use of notional life expectancy factors; and
- the permanent cancellation of a part of defined benefits after commutation,

an ***intended*** consequence?"

If that was not the intent, then these ill-considered aspects of the legislation already have ***unintended*** consequences.

Instead of making abstract observations, Mr Knockels could more helpfully turn his mind to changes that would **eliminate** those unintended consequences.

Mr. Nockels continues:

“The life expectancy tables are an actuarially based element of the calculation to determine a DFRDB 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.”

That is **not correct**. The life expectancy tables have **no effect** on the quantum of the lump sum entitlement, they are used to calculate the quantum of the **deduction** from the *retirement pay* entitlement after the member elected to commute.

The commutation lump sum was initially set down as a maximum of four (4) times a DFRDB member’s initial (per annum) *retirement pay* entitlement. That was increased progressively, from 1983 to 2002, to five (5) times the initial *retirement pay* entitlement, to compensate for increased taxation of lump sum payments.

The lump sum is a multiple of the member’s annual *retirement pay* entitlement and that entitlement has **never** been determined by the member’s life expectancy. A member’s *retirement pay* entitlement is determined **first** to enable the calculation of the portion to be paid as the commuted lump sum and the portion to be paid fortnightly, but commutation and the life expectancy tables have **never** changed the entitlement value.

Mr. Nockels continues:

“It is correct that updating the life expectancy tables alone would improve a member’s pension. However the life expectancy tables as currently defined are fundamental to the overall benefits of the DFRDB scheme. Any updating of the life expectancy tables would necessitate further updates to other aspects of the scheme, such as commutation factors, to ensure the entire scheme is appropriately contemporised. This would leave some members 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. This somewhat replicates the static commutation factors used in the civilian Commonwealth Superannuation Scheme (CSS).”

As already stated, the rate of *retirement pay* entitlement is determined **only** by members’ **final salary** and completed **years of service**. That entitlement should not alter because the member elected to commute a part of it. Yet, regardless of the rate of the *retirement pay* entitlement, the life expectancy tables result in a **different** rate of reduction, for **every** combination of gender, age on commutation and date of commutation, if the member lives beyond the static notional life expectancy factor, as has been the case for a large majority of members.

Theoretically, there can be 1,512 different outcomes, (male/female, ages 30 to 65 and commutation factors of 4 to 5 in increments of 0.05), for an identical *retirement pay* entitlement.

If the entire scheme were to be “*appropriately contemporized*”, it would ensure that, where two members are entitled to an **identical** rate of *retirement pay*, their entitlement is not reduced at a different rate because their gender, age on commutation or date of commutation differs.

Mr. Nockels continues:

“Where a member does not elect to commute, or commutes less than four times the pension, indexation is only applied to the ‘notional rate of retirement pay’. The ‘notional rate of retirement pay’ is the rate of pension that would be payable if the member had commuted four times the pension (which was the maximum amount that could be commuted at the time indexation arrangements were introduced).”

When automatic indexation was introduced in 1976 it was applied only to the ‘notional rate of retirement pay’ to reflect the employer funded part of the pension. The non-indexed portion of a pension reflects the employee funded (member contributions) part of the pension. This broadly replicates the indexation arrangements of the CSS and was consistent with the recommendations of the 1973 Pollard Review and the 1974 Melville & Pollard Review.”

The [Background Paper](#) to the [Minister’s Response](#) to Petition PN0063 also states:

“The Jess Committee recommended that pensions paid from the DFRDB scheme should be indexed annually to maintain relativity with Average Weekly Earnings. Although ad hoc increases in line with Average Weekly Earnings were made in the early years of the Scheme, the method finally adopted was for annual increases based on CPI. This decision was made following an independent report by actuary Professor A.H. Pollard in 1973. Although concluding that the purchasing power of pensions should be maintained, Professor Pollard noted that national productivity gains, as reflected in the Average Weekly Earnings measure, was an inappropriate criterion to be used in adjusting Commonwealth superannuation pensions for retirees.”

“Professor Pollard did however, recommend automatic annual indexation of the Government funded portion of the pension by 1.4 times the increase in the CPI between the two preceding March quarters, capped at the growth in Average Weekly Earnings over the same period (therefore inclusion of wage based index). This recommendation was also adopted on an ad hoc basis in relation to DFRDB and DFRB scheme pensions.”

That is **not correct**. The ad-hoc adjustment of DFRDB scheme pensions in 1974 **did not** apply 1.4 times the increase in the CPI. Rather, it applied the unfactored CPI increase to just five-sevenths (71.4%) of DFRDB pensions. Therefore, the 1974 increase of DFRDB pensions **discounted** the CPI increase **by** (1.4 minus 0.714) divided by 1.4 per cent, that is, **49%**.

The amendment which introduced automatic indexation, occurred in 1977. Effective from 1 July 1976, it linked the automatic adjustment of benefits directly to the Consumer Price Index (CPI), which had already been rejected in 1972 by the Joint Parliamentary **Jess Committee**, because **"the index does not fairly represent changes in the general community standards"**.

The **exclusion** from adjustment of a part of *retirement pay*, already diminished by the effect of unrepresentative CPI, **further diminishes** the current value of that *retirement pay* entitlement. The part excluded is determined by the same notional life expectancy factors which reduce members' entitlements after commutation and, therefore, also results in a different reduction of entitlements based on gender, age on retirement and date of retirement.

