

# Investigation into the administration of the Defence Force Retirement and Death Benefits (DFRDB) scheme

December 2019

Report by the Commonwealth Ombudsman,  
Michael Manthorpe, under the *Ombudsman Act 1976*

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# FOREWORD

In April 2019 I was approached by the Hon Darren Chester MP, Minister for Veterans and Defence Personnel and asked if I would look into the administration of the commutation provisions contained in the Defence Force Retirement and Death Benefits (DFRDB) scheme. I decided to do so under the Own Motion powers contained in the *Ombudsman Act 1976*.

‘Commutation’ refers to eligible retiring Defence Force members having the choice to take their benefits as a pension, or they could opt to commute a part of their pension into a lump sum and access a reduced pension.

It is important to note that there have only ever been two options available to DFRDB members: namely, to commute, or not to commute. DFRDB members reported being told that commutation was a loan to be repaid over their life expectancy. Such information is incorrect. At law, commutation is not a loan, but a permanent exchange of one type of entitlement for another. The result is a permanent reduction to retirement pay.

Many DFRDB members, likely numbering in the thousands, were provided incorrect information by Defence personnel who were responsible for providing advice about the workings of the scheme. Those DFRDB members were led to believe, incorrectly, that their commuted pensions would increase once they reached their life expectancy factor age. The absence of clear guidelines and instructions to staff led to this incorrect information being provided, which resulted in a misunderstanding of the basic design of the scheme. In my view, this amounted to defective administration by Defence.

The incorrect information created the idea that there was a hybrid option, i.e. a lump sum, plus a reduced pension, and that the pension would revert to the higher rate when the ‘loan’ represented by the lump sum was ‘paid off’. However, at law this option did not exist. It was not what the Parliament intended and, despite the raised expectations of some members, it was illusory. Most members did, in fact, choose to commute. Some members did so on the basis of the incorrect advice, while others did so based on a correct understanding of the scheme.

The information provided by the DFRDB Authority (now the Commonwealth Superannuation Corporation (CSC)) was at all times correct. However, while correct, the information was not sufficiently clear to correct the misunderstanding that many members had from their interactions with Defence. With the benefit of hindsight, I can now see how this information could have been clearer, as is the case with CSC’s current documents.

While these errors have now been fixed, I have turned my mind to what should happen to remedy the defective administration.

Although disappointing and frustrating, missing out on a benefit to which a person is not actually entitled under the law does not necessarily mean that the person suffered financial detriment. As a matter of principle, compensation should only be paid where poor administrative practices cause actual financial loss.

I wanted to determine whether those who were given misleading information were likely to have suffered overall financial loss as a result of their choice. I engaged two expert actuaries, the Australian Government Actuary (AGA) and KPMG to independently model a number of

scenarios to compare the real financial results of commuting and not commuting—that is, the two options that were actually available.

In all of the scenarios we modelled, using conservative assumptions about how retiring members might have used the lump sum, commutation has resulted in a beneficial overall financial outcome for DFRDB members to date. This is particularly true for DFRDB members who retired in the years before 2010. While some of those who discharged in recent years may be able to make the case that at some time in the future they could be financially worse off having commuted, I am satisfied these decisions to commute were made after CSC improved its publications to explicitly advise that the commutation reduction is permanent.

I am satisfied the decision to commute is not likely to have, of itself, caused financial loss, relative to the only other option that was available at law. I have therefore concluded that it is not appropriate to recommend compensation in a broad sense.

Although unlikely, I cannot rule out that there may be outlying cases with circumstances of which we are not aware. The Scheme for Compensation for Detriment caused by Defective Administration (CDDA scheme) is suitable for any such cases to be considered. However, to avoid giving false hope to individuals or creating unnecessary process for agencies, I have included a list of considerations which we suggest would need to be satisfied as part of any such claim.

Nevertheless, I acknowledge the disappointment, frustration and anger experienced by DFRDB members whose expectations were falsely raised. Even though the modelling suggests that they did not suffer financial detriment by commuting, relative to the other available option, it is undoubtedly the case that they experienced perceived detriment relative to what they had been told would occur. I have therefore recommended that the Secretary of the Department of Defence and Chief of the Defence Force apologise for the defective administration that occurred and for the disappointment members have experienced. I am pleased that my recommendation has been accepted, and I have included a copy of the apology letter as an appendix to the report

For completeness, I also considered whether, in light of the raised expectations and subsequent disappointment, the Government should provide some form of financial reparation or *ex gratia* payment to impacted DFRDB members. Such a payment could, theoretically, go some way towards addressing the perceived financial detriment between the commutation option and what members were informed would occur.

However, I have decided to stop short of making such a recommendation. There are two reasons for this. First, on the basis of the modelling, to do so would unreasonably place the cohort who commuted in an even stronger financial position than those who correctly understood the operation of the scheme and decided not to commute, which in the long run appears to have been the less beneficial choice for most people. Similarly, it would provide an unjustified windfall at taxpayers' expense for those who did understand the scheme and chose to commute.

Second, to do so would presume to contradict the intent of the Parliament that passed the legislation establishing the DFRDB scheme decades ago. It would of course be possible for the current Parliament and the current Government to consider whether the policy issue in question ought be re-opened in light of the analysis in this report.

For my part, while I have considerable sympathy for the thousands of members who were misled, my judgement is that to seek to compensate for that now through a reparation payment would invoke the old adage that two wrongs do not make a right.

I am satisfied that CSC's current material is now clear, but have recommended some changes to its correspondence to ensure relevant information is front and centre.

Of course, it is not CSC's role to provide financial advice, and I would not want it to. Equally, I would not want any person to understand this report as advocating one course of action over another for DFRDB members yet to make a commutation decision. As always, people should consider their own personal circumstances, and seek independent financial advice, before making decisions with significant financial consequences.

Instead, my recommendations go to two core principles of good public administration—the public should have all relevant information at their disposal to enable informed decision-making, and the importance of written procedural guidance and training to ensure accurate information is provided.

Some DFRDB members also argued for more beneficial options or scenarios to be applied, which are not currently available under the *Defence Force Retirement and Death Benefits Act 1973*. My power to investigate extends only to determining whether the law was correctly administered, not what might have been if Parliament had passed different laws. However, as these views were keenly felt, and people took the time to provide them to me, I have reflected those concerns in a separate part at the end of this report. The Government may wish to turn its mind to the policy questions articulated here, or otherwise make its position on these issues clear.

I wish to express my sincere thanks to each person who took time to share their views, and particularly to those who kept, and then supplied to us, contemporaneous documentary evidence dating back some 40 years. I also extend my thanks to the CSC and Defence staff who were responsive and co-operative, particularly noting our requests often sought significant amounts of information going back many decades.

Finally I thank my staff who worked tirelessly, impartially and professionally to consider the issues canvassed in this report.

Michael Manthorpe PSM  
Commonwealth Ombudsman



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## Part 1: INTRODUCTION AND SCOPE OF INVESTIGATION

### Background

1.1. On 25 March 2019 the Minister for Veterans' Affairs and Defence Personnel (the Minister), the Hon Darren Chester MP, together with the Assistant Minister for Treasury and Finance, Senator the Hon Zed Seselja, announced an independent inquiry into the Defence Force Retirement and Death Benefits (DFRDB) scheme.

1.2. On 5 April 2019, the Minister wrote to the Ombudsman asking that he consider undertaking an investigation into the DFRDB scheme. The Minister indicated his intention that the inquiry he announced would examine the accuracy of the information provided about commutation by the scheme administrators and relevant departments to DFRDB members.

1.3. The Minister indicated that he considered the Ombudsman, who is also the Defence Force Ombudsman, was well placed to investigate the issues and that his view was supported by the members of the Ex-Service Organisations Round Table (ESORT) held by the Department of Veterans' Affairs.

1.4. After considering the request, on 10 April 2019 the Ombudsman, Michael Manthorpe PSM, wrote to the Minister and advised that he had decided, pursuant to s 5(1)(b) of the Ombudsman Act, to commence an own motion investigation into the accuracy of information provided to DFRDB members by scheme administrators and relevant departments about commutation of retirement pay.

### Ombudsman's powers

1.5. The Office of the Commonwealth Ombudsman (the Office) was established to investigate complaints and provide independent oversight of public administration by Australian Government agencies and certain private sector businesses. The Ombudsman makes recommendations to improve government administration.

1.6. The Ombudsman cannot be directed to undertake an investigation, to arrive at a certain conclusion or on the scope of an investigation. Rather, the Ombudsman decides what is in or out of scope of his investigations in accordance with his statutory function as set out in the *Ombudsman Act 1976*.

1.7. The Ombudsman's role is limited to investigating 'action that relates to a matter of administration'.<sup>1</sup> Accordingly, our focus is on the administration or implementation of legislation and policy, by officials in government departments and statutory agencies.

### Scope

1.8. For this reason, the Ombudsman limited the scope of this investigation to the administration of the DFRDB Scheme, and particularly the issue of commutation. The primary focus of the investigation is the accuracy of information provided to DFRDB members. We set out the following questions to guide our investigation:

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<sup>1</sup> Section 5(1)(b) of the *Ombudsman Act 1976*, which relates to own motion investigations.

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- What information was provided to DFRDB members about the effects of commutation on future retirement pay entitlement?
- Was this information inaccurate, inadequate, ambiguous or misleading? If so:
  - what were the consequences?
  - what remedial action (if any) should be taken?
- Were retirement payments indexed as required by legislation? If not, what remedial action (if any) should be taken?

1.9. The following issues go to the nature of the legislation passed by parliament and matters of government policy, and therefore are out of scope of this investigation:

- Whether legislation is fair and just, including provisions for:
  - use of certain life expectancy tables
  - permanency of reductions to commuted pensions
  - indexation arrangements.
- Whether government ought to take different policy decisions or make amendments to legislation.

1.10. While these matters are not within scope, the submissions we received indicated a high level of dissatisfaction with current policy settings, as expressed through the statutory arrangements. A section has therefore been included to summarise the out of scope issues arising in the submissions received. There was also evidence of confusion among DFRDB members about how DFRDB legislation works. We have endeavoured to provide clarification on the operation of the legislation.

## Methodology

1.11. The administration of DFRDB was the subject of significant media and public interest immediately prior to the commencement of the investigation. Further, with some 53,163 DFRDB members, the majority of whom elected to commute their retirement pay, public interest in this investigation was high among this group. Accordingly, the Ombudsman invited submissions from DFRDB members and the public to inform the investigation.

1.12. A submission form was provided to guide contributions, but submissions were accepted in any format. The submission process opened on 20 May 2019 and closed on 30 June 2019, although all information received after this date was accepted and reviewed. In total, the Office received 3,436 submissions during the course of the investigation.

1.13. The Office also contacted stakeholder groups and interested veterans who had been advocating on this issue to ensure they were aware of the investigation and our call for public submissions. These stakeholder groups encouraged DFRDB members to make individual submissions. The Department of Veterans' Affairs also provided information about the investigation on its website and through the ESORT.

1.14. The Office met with stakeholder groups with a particular interest in this issue. We also interviewed more than 30 people, identified through submissions and other documents, who we felt could provide information of value to our investigation. Interviews were conducted by phone or in person where appropriate.

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1.15. For the purposes of informing the investigation about the effects of commutation on the DFRDB cohort, the Office commissioned external actuarial modelling from two sources, the Australian Government Actuary (AGA) and KPMG.

1.16. The modelling provided by both AGA and KPMG was factual, based on real-life scenarios with all assumptions chosen by our Office. Although we had regard to the actuaries analysis provided as part of their reports, the Office undertook its own independent analysis of the modelling results.

1.17. The Office also issued multiple sets of questions and requests for information to the Department of Defence (Defence) and Commonwealth Superannuation Corporation (CSC) under s 8 of the Ombudsman Act. The Office met regularly with these agencies to obtain and clarify information and provide updates on the investigation progress. The Office formally asked the Department of Veterans' Affairs whether it had ever provided advice on the DFRDB Scheme. In response, DVA confirmed that its practice has always been to refer questions about commutation to CSC (Appendix B).

1.18. During the early stages of the investigation the Office also met with the Australian National Audit Office and the Productivity Commission.

1.19. In accordance with s 15 of the *Ombudsman Act 1976*, the Office provided a copy of the draft report to the Chief of the Defence Force, the Secretary of Defence and the Chief Executive Officer of CSC. Their responses, along with the apology from Defence, are published at Appendices C, D and E.

1.20. The Office thanks those staff from Defence, CSC and all other agencies who provided information to this investigation. Agencies were at all times responsive to our requests for information and their cooperation is appreciated.

## Important terms

1.21. Some of the terms below are taken from the *Defence Force Retirement and Death Benefits Act 1973* (DFRDB Act). We have also adopted some simpler terms and phrases than those used in the legislation if it made it easier to explain complex concepts in plain English. A glossary with other terms used in the report can be found at Appendix G.

