

OFFICIAL



Australian Government

Department of Defence

PO Box 7900 CANBERRA BC ACT 2610

EC21-001254/IS21-000032

Standing Committee on Foreign Affairs, Defence and Trade
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Committee Secretary

**Senate Standing Committee on Foreign Affairs, Defence and Trade inquiry into the
'accuracy of information provided to Defence Force Retirement and Death Benefits
(DFRDB) members'**

The Department of Defence welcomes the opportunity to assist the Senate Standing Committee on Foreign Affairs, Defence and Trade regarding its inquiry into the 'accuracy of information provided to Defence Force Retirement and Death Benefits (DFRDB) members'.

The DFRDB scheme or elements of have been formally reviewed multiple times since the scheme began in 1973. A number of enhancements to the scheme have occurred during this period, to the benefit of members. Enclosure 1 is a summary of the main reviews of the DFRDB and enhancements and provides an explanation of commutation and life expectancy factors, indexation and accuracy of information provided to DFRDB members.

The most recent review of DFRDB was the 2019 independent investigation undertaken by the Commonwealth Ombudsman into the administration of the DFRDB scheme. The Ombudsman found that misleading information amounting to defective administration was provided in some cases to members by Defence personnel in relation to the DFRDB scheme, but this did not cause financial detriment to these members.

The Ombudsman did not recommend compensation be provided to DFRDB members as defective administration alone does not mean a financial detriment has occurred and there was no entitlement to compensation under the legislation as expressed. Independent actuarial analysis suggests where a member acted on the incorrect information and commuted their pension, it generally resulted in a beneficial overall financial outcome for DFRDB members, particularly for DFRDB members who retired before 2010.

We issued a joint apology for Defence having provided incorrect advice in the past to some DFRDB members and for any confusion and emotional impact this may have caused.

OFFICIAL

OFFICIAL

2

The final report and Defence letter provided information to DFRDB members on how to submit a Compensation for Detriment caused by Defective Administration (CDDA) claim to Defence if they believed they suffered a detriment due to defective administration of the DFRDB scheme. Currently no claims have been successful as claimants have been unable to demonstrate they have incurred a financial detriment due to this issue.

The Australian Government Actuary has advised that any changes to the scheme itself, including life expectancy factors could involve significant Commonwealth costs, both prospective and retrospective.

The DFRDB legislation is consistent with the policy intent of the scheme and is consistent with other Australian Public Service and Australian Defence Force defined benefit superannuation arrangements.

Our point of contact is First Assistant Secretary, People Policy and Culture Division, Mr David Nockels. David can be contacted by telephone on 02 5131 4141 or email: david.nockels@defence.gov.au.

Yours sincerely

Greg Moriarty
Secretary

28 April 2021

Angus J Campbell, AO, DSC
General
Chief of the Defence Force

28 April 2021

Enclosure:

1. Defence submission to the Senate Standing Committee on Foreign Affairs, Defence and Trade regarding the 'accuracy of information provided to Defence Force Retirement and Death Benefits (DFRDB) members'.

**Defence submission to the Senate Standing Committee on Foreign Affairs,
Defence and Trade**

**ACCURACY OF INFORMATION PROVIDED TO DEFENCE FORCE
RETIREMENT AND DEATH BENEFITS (DFRDB) MEMBERS**

Introduction

The Department of Defence submission to the Standing committee on Foreign Affairs, Defence and Trade regarding the 'accuracy of information provided to Defence Force Retirement and Death Benefits (DFRDB) members' provides:

- Section 1: an overview ADF superannuation schemes
- Section 2: a summary of the key historical reviews of the DFRDB and the key outcomes
- Section 3: a summary relating to the Commonwealth Ombudsman Investigation into the administration of the DFRDB scheme and additional information on the Compensation for Detriment caused by Defective Administration (CDDA scheme)
- Section 4: The use of set Life Expectancy Factors and the Resulting Permanent Reduction to Pensions (Commutation)
- Section 5: Indexation - Methodology and Application

1. Overview of ADF Superannuation Schemes

The DFRDB scheme legislation was derived from the 1972 report of the Joint Select Committee (the Jess Committee) which made 20 recommendations to the Government of the day. The majority of the recommendations were accepted, with modifications to some.