For members who separated from the Defence Force from 1983 to 2021, those benefit reductions range from 46% to 0% with the greatest detriment suffered by the **oldest** members who separated from the Defence Force before 1993.

As already stated, DFRDB is an **unfunded** scheme, where members' contributions bear no relationship to their benefits and the Commonwealth is responsible for **100%** of the benefits paid (see [s.125 of the DFRDB Act](#)). **In no way** does the exclusion of a part of *retirement pay* from adjustment, equal to a member's commutation entitlement, replicate the indexation arrangements of the CSS, where member contributions and Government co-contributions are invested and generate a substantial return for its members.

The 1973 Pollard Review and 1974 Melville & Pollard Review related to the **funded** Commonwealth Superannuation schemes, including the Defence Forces Retirement Benefit (DFRB) scheme. But neither of those Reviews considered the **unfunded DFRDB** scheme.

Mr. Nockels adds:

"The DFRDB scheme has been formally reviewed multiple times and these reviews have recognised the beneficial nature of the scheme."

"On 18 March 2021 the Senate referred the "Accuracy of information provided to Defence Force Retirement and Death Benefits (DFRDB) members" to the Foreign Affairs, Defence and Trade References committee for inquiry. The life expectancy tables, among other elements of the scheme, were considered as part of this inquiry. The final report was released on 2 July 2021."

As was the case with the 2019 investigation by the Commonwealth Ombudsman and the recent review by the Senate FADT References Committee, every review of the DFRDB has been constrained and the conclusions pre-destined by their terms of reference.

Not one of those reviews considered the effect of DFRDB benefit adjustment (indexation).

The [Background Paper](#) to the [Minister's Response](#) to Petition PN0063 concludes:

"In assessing the overall benefit of the DFRDB scheme, it is not reasonable to consider individual elements of the Scheme as a change to one element changes the entire basis on

which the Scheme was developed. This is true for all Commonwealth defined benefit schemes.

The Scheme, designed some 45 years ago, was at the time tailored to meet the unique requirements of military service. Similar to the DFRB, the scheme was developed to meet service requirements and personnel objectives, which at the time included early retirement ages and an understanding that military retirees went on to further careers. The need to ensure superannuation for military members remained relevant and contemporary resulted in the closure of the Scheme to new members in 1991. Enhancements subsequently occurred to the DFRDB scheme with the introduction of MSBS. The changes to indexation of pensions in 2014 have further improved the beneficial nature of the Scheme.”

No enhancements occurred to the DFRDB scheme with the introduction of MSBS. In fact, a substantial penalty was introduced for re-entrants, who were members of the DFRDB scheme, if they did not transfer to the MSBS scheme.

The changes to indexation of pensions in 2014 only **arrested the erosion** of DFRDB benefits, for members aged 55 and over, and did nothing to remediate the substantial erosion of DFRDB benefits resulting from the effect of the CPI-linked adjustments from 1976 to 2014.

DoD has not just misled DFRDB members. It has also misled responsible Ministers and, as a consequence, those Ministers misled their Cabinet colleagues and the Parliament.

In its 1972 recommendations for a new military superannuation scheme, the Joint Parliamentary **Jess Committee**:

- Recognized the requirement of the Defence Services to retain experienced personnel; and
- Acknowledged, in its recommended entitlements, the unique nature of long military service, for which there is no equivalent in civilian Commonwealth Public Service employment.

Those recommendations were adopted by the then newly elected Government.

Clearly, those entitlements were an **inducement**, for members to serve a minimum of 20 years, **to meet the requirements of the Defence Force**.

But from the outset, DoD reneged on the recommended entitlements by its wording of the commutation provision in the original DFRDB Act. It then concealed the further reduction of DFRDB entitlements in legislation which:

- Applied interim benefit increases in 1974 and 1976;
- Incorporated the automatic adjustment of benefits in 1977;
- Compensated for an increase in the taxation of lump sum benefits in 1984; and

- Closed the DFRDB scheme to new Defence Force members, after the introduction of the then new Military Superannuation Benefit Scheme.

All those measures were touted as **benevolent** changes, when, the effect was the very opposite.

DFRDB recipients are not seeking to increase the beneficial nature of the DFRDB scheme. They want to stop the insidious reduction of the defined benefit entitlements they were promised for serving in the Defence Forces for a minimum of 20 years.

DFRDB recipients are simply asking for an **honest** and **objective** review of the administration of the DFRDB scheme by an **unaligned** third party, from which we would expect to see:

- A direct and open repudiation of our perception, if that is the conclusion; and
- If not, positive recommendations to;
 - cease the erosion of the promised and legislated defined benefits; and
 - restore those benefits to a fair current value.

The cost of DFRDB benefits is met by an appropriation from the Defence Budget, where the entitlements for ex-service personnel conflict with other Departmental financial objectives.

DoD has shown its ageing ex-employees no loyalty whatsoever, and while it has budgetary responsibility for the DFRDB and other Military Superannuation schemes, that is unlikely to change.

Yours sincerely,



J G Hislop OAM

16 November 2021

President
Australian Defence Force Retirees Association Inc.