Figure 1—Important terms

Commutation	Commutation is an exchange of part of a DFRDB member’s future retirement pay for an immediate lump sum.
Minimum service period	The minimum service period required for eligibility for retirement pay is 20 years of effective service (or 15 years of effective service if the person has achieved the retiring age for their rank).
Retirement pay	Retirement pay is the pension component of DFRDB entitlements. It is worked out as a percentage of the annual rate of pay at discharge (the percentage is based on number of complete years of service).
Pre-commutation amount	The pre-commutation amount is the annual rate of retirement pay to which a person is entitled, prior to any decision to commute, and is the amount a person will receive if they do not decide to commute.  Retirement pay does not revert to the pre commutation rate when a DFRDB member reaches their life expectancy factor age.
Maximum commutation amount and Maximum commutation factor	The maximum commutation amount is the maximum amount a person may elect to commute. It is calculated by multiplying the person’s annual retirement pay before commutation by their maximum commutation factor.  The maximum commutation factor was four until 30 June 1983, when it began increasing by increments of 0.05 each year until it reached the current maximum of five on 1 July 2002.  This means the maximum amount a person may elect to commute, depending on the year they discharge, is between four to five times their annual retirement pay before commutation.
Commutation divisor and Life expectancy factor age	The commutation divisor is based on a person’s gender and age at retirement, used in the statutory formula for working out a person’s commutation reduction.  The DFRDB Act calls it the ‘expectation of life factor’ and some submitters know it as the ‘notional life expectancy factor’. This is because the commutation divisor is based on the 1960-1962 life expectancy tables.  A person’s life expectancy factor age is their life expectancy age <i>as it was in 1962</i> . This figure has been fixed in the Act since 1973. It is therefore lower than current Australian Bureau of Statistics life expectancy figures.
Commutation reduction	The commutation reduction is the amount by which the starting rate of a person’s retirement pay is permanently reduced if they elect to commute. The amount of the commutation reduction depends on how much the person elected to commute and their commutation divisor.
Retirement benefit	The retirement benefit is the total DFRDB benefits payable to a person in retirement (including commutation lump sum and retirement pay pension).

## Part 2: BACKGROUND ON THE DFRDB SCHEME

### History of the DFRDB

2.1. Prior to the DFRDB scheme commencing the Defence Forces Retirement Benefits (DFRB) scheme operated to provide retirement benefits to members of the Australian Defence Force (ADF).

2.2. The DFRB scheme was a specially designed pension arrangement which differed from other public sector superannuation schemes to accommodate the particular needs of the ADF.

<sup>2</sup> For example:

- retirement pensions were based on rank, took into account earlier retiring ages and were designed to supplement civil employment earnings
- commutation provided access to capital for relatively young retirees who were transitioning to civilian life.

2.3. In 1972 the Joint Select Committee on the DFRB scheme, known as the 'Jess Committee', made 20 recommendations, leading to the introduction of a new scheme 'to provide an annuity type benefit as a supplement to civilian earnings for those retiring early and as a means of support for members in later life'.<sup>3</sup> The Committee made recommendations to simplify the scheme and make it easier for members to understand, observing:

the difficulty is that the present scheme defies explanation in simple terms. We cannot over-emphasise the importance we attach to having a scheme in which contributions and benefits are capable of simple explanation to the members of the scheme.<sup>4</sup>

2.4. Commutation, the option to take a lump sum up front in exchange for a reduced retirement pay, had been included as a feature of the original DFRB scheme on the basis that an ADF member often required a lump sum on discharge to assist with re-settlement and transition to civilian life.<sup>5</sup> A DFRB member could request commutation, but the request had to be approved by the DFRB Board. The Board would only approve commutation for specific purposes (e.g. purchase of a house) and had discretion to not allow commutation if a medical examination indicated a person was unlikely to reach life expectancy. This led the Jess Committee to recommend that commutation be an unfettered right in the new scheme.<sup>6</sup>

2.5. Other beneficial changes that were recommended included capping contributions at 5.5 per cent of salary and annual indexation to maintain relativity with average weekly earnings.<sup>7</sup>

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<sup>2</sup> Defence Forces Retirement Benefits Board, July 1970, *D.F.R.B Booklet*, p. 3.

<sup>3</sup> Joint Select Committee on Defence Forces Retirement Benefits Legislation, May 1972, Parliamentary Paper No 74, ('Jess Report'), p. 31.

<sup>4</sup> Jess Report, p. 47. The Committee also considered that an advisory and counselling service would not be necessary for the proposed DFRDB scheme because of its relative simplicity.

<sup>5</sup> Jess Report, para. 106, p. 30.

<sup>6</sup> Jess Report, recommendation 14(a), p. 3, and commentary at para. 112, p. 31.

<sup>7</sup> Jess Report, recommendations 4 and 6, p. 1.

2.6. The DFRDB Act passed Parliament and received Royal Assent in 1973. Commencement of most of the substantive provisions of the DFRDB Act was backdated retrospectively to 1 October 1972.

2.7. The scheme was closed to new members from October 1991 following the Cole Review (1990)<sup>8</sup> as it no longer met the needs of the ADF. The Cole Review observed that while DFRDB provides ‘a generous benefit’ to those who serve the minimum service period (generally at least 20 years), there is no employer benefit payable and no return on contributions for people who discharge before the minimum service period. This meant it no longer met community standards, which by that time had changed in line with major superannuation reforms. Further, the scheme did not encourage members to serve beyond 20 years, resulting in the loss of experienced ADF members in the 20–22 years of service bracket.<sup>9</sup>

2.8. The Podger Review (2007)<sup>10</sup> considered the DFRDB, Military Superannuation Benefits Scheme (MSBS) and the proposal for a new contemporary scheme in the context of the unique nature of military service, ADF demographics and the wider Australian superannuation framework. It recommended the government consider indexing DFRDB retirement pay for members over 55 to the same benchmark as age pensions.<sup>11</sup> The government gave effect to this recommendation in 2014.<sup>12</sup>

## Important concepts explained

### *What is the DFRDB scheme?*

2.9. The DFRDB scheme creates a statutory entitlement to a defined benefit, part of which may be commuted, for ADF members who were required to participate in the scheme.

2.10. It commenced on 1 October 1972. All ADF members were required to contribute to the scheme. Contributors to the predecessor scheme, the Defence Force Retirement Benefits (DFRB) scheme, including members with active service in conflicts such as Vietnam, Korea, Indonesia and Malaysia, were also rolled into the DFRDB scheme with appropriate protections against detriment. The scheme has been closed to new members<sup>13</sup> since 1 October 1991 and closed to re-entering members since 1 July 2016.

2.11. The scheme was originally overseen by the DFRDB Authority and then from 2011, by CSC. While the day to day payments under the scheme were made by various agencies,<sup>14</sup> we

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<sup>8</sup> Defence Force Retirement and Death Benefits Scheme Review Committee, June 1990, Department of the Senate Paper No. 870 (‘Cole Report’).

<sup>9</sup> Cole Report, p. 3.

<sup>10</sup> Department of Defence, December 2007, Report of the Review of Military Superannuation Arrangements (‘Podger Report’).

<sup>11</sup> Department of Finance and Deregulation, December 2008, Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes (‘Matthews Report’), p. 47.

<sup>12</sup> *Defence Force Retirement Benefits Legislation Amendment (Fair Indexation) Act 2014*.

<sup>13</sup> Although the scheme was closed, a retiree could elect to return to the scheme as a contributor if they returned to the ADF on an engagement to undertake continuous full-time service (DFRDB Act, s 61B). Section 61B was subsequently repealed by the *Defence Legislation Amendment (Superannuation and ADF Cover) Act 2015*.

<sup>14</sup> Australian Government Retirement Benefits Office (1970s), then Retirement Benefits Office (1980s) then ComSuper from the 1990s until it merged into CSC on 1 July 2015.

have focussed on the DFRDB Authority and CSC, as these agencies were responsible for scheme information and materials and presented at retirement seminars.

2.12. The main features of the scheme are as follows:

- Compulsory<sup>15</sup> member contributions are paid into the Australian Government Consolidated Revenue Fund (CRF). All DFRDB entitlements are paid from the CRF.
- The compulsory contribution is 5.5 per cent of the member's salary.<sup>16</sup>
- Members may be entitled to retirement pay when they are discharged if they have served for the minimum service period, being either:
  - 20 years of effective service, or
  - 15 years' effective service if they have already reached the retiring age for their rank.<sup>17</sup>
- Retirement pay is calculated using a statutory formula based on salary at retirement and complete years of service (not the amount contributed).
- Members who are not eligible for retirement pay when they are discharged are refunded their contributions.<sup>18</sup>
- Members eligible for retirement pay also have the option to commute a portion of that pension into a lump sum.<sup>19</sup>
- Prior to 1 July 1983 the maximum amount a member could commute was the equivalent of 4 times their annual retirement pay. This figure was incrementally raised over 20 years from 1 July 1983, and the maximum commutation amount has been the equivalent of 5 times their annual retirement pay since 1 July 2002.<sup>20</sup>
- A member has 12 months from discharge to exercise their election to commute.<sup>21</sup>
- A member who elects to commute has their retirement pay permanently reduced according to the statutory formula set out in s 24(3)(b) of the DFRDB Act. The commutation divisor used in this formula has at all times been the *Commutation of retirement pay and Class C invalidity Pay—expectation of life factor* which is Schedule 3 of the DFRDB Act.
- Pensions are indexed according to a statutory formula.<sup>22</sup>

2.13. As a statutory defined benefit scheme, DFRDB is different to standard superannuation schemes.

2.14. For example, eligible DFRDB members receive indexed retirement pay for life. The rate of retirement pay is set by a legislative formula and is not affected by market performance. By

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<sup>15</sup> DFRDB Act, s 17—Contributions by members of scheme.

<sup>16</sup> DFRDB Act, s 19—Amount of fortnightly contributions.

<sup>17</sup> That is, the rank held immediately before their retirement—DFRDB Act s 23(1)(b)(ii).

<sup>18</sup> DFRDB Act, s 56—Refund of contributions. In some limited circumstances, members not eligible for retirement pay could instead apply to have their entitlements preserved on discharge.

<sup>19</sup> DFRDB Act, s 23—Entitlement to retirement pay; s 24—Commutation of retirement pay.

<sup>20</sup> *Defence Legislation Amendment Act 1984*.

<sup>21</sup> DFRDB Act, s 24(1AA).

<sup>22</sup> In addition to entitlements under the DFRDB Act, a one-off lump sum 'productivity benefit' is also payable, irrespective of whether the person elects to commute or not, under a ministerial determination made under s 52(1) of the *Defence Act 1903*.

contrast, the rate and duration of a superannuation pension product will be affected by factors such as how much the member contributed, fund performance and prevailing economic conditions (meaning a person may run out of superannuation before the end of their life).

2.15. Further, eligible DFRDB members may elect to commute part of their retirement pay entitlement into a lump sum at the time of their discharge regardless of their age (which could have been as early as age 36), or further employment. By contrast, superannuation members generally cannot access their funds until they have both reached their preservation age (which varies between age 55 and 60<sup>23</sup>) and retired from the workforce.

2.16. As recommended by the Jess Committee, the scheme is ‘unfunded’. This means there is no ‘fund’ held by a trustee. Rather, the government pays for the scheme from its consolidated revenue fund as liabilities fall due. Member contributions also go into consolidated revenue. The money from contributions is therefore not invested on behalf of the member—it is, in effect, no longer the member’s money.

2.17. However, no retirement benefits are paid if the member discharges before reaching the eligible effective service period. Instead, an amount equal to their contributions is refunded to them.<sup>24</sup>

2.18. This creates an incentive to remain in the ADF for at least the minimum service period (generally 20 years), because the benefits of retirement pay are considerable relative to a refund of contributions. It also incentivises discharging at or shortly after the 20 year mark by providing access to capital for retiring members, who may have several decades of working life remaining, and need to transition to civilian life and employment.

### ***What is commutation?***

2.19. Commutation refers to a member’s entitlement to receive a lump sum payment at the point of discharge, in exchange for a permanently reduced retirement pay.

2.20. Commutation was a feature of the DFRB scheme as well as the DFRDB scheme, but arrangements differ in the two schemes. Under the DFRB Act, commutation was only payable in limited circumstances, which required examination of what the member proposed to spend the lump sum on. The DFRB Board had discretion to approve or deny an application to commute a portion of a pension.

2.21. However, under the DFRDB Act, commutation is not restricted by any discretionary approval process and there are no limitations on the proposed use of commutation funds. Rather, commutation is available to each person discharging from the ADF who is eligible for retirement pay under the scheme. During our investigation, however, we heard that the commuted amount was very often used to help a member set themselves up for life, for example by buying a house. Indeed, we saw a recording of a presentation delivered by a DFRDB Authority staff member, in which this was suggested as an appropriate use for the lump sum.

2.22. The DFRDB Act prescribes the requirements for eligibility, the election process, and the effect a commutation election will have on future retirement pay. This means if a member

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<sup>23</sup> See Australian Taxation Office information available at <https://www.ato.gov.au/rates/key-superannuation-rates-and-thresholds/?page=11>, accessed 19 November 2019.

<sup>24</sup> Some DFRDB members, who left the ADF and were not eligible for retirement pay, may have also been eligible to receive a superannuation guarantee top up, and a gratuity, depending on their length of service and when they left the ADF.

meets these statutory criteria, their election to commute cannot be refused and must be paid in accordance with the legislation.

2.23. Equally, it means that the administrator has no discretion to decide *not* to reduce retirement pay in the manner required by the DFRDB Act.

2.24. While available as of right to all members who meet the minimum service period, receiving commutation requires an active choice to be made. To receive a commutation lump sum, members needed to fill in a commutation election form<sup>25</sup> and submit it to CSC within 3 months before retirement, or in the 12 months after discharge.

## The legal situation

2.25. A DFRDB member's statutory right to commute is found in s 24(1) of the DFRDB Act:

A person who is, or is about to become, entitled to retirement pay may, by notice in writing given to CSC, elect to commute a portion of his or her retirement pay in accordance with this section.

2.26. Eligibility to commute is therefore contingent on also meeting the requirements for retirement pay. Section 23 states, relevantly:

(1) A contributing member is entitled, on the member's retirement, to retirement pay ..... if:

(a) the member retires and is not entitled to invalidity benefit; and

(b) on the member's retirement:

(i) the member's total period of effective service is not less than 20 years; or

(ii) the member's total period of effective service is not less than 15 years and the member has attained the retiring age for the rank held by the member immediately before the member's retirement.

2.27. Thus contributing members who have met the minimum period of effective service (the minimum service period) will generally<sup>26</sup> also have a statutory right to elect to commute.

