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The Honourable Michael McCormack MP
Assistant Minister for Defence
Parliament House
CANBERRA ACT 2600

15 May 2016

Dear Minister,

Having served in the Australian Army for 20 years, including a tour of duty in Vietnam, I am a recipient member of the Defence Forces Retirement and Death Benefits (DFRDB) Scheme.

As this scheme falls within the portfolio responsibilities of the Assistant Minister for Defence, I am writing to you on the assumption that, during the federal election campaign, you are also the Coalition spokesperson on the subject.

You have held the portfolio for only a short time but have no doubt learned of the countless complaints about the operation of this scheme and the governing legislation from your predecessors because you have shown the same level of contempt for those addressed to you.

The evidence relating to those complaints is detailed in the appendixes attached. That evidence, which I am confident will stand up in any court of law, shows:

- During the period from 1991 to 2014, governments presided over a large scale reduction of DFRDB benefits, by using the Consumer Price Index for automatic cost of living adjustments.
- The governing legislation embodies a bogus indexation arrangement which denies the widows and dependent offspring, of deceased members, their full benefits.
- That legislation also embodies a sham commutation arrangement which is based on outdated life expectancy tables. Where, after having misled the members who took up the option, governments are now cashing in on the windfall created by the significant increase in life expectancy over that on which the scheme is based.

I have scoured Hansard and read every reference to the DFRDB scheme and the governing legislation but I cannot find any evidence that these outcomes were the intent of the Parliament.

I cannot determine the extent of the reduction of entitlements in precise \$ terms as every request I made, for DFRDB beneficiary statistics from ComSuper and FOI, has been denied. It is, however, a relatively simple task to determine the exact losses in individual case studies.

From those case studies it is clearly evident that recipient members, during the period from 1991 to 2014, have lost approximately one third of their benefits. It is also possible to estimate that the total reduction of DFRDB benefits is now in the order of \$7Billion.

No one has advocated for a retrospective restoration of those losses but as you may have noted, after the many years of systematic reduction, the cost of restoring those benefits to their rightful levels, going forward, will be considerable.

You are also probably aware that government has the means to do this now, without impacting the budget. But as you and your immediate predecessors have already indicated, you have no intention of revisiting the *closed* DFRDB scheme.

You may consider the scheme to be *closed* but as at 30 Jun 2015 there were still 2,410 contributing and 52,921 recipient members. For them, the DFRDB scheme will remain very much active until the day that they and their spouses are all dead. A period that will span at least another 40 years.

Minister, my 35% retirement pay entitlement, after 20 years of service to my country, pales in comparison with the generous benefit you and your Parliamentary colleagues will enjoy when you retire, despite the fact that you will never have to have to make the commitment my colleagues and I had to make.

Yet, you and a long list of your past and present Parliamentary colleagues have felt justified in retaining, in its present form, the legislation which has reduced my meagre retirement benefit by almost one third and will continue to deny me and my spouse our rightful benefits until the day we die.

What utter hypocrisy.

Minister, I believe that you may visit my electorate of Indi where the margin at the last federal election was less than 500 votes.

I am prepared to arrange a forum in Wodonga where there is a large population of retired and serving Defence Force members and I challenge you Minister, to face such an audience and explain to them:

- Why, after their many years of honourable service to their country, governments have seized on every opportunity to reduce and deny them their rightful retirement benefits.
- Why, the Coalition is so intent on continuing in that vein and
- Why, if they want justice, they will have to go to the High Court.

I look forward to your reply.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'H F Ellerbock', with a stylized flourish at the end.

(H F Ellerbock)

Appendixes:

1. The Intent of Parliament
2. The Systematic Reduction of Benefits
3. The Widows Benefit Swindle
4. The Commutation Swindle
5. The Restoration of Benefits

CC:

Ms Cathy McGowan AO, MP, Member for Indi
Mr Allan Lappin, Independent Candidate for Indi
Mr Eric Kerr, ALP Candidate for Indi
Ms Jenny O'Connor, Greens' Candidate for Indi
Mr Julian Fidge, Australian Party Candidate for Indi
Mr Marty Corboy, Nationals' Candidate for Indi
Ms Sophie Mirabella, Liberal Candidate for Indi

Foundation

The DFRDB scheme was the product of the endeavours of a Joint Select Committee on Defence Forces Retirement and Death Benefits Legislation (Jess Committee), under the chairmanship of Mr J. D. Jess, C.D.E. M.P., which was appointed by the Parliament on 2 September 1970 to review the operation of the Defence Force Retirement Benefits Act 1948.

The Jess Committee produced a report (Jess Report) dated May 1972, which set out the provisions for the introduction of a new Defence Force Retirement and Death Benefit arrangement, subsequently called the DFRDB Scheme.

When Lance Barnard, the Minister for Defence, Navy, Army, Minister, Air and Supply, put his motion for the Defence Force Retirement and death Benefits Bill 1973 to be read a second time, he stated:

“The Bills (the DFRDB Bill was grouped with several other Bills) give effect to the Government's decision announced last year to implement the recommendations of the Joint Select Committee on Defence Forces Retirement Benefits Legislation.” House of Representatives Hansard 25 May 1973.

A key Jess Report recommendation not included by Mr Barnard was:

“Provision has not been made in the main Bill for the automatic adjustment of retirement and invalidity pay as proposed by the Joint Select Committee.” And

“... there have been developments on pension updating in other Commonwealth pension schemes and I want these developments carefully investigated and assessed in relation to the new DFRB scheme.” .” House of Representatives Hansard 25 May 1973.

Purpose and Object

Under the terms of Section 15AA of the Acts Interpretation Act 1901, the Jess Report forms the legal basis regarding the “purpose or object”, underpinning the Defence Force Retirement and Death Benefits Act 1973 (DFRDB Act).

The Legislation

When the legislation was drafted, provisions in the Jess Report were altered or omitted and provisions which did not exist in the Jess Report were added, all to the detriment of the DFRDB beneficiaries. This was done without Defence Department consultation or scrutiny, as noted in his Second Reading speech by the Member for Herbert, Robert Bonnett, who stated:

“... how could simplicity of understanding be achieved, when the Minister permitted the exclusion of Service representation from the drafting committee? Surely the inclusion of Service representation during the drafting stages is a basic principle to abide by, for servicemen understand the problems of the Services far better than do their civilian counterparts in the Department of Defence.” House of Representatives Hansard 30 May 1973.

Legislation was put before and passed by the Twenty-Eighth Parliament in 1973. A reading of the Defence Force Retirement and Death Benefits Bill 1973 Second Readings Speeches (House

of Representatives Hansard, 30 May 1973), will conclude that the legislation was rushed through Parliament, providing little or no opportunity for scrutiny. In his Second Reading Speech, the Member for Isaacs, David Hamer stated:

“... what we are considering today are 3 Bills of great complexity. The main one contains 79 pages. These Bills affect about 70,000 present servicemen and many thousands of retired ones. It was introduced into this House last Friday and 5 days later we are debating it. For a Bill of such complexity, in my opinion, that is a grossly inadequate time for proper consideration.” House of Representatives Hansard 30 May 1973.

The *DFRDB Act* received Royal Assent on 19 June 1973.

Legislation Amendments

As at the date of this letter, the *DFRDB Act* has been amended on numerous occasions, including; 73 additions and insertions, 97 amendments, 11 repeals and 1 repeal and substitution. However, of major significance to the determination of *DFRDB* benefits are the following:

1. Defence Force Retirement and Death Benefits (Pension Increases) Act 1976 – Act No. 34 of 1976, effective 1 July 1975, for a single CPI percentage increase for 12 months to March 1975.
2. Defence Force Retirement and Death Benefits (Pension Increases) Act 1976 – Act No. 13 of 1977, effective 1 July 1976, continuing annual CPI increases.
3. Defence Force Retirement and Death Benefits (Fair Indexation) Act 2014 – Act No. 22 of 2014, effective 1 July 2014, altering the indexation of benefits for pensioners aged 55 or older, by basing adjustments on the more favourable of positive movements in:
 - (a) the consumer price index; and
 - (b) the pensioner and beneficiary living cost index;
with an adjustment if needed 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.

The benefits of all *DFRDB* recipients aged under 55 continue to be adjusted in accordance with increases in the CPI.

In his motion for the Defence Force Retirement and Death Benefits (Fair Indexation) Bill 2014 to be read a second time, the Assistant Minister for Defence, Robert Stuart stated:

“It is important to note that the new fairer indexation methodology will not result in a DFRB or DFRDB pension that is currently less than the MTAW floor percentage increasing to the floor percentage ...” House of Representatives Hansard 30 May 1973.

Closure of the DFRDB Scheme

On 1 October 1991 the Military Superannuation and Benefits Scheme (MSBS) came into effect to replace the DFRDB arrangement.

