



THE DFRDB COMMUTATION ISSUE

by
A STAFF WRITER

THERE REMAINS CONTINUING CONFUSION in some quarters about the operations of the DFRDB Scheme, particularly in respect to the issue of commutation and the use of outdated life tables.

DFWA policy objective on DFRDB Commutation has been consistent for over 15 years and is outlined on the DFWA website (<https://dfwa.org.au/policy/dfrdb-commutation/>) and put simply:

- The DFRDB expectation of life factor must reflect the actual life expectancy of the member at the date he/she chose to commute. A simple legislative change is all that is needed. This is cost neutral.
- All living DFRDB members who commuted must have their DFRDB pension reduction recalculated using their actual life expectancy at the time of their decision to commute.

It has also been explained in *Camaraderie* several times in recent years.

HISTORY

DFWA concerns with DFRDB were covered in an article by Win Fowles in the *Camaraderie* Vol No. 1 of 2011. It is reprinted below, with some additional commentary.

The article identified the key issues in 2011 and how DFWA was going to address them. It gives reason for DFWA prioritising fair indexation first, to be followed up with life tables. It also gives a fulsome explanation of commutation.

Indexation. The 2011 article pre-dates the setting-up of the DFWA/ADSO led “Fair Go” campaign which managed to get the Fair Indexation Amendment Bill introduced into parliament to provide improved indexation for the over 55s DFRDB recipients. This was notable as it was the first time a Bill concerning veteran superannuation was introduced in direct response to ESO lobbying. Lobbying started after 2011 and the Bill was introduced in 2014. Both major parties went to the election agreeing to introduce a Bill (each different) to address fair indexation.

The Bill only gained the fair indexation for the over 55s, despite DFWA lobbying for all Defence superannuants. Most DFRDB recipients now get that increased benefit by dint of time passed.

Having won part of the indexation battle in 2014, it was time to review, consolidate and progress with other campaigns.

Fair Indexation. DFWA continues to press for fair indexation for all the military super related pensions (Invalidity Benefits and reversionary pensions paid to family members on the veteran’s death) in DFRDB, the Military Superannuation and Benefits Scheme (MSBS), ADF Super and ADF Cover.

Note all parties agreed that the CPI was unfair and spoke in favour of the Fair Indexation Bill. It was also intimated that the other pensions should be treated fairly as well, when funds became available. That is what the Future Fund is for.

Life Expectancy Tables Benefits. DFWA made preparations for pursuing use of actual life expectancy of retirees at date of commutation to calculate the reduction. As life expectancy has increased, the amount of reduction would be less. Unlike some other groups lobbying for commutation changes, the DFWA objective benefits all DFRDB recipients:

- Those who commute, as they get more cash in hand.
- Those who do not commute, as it increases the part of their pension that is indexed, resulting in more cash in hand.

Statistics Used. When the DFRDB Bill was drafted, different life expectancy ages were applied to males and females as females lived longer. That indicates acceptance that differences in life expectancies should be applied. Parliament’s intentions in 1973 are important here, as is the fact that parliamentarians in 1973 did not and could not forecast the rapid rise in life expectancies from the mid-’70s after some 40 years (1932-1972) of almost static Australian life expectancies. And note that the 1960-62 life tables are, counter-intuitively, more beneficial to the DFRDB commuter than the 1970-72

tables, which is why Parliament put the 1960-62 tables in the 1973 DFRDB Act.

As the article shows, the difference in average life expectancy is financially significant and cumulative especially as the reduction in pension is for life.

64. As commutation is the expression in the form of a lump sum of part of future benefit payments, a reduction in retirement pay will apply following commutation. The annual reduction is found by dividing the lump sum by the members life expectancy at the date of commutation.

65. Although a life expectancy factor is used, full retirement pay is not restored should the member live beyond normal 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 dependants or the estate.

DFRDB Authority Circular No: 1973/7, File G61376, Date, Z 2 August 1973

Effectively, those who live longer are effectively subsidising those who died earlier (because those who died earlier are not required to “repay” anything to the Commonwealth). That is - Cost neutral. However, the increase in life expectancy means that the reduction applied to pensions means the government is getting more than necessary for cost neutral, and for a longer period of time, and is getting away with not having to index that amount.

The Commutation Misinformation Issue.

The DFWA campaign to use up to date life expectancies to calculate the appropriate reduction to the DFRDB pension on commutation was swamped in the furore concerning the non-realised expectations of many DFRDB pension recipients that the full DFRDB pension would be restored on reaching their average life expectancy age.

The Ombudsman Report clearly identified defective administration by Defence at different times by providing incorrect information to many DFRDB members that commutation was a loan which would be repaid on reaching average life expectancy and the full pension restored. Not only was there incorrect information given, at times, no information was provided at all. Apologies were issued by Defence, but no financial compensation offered. This was followed by a further Senate Inquiry, which also provided no compensation or recommendations to change the law.

This Camaraderie article was published years before the commencements of campaigns by the Australian Defence Force Retirees Association Inc (ADFRA) and Mr Ken Stone concerning DFRDB Commutation and resulting in the two Inquiries.