The Defence Forces Retirement Benefits (DFRB) scheme was established in 1948 and closed to new members when DFRDB commenced on 1 October 1972. All contributory members of DFRB were transferred to DFRDB at that time. Pensions payable under the DFRB however, continue to be paid under the provisions of the *Defence Forces Retirement Benefits Act 1948* (DFRB Act).

DFRDB is a fully unfunded defined benefit arrangement and was closed to new members from 30 September 1991 when the Military Superannuation and Benefits Scheme (MSBS) was introduced. MSBS is a 'hybrid' scheme consisting of a mostly unfunded defined benefit and a fully funded accumulation benefit. Contributing members of DFRDB were able to elect to transfer schemes from 1 October 1991 until 30 September 1992. It was not compulsory for DFRDB contributory members to transfer to the MSBS.

MSBS closed to new members on 30 June 2016. From 1 July 2016 ADF Super became the default employer fund for all new ADF members however, members may also choose another complying superannuation fund (Choice members). ADF Cover provides statutory death and invalidity cover for all ADF members who are ADF Super or Choice members.

2. Summary of the Key Historical Reviews of the DFRDB and Key Outcomes

2019 Commonwealth Ombudsman: *Investigation into the administration of the DFRDB scheme.* The 2019 independent investigation undertaken by the Commonwealth Ombudsman focused on the accuracy of information about commutation provided to scheme members by Defence and the DFRDB scheme administrators (including the Commonwealth Superannuation Corporation (CSC)).

Outcome: The Ombudsman found that some DFRDB scheme members were provided with misleading, and in some cases incorrect advice about the effect of commutation on the retirement pension but did not recommend that compensation should be paid to these members. The Ombudsman found this to be defective administration by Defence and recommended an apology be issued. More information on the 2019 independent investigation undertaken by the Commonwealth Ombudsman, including the findings is provided in [Section 3](#).

2008 Matthews Review: *Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes.* The 2008 Matthews Review was a Government commitment which was tasked with looking at the indexation of superannuation pensions and whether the Consumer Price Index (CPI) was an appropriate measure or if there are more appropriate measures that could be used.

Outcome: The 2008 Matthews Review recommended no change to indexation for any of the Government schemes including DFRDB. The Government of the day accepted this recommendation and CPI continued to be used as the indexation method until 2014.

2007 Podger Review: *Report of the Review into Military Superannuation Arrangements.* The 2007 Podger Review considered the military superannuation arrangements (MSBS and DFRDB) and the long term viability of MSBS. The 2007 Podger Review considered the unique nature of military service while considering the on-going unfunded liability of the DFRDB and MSBS.

Outcome: The 2007 Podger Review resulted in a change to the indexation methodology in 2014 for all DFRB and DFRDB pension recipients aged 55 and over. As a result, these pensions are now indexed in the same way as age and service pensions. The 2007 Podger Review also recommended that there should be no change to the DFRDB life expectancy factors.

2002 Senate Select Committee on Superannuation (2002 Watson Committee): *Superannuation and standards of living in retirement.* The 2002 Watson Committee reviewed the adequacy of the tax arrangements for superannuation and related policy to address the retirement income and aged and health care needs of Australians.

Outcome: The 2002 Watson Committee recommended that the indexation methodology could be changed for the Commonwealth funded schemes, however the Government of the day did not accept this recommendation and no changes to indexation were made at that time.

2001 Senate Select Committee on superannuation and financial services (2001 Watson Committee): *A 'Reasonable and Secure' Retirement?* The 2001 Watson Committee reviewed the benefit design of Commonwealth public sector and Defence Force unfunded superannuation funds and schemes.

Outcome: The 2001 Watson Committee review resulted in bi-annual CPI indexation adjustments being adopted for all Commonwealth schemes from January 2002. The 2001 Watson Committee also recommended that the feasibility of changing the indexation method from CPI should be examined. However the Government of the day did not support this recommendation and no changes to indexation were made until 2014.

1990 Cole Review: *Report of the DFRDB scheme review committee.* The 1990 Cole Review report looked into the suitability of DFRDB and the creation of a new scheme.

Outcome: The 1990 Cole Review considered the design of a replacement scheme for DFRDB and MSBS was introduced in 1991 as a result. The 1990 Cole Review also formalised the three per cent Productivity Benefit arrangement for DFRDB members and introduced the option of commutation for dependent spouses on the death of a contributing member.