Conclusion

The Parliament made clear its intention to implement the recommendations of the Jess Report. However, anyone; who has read the Jess Report, Hansard and DFRDB Act, will conclude that the legislation and its operation is not a true reflection of the provisions set out by the Jess Committee.

The legislation, which was not scrutinized by Service representatives, was rushed through the Parliament at such a pace that not even the members of the Jess Committee, who spoke to the Bill at its Second Reading, recognized the departure of the legislation from the recommendations in their own report.

The Jess Report Recommendation

Recommendation (6) of the Jess Report states:

“That *retired pay* and *invalid pay* be expressed as a percentage of final pay and be adjusted annually so that relativity with average weekly earnings is maintained.”

In its conclusion under the heading AUTOMATIC ADJUSTMENT, paragraph 124 of the *Jess Report* states:

“The committee has concluded that the adjustment should be related to average weekly earnings and the relativity of *retired pay* with that index maintained. This will ensure that the man in retirement will be able to maintain his position in relation to rising community standards and that he will obtain those increases when they are needed. To some extent this is a compromise between the proportion of salary method of adjustment discussed in paragraphs 118-119 (the notional salary method and adjustments based on Government decision) and the proposal that adjustment be related to the Consumer Price Index (CPI). The Committee rejects the latter suggestion because it considers that the index does not fairly represent changes in general community standards.”

But that recommendation was not honoured until the DFRDB Fair Indexation Act was passed in 2014.

Impact of the Consumer Price Index

The impact of adjusting DFRDB benefits using the CPI was considerable as the CPI lagged the movement in Male Total Average Weekly Earnings (MTAWE) by a considerable margin from 1991 onwards. Figure 1 below shows the extent of that lag.

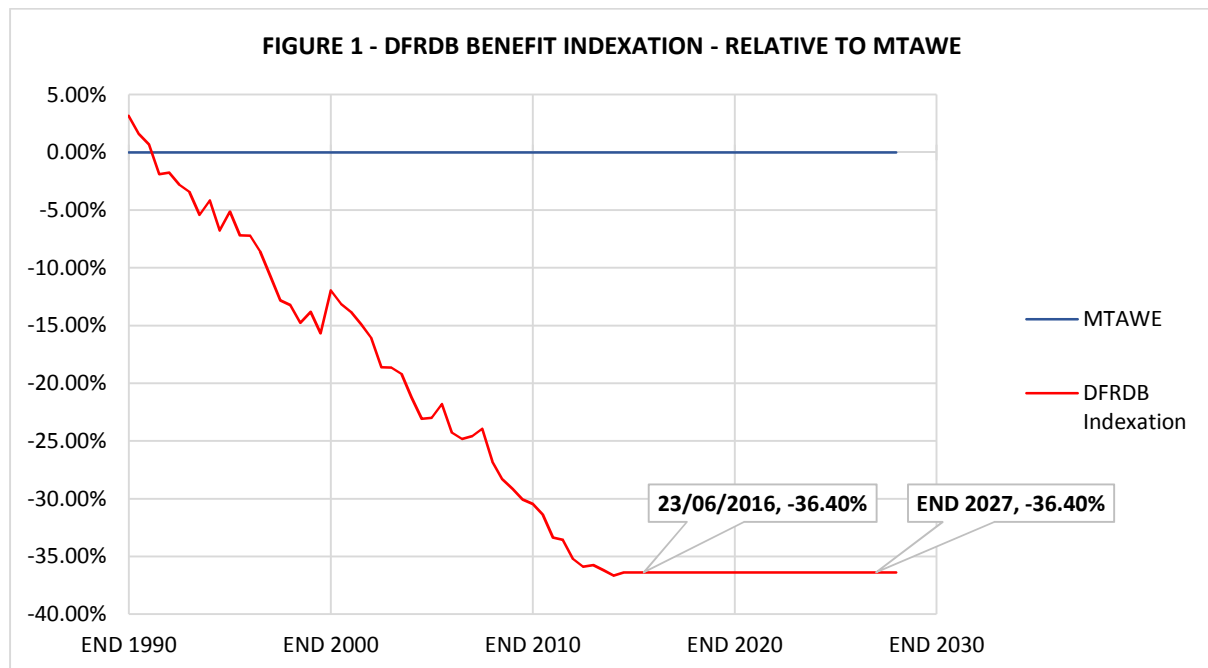


Figure 1 shows that in 2014 the DFRDB Fair Indexation Act arrested the lag of DFRDB indexation but by that time it had fallen more than 36% below MTAWE. Projected inflation over the next 15 years is based on a 1.67% linear trend of DFRDB indexation over the past 15 years.

APPENDIX 2 – THE SYSTEMATIC REDUCTION OF BENEFITS

Providing DFRDB indexation maintains its current relativity with MTAW, that differential will remain in place ad infinitum.

The effect on DFRDB recipients has been a real reduction in their benefits.

The examples used to illustrate the effects of using the CPI to index DFRDB benefits relates to an Army Warrant Office Class 1 aged 36, who retired in January 1983 after completing 20 years of service

Table 2 below shows the effect on the Warrant Officer's rate of Retirement Pay.

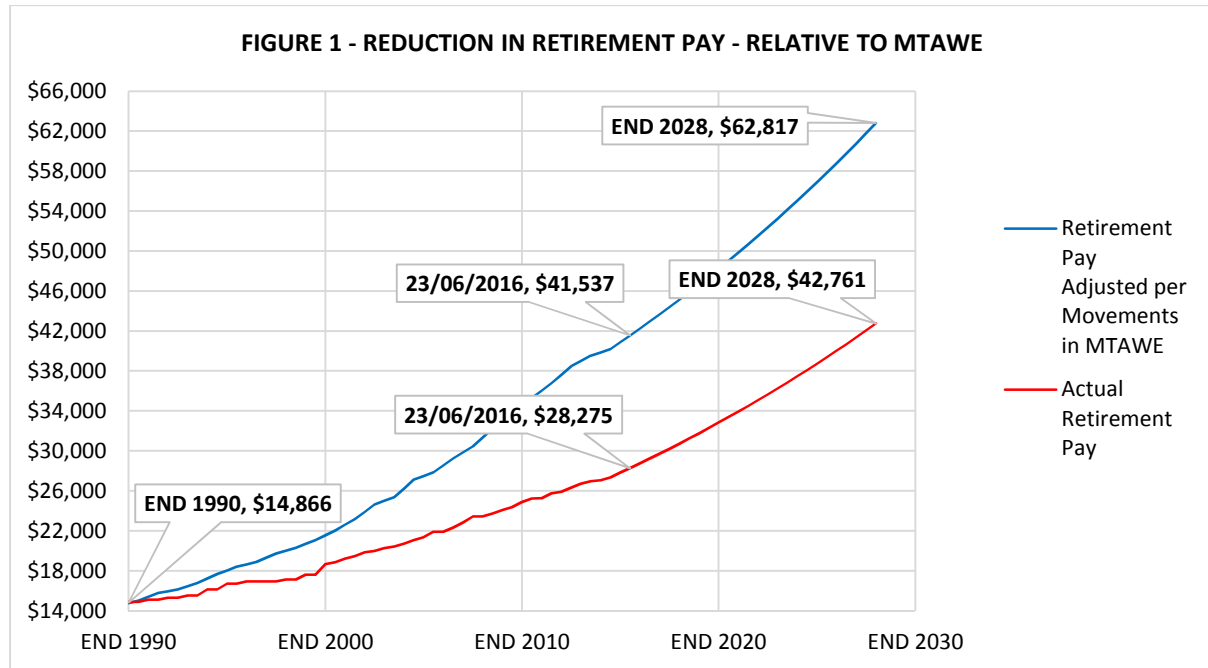
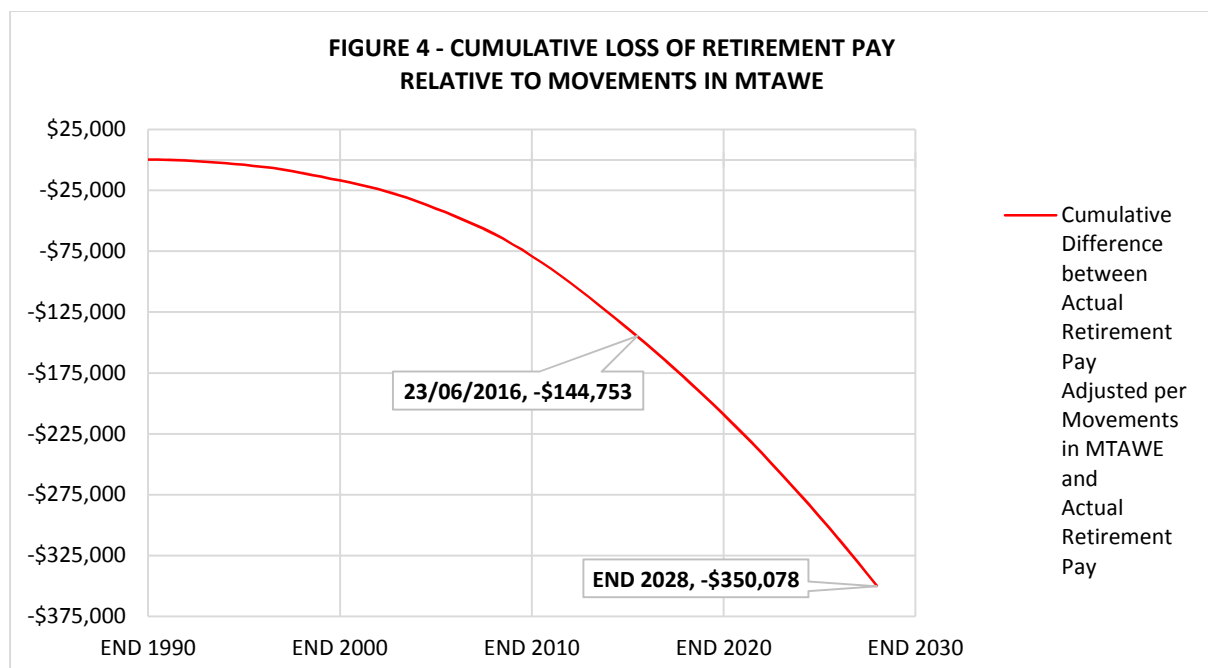