It is interesting to see the DFWA understanding of DFRDB legislation, the issues identified, and the information provided to Camaraderie readers way back in 2011. Have a read and let us know what you think. I have also included some in-line comment:

ARTICLE ON DFRDB COMMUTATION – PUBLISHED 2011 ISSUE 1.

CLARIFYING COMMUTATION

By

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BACKGROUND

As most Camaraderie readers will know, the “life tables” (a convenient term) used to calculate reductions to DFRDB pensions after commutation are out of date by nearly half a century.

The tables do not reflect the life expectancy of today’s or even yesterday’s beneficiary, which means that your military superannuation pension reduction is higher than independent actuaries say it should be.

In other words, DFRDB pensions for most beneficiaries are well below what they should be.

The life tables issue attracts periodic comment and has, quite rightly, done so again lately. It is a glaring injustice. But there is more to commutation than life tables, and care is called for.

This short article looks at commutation issues, which are not

confined to life tables alone.

Life Tables – What are they?

Life tables tell us how long we are likely to live. The tables for government purposes are generated by the Australian Government Actuary (www.aga.gov.au) and Australian Bureau of Statistics and are updated every few years.

The DFRDB pension reduction is calculated on the basis of the individual retiree’s life expectancy at the date he/she receives his/her commuted sum. *[Comment – Strictly, it is based on the date the actual application to commute is received by DFRDBA/CSC.]* If your actuarial life expectancy at retirement is, say, 26 years then your DFRDB pension reduction is designed to cover your commutation over 26 years even if you die before (or after) your 26 years are up. *[Comment – Legally the reduction is for life.]*

The reduction principle is good but the management is bad,

because DFRDB pensions for people who chose to commute are reduced by far more than was correct actuarially at the time they retired.

And, sensibly, most people commute. This means the penalties to DFRDB retirees and their families over the decades are significant.

An Example

Let's say a male aged 44 retires today *[Article written in 2011]* and takes \$100,000 commutation. His life expectancy is 37.2 years according to the latest (2007-2009) life tables. His DFRDB pension reduction should be about \$2,700 per year to cover his \$100,000 commutation.

But the DFRDB pension reduction for people who commute is still calculated using 1960s life tables. These outdated tables say that our 44 year old retiree's life expectancy is only 28.25 years. His DFRDB pension reduction will be about \$3,500 per year to cover his \$100,000 commutation.

So our retiree's DFRDB pension reduction is about \$800 per year more than it should be. In other words, he loses about \$800 per year every year for the rest of his life and the indexation on that \$800 !

Each retiree's specific case is of course different, but it is reasonable to conclude that all DFRDB retirees since the scheme started in the early 70s are receiving lower pensions than they should.

Why Commutation?

Commutation is not a loan. Nor is its purpose, as some armchair critics mistakenly claim, to gain a return on investing the commuted sum. Its purpose is to help set up a home and/or business that the ADF member and his/her family did not have an opportunity to do when serving because of frequent postings and all the other disadvantages and disruptions of military service when compared with other forms of service to the nation.

Commutated dollars are meant to be spent on a home or business, not saved in a bank account or invested in the stock market. The possibility that some beneficiaries may do the latter does not change the intent of commutation.

Commutation helps recognise that military service is unique. Commutation is one way that the nation can help ease the burden upon servicemen and women who are transitioning to civilian life for the vicissitudes it imposes, uniquely, on its ADF members.

And let's not forget that until recently ADF members were required to leave at an early age, no later than 47 for the vast majority of servicemen and women. A young ADF is in the national interest, a fact recognised by successive governments at least until recently. *[While there was a compulsory retirement age (CRA), to keep the ADF young, the original intent was also to incentivise service to at least 20 years – hence the carrot of commutation. To counter this commutation carrot to retire at 20 years, early retirement by officers was penalised by reduction of*

retired pay by 3% for each year below their notional retirement age, e.g., 42 for Major and below, 45 for LTCOL and so on.]

The fact that yesterday's compulsory early retirement applies to an overwhelming majority of today's DFRDB pensioners is conveniently forgotten by the critics who measure everything against the nominal military retirement ages applying in 2011. *[CRA is generally 60 yrs and 65 yrs for Reserves, probably (opinion) based on "common employment principles" and not really considering the unique nature of military service.]*

Cost of Commutation

Importantly, commutation costs the taxpayer little if anything extra. This is because, as outlined earlier, each commuted sum is returned to the taxpayer by way of a smaller military superannuation pension for the rest of the beneficiary's life. Not merely until age 60 or 65, or for a fixed period, but for life.

In addition, it is reasonable to claim that government has profited handsomely from the commutation regime over the past four decades because of its use of grossly outdated life tables. And that's before remembering that the commutation lump sum was also taxed, at the rate applying to all Australians, before the military retiree received a commuted cent.

Does Government Want Commutation?