2.28. The **rate of retirement pay** is a percentage of the person's salary immediately before discharge. Percentages depend on the number of complete years of effective service and are set out in a table in Schedule 1 of the DFRDB Act.<sup>27</sup> For example, a member retiring with 20 complete years of effective service will receive retirement pay at a rate of 35 per cent of their salary at discharge. The rate increases with each additional year of completed service until 40

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<sup>25</sup> Currently form D21

<https://www.csc.gov.au/Search/?terms=dfrdb%20commutation%20election%20form>.

<sup>26</sup> There are several qualifications to this broad right to commute. Section 23(1)(a) provides that members who are eligible for an invalidity benefit may not commute; ss 24(1A) and (1B) exclude certain former invalidity pay recipients. A person who elected to commute on their initial discharge, who subsequently re-entered the ADF and discharges, is also prohibited from commuting again.

<sup>27</sup> DFRDB Act, s 23(2); Schedule 1—Retirement pay expressed as a percentage of annual rate of pay.

years' service when the retiree will receive retirement pay at a rate of 76.5 per cent of their salary at discharge.<sup>28</sup>

2.29. Subsection 24(1AA) places a **time limit** on the election to commute. A notice to commute must generally be given either in the three months before, or the 12 months after discharge.

2.30. Subsection 24(2) requires the member to **specify the amount** they wish to commute in their election notice (i.e. on the form). The maximum amount a member can commute (including any earlier commutation payments) is equal to their annual retirement pay, multiplied by the maximum commutation factor.<sup>29</sup> When the scheme commenced in 1972, the maximum commutation factor was four times their annual retirement pay. Between 1 July 1983 and 30 June 2002 the maximum amount a member could commute was increased by 0.05 each year, with the result that the amount increased from 4 to 5 times the member's annual retirement pay.<sup>30</sup> So for example, in August 1987, the maximum amount a member could commute was 4.25 times their annual retirement pay.

2.31. Subsections 24(3) and (4) explain the steps to be taken if a commutation election is made:

(3) Where a person makes an election under this section, then...:

(a) there shall be paid to him by the Commonwealth an amount equal to the amount specified in the election as the amount that is to be payable to him by virtue of the commutation; and

(b) the amount per annum of the retirement pay payable to him, **on and after the day on which the election takes effect**, is the amount per annum that, but for this paragraph and subsection 98K(1), would be payable reduced by an amount calculated by dividing the amount referred to in paragraph (a) by the expectation of life factor that, having regard to the age and sex of the person on the day on which the election takes effect, is applicable to him under Schedule 3.

(4) For the purposes of this section, an election shall be deemed to have been made, and shall take effect, on the day on which the notice of election is received by CSC or the day following the day on which the person retires, whichever is the later. (*emphasis added*)

2.32. The substance of this wording has not changed since commencement of the scheme in 1972.<sup>31</sup>

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<sup>28</sup> However, there is a penalty rate reduction, for members with 20 years effective service, if they retire at their own request or following disciplinary action, before reaching the notional retiring age for their rank (Schedule 2). The retirement pay reduction is three per cent (3 per cent) for every year that their actual age is below the notional retiring age (s 23(3)-(4)).

<sup>29</sup> DFRDB Act, s 24(2A).

<sup>30</sup> *Defence Legislation Amendment Act 1984* introducing s 24(2B).

<sup>31</sup> This wording has not changed since commencement of the scheme in 1972, except for adding references to s 24(8) and (9) and s 98K—neither of which are directly relevant for present purposes (s 24(8) and 24(9) relate to certain situations where a person has a surcharge debt with the tax office and s 98K relates to certain situations where a person held an acting or temporary rank on retirement).

2.33. Subsection 24(3)(a) means that if a member elects to commute, CSC has no discretion to refuse, and must pay the commutation lump sum. Paragraph 24(3)(b) contains a statutory process for calculating the resulting reduction to retirement pay: the commutation lump sum is divided by the person's 'expectation of life factor' to produce the annual reduction for commutation. The expectation of life factor is worked out according to their age and gender using a table in Schedule 3.<sup>32</sup> For the purposes of this report, we refer to the expectation of life factor as the 'commutation divisor'.

2.34. Importantly, subsection 24(3)(b) specifies that the reduction commences '**on and after the date the election takes effect**', which is the later of the day CSC receives the election notice, or the date of retirement.<sup>33</sup>

2.35. The words 'on and after' are used in legislation<sup>34</sup> to indicate that a legislated outcome is to commence and continue. If the words 'on or after' are used without being qualified by a fixed time frame or end date the legislated outcome will continue forever, unless another legislated outcome displaces it, for example due to:

- another legislative provision (which may be in the same or another act), comes into operation, or
- parliament amending the provision, e.g. to insert a fixed time frame.

2.36. Where it is intended that a legislated outcome will be for a fixed time frame, this will be specifically included by drafters, with phrases such as:

- for a period of six months commencing on and after [date/event]
- on and after [date/event] until such time as the person reaches [age]
- on and after [date/event] until a date to be determined by [decision maker]<sup>35</sup>

2.37. In subsection 24(3)(b), the commutation reduction commences 'on and after' the election takes effect. There is nothing in 24(3)(b) which creates a fixed time frame or end date for the reduction. Nor is there any other provision, in the DFRDB Act or any other legislation, which would cease the reduction.

2.38. It was submitted to us that the complexity of the 1973 Bill meant that parliamentarians did not properly understand what they were voting on and that the commutation provision had been interpreted contrary to the intentions of the Jess Report, and the parliament. Some submitters asserted that a permanent reduction is inconsistent with the Jess Report recommendation of a 'proportionate' reduction, and that therefore the Jess Report should take precedence.

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<sup>32</sup> DFRDB Act, Schedule 3—Commutation of retirement pay and Class C invalidity pay—expectation of life factor.

<sup>33</sup> DFRDB Act, s 24(4).

<sup>34</sup> It is used, for example, throughout the *Acts Interpretation Act 1901*.

<sup>35</sup> An example of this can be found in the *Social Security (Administration) Act 1999* (SSAA). The Secretary may decide that a social security pension is not payable in situations where a person fails to comply with a reasonable requirement to attend the department (SSAA, s 64(1)). This in turn results in suspension (SSAA, s 80). However, the Secretary may later reverse the decision about payability 'on and after a date specified by the Secretary' (SSAA, s 64(4)). This means that the pension will again become payable indefinitely, unless a situation arises to trigger another legislated suspension or cancellation outcome (e.g. due to death, gaining employment, or again failing to attend the department).

## Commonwealth Ombudsman—Investigation into the DFRDB scheme

2.39. Where the meaning of a provision is unclear or ambiguous, or the plain meaning appears inconsistent with the purpose of the DFRDB Act, it may be appropriate to look to extrinsic materials to ascertain the intention of parliament (such as explanatory memoranda and reading speeches).

2.40. However, that is not the case here. Although it may be difficult for a lay person to read subsection 24(3) and understand its meaning, in our view the legal meaning is plain and not capable of any other interpretation. Placing limits on the benefits to be provided is not inconsistent with the purpose of the DFRDB Act, which must necessarily contain some limits on entitlements. What individual parliamentarians understood is not relevant.<sup>36</sup> The DFRDB Act, as passed by parliament, requires a permanent reduction.

2.41. This was also the view of the Administrative Appeals Tribunal (AAT), which considered s 24(3) in the case of *Reynolds and Defence Force Retirement and Death Benefits Authority*.<sup>37</sup> In the case, the AAT found ‘neither ambiguity nor obscurity’ in the provision:

[I]t is not reasonable to say that the phrase ‘amount payable....on and after the day on which the election takes effect....’ has a limitation based on the life expectancy factor used in a calculation to arrive at the amount. In the opinion of the Tribunal such an interpretation is simply untenable and would be counter to the plain words of the provision.<sup>38</sup>

2.42. The Office therefore considers that CSC was correct in its interpretation that s 24(3)(b) results in a permanent reduction to pension following commutation.

### Commutation—definition and interpretation issues

2.43. Some submitters also raised concerns that the term ‘commutation’ is not defined in the DFRDB Act, and that the scheme administrators failed to effectively communicate its meaning to members.

2.44. The Office agrees that failure to effectively communicate the meaning of commutation to people is a matter for concern. This investigation has been focussed on what Defence and CSC information was provided about the meaning of commutation, and its effect on retirement pay.

2.45. However, the fact that the term commutation is not defined in the ‘definitions’ section of the DFRDB Act is not of itself a concern. This is because not all terms used in legislation need to be specifically defined.

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<sup>36</sup> The High Court observed in *Zheng v Cai* [2009] HCA 52 at [28]: ‘It has been said that to attribute an intention to the legislature is to apply something of a fiction. However, **what is involved here is not the attribution of a collective mental state to legislators**. That would be a misleading use of metaphor. Rather, judicial findings as to legislative intention are an expression of the constitutional relationship between the arms of government with respect to the making, interpretation and application of laws. .... the preferred construction by the court of the statute in question is reached by the application of rules of interpretation accepted by all arms of government in the system of representative democracy (emphasis added). This view was reaffirmed in *Lacey v Attorney General* [2011] HCA 10: **The purpose of a statute is not something which exists outside the statute**. It resides in its text and structure, albeit it may be identified by reference to common law and statutory rules of construction (emphasis added) at [43-44].

<sup>37</sup> [2001] AATA 599 (‘Reynolds’).

<sup>38</sup> Reynolds at [15].

2.46. Where terms are not defined in an Act, and some ambiguity arises, courts will look to whether there may be a common law definition, or their ordinary meaning is applied.<sup>39</sup>

2.47. The DFRDB Act's commutation provisions are not ambiguous from a legal point of view, even though its meaning may not be immediately apparent to a lay person. A definition of the word commutation is not required, because the DFRDB Act comprehensively sets out the steps involved in commutation, including eligibility, calculating the commutation and permanently reducing retirement pay using the formula in the statute.

2.48. However, as a matter of good administration, even if a term is not defined in an Act it will often be appropriate for an administrator to provide a plain English definition of legislated concepts for people affected by the legislation. For example, the DFRDB Authority could have provided a plain English definition of commutation which clearly explained the permanence of future retirement pay reductions.

2.49. Given a decision to commute will involve weighing the benefits and risks of taking an early lump sum against a permanent reduction to retirement pay, it was important that members be provided with sufficient information to either make an informed decision or alert them to the need to obtain further information or advice.

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<sup>39</sup> Although there is no need for a specific definition of commutation in the DFRDB Act, we note that commutation, as set out in s 24, is not inconsistent with the ordinary or legal definition of the word 'commutation'. Commutation is defined in a number of leading dictionaries, including the Collins English Dictionary, the Oxford English Dictionary and the Butterworths Australian Legal Dictionary, as involving a substitution or exchange of one thing for another. In legal terms, commutation often involves substitution of a greater thing for a lesser one. Thus, for a convict whose sentence of hanging is commuted to a sentence of seven years deportation, commuting a sentence means reducing it. It is therefore consistent with legal and ordinary meanings of commutation, that members who commute may receive less in the lump sum commutation itself than the total amount of retirement pay reductions over their actual lifetime.

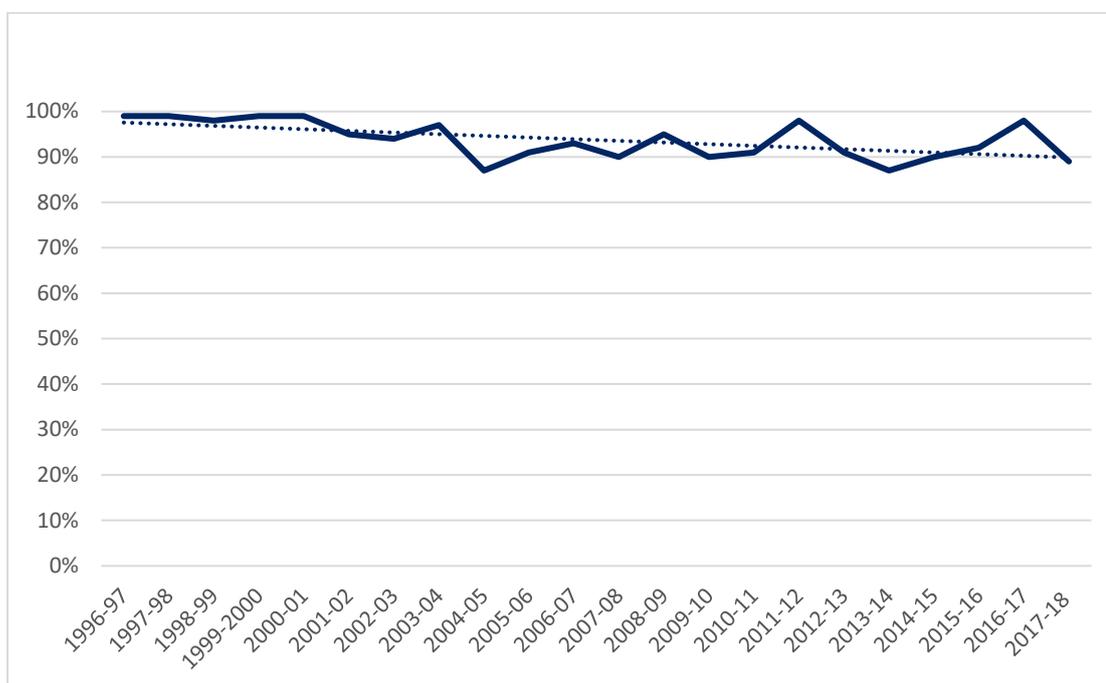
## Part 3: ISSUES ARISING OUT OF INVESTIGATION— COMMUTATION

### Commutation data

3.1. At 30 June 2019 the DFRDB had 53,163 members, of whom 39,400 are receiving retirement pay and 12,549 are receiving either a reversionary or invalidity pension.<sup>40</sup> A further 1,214 contributing members are yet to discharge from the ADF.