Table 3 below shows the cumulative reduction of the Warrant Officer's Retirement Pay.



APPENDIX 2 – THE SYSTEMATIC REDUCTION OF BENEFITS

The loss of relativity with MTAWWE constitutes an effective reduction of the Warrant Officer's retirement pay. By the end of June 2016, the rate of his retirement pay has fallen \$13,262 per annum. Even after the lag in indexation has been halted the effective reduction in the rate of retirement pay continues because the basis for adjustment has fallen so far. At the projected rate of inflation, the Warrant Officer's rate of retirement pay will have been reduced by \$20,056 at the end of 2028.

The cumulative loss the Warrant Officer will have suffered at the end of Jun 2016 will be \$144,753. By the end of 2028 his cumulative loss will be \$350,078.

Conclusion

If the Warrant Officer's benefit is typical of the 50,000 plus DFRDB recipient population, then since the end of 1990, the collective reduction of DFRDB benefits will be in the order of \$7Billion. This is a denial of rightful DFRDB benefits on an unprecedented and monumental scale.

The effects of this reduction flows on to all widow and dependent offspring benefits.

Action Required

Increase the rate of all DFRDB benefits to bring them back in line with the floor percentage of MTAWWE.

The cost of restoring DFRDB Benefits to their rightful levels

There is no recently published record of current DFRDB beneficiary statistics and requests for ComSuper to provide that information have been denied.

However, if the reduction of benefits for the Warrant Officer described in the example above is in any way typical of the DFRDB recipient population, a very broad estimate of the cost of restoring DFRDB benefits to their rightful levels can be made.

As at the end of 2015 there were 2,410 contributing and 52,921 recipient members of the DFRDB. For the purpose of this estimate we will assume that as at 22/06/2017 all 55,331 members will be recipient members. We will further assume that 25% are deceased and survived by a widow.

On 1 July 2017, the Warrant Officer's projected rate of retirement pay will be \$13,938 below MTAWWE. Therefore, the initial annual cost of restoring this assumed population's benefits to their rightful levels would be:

$$(\$13,938 \times 55,331 \times 0.75) + (\$13,938 \times 55,331 \times 0.25 \times 0.625) = \$698,903,152 \text{ (\$700M)}$$

Definition

Standard dictionaries ascribe the following meaning, or one very similar, to the term *notional*:

Not evident in reality, hypothetical or imaginary.

Operation of the DFRDB Act

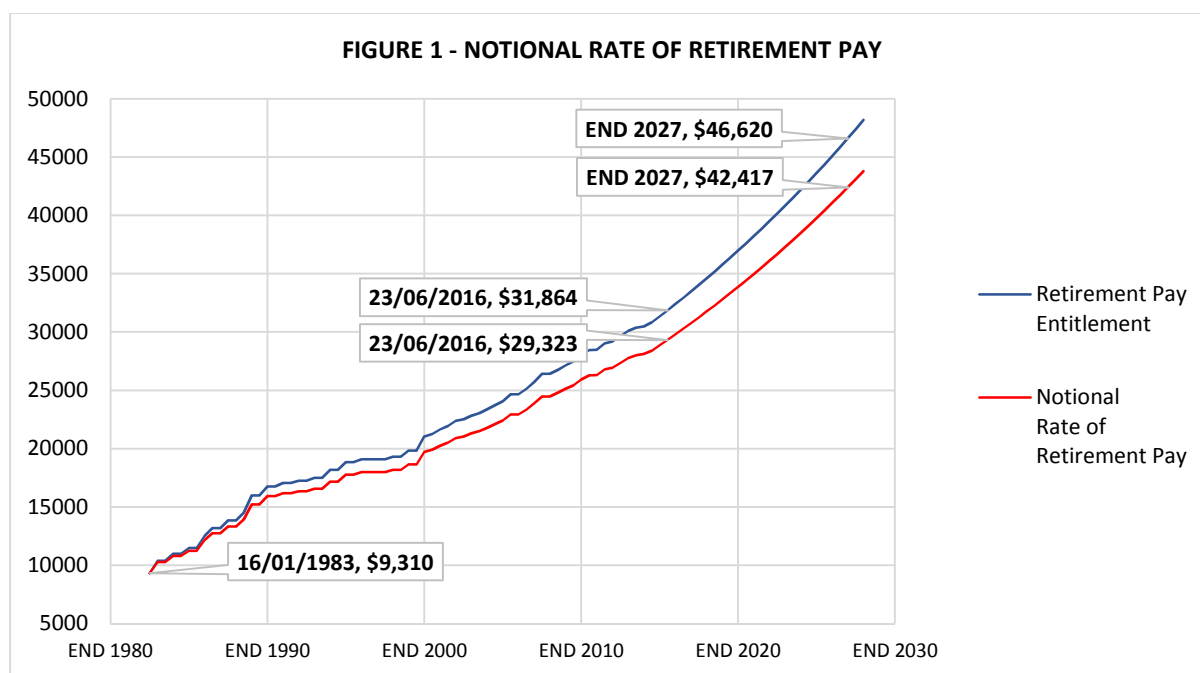
Section 98B (5) (a) states:

“a *notional* rate of retirement pay is applicable to a recipient member if and only if that member has not elected under section 24 to commute a portion of his retirement pay equal to or greater than 4 times the amount per annum of the retirement pay to which he was entitled upon his retirement, and the notional rate of retirement pay applicable to the member at a particular time is the rate at which retirement pay would have been payable to him at that time if he had immediately upon his retirement commuted a portion of his retirement pay equal to 4 times the amount per annum of the retirement pay to which he was entitled;”

The effect of this section of the Act is to impose an arbitrary penalty on any member who did not commute at least 4 times their retirement pay entitlement.

The example used to illustrate the effect of the notional rate of retirement pay relates to an Army Warrant Officer Class 1 aged 36, who retired in January 1983 after completing 20 years of service.

Figure 1 below shows how the notional rate of retirement pay relates to Warrant Officer's retirement pay entitlement. . The projections beyond 23/06/2016 are based on a linear inflation rate of 1.67% based on the trend of DFRDB indexation over the past 15 years.



The effect of the notional rate is to base indexation adjustments on a reduced rate of retirement pay which would have resulted had that member commuted 4 time his/her retirement pay entitlement.

Spouse's Pension on Death of Recipient Member

Section 39 (1) of the DFRDB Act states:

Where a member of the scheme who is a recipient member dies and is survived by a spouse, then, subject to sections 47 and 75, the spouse is entitled to a pension at a rate equal to five-eighths (62.5%) of the rate at which retirement pay or invalidity pay was payable to the deceased member immediately before the member's death or, if the member had commuted a portion of the member's retirement pay under section 24 or a portion of the member's invalidity pay under section 32A, at a rate equal to five-eighths of the rate at which retirement pay or invalidity pay, as the case may be, would have been payable to the member immediately before the member's death **if the member had not so commuted a portion of the member's retirement pay or invalidity pay**, as the case may be.

The interpretation of the highlighted part of this section, by ComSuper, is to apply Section 98B (5) (a) above. That interpretation is also applied under sections 42 (3) and 43 (3), which define the benefit payable for the deceased member's dependent children and orphans.

Figure 2 below shows the impact of the notional rate of retirement pay on the benefit of the Warrant Officer's spouse.