Successive governments clearly wanted DFRDB retirees to commute as opposed to taking all their DFRDB benefits as a military superannuation pension. They still do. Why else would governments only index that portion of the military superannuation pension that could not be commuted, and not index the commutable portion at all, not even to today's derisory CPI? *[Note - The Fair Indexation Bill introduced in 2014, has the index based on the more favourable of positive movements in the CPI and the pensioner and beneficiary living cost index and any increase to ensure that affected pension benefits are increased by at least the percentage required to maintain a hypothetical pension at 27.7% of male total average weekly earnings.]*

This significant point has never received the attention it deserves, with armchair critics of military superannuation being content to speak erroneously and shallowly of commutation's alleged "generosity".

DFRDB Pension Purchasing Power

The indexation exclusions imposed by government mean that the purchasing power of an uncommuted military superannuation pension erodes even more quickly than the purchasing power of a commuted pension. And that's saying something.

Indexation considerations alone means that ADF retirees have no financial incentive to take an uncommuted pension. They never did. The opposite is the case which, again importantly, was clearly each government's intention.

Government and Life Tables

Governments of all colours like to claim that they are driven by actuarial advice and "fairness" considerations. But they are not. Former Finance Minister Tanner's 2009 handling of the discredited 2008 Matthews report is merely the most recent instance.

Government claims of fairness are clearly specious. Actuarial advice over the decades says that the life tables are wrong and yet successive governments did not update them in the 20th century. They still won't in the 21st. *[This is the challenge. It requires a united voice as was done with the Fair Go, Fair Indexation Campaign.]*

Care Needed

As mentioned earlier, commutation is not a loan. As mentioned in other forums, DFWA is concerned about people using words such as "repaid" and "loan" when discussing commutation. There is no question about the principle that the life tables are way out of date or that the over-reduction of military superannuation pensions to compensate the Commonwealth for commutation is indefensible, but the last thing beneficiaries want is for commutation to be treated as a loan. It would add insult to injury.

If commutation is treated as a loan, there is little doubt that the Department of Finance and Deregulation (DoFD) would then say that the interest rate will be X% and, when one does the sums, the residual pension may be even lower than at present and/or the commutation sum may never be "repaid" regardless of life table changes.

DFWA and its partners need to tread carefully on the life tables issue. An opportunistic DoFD may well agree to introduce updated life tables while then treating commutation as a loan, with significant additional disadvantage to ADF servicemen and women and their families.

DFWA Policy

DFWA is considering its position on life tables and welcomes input from members. At this stage we believe we need to have one agreed life tables position upon which DFWA and its DSO partners proceed. The agreed position will not be as simple to develop and stick to as it may at first appear.

[Comment - This was well-predicted by Win. Unfortunately, the issue concerning incorrect information given by the Service Offices regarding commutation as a loan, has adversely affected gaining a united position on the life tables.]

It is not just a matter of saying that the Commonwealth should adopt up-to-date life tables and leaving it at that. Given DoFD's track record, new ADF retirees under DFRDB may

well then find themselves worse off. Concurrently, existing retirees are unlikely to benefit because no government would of its own volition backdate benefits nominally accruing to existing retirees if up-to-date life tables are introduced. That's not right and not fair but that's what history demonstrates.

In addition, given our limited financial and staffing resources, DFWA considers the life tables issue should not be permitted to distract from our pursuit of indexation reform for DFR(D) B and MSBS members. *[Note - DFWA is not just focussed on DFRDB, but all military super schemes, MSBS and ADF Super/ADF Cover]* Indexation reform will right a wrong for far more people than will life table reform, even though the latter is most important for serving DFRDB people. Note here that DFRDB has 4,246 contributors still serving while there are 64,665 DFRDB and MSBS military superannuation pensioners (30 June 2010).

Conclusions

The Commonwealth clearly wants its ADF members who contribute to DFRDB to:

1. **Retire early** (but with >20 years service) in order to keep the ADF young. It is in the national interest to do so. The nation does not want 64 year old infantrymen in Afghanistan anxiously awaiting their 65th birthdays.
2. **Take a modest lump sum** (commutation) so that the "young" retiree (mostly aged 40+) can set him/herself up with a home and/or a business and then lead a productive life as a taxpaying civilian citizen.
3. **Compensate the taxpayer** for commutation by reducing future military superannuation pension entitlements for life and, to encourage commutation, not index that portion of the military superannuation pension that could have been commuted.

DFWA does not have the resources to pursue all issues affecting DFRDB and MSBS members but recognises that the life tables issue is a major and long-standing injustice.

[Comment - DFWA current objectives includes DFRDB Life Tables and extension of the fair indexation achieved for DFRDB to all Invalidity Benefit pensions and reversionary pensions provided by DFRB, DFRDB, MSBS and ADF Super/ADF Cover.]

What do you think about this state of affairs?

... OOPS SAYS THE EDITOR!

Your editor sincerely apologises for a couple of "oops" in the last edition, in particular to our Padre whose article was incorrectly titled. The article title should have read Hamutuk-the Timorese Word for Togetherness. The incorrect title was also shown on the contacts page, as was a reference to an article that was not published in that edition.

Sometimes, being an editor's job is fraught with frustrations!