3.2. The majority of people who were eligible to commute<sup>41</sup> chose to do so. We noticed that the uptake of commutation has dropped slightly in recent years, but still remains high (at or above 85 per cent) as Figure 2 shows.

Figure 2—Commutation as a percentage of eligible retirement exits



3.3. Some stakeholders suggested that the downturn in the number of people electing to commute coincided with the publication of more explicit information about the ‘permanency’ of the reduction of post commutation retirement pay in CSC documents from 2004.<sup>42</sup> This was pointed to as evidence that people would not have commuted had they always been aware that the reduction was permanent.

3.4. There does appear to have been a decrease in commutation since 2001, particularly in 2004 (although 86 per cent of eligible members still decided to commute). It is worth noting that the AAT decision in Reynolds was also handed down in 2001, making it clear that

<sup>40</sup> A reversionary pension is payable on the death of a retirement pay recipient to an eligible spouse or child.

<sup>41</sup> All retirement, redundancy and Invalidity C benefits where a commutation election was possible.

<sup>42</sup> The first explicit mention of the commutation reduction being permanent was contained in the June 2004 edition of the Retirement Benefits information sheet (discussed at para. 1.95).

retirement pay cannot revert to the pre commutation rates once life expectancy factor age is achieved.

3.5. It is also important to note that while there is a downward trend, there have also been peaks as well. There may also be other reasons why commutation rates may have been dropping in recent years. Without purporting to be an exhaustive list, reasons could include the following:

- Lower interest rates, particularly since around the year 2000, may have reduced the attractiveness of receiving a lump sum payment on discharge from the ADF, when compared to the maximum indexed pension.
- Other schemes may have affected the rate of uptake including the introduction of the Defence Home Ownership Assistance Scheme<sup>43</sup> on 1 July 2008 which extended access to subsidised home loans to serving members. As more members became eligible to access a subsidised home loan under other schemes, there may have been less need for members to access a commutation lump sum.
- As the scheme has been closed since 1991, members who discharged recently have longer periods of service, are from higher ranks and are receiving higher salaries than members who discharged in the 1970s through to the 1990s. A discharging DFRDB member is now more likely to be closer to conventional retirement age—with less need for a lump sum, and a higher age meaning a lower commutation divisor (and so a greater reduction in retirement pay).
- It is also possible that changes to superannuation and tax legislation may also have had an impact on the uptake, depending on a person's personal circumstances.

### **What DFRDB scheme members told us**

3.6. The office received 3,436 submissions during the course of the investigation, with a relatively even spread across the three Defence services. Concerns raised in the submissions fell broadly into three categories:

- Concern that members had been misled to believe that the reduction to their retirement pay was temporary, and would cease on reaching life expectancy factor age. Members asserted that they had relied on this information, to their detriment.
- Dissatisfaction with the DFRDB Act provisions which make the reduction permanent. These submitters argued government should take steps to ensure the scheme operates as it had been represented to them (i.e. amend the DFRDB Act so that reduction ceases on reaching life expectancy factor age).
- Assertions that the reduction amount is increasing each year following indexation.

3.7. Some submitters felt that CSC, in applying a permanent reduction, had misinterpreted the commutation provisions in the DFRDB Act. We also heard concerns about the absence of a definition of commutation in the DFRDB Act, and concerns about CSC's interpretation of the commutation provision.

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<sup>43</sup> *Defence Home Ownership Assistance Scheme Act 2008.*

3.8. However, most submitters were primarily concerned with what they perceived to be inaccurate information from Defence and CSC’s predecessors about the permanent effect commutation would have on their retirement pay.

#### Submission data

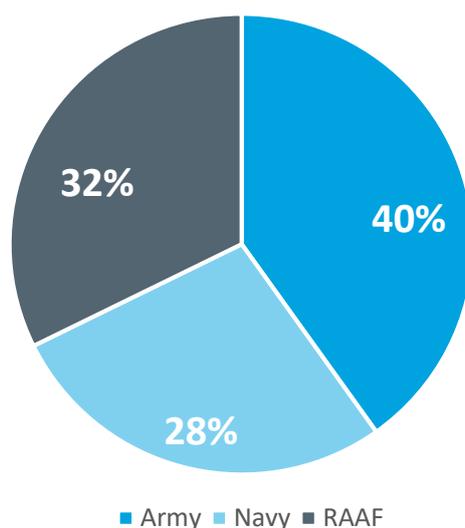
3.9. The 3,436 submissions consisted of 2,694 substantive tailored submissions and 739 standard form statutory declarations.

3.10. Of the substantive submissions, 97 per cent of submitters told us they had elected to commute. Less than 2 per cent told us they decided not to commute.<sup>44</sup>

3.11. The statutory declarations were not prepared specifically for this investigation. However we treated them as if they were submissions and have extracted from them information relevant to the investigation.

3.12. There was an even spread of submissions from across the three Defence services, of those submitters who identified their service<sup>45</sup> (see Figure 3). The reported experiences were also broadly consistent across the three Defence services.

Figure 3—Submissions by service



3.13. Eighty nine percent of submitters identified an issue with the information they were provided, or were not provided, about commutation. Of these, 60 per cent said they received insufficient information or incorrect information. Only a small proportion, about 2 per cent, identified ambiguity or inaccessibility being their primary issue. The statutory declarations (26

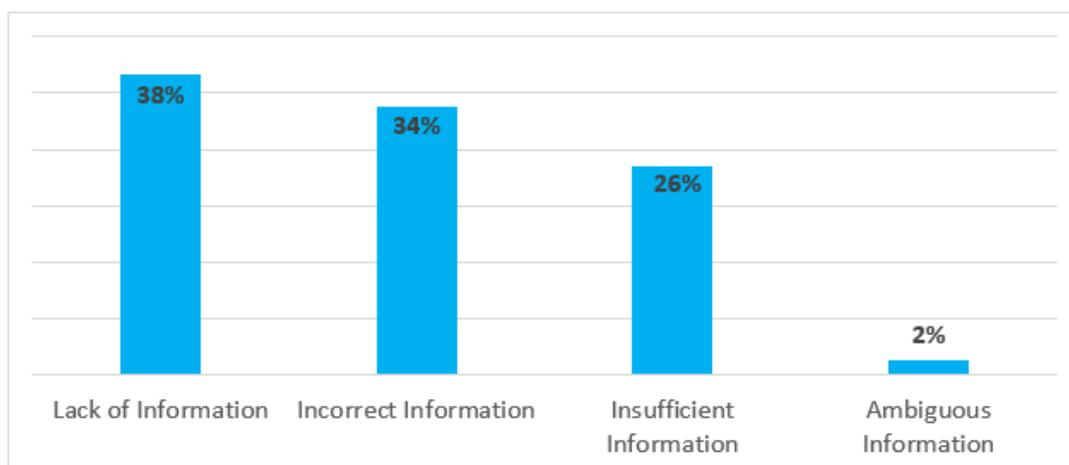
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<sup>44</sup> The remaining submissions did not indicate whether they had commuted or not.

<sup>45</sup> Twenty three per cent of total submissions were statutory declarations which did not clearly identify a service.

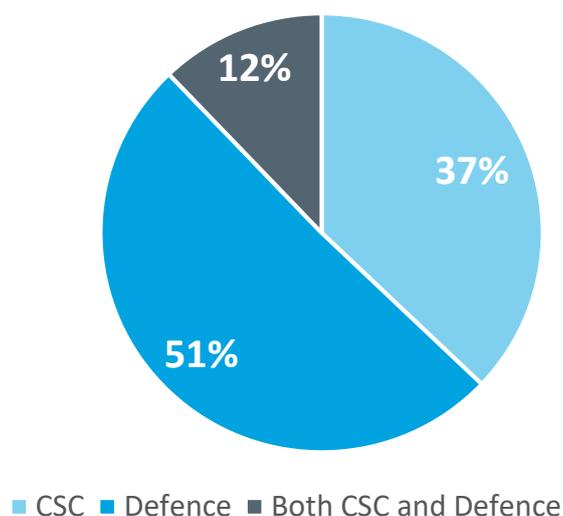
per cent) indicated that the information provided by the DFRDB Authority was insufficient (see Figure 4).

Figure 4—Primary commutation issue (where primary issue was specified)



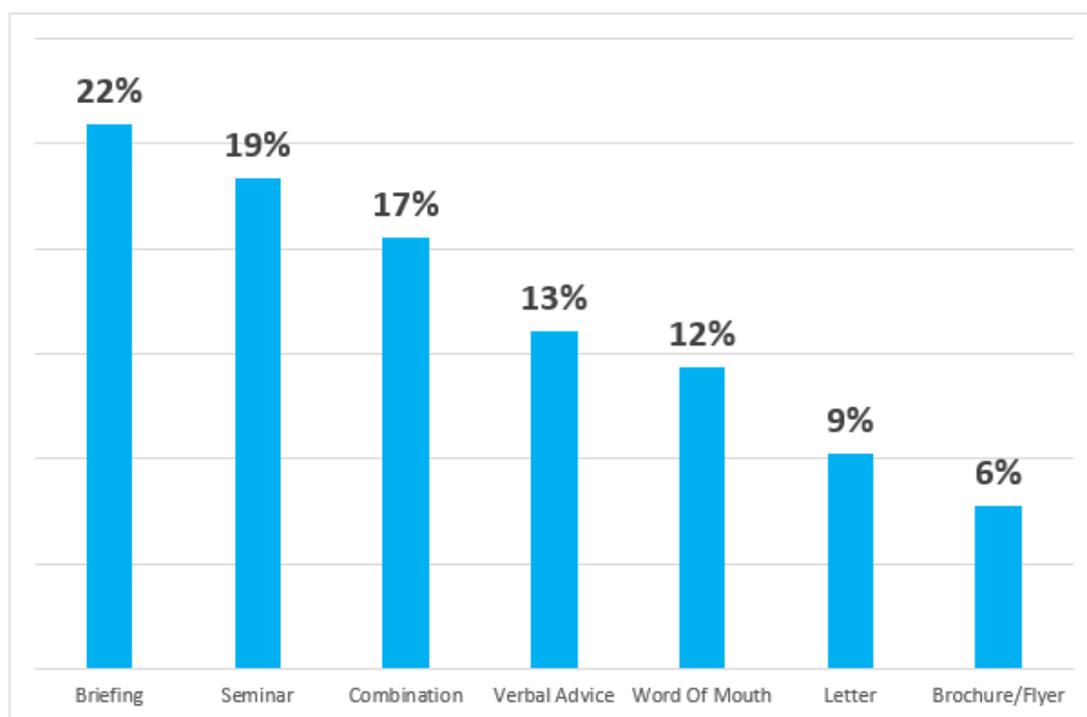
3.14. Of those who told us where the information came from, 51 per cent said Defence, 37 per cent said CSC (or the DFRDB Authority, as it was at the time) and 12 per cent said both (see Figure 5):

Figure 5—Commutation information source



3.15. Seventy one per cent of people who identified their information source said it came from a briefing, seminar, verbal advice or a combination of sources. Mediums such as letters, brochures and handbooks were identified, but as less common sources of information (see Figure 6).

Figure 6—Common information mediums<sup>46</sup>



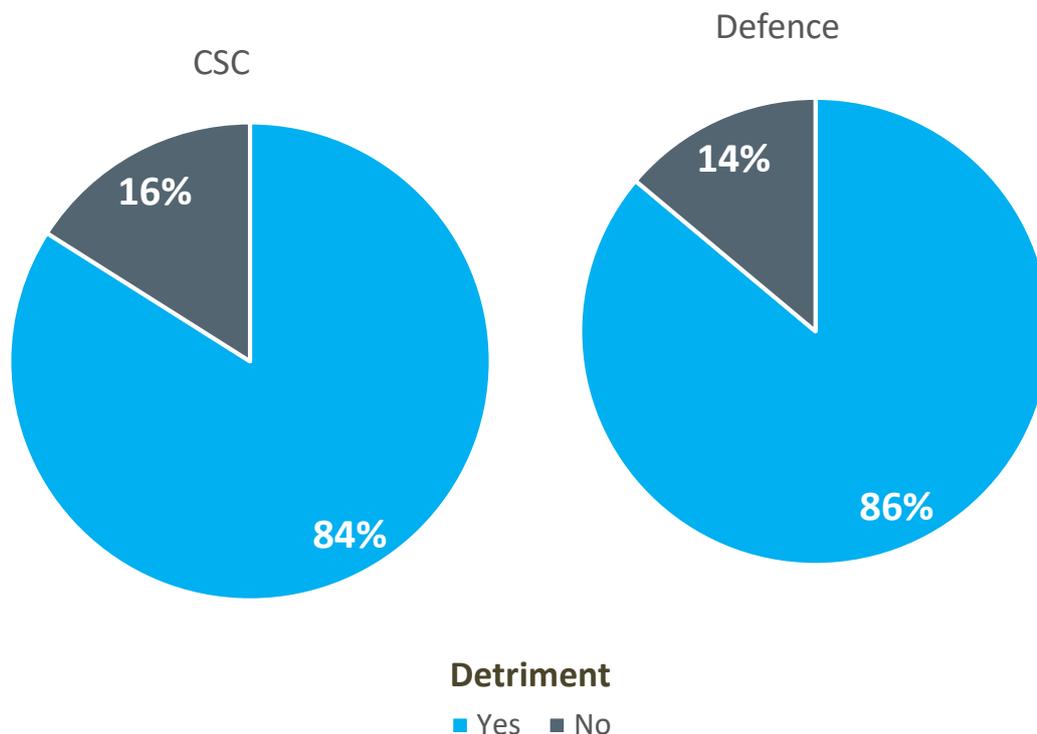
3.16. Overall 81 per cent of submitters provided information that either clearly stated, or from which we could imply, they considered themselves financially worse off than they expected they would be on reaching life expectancy factor age.<sup>47</sup> However, almost all of the reported financial ‘detriment’ related to the higher amount members felt they should have been paid after reaching life expectancy factor age. A small number of people (less than 10 total) also considered they had experienced non-financial ‘detriment’ (for example, exacerbation of existing depression).