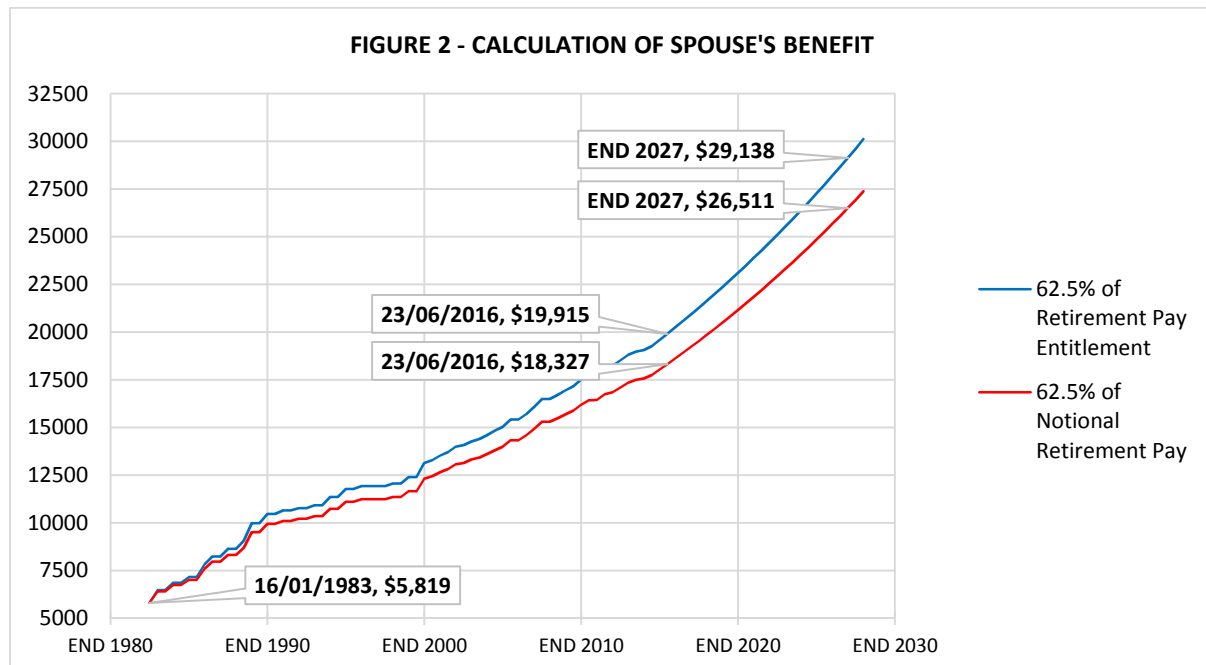


Figure 2 shows that if the Warrant Officer passes away when he reaches his Life Expectancy of 82, the annual benefit his spouse will receive is \$2,676 less than it should be.

Figure 3 below expresses his spouse's benefit as a % of his retirement pay entitlement.

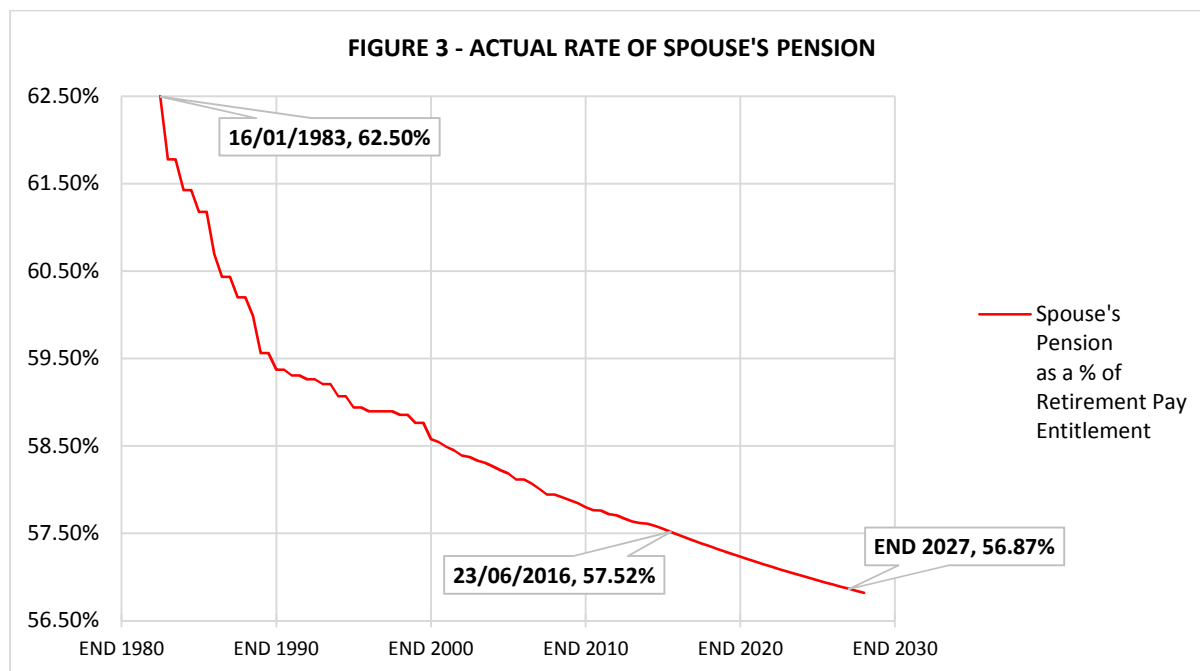


Figure 3 shows that if the Warrant Officer passes away when he reaches his Life Expectancy of 82, the rate of his spouse's benefit (56.87%) will be substantially less than the 62.5% rate to which she should be entitled.

What individuals approaching retirement were told about Notional Retirement Pay

Information on the DFRDB scheme was typically disseminated at Resettlement Seminars and via information pamphlets published by the DFRDB Authority. While the record of what information was conveyed at Retirement Seminars is anecdotal only, an examination of every publication ever issued in relation to the DFRDB Scheme will show that there is no reference whatsoever to a *notional* rate of retirement pay.

The Jess Report on Notional Retirement Pay

The only reference in the Jess Report Recommendation to the term *notional* appears in 15 (b) which states:

“That the widow of a *contributing member* receive an annuity of five eighths of his **notional** *invalid pay* entitlement on the assumption that he had been classified as an invalid Class 'A' at the date of his death.”

The term also appears in

1. Paragraphs 59 and 62, which discuss “**notional** funding” in relation to funding methods for the Scheme.

2. Paragraph 73 which refers to a “notional pension” for pre-1959 entrants to the Commonwealth Public Service Superannuation Fund and paragraph 80 stating the possible need for the Commonwealth to maintain a “notional fund” for its own costing of the Scheme.
3. Paragraphs 88, 92 and 93, which discuss “notional age” of officers.
4. Paragraph 118 which discusses the “notional salary method” under automatic adjustment”.
5. Paragraph 154 which describes, in relation to Family Benefits provided under the under the DFRB Act 1948, the “notional entitlement” of a member who dies in service.

Conclusion

Nothing in the Jess Report provides any justification for the application of a *notional* rate of retirement pay to the determination of the benefits payable; to members who do not commute at least 4 years of their retirement pay entitlement or the spouses and dependent offspring of those members who are deceased.

Section 98B (5) of the DFRDB Act appears to be some remnant of the superseded DFRB legislation or possibly related to a condition that was relevant in Commonwealth Public Service Superannuation legislation.

Action Required

Repeal section 98B (5) of the DFRDB Act and all references to that section.

The cost of restoring Widows Benefits to their rightful level

There is no published record of the profile of current DFRDB beneficiaries and requests for ComSuper to provide that information were denied.

However, if assumptions of Appendix 2 regarding the DFRDB recipient population are adopted, a very broad estimate of the cost of restoring Widows benefits to their rightful levels can be made.

On 1 July 2017, the projected rate of spouse’s pension will be \$1,702 below what it would be if it were based on the member’s full retirement pay entitlement. Therefore, the initial annual cost of restoring the assumed population’s widows’ benefits to their rightful levels would be:

$$(\$1,702 \times 55,331 \times 0.25 \times 0.625) = \$23,543,341 \text{ (\$24M)}$$

Definition

Standard dictionaries ascribe the following meaning, or one very similar, to the term *commutation*:

A substitution of one form of payment or charge for another.

Operation of the DFRDB Act

Section 24 of the DFRDB Act entitles Defence Force retirees who served a minimum of 20 (15 for Late Entrant Officers) years to *commute* (take as a lump sum an advance payment of) a portion of his/her retirement pay to assist with their resettlement into civilian life. Depending on the year of retirement, the amount *commuted* could be up to a maximum of 5 times the individual's retirement pay entitlement.

In respect of that *commutation*, the ongoing per annum amount of retirement pay payable is then reduced by an amount calculated by dividing the amount commuted by the expectation of life factor for the individual's age and gender, on the day on which the election takes effect.