1974 Melville & Pollard Review: *Report of the Treasurer's proposals for a new superannuation scheme for Australian Government Employees* and **1973 Pollard Review:** *Enquiry into superannuation pension updating.* The 1974 Melville & Pollard Review focused on the suitability of the existing arrangements for the superannuation of Australian Government employees (1922 Scheme), the proposal for a new Commonwealth superannuation scheme and what indexation method should apply for pensions paid under the new Commonwealth superannuation scheme. The 1973 Pollard Review enquired into the methods of adjusting the Commonwealth superannuation and DFRB scheme pensions.

Outcome: The 1974 Melville & Pollard Review considered the design of a new superannuation scheme for Australian Government employees and the Commonwealth Superannuation Scheme (CSS) was introduced in 1976 as a result.

Both the 1974 Melville & Pollard Review and the 1973 Pollard Review recommended automatic indexation of the Commonwealth superannuation scheme pensions using CPI as the method of indexation. This resulted in the introduction of automatic annual indexation using CPI for DFRDB pensions in 1976.

1972 Jess Committee: *Joint Select Committee on DFRB legislation.* The 1972 Jess Committee focused on the suitability of the DFRB scheme and the proposal for a new superannuation scheme for ADF members.

Outcome: The 1972 Jess Committee considered the design of a new superannuation scheme for ADF members and made a range of recommendations for the new scheme. As a result DFRDB was introduced in 1973 and the Government of the day accepted most of the 1972 Jess Committee recommendations when creating DFRDB, but did not accept them all.

3. A summary relating to the Commonwealth Ombudsman Investigation into the administration of the DFRDB scheme and additional information on the CDDA scheme

Commonwealth Ombudsman Investigation into the administration of the DFRDB scheme

The 2019 independent investigation undertaken by the Commonwealth Ombudsman concluded there were numerous examples of incorrect written and verbal information that had been disseminated within Defence from commencement of the DFRDB scheme. This information helped create and reinforce a relatively widespread misunderstanding among DFRDB members that the retirement pay reduction due to commutation would cease on reaching life expectancy factor age.¹

The Ombudsman found that Defence was responsible for allowing this incorrect information to be provided to members of the DFRDB and this amounted to defective administration by Defence. Many DFRDB members were misled to believe that the commutation related reduction to their retirement pay would cease upon reaching life expectancy factor age.²

From the early 2000s onwards Defence has provided DFRDB members with the correct information and all CSC information was updated to contain correct information.³

The Ombudsman recommended that the Secretary of the Department of Defence and the Chief of the Defence Force apologise for the defective administration that occurred and the disappointment this had on affected DFRDB members. This recommendation was accepted and an apology letter was included in the final Commonwealth Ombudsman report.

The Ombudsman commissioned expert independent actuarial reports from the Australian Government Actuary (AGA) and KPMG which showed that it is unlikely any ADF members who commuted through the DFRDB scheme would have suffered a financial detriment. Both KPMG and the AGA considered a range of investment scenarios in coming to this conclusion. The scenarios used were based on conservative assumptions including:

- the commutation lump sum being invested in property and thus reducing the amount the member would have to borrow in relation to a home loan;
- the commutation lump sum being invested using the cash rate; and
- the commutation lump sum being invested in a term deposit.

The Ombudsman found that the modelling demonstrated having early access to capital provided by commutation was generally beneficial to DFRDB members relative to the alternative of not commuting.

¹ 2019 Independent Commonwealth Ombudsman *Investigation into the administration of the DFRDB scheme*, Mr Michael Manthorpe, December 2019 (Page 22).

² 2019 Independent Commonwealth Ombudsman *Investigation into the administration of the DFRDB scheme*, Mr Michael Manthorpe, December 2019 (Page 54).

³ 2019 Independent Commonwealth Ombudsman *Investigation into the administration of the DFRDB scheme*, Mr Michael Manthorpe, December 2019 (Page 55).

Information on the CDDA scheme

The Ombudsman could not exclude the possibility that there may be outlying cases in which financial loss might have occurred and said those should be dealt with on a case by case basis under the CDDA scheme. Members who believe they suffered a detriment have been, and are still able to, lodge claims on a specifically designed form. Information about how to make a claim can be found on the [Defence Directorate of Special Financial Claims website](#).⁴ The special claim form for DFRDB members can also be accessed on this page.

In each case that Defence has already considered and finalised, Defence contacted the claimant by email, mail or telephone to discuss the issues arising in the claim. In particular, their attention was drawn to the relevant conclusions of the Ombudsman: that there had been defective administration in the information supplied to members but that the defective administration alone did not cause financial detriment.

