

## **DFRDB AND COMMUTATION**

### **WHAT'S ALL THE FUSS ABOUT ?**

This article was recently published in *Camaraderie*, the journal of the Defence Force Welfare Association (DFWA). It has been slightly updated, and whilst it explains the position of the DFWA (which some may or may not agree with), it provides useful background information for all DFRDB recipients.

By way of background, the Senate Foreign Affairs, Defence and Trade Committee held a hearing in May this year on the DFRDB Scheme, and the issue of commutation and use of outdated life tables was raised. Unfortunately the Committee made no recommendations on either of these matters, both of which impact on DFRDB benefits. The Committee's report and deliberations can be found on the APH website.

#### **What is 'Commutation'?**

Upon leaving the ADF, the 1973 DFRDB scheme allowed DFRDB superannuants to receive part of their superannuation entitlement as a lump sum in advance.

The purpose was to help these former ADF members buy a house or establish a business, remembering that conditions of service are much better today than then. ADF pay was low, most ADF members were required to "retire" by age 47, and many women were required to resign from their jobs upon marriage. DFRDB commutation and the subsequent pension helped support a family, not just the retired veteran, noting that DFRDB is a superannuation scheme. It is not welfare.

Commutation is not a loan, but results in reduced fortnightly payments (i.e. the fortnightly DFRDB superannuation pension) for life. The reduction is calculated on the life expectancy of the recipient so that the taxpayer is recompensed over the recipient's expected lifetime.

#### **Restoring the Pension upon Reaching Life Expectancy Age**

Some, not DFWA, argue that once the benefit (i.e. the commuted lump sum) was nominally 'repaid', the fortnightly reduction in the pension should cease. The DFRDB pension would then be restored to its pre-commutation level (i.e. to the level that would have been paid if commutation did not occur).

Restoration would occur when the recipient reached his/her legislated life expectancy. If Schedule 3 of the 1973 DFRDB Act says that a recipient's life expectancy is, say, 72 years then the argument is that DFRDB pension restoration should take place on and from the recipient's 72<sup>nd</sup> birthday.

This approach is superficially attractive but is not practical for reasons explained later.

In addition, because the reduced DFRDB pension continues for life, some argue that the Commonwealth has an obligation to refund the 'repayments' made after life expectancy had been reached, as the commuted amount had been 'repaid'.

### **More on the Life Expectancy Issue**

Life expectancy has increased, albeit not steadily, since records first commenced. Notably, average life expectancies increased by just six months in the 40 years 1932-1972 but increased by ten years in the 40 years 1972-2012.

Schedule 3 of the 1973 DFRDB Act uses 1960-62 life expectancy tables. DFRDB's bipartisan architects did not and could not anticipate the huge increase in life expectancy over the following 40 years.

The DFRDB Act has never been updated to reflect the evolving increases in life expectancy of the Australian population between 1973 and today.

So what, you may say?

Well, if the outdated tables in the Act indicate a life expectancy of, say, 20 years at the date of commutation, the pension is reduced by  $1/20^{\text{th}}$  so that after 20 years, the taxpayer is fully recompensed.

But if the individual's correct life expectancy is 30 years, the reduction would be just  $1/30^{\text{th}}$  so that after 30 years, the taxpayer is fully recompensed.

In both cases, the reduction in DFRDB pension then continues until death.

But an average life expectancy is just that, an average. Half will die before the average age is reached, and half later – if correct life expectancies are used. That means the Commonwealth will be fully recompensed for its commutation advance because those who live longer are in effect subsidising those who die earlier.

Others dismiss or ignore this key 'subsidy' issue. They do not address the matter of DFRDB pensioners who die early. Would they want the veteran's family to recompense the Commonwealth from the veteran's estate? Surely not. So how is the taxpayer to be recompensed for these veterans' commutation?

The key problem is that the average ages legislated in 1973 are significantly wrong, and have been wrong since the mid-1970s when Australian life expectancies started to rise.

Few die before the 1973 legislated average age. Most die much later. That means the Commonwealth has been and is grossly over-recompensed for the amount it advanced in commutation.

DFRDB veterans who commuted are in effect subsidising the Commonwealth instead of just subsidising their mates who died earlier. That's clearly wrong.