The expectation of life factor is based on the outdated 1960-1962 Life Expectancy Tables published by the Australian Bureau of Statistics (ABS), whereas the most recent Life Expectancy Tables compiled by the ABS are the 2010-2012 Life Expectancy Tables, published in 2014.

Assumptions behind the reduction of Retirement Pay after Commutation

The Jess Report provides some insight into the assumptions behind the reduction of retirement pay after commutation.

Under the heading COMMUTATION, paragraph 109 states, in part:

The provision made for commutation in the existing legislation (DFRB Act) 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 converse is equally valid.

The reduction of retirement pay, in respect of that commutation, should not leave the retiree with any less than he would otherwise be expected to draw.

Paragraph 109 continues with:

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.**

This is irrelevant in the DFRDB Scheme and is factually incorrect. There is no fund to which interest earning apply and the commutation factors applied by the Actuary bear no relationship to interest earnings. They are simply based on historical rates of death.

Life Expectancy

Figures 1 to 5 below provide an overview of Life Expectancy factors.

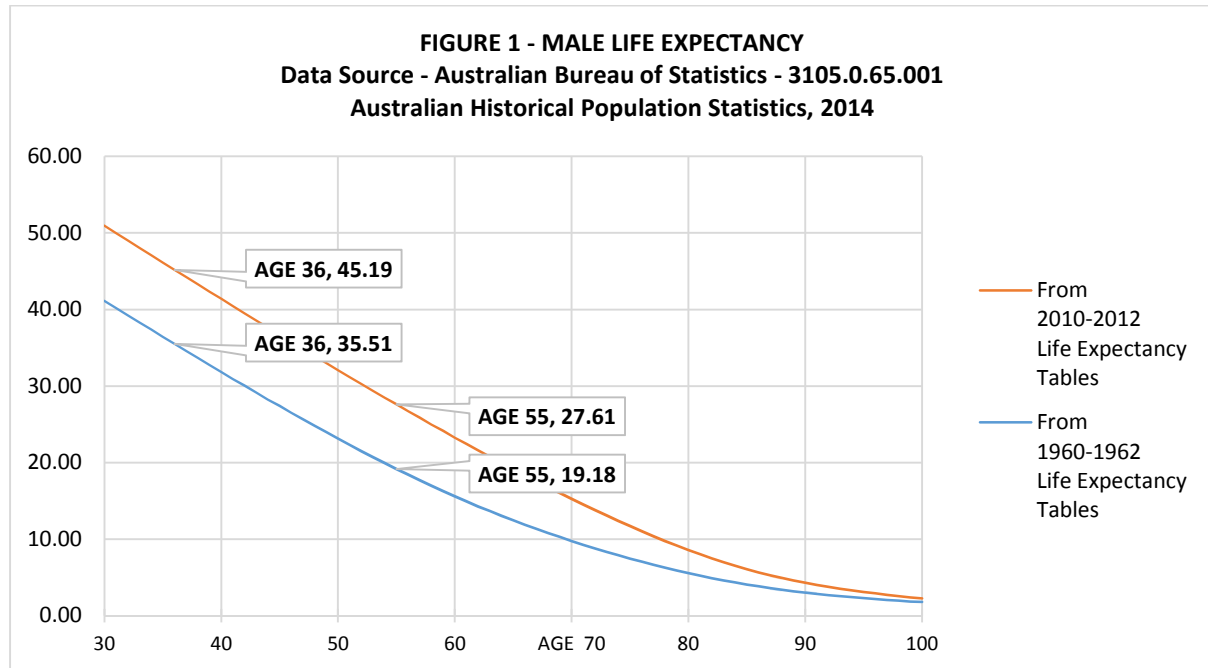
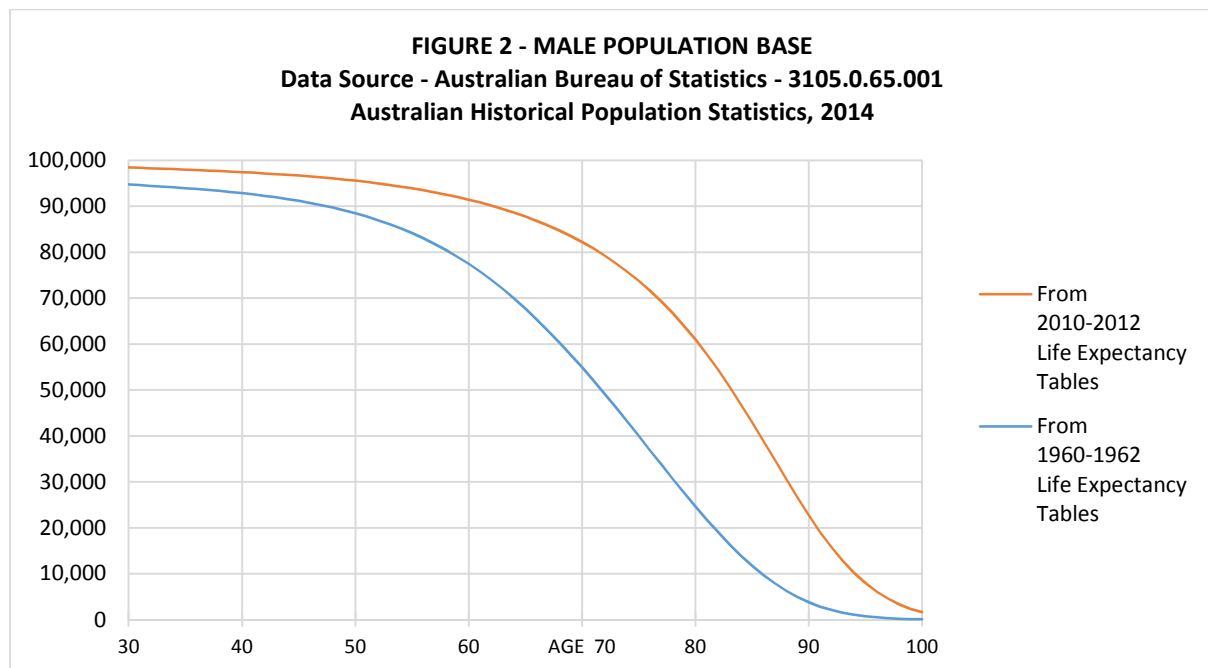


Figure 1 shows the Life Expectancy by exact age from both the 1960-1962 and 2010-2012 Life Expectancy Tables published by the ABS. A comparison; of the *Expectation of Life Factors* in Schedule 3 of the DFRDB Act with the ABS 1960-1962 Life Expectancy Tables, shows that they are one and the same.

The Life Expectancy factors in Figure 1 are determined by applying the probability of dying at an exact age to a population base of 100,000. Figure 2 below shows the distribution of that population by exact age.



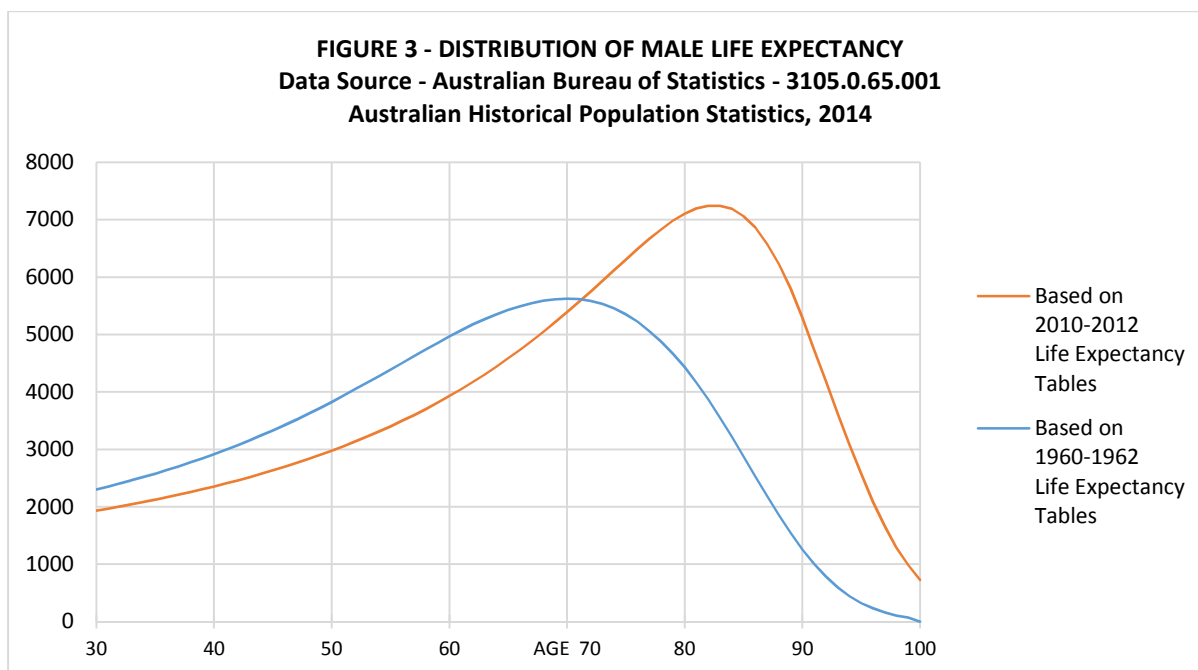


Figure 3 above shows the distribution of Life Expectancy by exact age. The chart shows that the means of the Life Expectancy distributions of the 1960-1962 and 2010-2012 tables occur at approximately 70 and 82 years of age respectively and that the distribution of Life Expectancy is not symmetrical.