Claimants were asked to turn their mind to how their situation might have differed from the rest of their cohort, who were shown not to have sustained any detriment based on the modelling undertaken for the Ombudsman. Several members rang or emailed before they lodged a claim and Defence discussed with them the issues they should turn their minds to. The AGA was not engaged formally for the CDDA process, however AGA were consulted on some technical issues raised in specific claims. All claimants received a decision from Defence with reasons.

As at 9 April 2021, there has been 38 claims under the CDDA scheme. 36 claims were refused and two claims were withdrawn after discussion or correspondence. Two of the 36 claimants sought internal review of their decision. Both decision were affirmed on review. There were also telephone and email enquiries from a handful of others who did not choose to make a claim.

The Director, Employment Law and Discretionary Claims (previously Director, Special Financial Claims), in Defence Legal, made most of the decisions. Some decisions were made by the Assistant Director. One review decision was made by General Counsel-Defence.

Consistent with the Ombudsman's conclusion, Defence accepts there was defective administration in the information supplied to members before 2004. However, there were cases where it was apparent or acknowledged that the member did know in advance of their election that the pension would not be restored to the pre-commutation amount when they reached the life expectancy factor age.

On examination of claimants' circumstances, none were able to show how their situation differed from those who the Ombudsman's commissioned modelling showed were generally better off having commuted. Most were in the cohort who used the commutation lump sum to help them purchase a house.

Generally, the claimants did not dispute they were better off having commuted than had they not commuted. Their complaint about the DFRDB scheme and the Ombudsman's conclusion was that the scheme was not as generous as they were led to believe it would be.

⁴ <https://www.defence.gov.au/Legal/Directorates/dsfc.asp>

For compensation to be payable under the CDDA scheme, claimants must be able to show that they have sustained detriment of some kind. The distinction between financial detriment and financial disappointment is addressed in the CDDA Guidelines:

'Financial detriment can be distinguished from financial disappointment - for example, where a formal assessment results in the amount of an entitlement being less than a "ballpark" figure given to a person at the time they made inquiries. A claimant does not suffer financial detriment merely because they were correctly not granted a benefit after being advised that they would receive that benefit, or if a debt was raised due to a benefit being incorrectly paid'.⁵

On that test, none of the claimants were able to show they had suffered detriment.

Information on the CDDA scheme was included in the letter of apology from the Secretary and CDF dated 3 December 2019. This information was also published on the [Defence website](#)⁶ as an annexure to the [Ombudsman's report](#)⁷ and on the [CSC website](#)⁸.

Defence is also aware that affected DFRDB members were encouraged to claim by the Australian Defence Force Retirees Association (ADFRA) on their [website](#)⁹ and in their newsletter. Many of the claims were copied directly from a template supplied to claimants by ADFRA.

4. The use of set Life Expectancy Factors and the Resulting Permanent Reduction to Pensions (Commutation)

Commutation is the early payment of part of a member's retirement pay in the form of a lump sum. The decision to commute is entirely voluntary and is neither an advance nor loan, but rather an immediate payment in exchange for a permanent reduction in pension. The lump sum forms part of the member's overall superannuation benefit and the pension is permanently reduced to recognise that lump sum recipients obtain long-term advantage from the immediate use of their lump sum.

The DFRDB commutation provisions reflect the recommendations of the 1972 Jess Committee on DFRB legislation and include the retention of a permanent reduction to the pension to account for the commutation.

When the *DFRDB Act 1973* was legislated, the commutation provisions were mirrored off the DFRB scheme. The 1970 DFRB Booklet provides that:

'Every pensioner should think carefully before relinquishing portion of his continuing pension entitlement to obtain an immediate lump sum payment. Factors such as the following are significant;

- *Once commutation is approved, the relevant portion of the pension is cancelled and cannot be restored subsequently*
- *By commutation the pensioner cancels, not only a portion of this current pension entitlement at the date of approval of the commutation, BUT ALSO a similar*

⁵ <https://www.finance.gov.au/individuals/act-grace-payments-waiver-debts-commonwealth-compensation-detriment-caused-defective-administration-cdda/scheme-compensation-detriment-caused-defective-administration-rmg-409> (para 56, emphasis added)

⁶ <https://www.defence.gov.au/PayAndConditions/ADF/Super-DFRDB-review.asp>

⁷ <https://www.ombudsman.gov.au/How-we-can-help/australian-defence-force/dfldb>

⁸ <https://www.csc.gov.au/Members/News/DFRDB-Commutation-Inquiry/>

⁹ <https://www.adfra.org/>

portion of any likely pension increases by the notional category method¹⁰ based on that pension entitlement'.¹¹

The calculation undertaken to determine a member's lump sum and residual pension benefit includes a Life Expectancy Factor.¹² The Life Expectancy Factor is an element of the commutation calculation, which is undertaken to determine a DFRDB member's lump sum and resultant pension benefit.