## The DFWA Case

The DFWA case centres on these two key elements:

1. As it stands, the families of those who commuted but die early are not required to 'reimburse' the Commonwealth for the unrecompensed portion of the deceased veteran's commutation advance. The other side of the coin is that those who die later than their Schedule 3 life expectancy continue with their reduced DFRDB pension for life. As outlined above, those who live longer effectively subsidise those who die earlier. ***DFWA, unlike others, supports the 'subsidy' principle.***
2. ***DFWA objects strongly to the grossly out of date life tables*** upon which the lifetime DFRDB pension reduction is calculated. The Commonwealth has been, and continues to be, over-recompensed by many hundreds of millions of dollars by DFRDB pensioners who chose to commute, because of the massive increase in Australian life expectancy since the DFRDB Act was passed in 1973.

## The DFWA Proposal

DFWA wants lifetime DFRDB pension reductions calculated using the life expectancy table applying to each individual ***on the date he/she chose to commute.*** That's fair to the DFRDB pensioner and, importantly, to the taxpayer.

Three steps are required:

1. Amend the 1973 DFRDB Act so that the applicable life expectancy is the one applying to a retiring DFRDB member on the date he/she elects to commute. Delete the 1960-62 tables at Schedule 3.
2. Create a simple program, or amend an existing program, in order to establish the correct DFRDB pension reduction for each existing and future DFRDB pensioner who commuted. All data elements (age, length of service, salary for superannuation purposes etc.) already exist and are used to calculate reductions now. The only change is to use the correct life expectancy instead of the grossly outdated 1960-62 tables in the 1973 Act.
3. Adjust the DFRDB pensions, including reversionary pensions, of all living DFRDB pensioners in the light of Step 2. Subject to actuarial confirmation, DFWA estimates that DFRDB pensions would rise by about 1.3% or, on average, about \$400 per annum.

Refund of the Commonwealth's windfall over the decades since 1973 would be fair but is not, in DFWA's opinion, achievable. DFWA would like to be wrong here, but political and bureaucratic obfuscation since DFWA first raised this issue in the 1980s has been relentless, so DFWA expects that pursuit of refunds, however fair, would delay any resolution until all DFRDB pensioners are dead.

That is why DFWA, very reluctantly, is not pursuing fair refunds. The Commonwealth would remain grossly over-recompensed under DFWA's proposal.

DFWA chooses to focus on an achievable and affordable outcome that recognises political and bureaucratic realities. Even in an election year, let alone in today's COVID-affected financial climate, DFWA does not believe that any government or political party would contemplate refunds, however justifiable.

### **Cost of Proposal**

DFWA, very conservatively, estimates the Government has been over-recompensed by \$400M. Others put this figure at \$1B and more.

That's why the DFWA recommendation is to adjust DFRDB pensions in line with the recipient's correct life expectancy table at the date they elected to commute. DFWA estimates the gross cost to the Commonwealth to be an affordable \$20M per annum. That's a net cost of about \$14M after 30% 'clawback' due to increased income tax and GST, and reduced Age/Service pensions. (DFRDB pensions are taxable, less a 10% offset.)

Even if DFWA's estimates are out by 100%, the cost is still affordable. If a critic says the Commonwealth cannot afford to redress its windfall even in this small part, then DFWA merely reminds the critic that DFRDB superannuation pensioners could not afford to overpay the Commonwealth in the first place. And they still overpay.

DFWA recognises that in a perfect world the Commonwealth should and would refund its gross windfall *and* adjust DFRDB pensions. That's cost-neutral for the taxpayer and fair to these veterans. But today's world is not perfect, so DFWA pragmatically promotes what it believes to be achievable.

The perfect is the enemy of the good, so the perfect pursuit of refunds would merely further delay the good of DFRDB pension adjustments.

### **Some Final Considerations**

DFWA notes that the average (mean) DFRDB pension for the scheme's 51,560 pensioners is \$30,196 (2019-20 CSC Annual Report) compared with \$41,861 and \$34,485 for CSS and PSS, which are also defined benefits Commonwealth superannuation schemes. The three schemes differ but the comparison is valid enough to show that DFRDB veterans and their families are not the fat cats that certain political and bureaucratic critics of Defence conditions of service would want the public to believe.

Regrettably, many politicians and others over the years, including ministers, repeatedly used the word "generous" to rail noisily against fair indexation of DFRDB and MSBS pensions. It seems they still do in regard to DFRDB commutation and other matters. But DFRDB is demonstrably not "generous" for the average veteran and his/her family. Look at the evidence.

### **Conclusion**

DFRDB superannuation pensioners are dying off, meaning that further obfuscation and delay is unacceptable both morally and financially. These veterans and their

families must not be forced to continue subsidising the Commonwealth until all are dead.

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