The Distribution of Liability

The distribution of liability embodied in the DFRDB Act can be readily be established by viewing 2010-2012 (current) Life Expectancy around the 1960-1962 mean (on which the DFRDB Act is based). Figure 4 below shows that distribution.

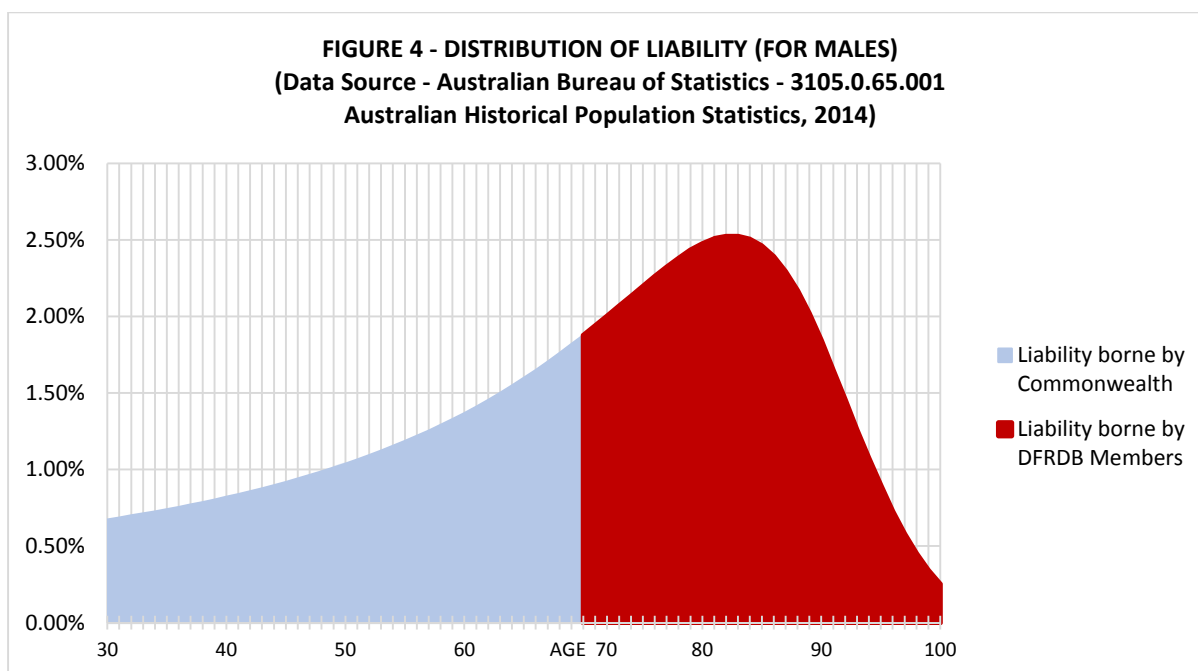


Figure 5 below shows the proportion of liability carried by the Commonwealth.

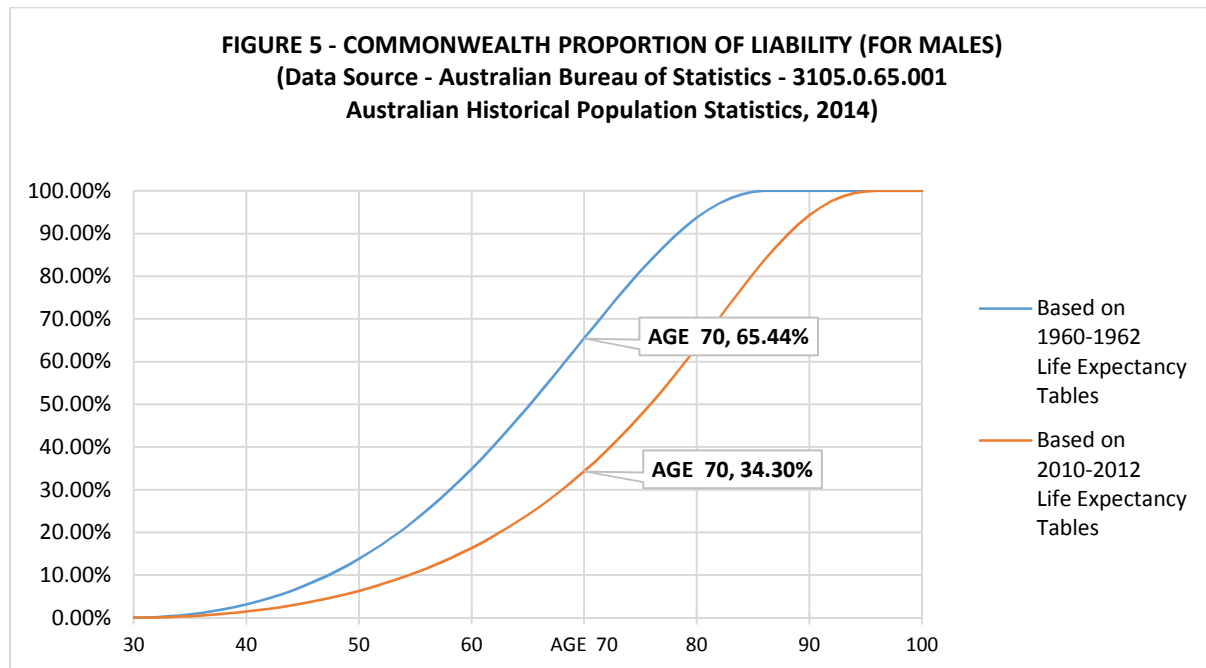


Figure 5 shows that if current Life Expectancy accorded with the ABS 1960-1962 Life Expectancy Tables, the Commonwealth would have carried almost two thirds of the liability under the commutation arrangement in the DFRDB Act. However, due to the increase in Life Expectancy, the Commonwealth now carries just over one third of the liability.

Figures 1 to 5 above and the associated descriptions relate to Male Life Expectancy but apply equally to Female Life Expectancy. The difference is that the statistical means for Female Life Expectancy occur at ages approximately 4 years higher than those for Male Life Expectancy.

What individuals approaching retirement were given to understand about Commutation

While the record of what information was conveyed at Retirement Seminars is anecdotal only, No publication on the DFRDB Scheme issued, up until the closure of the scheme in 1991, stated that retirement pay after commutation would be reduced permanently. The DFRDB Handbook 2013, published 40 years after the commencement and 22 years after the closure of the scheme, was the first to include the following statement:

Note: Commutation of a benefit results in a **permanent reduction** in your retirement benefit based on your life expectancy ... Your retirement benefit will not be set to the pre-commutation rate, even if you attain or exceed your life expectancy.

None of the DFRDB publications state that individuals who lived beyond their life expectancy were required to indemnify the members of the scheme who did not.

The meaning of the term *commutation* implied a ‘like’ for ‘like’ exchange to individuals considering the option and did not convey a sense of permanence.

The general understanding was that those who elected to commute would exchange a lump sum payment for a reduction in retirement pay, for the period of their Life Expectancy.

What individuals who reached their Life Expectancy were told

When individuals who had reached their Life Expectancy began to question why their retirement pay had not been restored to its full level, they received responses from the DFRDB Authority which typically conveyed the following.

“The life expectancy is actuarial factor that is designed to provide broad averages over large populations.” and

“... your pension does not cease once you reach your life expectancy. After a member lives beyond their life expectancy their benefits continue to be funded from consolidated revenue. Likewise, if a member commutes an amount and passes away shortly thereafter, their estate is not liable to repay the commuted amount.”

This could be valid if DFRDB was an insurance scheme and Life Expectancy (i.e. the risk) was distributed evenly about the mean. Neither is the case. Yet that the object of the legislation. Members who survive their life expectancy are required to indemnify those who do not.

The effect of Indexation on Commutation Payback

The only reference made to indexation in Section 24 of the *DFRDB Act* is in Section 24 (7) which directs that the commutation amount payable to a member, who had previously retired and commuted and then subsequently re-engaged, to be reduced by the indexed value of the previous commutation paid to the member.

The example used to illustrate the effect of indexation on commutation payback relates to an Army Warrant Office Class 1 aged 36, who retired in January 1983 after completing 20 years of service. He elected to commute his maximum entitlement of \$34,240. His life expectancy factor was 35.51 under the 1960-1962 Life Expectancy tables and 45.91 under the 2010-2012 Life Expectancy tables, corresponding to 71.51 and 81.91 years of age and reaching those Life Expectancies in 2017 and 2027 respectively.