3.17. Eighty six percent of people who identified Defence as their information source reported experiencing financial ‘detriment’, a slightly higher percentage than where the source of information was CSC or the DFRDB Authority (84 per cent, see Figure 7).

<sup>46</sup> The chart represents 98 per cent of information sources identified. The remaining 2 per cent included various other sources.

<sup>47</sup> The submission form asked ‘Do you believe that reliance on this information caused you detriment? If yes please provide a very brief description’. Our investigation team assessed from the description what type of detriment we understood them to mean.

Figure 7—Submitters who identified their information source, by whether they experienced detriment



3.18. Forty six per cent of submitters could not recall when they received the information about commutation. Of those who could, 81 per cent told us it was within 12 months of their retirement date. However, for some submitters there was a large gap in the period between when they received information about commutation and their date of retirement of more than 12 months or in some cases, more than 10 years.

3.19. Only a small proportion of submitters (around 12 percent) had obtained independent financial advice before deciding to commute. Based on our conversations with individual submitters, it appears likely that some who said they received financial advice may have been referring to conversations with private sector financial representatives who attended seminars, about investment strategies for the lump sum.

## What agencies told us

3.20. CSC asserted that comprehensive material about commutation was issued over the years, including circulars, letters and publications. CSC provided a large quantity of historical documents of this kind.

3.21. CSC considers that there was consistency and uniformity in the message conveyed by the previous administrators of the DFRB and DFRDB schemes. It said that for each scheme, the message was that a person who commuted their pension to a lump sum would not have their pension restored if they outlived their life expectancy factor age.

3.22. CSC asserted that this was made explicitly clear in scheme literature, benefit application form instructions and in material provided by the DFRDB Authority to Defence. It asserted it had been explicit in its communication from commencement of the scheme, with the use of wording that said the commuted portion ‘cannot be restored’ and that retirement pay will reduce ‘on and after’ or ‘from’ the time the election is received, or will reduce ‘thereafter’.

3.23. In reference to the RAAF Personnel Handbook which was the subject of recent media attention, CSC said that it had been unaware of the contents of this handbook prior to the media attention and it held no records that indicated that the DFRDB Authority was aware of this publication either.

3.24. Defence provided a large quantity of historical information, including publications, explanatory memoranda and reports, Ministerial responses and Pay and Administration Branch documents.

3.25. Defence advised it is possible that Army members were required to provide information to transitioning members, but what that information was can no longer be ascertained. Navy found no material indicating that staff were required to brief on the DFRDB in the course of their duties.

3.26. Defence advised the Air Force’s Directorate of Personal Services ‘had responsibility for DFRDB matters, including consultation on legislative changes, representation as part of the DFRDB Authority and drafting/clearing general information news articles .... (notably, with disclaimers to consult the DFRDB Authority for official advice)’. Defence also noted that, at that time, there would have been no restriction on the Directorate proffering advice in response to DFRDB issues raised with them directly.

## What we found

### *Current communication*

3.27. The current ‘Retirement Benefits’ factsheet published by CSC clearly and explicitly advises members that a commuted pension does not revert to the pre-commutation rate on reaching life expectancy factor age. It reads:

There are some other things you should know about commutation. One of them is that once the conversion has been made the portion you commute cannot be restored **regardless of you exceeding your life expectancy** (see Table 2 on the next

page). Also, your retirement pay will be reduced from the date your commutation takes effect (*emphasis added*).<sup>48</sup>

3.28. The earliest occurrence of this explicit messaging is in the **June 2004** edition of the Retirement Benefits factsheet, which stated:

commutation gives you the option of converting part of your retirement pay to a lump sum ... once the conversion has been made the portion you commute cannot be restored **regardless of you exceeding your life expectancy** (*emphasis added*).<sup>49</sup>

3.29. Similarly, the current 'DFRDB Book' entitled 'About Your Scheme'<sup>50</sup> explains that the reduction is permanent. It highlights this information by applying visual markers and bold green font to signify the importance of this information:

Note: Commutation of a benefit results in a **permanent reduction** in your retirement benefit based on your life expectancy, see factors at Table 3 on page 15. Your retirement benefit will not be set to the pre-commutation rate, even if you attain or exceed your life expectancy (*original emphasis*).

3.30. The earliest occurrence of this precise 'permanent reduction' wording appears to be in the 2007 edition of the DFRDB Book.

3.31. The addition of the words 'regardless of you exceeding your life expectancy' and 'permanent reduction' significantly improved CSC's communication about this issue to DFRDB members. In our view, this wording serves to remove any reasonable misunderstanding about the permanence of the commutation reduction. The only reasonable conclusion a reader can draw, *even if they received incorrect information from another source*, is that the reduction will be permanent and continue regardless of the age they achieve.

3.32. Both the Factsheet and the DFRDB Book are readily available on the CSC website and can be conveniently found.

3.33. We saw examples of submitters receiving current CSC information who said they understand the reduction is permanent.<sup>51</sup>

Mr A is a current serving member of the Royal Australian Navy (RAN). He intends to discharge in the near future and plans to commute a portion of his retirement benefit into a lump upon retirement.

Mr A has obtained information from the CSC website, CSC DFRDB fact sheets and has attended a Transition Seminar. Mr A has also met with a CSC representative. From the information provided about his DFRDB entitlements, Mr A understands that he can commute a portion of his retirement benefit as a lump sum and his retirement pay will be permanently reduced.<sup>52</sup>

<sup>48</sup> Factsheet DB04 06/14 at <https://www.csc.gov.au/Members/Advice-and-resources/Factsheets-and-publications/?dfrdb>, accessed 20 August 2019.

<sup>49</sup> CSC response document p. 175.

<sup>50</sup> At <https://www.csc.gov.au/Members/Advice-and-resources/Factsheets-and-publications/?dfrdb>, accessed 20 August 2019.

<sup>51</sup> These submitters made submissions on the basis they consider the scheme design is unfair (i.e. that while acknowledging the reduction *is* permanent, they don't believe it *should be*).

<sup>52</sup> Submission 676.

3.34. CSC provided copies of current letters sent immediately prior to and after commutation. While correct, these letters do not use the improved language contained in brochures and the DFRDB Book to warn about the permanency of the commutation reduction to retirement pay, although the letter sent prior to commutation does refer the reader to scheme literature. CSC also sends copies of the factsheet/brochure to members on request.

3.35. Similarly, the current form for members to elect to commute<sup>53</sup> does not use the improved language used in brochures and the DFRDB book to warn that there will be a 'permanent' reduction in retirement pay if a person elects to commute. Like the letters, the form also recommends readers read the DFRDB book, with text on the first page under the headings 'Important information about this form' and 'Before you use this form'.

3.36. Defence advised that the ADF does not provide specific commutation information to DFRDB members but refers people to CSC for information and advice. Defence records show that CSC continues to present at Defence Community Organisation transition seminars. ADF transition coaches draw attention to transition resources but do not give advice.

### ***Historical Defence communication***

3.37. As part of this investigation we looked closely at what historical information was provided to staff and members about the consequences of commutation, and whether this information was accurate and adequate in the circumstances.

3.38. There are numerous examples of incorrect written and verbal information being disseminated within Defence from commencement of the scheme in 1973 onwards. 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.

3.39. For example, the Navy News incorrectly described commutation as a 'loan' to be 'repaid':

Many people separate from the Service just for the commutation. When family expenses are high, the prospect of a considerable amount of money can be enticing, but commutation is not designed to help you meet your expenses. Its purpose is to provide **an interest-free loan** to help you settle into a new career when your relatively short career in the service is over (*emphasis added*).<sup>54</sup>

3.40. A number of ADF handbooks also incorrectly described commutation as a loan to be repaid over a person's life expectancy. For example, the RAAF Personnel Information Handbook read:

When you receive retired pay (ie, pension) you will have the right to 'commute'. This means that you are able to **borrow** an amount equal to several times your retired pay at the time of your discharge and **repay that amount over your life expectancy** (*emphasis added*).<sup>55</sup>

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<sup>53</sup> Form D20, at <https://www.csc.gov.au/Members/Advice-and-resources/Forms/>, accessed 20 August 2019.

<sup>54</sup> Navy News, 8 October 1982, p. 17.

<sup>55</sup> RAAF Personnel Information Handbook, February 1993, p. 92. This wording remained substantially the same in all versions of the RAAF handbook we received, up to and including the 6<sup>th</sup> edition (1993).

3.41. In April 2008, Comsuper wrote to one submitter (who had drawn its attention to the incorrect statement in the RAAF Personnel Information Handbook) to advise that it had contacted Defence and been assured this information had now been removed.

3.42. Similar wording appears in the Royal Australian Navy Pre-Discharge Handbook (June 1988), supplied by a submitter:

If you commute, your annual pension will be reduced accordingly so that the commuted amount is **'repaid' over your remaining life expectancy** (*emphasis added*).

3.43. Other Defence publications we have seen either did not mention the commutation reduction at all, or where they did, did not address the issue of the permanence or otherwise of the reduction to retirement pay.

3.44. However, we did find examples where Defence had clarified this point. For example, in an 'Official Reply' from the Acting Assistant Secretary, Defence Industrial, Mr Peter Skinner, published in the Army News in December 1988:

Commutation is a lump sum advanced to a retiree and 'repaid' through a reduced pension. The number of years over which these payments are made is calculated by referring to the DFRDB Act.....Should the member die at this average age the equation would be considered square. However few retirees actually die at this age, causing most to either fall short of, or extend beyond this theoretical commitment. The reason no attempt is made to adjust for this is that the present result is considered fair for the great majority of members. Thus if a serviceman dies shortly after retirement, his widow is not asked to repay the balance of her husband's commutation. By the same philosophy, **retirees fortunate to live beyond expectancy are not granted an increased pension from that point onward'** (*emphasis added*).

3.45. We also interviewed a number of former ADF members whose role had involved providing information about the DFRDB scheme during the discharge process. These former ADF members said they had provided incorrect information to thousands of discharging DFRDB members.

Mr B worked in a discharge unit explaining entitlements and assisting with resettlement. Other than the DFRDB brochure and on the job training from his predecessor, he received no training or guidance on the scheme. Mr B said that, in accordance with what his predecessor trained him to say, he told members commutation was an advance on their pension and once paid back, the member would go back onto a full pension. He explained that he in turn trained the person who replaced him to do the same.

Mr B said he spoke about the DFRDB at a resettlement seminar again explaining that the pension would go back up once the commutation was paid off. Mr B said he was responsible for 17 staff, all of whom were providing the same incorrect information.

Mr B estimated this incorrect information would have been provided to around 1500 people who went through his discharge unit during his employment there in two separate periods totalling four years in the 1970s and 80s.<sup>56</sup>

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<sup>56</sup> Submission 1354.

3.46. A number of the former ADF members we spoke to provided similar accounts:

Mr C worked in the financial area of the RAAF for 20 years. He spoke at retirement seminars and says he was involved in the discharge of thousands of members. He says he told people they would pay their commutation back until they reached life expectancy, then the pension would go back to the normal full rate because they had paid the commutation back.

Mr C was in the service when the DFRB transitioned to DFRDB. He said he remembered that the DFRB literature had provided a warning, but he recalled that the DFRDB brochure did not say the reduction continued after life expectancy.

He said he and other advisers received no training on the DFRDB, but if he had a question he would ring the DFRDB Authority. He said he thought the scheme was simple. He thought it made sense that the pension would revert to the full amount on reaching life expectancy, because this is what happens when a person actually dies (the members dependents receive a portion of the full pension, as if the member had never commuted).<sup>57</sup>

3.47. Other submitters expressed a similar view to Mr C. The fact the pension reverts to the pre-commutation amount for calculating *spouse benefits* when a member dies<sup>58</sup> led them to assume this reversion also occurred on reaching life expectancy factor age.

3.48. Defence said it also spoke with former ADF members who had worked as former administrative clerks responsible for discharge. They said their role had included providing information on DFRDB and how to fill in forms, answering questions and who to contact. They also conceded there was no formal training and information passed from more experienced, longer serving clerks.

3.49. Former ADF members we spoke to who told us they developed documents and presentations about the DFRDB scheme described clearance processes which involved superior officers checking their speaking notes for seminars, but none could recollect information being sent to DFRDB Authority prior to publication or presentation.

3.50. One former DFRDB Authority staff member we interviewed recalled that the three Defence services had a representative on the DFRDB Authority Board, who could act as a conduit for information between the agencies, but was unable to recollect specific examples of Defence information being reviewed by the DFRDB Authority.

3.51. While there was incorrect information provided by some handbooks we saw and by ADF members we interviewed, the handbooks also encouraged people to contact DFRDB Authority, as did some of the former ADF members we spoke with.

3.52. The Office also received video footage of two Defence retirement seminars.<sup>59</sup> The videos record the information provided by DFRDB Authority staff invited to speak at the seminars. Both speakers give correct information that retirement pay will not go back up on reaching life expectancy factor age. In the first video, the issue is not addressed in detail until an audience member specifically asks a question about it. In the second, while the speaker is

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<sup>57</sup> Submission 2525.

<sup>58</sup> Eligible dependents are entitled to five eighths (62.5 per cent) of the DFRDB member's pension, calculated using the pension rate that would have applied had the member not commuted.

<sup>59</sup> While not precisely dated, information in the videos indicate that they were likely recorded in 1984 and 1989 respectively.

explaining a worked example, he initially states that the repayment is over the life expectancy period, but later corrects this statement.

3.53. Based on interviews with submitters, it appears that some people misunderstood the information provided at resettlement seminars, and spread the misunderstanding to colleagues during conversations with their peers when they returned to their units.