Should a member live for more than the Life Expectancy Factor years used in the calculation of their lump sum, the pension is not adjusted accordingly. No part of the lump sum is recovered from a deceased member's estate, should the recipient die before reaching the Life Expectancy Factor years used.

The AGA has advised Defence that when the DFRDB scheme was introduced, the use of the 1960-1962 Australian Life Tables as a commutation factor was favourable to members relative to the alternative pension.

Over the years, it has been suggested by some DFRDB pensioners that the existing Life Expectancy Factors in DFRDB should be replaced with the current (or more contemporary) Australian Life Tables in the belief that the increase in life expectancy will improve a member's pension. The AGA has advised Defence that were the Life Expectancy Factors to be increased for future retirees, there would be increased Commonwealth costs due to this benefit improvement.

The 2019 independent investigation undertaken by the Commonwealth Ombudsman made note of the Life Expectancy Factors.¹³ The Ombudsman noted that if the commutation divisor increased, it could have a beneficial flow on to members, however 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.

¹⁰ Pensions paid under the DFRB scheme were reviewed by the Government in conjunction with the annual Budget reviews. When pension increases were budgeted as part of the Federal Budget, the cost of the increase had historically been met from Consolidated Revenue. Pensions were increased using a notional category method applicable to their rank at termination from Service (Page 48 para 138).

¹¹ The DFRB Booklet issued by the DFRB Board in 1970 was at the time considered the equivalent of a Trust Deed and Rules for the DFRB scheme (Page 94 para 251).

¹² Schedule 3 of the *DFRDB Act 1973* provides for the 'Expectation of Life Factor' to be used for the commutation of retirement and Class C Invalidity pay. The 'Expectation of Life Factor' is interchangeably known as the Life Expectancy Factor or Life Expectancy Tables. The Expectation of Life Factor is based off the Australian Bureau of Statistics (ABS) 1960-1962 Australian Life Tables but does not use the ABS table itself.

¹³ 2019 Independent Commonwealth Ombudsman *Investigation into the administration of the DFRDB scheme*, Mr Michael Manthorpe, December 2019 (Pages 51-52).

The 2007 Podger Review, acknowledged there had been a significant improvement in life expectancy and found that:

...the conversion factor based on a 1960s life expectancy is substantially more generous than a cost-neutral factor that takes into account opportunities to earn interest on the commuted lump sum. A conversion factor based solely on current life expectancy figures would be even more excessively generous...

...

If any change were made to the DFRDB, it should be to require a substantially larger reduction in pension in return for the commuted lump sum, not a smaller reduction. In line with the Terms of Reference requirement of no detriment, the Review Team recommends no change to the life expectancy factors currently applying to the DFRDB commutation calculation.¹⁴

The permanent lifetime reduction to a DFRDB pension as a result of commutation is consistent with the arrangements in the other civilian and military superannuation schemes. In CSS, the Public Sector Superannuation Scheme (PSS) and MSBS if a member chooses to take part of their benefit as a lump sum, the amount of their lifetime pension is permanently reduced from what it would have been had the member not taken a lump sum. The factors used to convert pensions into lump sums (or vice versa) in the CSS, PSS and MSBS have not been amended or reviewed since the schemes commenced and are considered as permanent design features of the schemes.

5. Indexation - Methodology and Application

Indexation Methodology

Since the introduction of DFRDB in 1973 there have been a range of reviews to consider the most appropriate method of indexation for DFRDB pensions. While some reviews differ in the exact methods to be used, they broadly agree that a fair method of indexation allows for pension recipients to maintain the purchasing power of the pension over time.

The 1973 Jess Committee recommended that pensions paid from DFRDB should be indexed annually to maintain relativity with Average Weekly Earnings. However, only ad hoc increases in line with Average Weekly Earnings were made to pensions between 1973 and 1976.