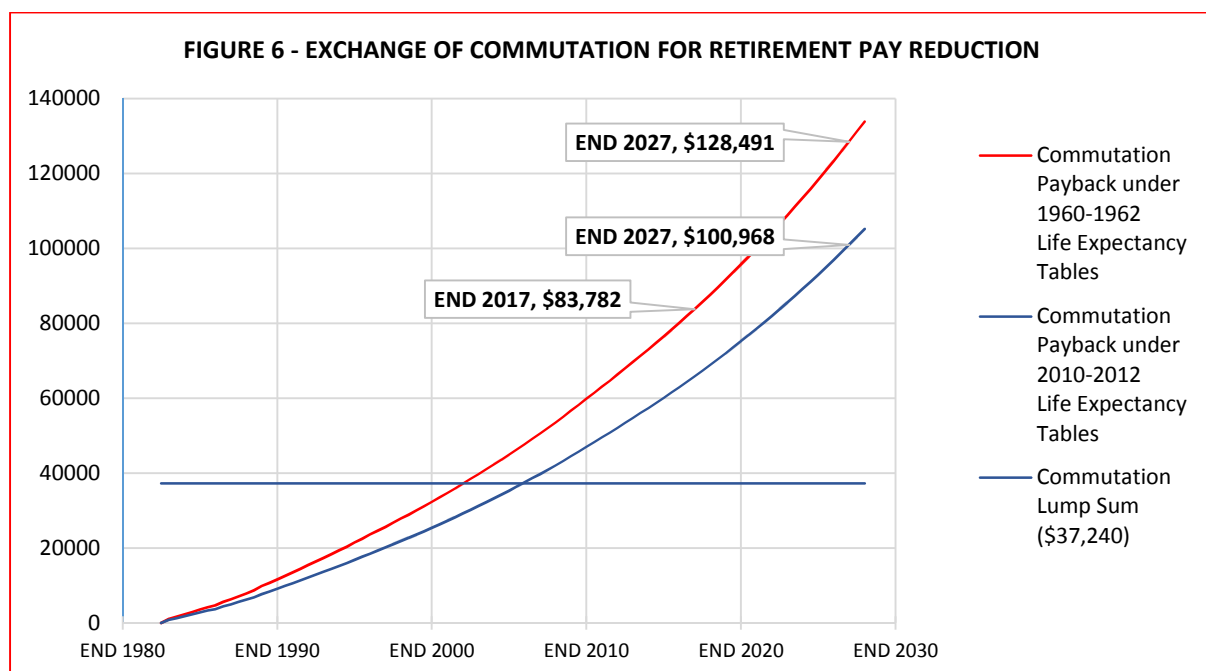


Figure 6 above shows the accumulated difference between payments at the reduced rate of retirement and payments at the rate of retirement pay before reduction, fully indexed. The projections beyond 23/06/2016 are based on a linear inflation rate of 1.67%.

Figure 6 shows that under the 1960-1962 Life Expectancy tables the Warrant Officer will have exchanged 2.25 times his commutation lump sum when he reaches his life expectancy (72 in 2017) as determined under the DFRDB Act. However he will have exchanged 3.45 times that amount when he reaches his current life expectancy (82 in 2027), under the 2010-2012 Life Expectancy tables.

Even if the Warrant Officer's retirement pay reduction was based on the 2010-2012 Life Expectancy tables, he will still have exchanged 2.71 times his commutation amount when he reaches his life expectancy of 82 years of age.

Commutation after Re-enlistment

When a member re-enlists after having retired and elected to commute and subsequently retires again, his/her retirement pay and commutation entitlement are determined in the same manner as the previous occasion, based on his/her current salary, total years of service and age. However, the conditions which apply to commutation differ, in that:

1. If the member commuted after the first engagement he/she has no option but to commute again.
2. The total amount of the first (or prior) commutation, indexed in the same manner as retirement pay, is deducted from the subsequent commutation amount.

However, no allowance is made for the portion of the amount commuted which is repaid by virtue of the reduced rate of retirement pay during the first (or prior retirement). **The nett effect is that that amount must be repaid again.**

Operation of the DFRDB Act regarding Commutation after Re-enlistment

The following example illustrates the operation of the DFRDB Act. It describes the situation of a Navy Lieutenant Commander aged 37 who retired in January 2000 after completing 20 years of service. In May 2014, he re-enlisted for a further 2 year engagement.

Table 1 below shows his first retirement entitlements and his position at the time of his re-enlistment.

TABLE 1		
First Retirement Entitlements		
A	Retirement Pay Entitlement	\$21,483.35
B	Commutation Lump Sum	\$88,565.11
C	Reduced Retirement Pay	\$15,700.42
At Re-enlistment		
D	Indexed Commutation Lump Sum	\$136,932.80
E	Indexed Cumulative Retirement Pay reduction	\$45,967.57

APPENDIX 4 – THE COMMUTATION SWINDLE

Table 2 below shows the Lieutenant Commander's retirement entitlements, in accordance with the *DFRDB Act*, when he retires again in May 2016.

TABLE 2		
Second Retirement Entitlements		
F	Retirement Pay Entitlement	\$48,932.22
G	Commutation Entitlement	\$244,661.10
H	Life Expectancy Factor	20.72
Commutation Lump Sum and Reduced Retirement Pay		
I	Commutation Lump Sum = $G - D$	\$107,728.30
J	Reduced Retirement Pay = $E - (G \div H)$	\$37,124.25

Under section 24 (7) of the DFRDB Act, the determination of the Lieutenant Commander's commutation lump sum and his reduced retirement pay takes no account of the commutation he repaid during his first retirement, by virtue of his reduced retirement pay.

Fair and Reasonable Credit for Repaid Commutation

It is only fair and reasonable for the Lieutenant Commander to receive a credit for the portion of his first commutation he has repaid. That credit should optionally be made available to him as a deduction from either;

1. the indexed value of his first commutation, giving him an increased commutation lump sum payment or;
2. the commutation amount used to calculate his reduced retirement pay.

Table 3 below shows the outcomes of the two options.

TABLE 3		
Option 1 - Credit applied to Commutation Lump Sum		
K	Commutation Lump Sum = $G - D + E$	\$153,695.87
L	Reduced Retirement Pay = $F - (G \div I)$	\$37,124.25
Option 2 - Credit applied to Reduced Retirement Pay		
M	Commutation Lump Sum = $G - D$	\$107,728.30
N	Reduced Retirement Pay = $F - ((G - E) \div I)$	\$39,342.76

Conclusion

The operation of Section 24 of the DFRDB Act is a significant departure from Recommendation (7) of the Jess Report, which states:

“That the *Proposed DF.R.B. Scheme* not be ‘funded’; that members' contributions not represent a fixed proportion of the cost of the benefits provided; that the contributions

of members be payable to the Commonwealth; that the Commonwealth guarantee the benefits provided and meet all costs not covered by members' contributions.”

Through the use of outdated Life Expectancy tables and the assumption that DFRDB recipients, who live beyond their life expectancy, should indemnify those who don't constitutes a substantial denial of DFRDB benefits.

The DFRDB Authority, now ComSuper, has seized on the unanticipated windfall created by the increase in Life Expectancy, to further deny members their rightful benefits.

The arrangement for Commutation under the DFRDB Act is neither fair nor equitable. Rather than a “like for like” exchange of one benefit for another, it is akin to the exchange of a fixed lump sum for a blank cheque.

Action Required

Amend Section 24 of the *DFRDB Act* as follows:

Limit the period of time for which a reduction in retirement pay, in respect of commutation, remains in effect, to the expectation of life factor expressed in whole days that; having regard to the age and sex of the person on the day on which the election takes effect, is applicable under Schedule 3.

Include the indexed accumulated reduction in retirement pay, in respect of a previous commutation election, by allowing the member to elect either;

- (a) add that amount to the commutation lump sum payment, in respect of the subsequent retirement or;
- (b) deduct that amount from the commutation amount used to calculate his reduced retirement pay.

Cost of restoring Retirement Pay to full level after reaching Life Expectancy

There is no published record of the profile of current DFRDB beneficiaries and requests for ComSuper to provide that information have been denied.

However, if the assumptions in Appendix 2, regarding the DFRDB recipient population are adopted, a very broad estimate of the cost of restoring Retirement Pay to full level after the member reaches Life Expectancy can be made.

On 1 July 2017, the projected rate of reduced retirement pay will be \$3,772 below what it would have been had the member not commuted. If we assume that 50% of members have reached their Life Expectancy, the initial annual cost of restoring the assumed population's retirement pay to full level would be:

$$(\$3,772 \times 55,331 \times 0.75 \times 0.5) = \$78,265,700 \text{ (\$80M)}$$

Cost of crediting prior engagement Commutation Payback

The number of members affected would be pure guesswork. No estimate is attempted.