### ***Historical DFRDB Authority Communication***

#### **Operational guidelines**

3.54. In addition to the video footage described above, we examined contemporaneous copies of CSC brochures, forms, and letters from 1973 to present, examples of which were provided by CSC and individual submitters. We also had regard to how commutation had been explained in the predecessor DFRB scheme literature.

3.55. The DFRB book included a warning about the effects of commutation on a pension under that scheme:

251. Every pensioner should think carefully before relinquishing portion (*sic*) 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** (*emphasis added*).<sup>60</sup>

3.56. At the commencement of the scheme in 1973, the DFRDB Authority issued a circular to all Defence service agencies,<sup>61</sup> explaining how the scheme would operate. This circular clearly explained the permanence of the commutation reduction:

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 the dependents or the estate (*emphasis added*).<sup>62</sup>

3.57. In our view, the inclusion of this paragraph when explaining the new scheme in 1973 demonstrates an awareness by the DFRDB Authority that what happens after reaching life expectancy factor age might be an issue on which people would seek clarification, or not otherwise immediately understand to be the case.

3.58. We were not provided with any other internal DFRDB guidelines, other than the first issue of the DFRDB Manual compiled by the Australian Government Retirement Benefits Office in 1983. This manual stated:

A member who commutes has his or her pension reduced. **The reduced pension cannot be restored during the member's lifetime**. The reduction is calculated

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<sup>60</sup> Defence Forces Retirement Benefits Board, July 1970, DFRB Booklet, para. 251, p. 94.

<sup>61</sup> Prior to their amalgamation into the Department of Defence on 30 November 1973, the Department of the Navy, Department of the Army and Department of Air Force were responsible for the administration and finances of the Royal Australian Navy, the Australian Army and the Royal Australian Air Force respectively.

<sup>62</sup> DFRDB Authority, August 1973, Defence Force Retirement and Death Benefits Scheme Circular, issued to all service departments, p. 17.

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according to life expectancy. Effectively, the member notionally repays the commutation lump sum by recovery from pension (*emphasis added*).<sup>63</sup>

3.59. Due to the passage of time, there were no other internal (staff only) DFRDB Authority or Defence procedural guidelines that could be provided to the investigation.

3.60. Based on our interviews with former ADF members and DFRDB Authority staff there does not appear to have been sufficient training or instruction (if any) that staff in either organisation should proactively and specifically explain to members that full retirement pay is not restored should the member live beyond their life expectancy factor age. Despite what appears to be an absence of guidance to proactively provide such advice, we are satisfied that DFRDB Authority staff were aware of how the legislation works, and would provide correct information if a specific question about duration of the reduction came up.

### Brochures

3.61. At commencement of the scheme, DFRDB Authority produced a brochure on transfer arrangements which explained:

the annual rate of retirement pay is reduced by an amount which is calculated by dividing the lump sum amount received, by the retired members life expectancy.<sup>64</sup>

3.62. In 1975, another brochure described commutation as the option:

to receive a lump sum **prepayment** of a portion of future payments and a **reduced benefit thereafter** (*emphasis added*).<sup>65</sup>

3.63. Like the DFRDB Act itself, these brochures say that retirement pay is reduced, and do not indicate any end date to the reduction. In 1975, the use of the word ‘thereafter’ also indicates that the reduction is continuing. It also refers to commutation as a ‘prepayment’ of a portion of future payments. However, neither brochure explicitly states that the reduction will continue after reaching life expectancy factor age.

3.64. Similar wording was used in brochures until the early 2000s. The Retirement Benefits leaflet continued to describe the election as an option to receive a ‘lump sum prepayment’ and that ‘your reduced retirement pay following commutation is determined in accordance with your life expectancy on the date the election is received’.<sup>66</sup> From July 1995 the Retirement Benefits leaflet also stated ‘the portion you commute cannot be restored’.

### Forms

3.65. The original 1973 form required members to sign an acknowledgement:

I realise that under the provisions of Section 24 future retirement pay payments will be reduce as a consequence of this election **on and from** the date the election is received by the Authority (*emphasis added*).

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<sup>63</sup> Australian Government Retirement Benefits Office, 1983, DFRDB Manual, para. 6.3.

<sup>64</sup> DFRDB Authority Brochure, October 1972, Transfer to the new scheme of existing contributors as at 1 October 1972, p. 2.

<sup>65</sup> DFRDB Authority Brochure, June 1975, Preservation of Rights, p. 12.

<sup>66</sup> For example letters we received dated December 1981, January 1985, 1987, September 1989.

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3.66. The form also contained the relevant extract from s 24 explaining calculation of the reduction ‘on and after the day on which the election takes effect’.

3.67. The acknowledgement and extract of s 24 were removed from the forms in 1978. However, from 1978 the form was accompanied by ‘Explanatory Notes’ which explained that the member should obtain a brochure on retirement benefits from their unit or the DFRDB authority and stated:

Commutation is a conversion of a portion of future retirement pay payments to a one time lump sum. Once the conversion is made the portion commuted **cannot be restored during the member’s lifetime** (*emphasis added*).

3.68. As discussed in the analysis section below, members told us that they understood that ‘cannot be restored’ meant that the election to commute could not be reversed.

3.69. Forms were often accompanied by a printout of the commutation calculation and future rate of retirement pay.

### Letters

3.70. There are two categories of letters to members that were examined during this investigation. The first is letters that were sent to a person who contacted the DFRDB Authority prior to discharge, and the second is the letter sent to members after discharge and the election to commute had been made.

3.71. The DFRDB Authority provided a service where members could contact the DFRDB Authority to ask for detailed information about their retirement benefits. This could be done by telephone, in writing, or in person.

3.72. The DFRDB Authority would provide information about entitlements, including a letter setting out calculations which explained how much a person would receive if they decided to commute and the amount of retirement pay they would receive.

3.73. These letters used phrases such as:

Retirement pay is reduced with effect from [date]....

Retirement pay thereafter would be at the rate of [\$amount] per annum

Reduced retirement pay following commutation - [\$amount]

3.74. Letters sent to a person following discharge were similar, using phrases such as:

Your election to commute became effective on [date] and accordingly your retirement pay entitlement is reduced from that date to [\$amount] per annum.

### Analysis

3.75. Although the passage of time means many corroborative historical records are no longer available, we are satisfied that the former ADF members and DFRDB Authority staff we interviewed were credible and the information they provided to us was reliable.

3.76. We are satisfied that some information about the long term impact of commutation on retirement pay provided by some Defence publications and former Defence personnel (in

administrative roles) was incorrect. While the scale of dissemination of incorrect information cannot be known, it is likely that the count of members who received incorrect information numbers in the thousands.

3.77. The DFRDB Authority brochures, forms and letters did not explicitly state that the reduction would be permanent, nor did they suggest that the reader obtain independent financial advice prior to making their election to commute. They mirrored the ‘on and after’ language in the legislation, explaining only that there would be a reduction in retirement pay after commutation. It appears a similar approach was taken in the verbal advice that was provided by the DFRDB Authority.

3.78. This meant the member had to impute meaning from what was **not** said.

3.79. To receive the correct message, members had to understand that the absence of language limiting the period for reduction meant the reduction was permanent. This is possible where the member is experienced in reading technical or legal language, but is harder for members whose skills lay elsewhere, and harder still if they have already received incorrect information which has influenced their views.

3.80. We were told by some submitters we spoke to that the absence of an end date did not alert them to the fact that the pension reduction was permanent. We understand this was because they either assumed, or had been led to believe, that the year they reached life expectancy factor age was their ‘end date’. In effect, they understood ‘thereafter’ meant during what they thought was the ‘repayment period’. Others told us it simply did not occur to them to think beyond life expectancy—perhaps not surprising given retirees were as young as 36 so life expectancy factor age could be many decades into the future.

3.81. This understanding of the word ‘thereafter’ appears to have been shared by the authors of the RAAF Handbook which, after describing commutation as being an amount you borrow and repay over your normal life expectancy, says that ‘this is achieved by paying you a lump sum, and a reduced amount of retired pay **thereafter**’ (emphasis added).

3.82. The absence of explicit information was compounded by the use of words capable of misinterpretation. It appears likely some members may have misunderstood the use of the word ‘prepayment’ to mean a fixed amount in the nature of an advance or loan to be repaid.

3.83. Use of the word ‘prepayment’ without a fuller explanation was also, with retrospect, unfortunate. Commutation is not a simple prepayment similar to a loan or advance. It is an exchange of one type of entitlement for another.

3.84. We interviewed 20 people who had attached copies of letters to their submissions. Only three of the people we spoke to understood the letter to be saying that the reduction was permanent, and of these:

- two had already known the reduction was permanent when they read the letter
- the other was the only one of the 20 who had no prior understanding (they had not previously heard or thought about the effect of commutation) when they read the letter.

3.85. The remaining 17 said they did not understand from the letter that the reduction would be permanent, as the example of Mr D shows:

Mr D served in the Royal Australian Navy (RAN) and discharged in 1983 where he chose to commute a portion of his retirement benefit. Prior to commuting Mr D received a letter in 1982 from the DFRDB Authority which detailed his entitlements and retirement pay.

Mr D stated there was nothing contained in the letter that made him think his retirement pay wouldn't go back up eventually. The use of the words 'reduced with effect from that date' and similar in the letter, did not cause him concern, as he did not interpret them as meaning a permanent reduction.

Mr D stated that the use of life expectancy tables made him not worry about the length of the reduction. He said "by using life expectancy figures in the calculation, it gave me the impression it would go back to normal." Prior to receiving the letter, Mr D already held an understanding that his pension would revert at some stage. As far as he was concerned the letter appeared straight forward and answered all the questions he had at the time.<sup>67</sup>

3.86. Members we spoke to also indicated that they misunderstood the warning that 'the portion you commute cannot be restored'<sup>68</sup> as meaning only that they could not reverse their decision to commute. They said they did not realise that it meant the pension would not be restored on reaching life expectancy factor age.

Mr E interpreted the phrase "once the conversion is made the portion commuted cannot be restored" as, once you sign up to it, that sets the agreement in stone and changes to the agreement won't be accepted.<sup>69</sup>

3.87. In our view, at least for some members, these interpretations were influenced or reinforced by the misunderstanding they already had following incorrect information from Defence publications, staff involved in discharge, and their peers (including members returning from resettlement seminars).

3.88. However we also saw examples of relatively financially astute members (who did not have a misunderstanding of the nature of commutation when they received information about entitlements) yet still misinterpreted the DFRDB Authority information. This is illustrated in the example of Mr F:

Mr F was a commissioned officer in the RAAF who discharged and commuted his retirement pay in 2002. Mr F already owned his home outright at the time he discharged and says he was therefore ambivalent about whether he should commute or not, having no immediate need for a lump sum and was primarily concerned at the time with maximising future retirement income.

He attended a retirement seminar. He heard from a DFRDB speaker and spoke with the financial advisor present. Mr F says that he listened to the explanations about the scheme and read the brochure materials carefully. He said the DFRDB presenter did not specifically state that the pension would go back up on reaching life expectancy factor age, however this is how

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<sup>67</sup> Submission 2459.

<sup>68</sup> As it happens, since 1988 the decision to commute *can* be reversed in some circumstances. The DFRDB Act, s128A, states that a person can apply to CSC to cancel the election within three months after making the election (or such further period as CSC may allow in special circumstances).

<sup>69</sup> Submission 858.

he had understood commutation, putting together the information he had received about it being like a loan and the fact it was worked out using life expectancy tables.

At the time, he put his commutation into his superannuation fund. He currently directs all of his remaining retirement pay into superannuation. He thinks, with hindsight, he may have decided instead to 'trickle invest' the full pension, rather than taking and investing a commutation lump sum. He is unsure whether he has suffered an overall financial benefit or detriment.<sup>70</sup>

3.89. Having considered the documentation and personal statements from individuals, we are satisfied that Defence at times provided incorrect information to members.

3.90. We are satisfied the information provided by DFRDB Authority was correct. However, prior to 2004, when the words 'regardless of you exceeding your life expectancy' were added, followed by the addition of the word 'permanent' in 2007, the stand alone statement that the pension 'cannot be restored' was, as illustrated above, often misunderstood.

3.91. It also appears likely this information was rarely given in verbal DFRDB presentations and discussion, as the question was not often asked by members and DFRDB staff had not been directed to include explicit explanations on this issue.

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<sup>70</sup> Submission 1756.

## Did this amount to defective or deficient administration?

3.92. The Commonwealth government process for compensating loss caused by poor government administration is the *Scheme for Compensation for Detriment caused by Defective Administration* (CDDA).

3.93. The purpose of the scheme is to provide a mechanism for government to compensate people who have experienced detriment as a result of defective or deficient administration.

3.94. The principles underpinning the CDDA are a useful guide for our analysis in this case. This is because CDDA focuses on whether there is a moral obligation to pay compensation in situations where legal compensation is not payable.

3.95. The CDDA scheme cannot compensate financial disappointment or unmet expectations.<sup>71</sup> Nor can it be used to make payments that would effectively override a legislated cap on a statutory entitlement.<sup>72</sup> As a matter of principle, this means compensation cannot be used to pay members the pre-commutation rate of retirement pay after reaching life expectancy factor age, because to do so would involve paying members more retirement pay to which they are entitled under the legislation.

3.96. However, if a person suffered a financial or economic loss as a result of defective administration, the CDDA scheme principles would suggest that compensation may be appropriate.

3.97. In considering whether, as a matter of principle, compensation ought to be paid, the first question to answer is whether there was any defective administration.