Annual indexation adjustments to DFRDB pensions commenced in 1976 using the CPI rate, following the recommendations from the 1973 Pollard Review and the 1974 Melville & Pollard Review.

The 2001 Watson Committee review recommended bi-annual CPI indexation adjustments being adopted for all Commonwealth funded schemes including the DFRDB. This took effect from January 2002 after the Government announced an increase to Commonwealth superannuation pensions in the 2001-02 Budget in line with CPI twice yearly instead of annually.¹⁵ The 2001 Watson Committee also recommended that the feasibility of changing the indexation method from CPI should be examined.

¹⁴ 2007 Podger Review *Report of the Review into Military Superannuation Arrangements*, Mr Andrew Podger, July 2007 (Pages 61-62).

¹⁵ 2001-02 Federal Budget *Budget Paper No.1 Statement 1 Part III Budget Priorities*, May 2001 (Page 1-16).

The 2002 Watson Committee recommended that the Government consider indexing Commonwealth funded superannuation pensions (including DFRDB) in line with increases to the Male Total Average Weekly Earnings or CPI, whichever is the higher, in order that recipients share in the increases in living standards enjoyed by the wider community.¹⁶ The Government of the day did not adopt this recommendation and bi-annual CPI indexations adjustments continued to be used.¹⁷

The 2007 Podger review recommended that 'if the Government is willing to go beyond the envelope of current costs, it should consider indexing DFRDB and DFRB pensions for those over 55 on a similar basis to that applying to age pensions'. In its finding, the review noted that given government policy on preservation arrangements, it considered there was no case to increase the generosity of benefits payable prior to age 55.¹⁸

While the 2007 Podger Review considered there was an in-principle case for changing the indexation arrangements of these pensions, it also found 'the DFRDB is a particularly generous scheme for those in receipt of pensions; that CPI indexation does maintain purchasing power, and is generous when compared to most contemporary superannuation schemes that may only provide account-based pensions at the member's risk'.¹⁹

The 2008 Matthews Review recommended that the Commonwealth funded superannuation pensions (including DFRDB) should continue to be indexed by CPI. The 2008 Matthews Review acknowledged that although CPI has changed in some respects over time, it remained the most suitable available prices index for the purpose of pension indexation.²⁰ The Government of the day accepted this recommendation and no changes were made.

In 2014 in line with the recommendation of the 2007 Podger Review, the Australian Government made a beneficial change to the DFRDB and DFRB schemes indexation methodology. This change means DFRDB and DFRB pensions for people over age 55 are now indexed in the same way as age and service pensions.

Since 2014 there have been no further changes or reviews into the indexation methodology for DFRDB pensions.

Indexation Application

¹⁶ 2002 Watson Committee *Senate Select Committee on Superannuation: Superannuation and standards of living in retirement – Report on the adequacy of the tax arrangements for superannuation and related policy*, December 2002, (Page 194 para 14.28).

¹⁷ Government Response *Senate Select Committee on Superannuation: 'Superannuation and Standards of Living in Retirement'*, tabled in Parliament 14 February 2005 (Page 19).

¹⁸ 2007 Podger Review *Report of the Review into Military Superannuation Arrangements*, Mr Andrew Podger, July 2007, (Pages 60-61).

¹⁹ 2007 Podger Review *Report of the Review into Military Superannuation Arrangements*, Mr Andrew Podger, July 2007, (Page 60).

²⁰ 2008 Matthews Review *Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes*, Mr Trevor Matthews, December 2008 (Page 47).

If a member does not elect to commute or commutes less than four times the pension then indexation is only applied to the 'notional rate of retirement pay'.²¹ 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).

If a member does not elect to commute or commutes less than four times the pension there will be a non-indexed portion of the pension. If a member commutes four times or greater (maximum five times) the residual pension is fully indexed.

Reversionary benefits under the DFRDB scheme are payable to eligible spouses and children on the death of a DFRDB pensioner. An eligible spouse and any eligible children are entitled to a portion of deceased members pension calculated on the pension amount the member would have received had they not commuted. As reversionary pensions are calculated using the non-commuted pension amount, there will always be a non-indexed portion. The non-indexed portion reflects where a member has commuted, the member has received the benefit of that portion as a lump sum upfront. Where a member does not commute, the non-indexed portion reflects that a lifetime pension is being paid instead of the member receiving the benefit from a lump sum being paid up front.

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.

²¹ *DFRDB Act 1973* subsection 98B(5)