The DFRDB Beneficiary Population

DFRDB beneficiary population statistics were requested from ComSuper but even via *Freedom of Information*, those requests were denied. Hence a profile of the DFRDB beneficiary population could not be produced nor could a precise starting point for the cost projections be established.

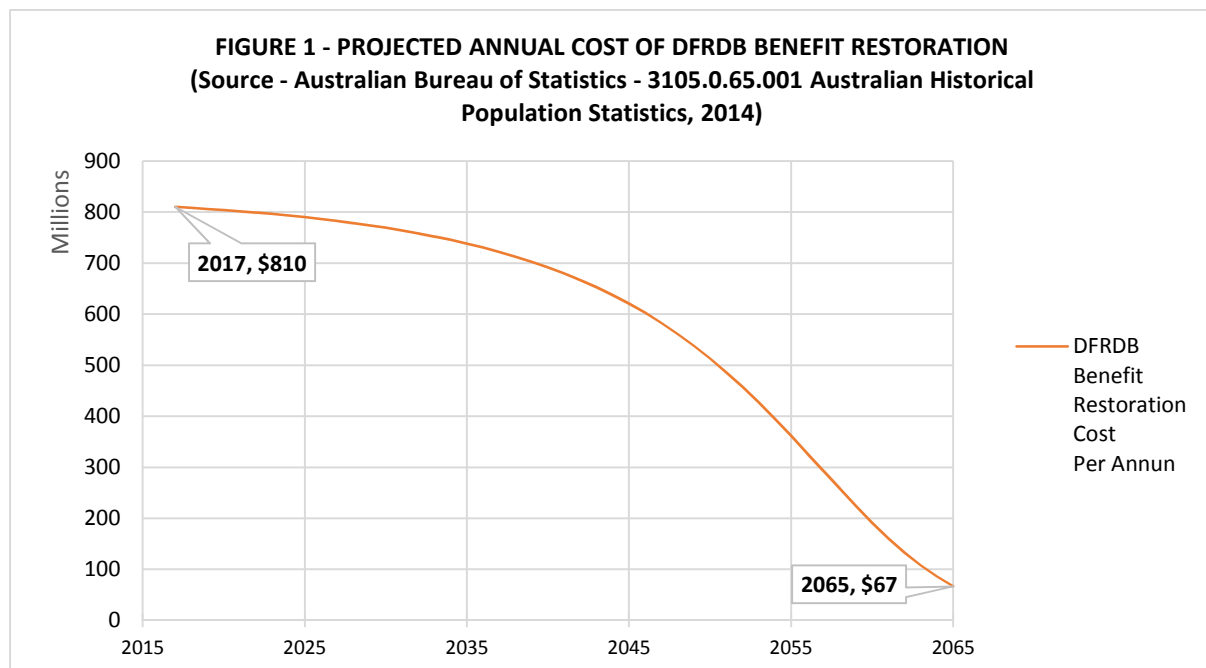
However, using the assumptions made in Appendixes 2, 3 and 4 and the population decay data provided in the ABS Australian Historical Population Statistics of 2014, a very broad estimate of the initial annual cost can be established.

The cost of restoring DFRDB Benefits to their rightful levels

Based on the assumptions in Appendixes 2, 3 and 4, a broad estimate of the initial per annum cost of restoring DFRDB benefits to their rightful levels, at 1 July 2017 benefit rates, is shown in Table 1 below.

TABLE 1 – INITIAL ANNUAL COST ESTIMATE	
Restoring DFRDB Benefits to MTAWF Floor Rates	\$700M
Eliminating Notional Rate of Retirement Pay	\$24M
Restoring Retirement Pay after reaching Life Expectancy	\$80M
TOTAL	\$804M

Figure 1 below shows that initial cost (rounded up to \$810M) projected forward on the basis of the population decay data in the ABS 2010-2012 Life Expectancy tables.



Funding source to restore DFRDB Benefits to their rightful levels

The quantum of funding required to restore DFRDB benefits, after many years of systematic reduction, is considerable and almost certainly beyond the capacity of the budget. However, a funding source already exists.

In 2006, the Howard Government established the Future Fund under the Future Fund Act 2006, which states in Section 3 – Object, sub-paragraph (2):

The Future Fund will make provision for unfunded superannuation liabilities that will become payable during a period when an ageing population is likely to place significant pressure on the Commonwealth's finances.

The argument against utilizing the Future Fund to restore DFRDB Benefits

Government has already indicated it will not access the Future Fund before 2020. However, the Future Fund Act 2006 states in Schedule 2 – Debits of amounts from the Future Fund, Section 1:

The main purpose of the Fund Account is to discharge unfunded superannuation liabilities from whichever is the earlier of:

- (a) the time when the balance of the Fund is greater than or equal to the target asset level;
- (b) 1 July 2020.

Note: The target asset level is specified in a declaration (a *target asset level declaration*) given by the designated actuary under Schedule 3. The target asset level represents the amount that is expected to offset the present value of projected unfunded superannuation liabilities.

Future Fund Assets

Future Fund Annual Report 2014/2015 states:

As at 30 June 2015, the balance of the Future Fund was \$117.2Billion.

That Report also states:

In 2014/15 the Future Fund produced a return of 15.4%. Since it was established its return is 8.0% per annum. In comparison the Fund's target benchmark return for these periods was 6.0% and 7.1% pa respectively.

The Report does not include a *target asset level declaration*.

The impact of using the Future Fund to restore DFRDB Benefits

Figure 2 below shows the impact of using Future Fund assets to restore DFRDB benefits to their rightful levels.

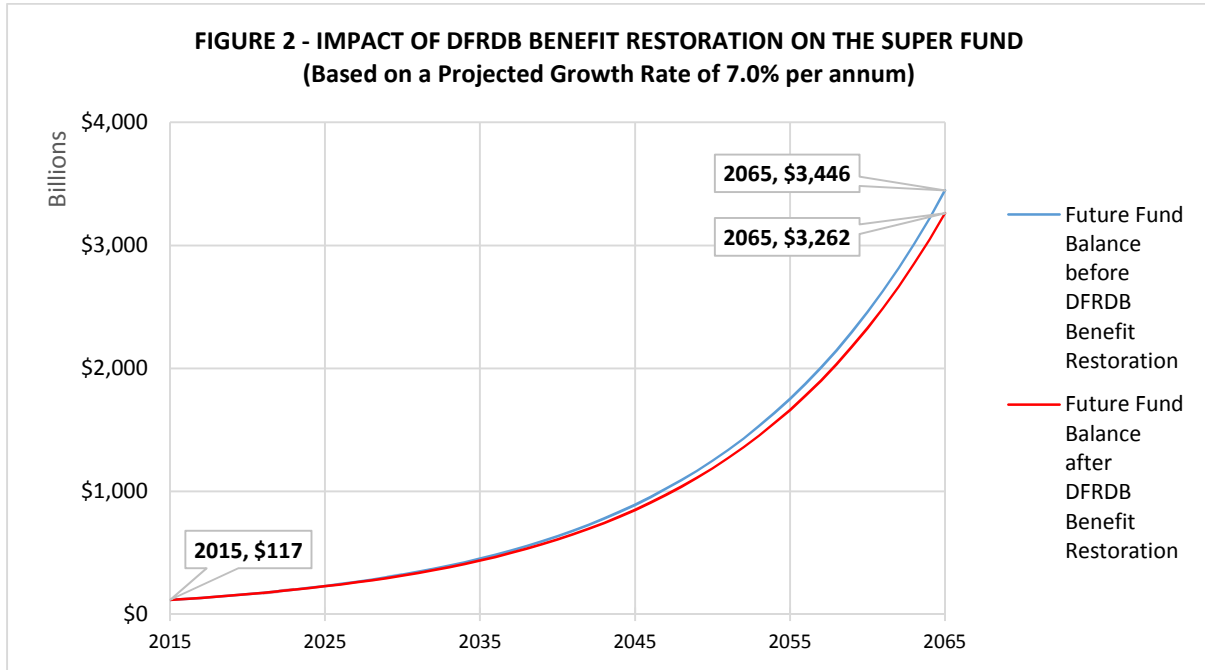


Figure 2 shows that while the cost of restoring DFRDB benefits to their rightful levels is considerable, the impact of meeting those costs from the Future Fund would be minimal.

Conclusion

DFRDB beneficiaries have been denied a considerable part of their rightful entitlements for many years and with each passing year their losses increase.

The Future Fund is the obvious funding source to restore those benefits to their rightful levels.

The Future Fund Act 2006 makes provision for the assets of the Future Fund to be used before 2020. The higher than expected performance of Future Fund and the absence of a target asset level declaration suggest that the assets of the Fund can be used now.