3.98. Giving advice to a person that was, in all circumstances, incorrect or ambiguous may amount to defective or deficient administration.<sup>73</sup>

3.99. Administration can also be defective if there is an unreasonable failure to give a person proper advice that was within an agency's power and knowledge to give.<sup>74</sup>

### **Defence**

3.100. While Defence was not directly responsible for administration of the DFRDB scheme, there can be no doubt that people understood Defence personnel, particularly those involved in the discharge process or from the Directorate of Service Conditions, to be speaking authoritatively and providing definitive advice. This is illustrated by submission comments such as the following:

The explanation at the seminar was that we could 'borrow' this money as a commutation and then pay it back over a protracted period of time and then revert back to our normal pension after the commutation had been repaid.....The information offered was insufficient for me to realise that I was about to enter into

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<sup>71</sup> Department of Finance, November 2018, *Scheme for Compensation for Detriment caused by Defective Administration Resource Management Guide No 409* ('CDDA Guideline 409'), para. 57.

<sup>72</sup> CDDA Guideline 409, para. 24.

<sup>73</sup> CDDA Guideline 409, para. 17.

<sup>74</sup> As above.

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a never-ending debt. It was not ‘sold’ by professional ‘spin doctors’ but by a uniformed officer in whom I had complete confidence and trust.<sup>75</sup>

3.101. Defence personnel provided information to DFRDB members about the longer term impacts of commutation on retirement pay. Some of this information was incomplete or misleading, enabling people to reasonably draw the wrong conclusion. Some information provided was simply wrong, including information that retirement pay would be restored to the pre commutation amount on reaching life expectancy factor age.

3.102. We were not provided with internal guidelines given to DFRDB Authority staff or Defence personnel working in discharge or other relevant areas. While this may be because they have been lost due to the passage of time, our discussions with former staff working in these areas suggest it may be because such written policy guidance never existed. Whatever the reason, we have seen examples of Defence handbooks with information that is plainly misleading.

3.103. Further, although we have not seen any written documents from Defence that used the phrase to the effect of ‘your pension will be restored’, we have spoken with former discharge workers who confirm they did provide this exact advice, understanding it to be true. We can say that the incorrect information provided was not an isolated incident, or only attributable to one or two individuals.

3.104. It appears the *absence* of clear policies, good records and adequate process enabled incorrect information to be provided. The Defence personnel whose job it was to provide information to DFRDB members were not given adequate information or training which would have ensured that only accurate information was provided.

3.105. Information provided by the DFRDB Authority in a Circular to Defence at the commencement of the scheme in 1973 explicitly addressed this issue, stating:

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

3.106. Appropriate policies and guidance should have been in place within Defence to ensure only accurate information was provided, particularly when the correct information had been provided to Defence by the DFRDB Authority at the commencement of the scheme.

3.107. Defence is to be commended for its decision to host retirement seminars and provide discharge services to ensure that its personnel were well informed of their rights and entitlements on discharge. However, in doing so, it was incumbent upon Defence, both the ADF and the department, to ensure accuracy in the information provided.

3.108. Defence’s practices were not sufficiently rigorous to ensure this accuracy. We find that Defence was responsible for allowing the incorrect information to be provided. We are satisfied that the deficient practices that allowed this to occur amount to defective administration by Defence.

### **CSC/DFRDB Authority**

3.109. In contrast, we did not identify any information provided by the DFRDB Authority that was incorrect, either in its written materials or in its verbal briefings. Although not as clear as

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<sup>75</sup> Submission 1150.

subsequent publications, which used the word ‘permanent’ or referenced the reduction ‘not being restored regardless of you exceeding your life expectancy’, we do not think the information was ambiguous, in the sense that it was capable of two meanings. Like the legislation itself, when read correctly, the meaning was unambiguous.

3.110. Overall, the DFRDB Authority provided a high quality and accessible information service which meant members could contact the DFRDB Authority at any time to seek and clarify their understanding of any aspect of the scheme.

3.111. Information about these long term consequences was centrally relevant information for members making decisions about whether, when and how much to commute. With the benefit of hindsight, the DFRDB Authority could have used clearer language to explain the long-term impacts of commutation on retirement pay from the commencement of the scheme. In our view, the misunderstanding that ensued may have been avoided if it had included in its brochures the same clear language currently found in the DFRDB Book, or even the level of detail found in its 1973 circular to agencies.

3.112. However, while it would have been preferable if the brochures and information provided by the DFRDB Authority had been clearer on this issue, the information it provided was in fact correct.

3.113. For this reason, while we can point to better practice with the benefit of hindsight, we do not find that the DFRDB Authority’s conduct amounted to defective administration or was otherwise wrong.

### **Did the defective administration result in detriment?**

3.114. Defective administration does not automatically mean compensation is payable to the people affected. For compensation to be payable a person must have suffered ‘detriment’ which was directly caused by the defective administration.

3.115. Having found defective administration on the part of Defence, the second question to consider is whether the defective administration caused any detriment.

#### ***What can constitute detriment?***

3.116. Detriment is the amount of quantifiable financial loss caused by the defective administration.<sup>76</sup> **Financial disappointment and unrealised expectations are not compensable.** For example, a person will not be eligible for compensation if they are incorrectly granted a pension, and are disappointed when their pension is later cancelled.

3.117. This is because the person must suffer a **financial detriment** as a result of a decision they made relying on the incorrect advice. Further, it must have been reasonable to rely on the incorrect advice, and they must have taken reasonable steps to minimise the loss.

3.118. Where it is impractical to demonstrate part or all of the quantifiable loss, the decision-maker assessing whether compensation should be paid may make whatever assumptions as to the amount as are reasonable and necessary in all the circumstances.<sup>77</sup>

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<sup>76</sup> While the CDDA scheme and other compensation processes can address detriment stemming from personal injury or damage to property, we have not received any information alleging either of these types of detriment.

<sup>77</sup> CDDA Guideline 409, para. 55.

### Financial detriment and the initial decision to commute

3.119. For most people, the relevant decision they made relying on the incorrect information was the decision of whether or not to commute. We therefore had to consider: did the incorrect information influence members to commute, and if so, did members suffer a detriment as a result of their decision to commute?

3.120. As part of our interviews with some DFRDB members, we specifically explored whether they would have commuted even if they had known at the time that the reduction would be permanent. With very few exceptions, we were told they would have still commuted, because at the time they needed access to capital, for example to purchase a home or business.

3.121. Some members said in their submissions they would not have elected to commute, but only a handful pointed to specific alternative course of action they felt they would have taken, as the following case studies illustrate.

Mr G discharged in 1992. He says he invested half his commutation into a franchise business, and put the remaining half into superannuation. He said 'If I had known that my retirement pay would be reduced for life I would simply have borrowed the funds to purchase the business, and received my full retirement pay. If I had followed this course I believe that I would be much better off financially today'.<sup>78</sup>

Mr H stated '... the vital factor that I would be paying the lower pension for the rest of my life would have been of huge significance. I was buying a home after years of postings and occupying poor quality married quarters - if I had known that vital information I could have made enquiries to a bank for advice on a housing loan, repayment details, etc., I would at least have known that there was an end to bank repayments and it would have been an important comparison with commutation arrangements'.<sup>79</sup>

3.122. In our view, it is likely many submitters would have commuted, even if they had received correct information about its permanent effect on retirement pay. However, there may be some submitters who, having less immediate need of a lump sum, may have otherwise decided not to commute their retirement pay.

3.123. While there was abundant evidence of financial disappointment, frustration and unmet expectations, this was based on financial disappointment from not receiving the entitlement *to which they believe they were entitled* (i.e. a restored pre-commutation amount) as opposed to the entitlement permitted by law.

3.124. The submitters who asserted they would not have chosen to commute if they had understood the reduction was permanent claimed they would have been better off financially not commuting.

3.125. To test this claim, we sought financial modelling of the two outcomes available under the law (that is, to commute with a permanent reduction, or to not commute and maintain a higher retirement pay).

3.126. Our modelling does not compare the hypothetical outcome if the law had permitted retirement pay to increase on reaching life expectancy factor age. While DFRDB members would undoubtedly be better off financially under this approach, it is not a suitable point of

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<sup>78</sup> Submission 2402.

<sup>79</sup> Submission 1285.

comparison. This is because, while disappointment and unmet expectations are legitimate causes for concern, particularly where they are the consequence of defective administration, they are unlikely to be financially compensable, in court proceedings, as a person was never entitled to this financial outcome.

3.127. As proof of financial loss, some submitters provided the results of an online tool that had been developed by and circulated among DFRDB members, known as the DFRDB Loss Calculator Version 2.<sup>80</sup> However, the calculator does not compare the two available legal scenarios (commuting or not commuting). Rather, it compares actual benefits received to the benefits that would be received if the law was changed (see further Part 5).

3.128. The modelling we commissioned is, in our view, a more accurate way of determining the likelihood of a person experiencing an actual loss (as opposed to financial disappointment) as the result of deciding to commute when compared to not commuting. It takes into account, using conservative assumptions, the economic benefits of both options.

### ***Modelling financial outcomes of the two available options***

3.129. The Office commissioned external modelling from two sources, the Australian Government Actuary (AGA) and KPMG. Both firms were provided with relevant data from 12 de-identified real life cases<sup>81</sup> and asked to model and compare the financial outcomes which flowed from the two options available under the DFRDB Act:

- commutation, with reduced retirement pay (which is what occurred in all 12 cases)
- no commutation and higher retirement pay.

3.130. To compare the options that were available under the DFRDB Act, we asked the actuaries to assume two investment scenarios for each case.

3.131. The first scenario is based on the lump sum being invested in **the purchase of a home** (thereby saving mortgage interest which would otherwise be payable on that lump sum amount). According to the submissions received, interviews we conducted and historical presentations we viewed, this is likely to have been the most common use of the lump sum.

3.132. The second scenario is based on the lump sum being placed in **a term deposit**. It is important to consider detriment in the context of likely financial outcomes for people who were not savvy investors. While it stands to reason that some financially astute members would have achieved better investment returns than others, we wanted to understand the likely returns for a member with no relevant financial skills or capital investment experience.

3.133. We therefore sought to model outcomes for conservative human behaviour and economic circumstances. The actuaries were instructed to use actual historical term deposit and home loan rates, and to assume the current historically low rates (four percent for home loans and two percent for term deposits) would continue into the future.

3.134. A person who commutes would start with a higher initial lump sum. We therefore asked the actuaries to consider how this sum grew relative to a person who received no lump

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<sup>80</sup> The calculator is published on the Australian Defence Force Retirees Association website at <https://www.adfra.org/ref.php>, accessed 21 October 2019.

<sup>81</sup> The sample was selected to include at least one commissioned officer and other rank members from each service, one retiree from each decade since 1973, one third females, a range of ages on retirement and lengths of service.

sum but a higher annual pension. We asked the actuaries to indicate the ‘break-even’ points in the various scenarios. This is the point at which a person, with hindsight, may have been better off had they not commuted.

3.135. Given the conservative assumptions we have used, it is likely that the real-life ‘break-even’ age for many people would be considerably higher than the result of the modelling. This is because the outcomes do not take into account the other benefits of commutation which may have been associated with use of the lump sum, including:

- capital gains to property or the increase in value of assets purchased with the lump sum
- income streams from the purchase of income generating assets, superannuation or businesses
- beneficial taxation treatment—all outcomes are in gross figures (i.e. before tax) and ignore all tax implications.<sup>82</sup>

3.136. Although the financial modelling used real-life figures, we are not suggesting it represents the outcomes for any particular individual. The modelling does not take into account situations where a member diminished the value of their lump sum by spending or investing it in a way that lost value (or indeed invested it to result in a significant *increase* in value).

3.137. Equally, modelling cannot account for non-financial benefits able to be obtained from a lump sum, such as education (some submitters told us they used the lump sum to fund their children’s education), health or other lifestyle benefits. It also does not take into account the possibility that the commutation could have been spent or invested in a way that delivered even lower returns than simply putting the lump sum in the bank. In such a case, the financial loss is clearly due to spending or investment choices, rather than the decision to commute.

### **Results of the modelling**

3.138. AGA’s and KPMG’s reports have been published in full on our website along with this report. Each report contains a detailed explanation of the scenario, methodology and assumptions used to produce each set of outcomes.

3.139. The results of the two sets of modelling are different. This is because the two actuaries have used slightly different interest rates and different methodology.

3.140. For example, AGA has compared only the portion of a person’s retirement pay that was commutable (and therefore comparing it being taken as a lump sum with it being provided on an annual basis). This is because that part of the pension that was *not* taken as a lump sum is available to the member regardless of whether they commuted or not. By taking this approach, the modelling is only comparing the outcome of taking the commutable amount as a lump sum

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<sup>82</sup> This was done because tax scenarios are different for every individual and tax laws have changed regularly since the commencement of the DFRDB scheme. As a result it would have required too many assumptions to be meaningfully modelled in bulk. However, for most people, ignoring tax implications also ignores significant financial benefits that come from commutation (for example, prior to 1 July 1983, only 5 per cent of a person’s commutation was taxed compared to all of their pension). As there are no limits to use of the lump sum, a person could choose to invest it in a way that attracts beneficial taxation treatment or concessions.

to taking it in fortnightly instalments. In contrast, KPMG has considered the full pension received in both scenarios.

3.141. There are also difference in how the actuaries have modelled the outcomes for the purchase of a home. KPMG's methodology is based on the savings which result from investing the lump sum in a home loan being the equivalent of a person 'earning' at home loan interest rates on the lump sum amount.

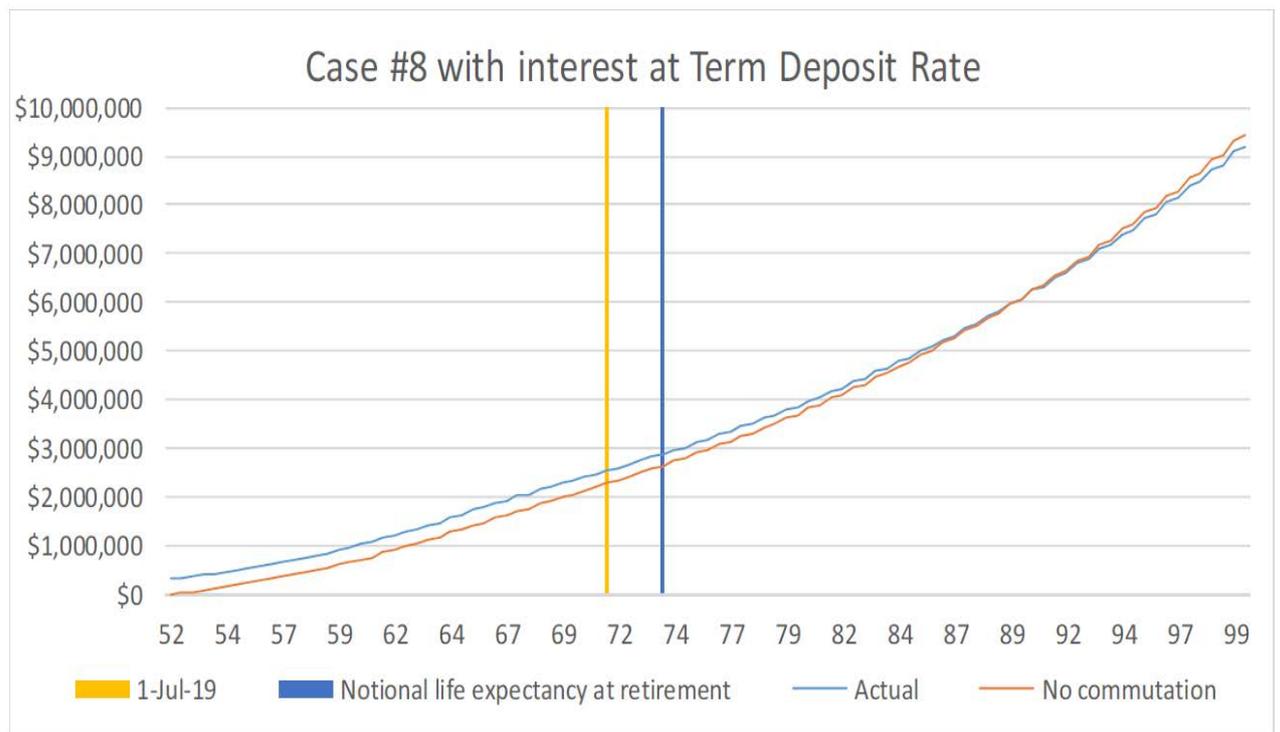
3.142. The AGA methodology (which is explained in detail in its report) involved calculating the lower repayments which would be made if a person was able to borrow less for their home loan because they had access to the lump sum. The AGA modelled the effect of depositing the amount equal to the difference in repayments into a term deposit (thereby earning term deposit interest rates), from which they withdrew the commutation reduction amount annually. That is, in either scenario, the person has access to the same commutation reduction amount, either through drawing down on this account or by receiving this sum annually as part of their pension payment.

3.143. The AGA modelling further assumes that once the home loan is paid off after 25 years no further savings payments are made into the account (although the account would continue to earn term deposit interest). The commutation reduction amount continues to be withdrawn annually until the account has a zero balance. The 'break-even' point occurs when the account balance reaches zero.

3.144. Despite these differences in methodology, both sets of modelling produce broadly consistent overall results. Both sets of modelling suggests people would have been better off financially commuting if they exercised even a very conservative investment strategy. Further, the modelling does not identify any cohort of people who commuted prior to CSC clarifying its information, who experienced actual financial loss, compared to the other available option.

3.145. To illustrate this, Figure 8 shows the term deposit rate modelling completed by KPMG for one set of figures ('case #8'). It shows the 'break-even' point (where the orange and blue lines intersect) as being age 89.

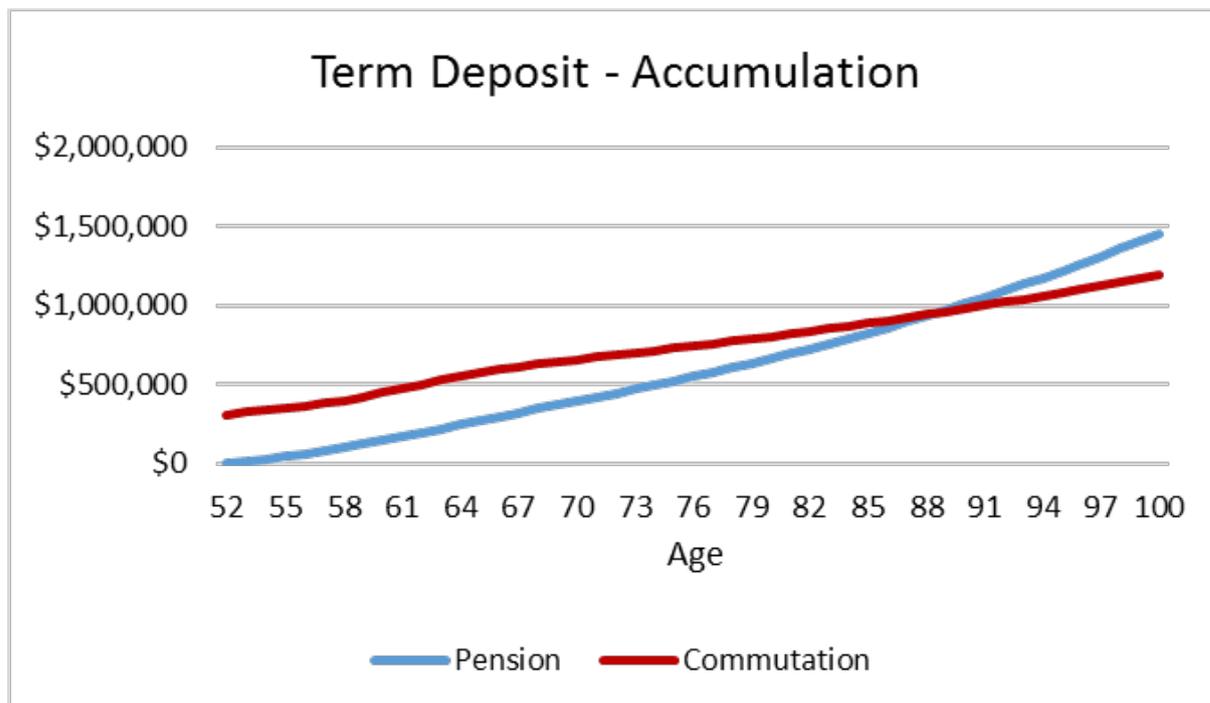
Figure 8—KPMG modelling outcome—Case #8 Term deposit scenario<sup>83</sup>



3.146. Figure 9 below shows the term deposit rate modelling completed by the AGA for the same set of figures. It shows the 'break-even' point (where the red and blue lines intersect) as being age 88.

<sup>83</sup> KPMG report, p. 25.

Figure 9—AGA modelling outcome—Case #8 Term deposit scenario<sup>84</sup>

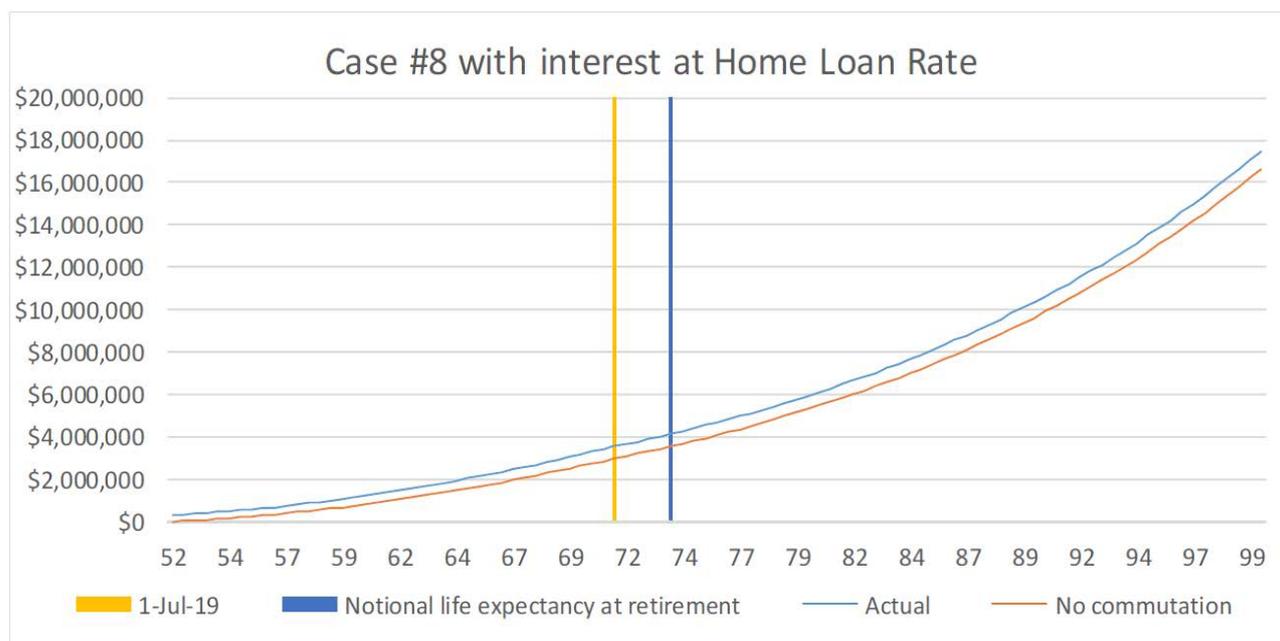


3.147. The results when modelling the use of a commutation lump sum to assist with purchase of a home show an even stronger financial benefit from commuting when compared to not commuting. The results are again broadly consistent between the two sets of modelling, even though the methodology used by the AGA and KPMG is different as outlined above.

3.148. Figure 10 shows the results of the KPMG modelling of using the commutation lump sum for the purchase of a house, again using the same set of figures. There is no 'break-even' point as the orange and blue lines do not cross before age 100 (the limit of the modelling).

<sup>84</sup> AGA report, p. 28.

Figure 10—KPMG modelling outcome—Case #8 Home loan scenario<sup>85</sup>

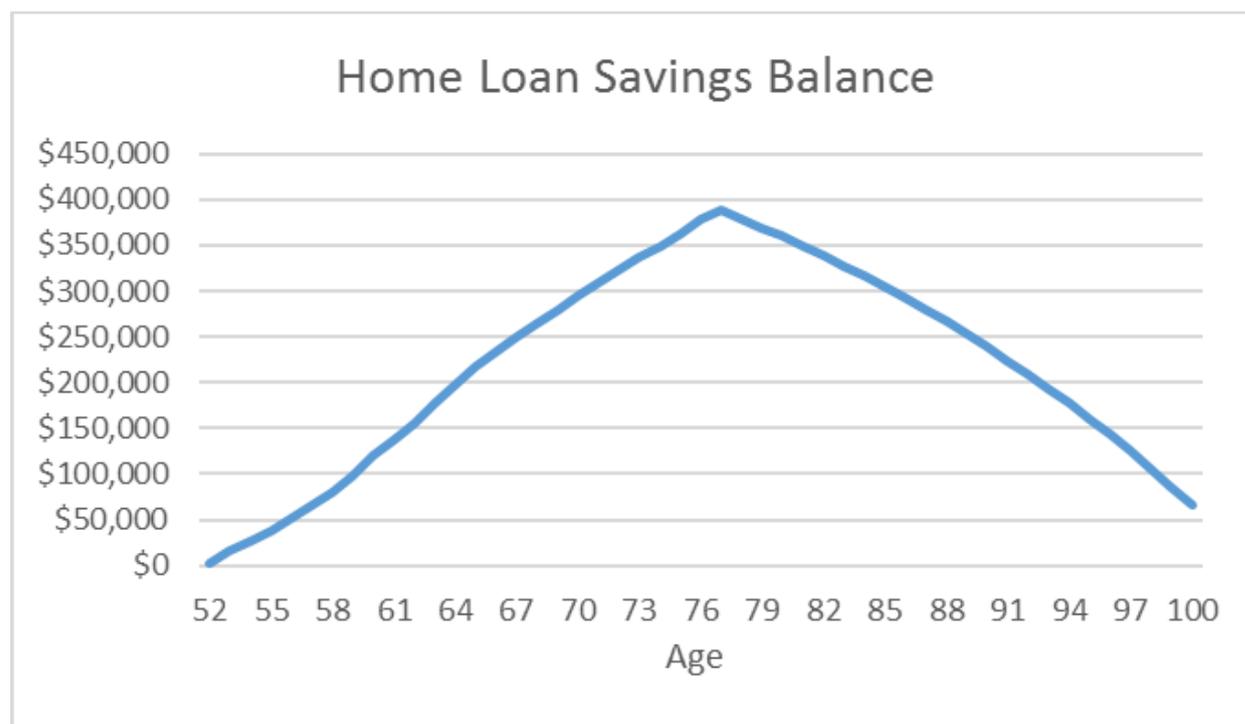


3.149. Figure 11 shows the results of the AGA modelling of using the commutation lump sum for the purchase of a house. Again, there is no ‘break-even’ point before age 100, because the blue line does not reach the zero dollar axis on the chart.<sup>86</sup>

<sup>85</sup> KPMG report, p. 25.

<sup>86</sup> For comparative purposes, the AGA graph also ends at age 100, although it modelled beyond this age and found a break-even age for the home loan scenario in case #8 of 104 (AGA report, p. 12).

Figure 11—AGA modelling outcome—Person #8 Home loan scenario<sup>87</sup>



3.150. Despite the ADF’s defective administration in providing incorrect information about the long-term effects of commutation decisions on retirement pay, the modelling suggests that it did not lead to financial detriment relative to the other available choice of not commuting. The modelling shows the opposite: that choosing to commute, even if on the basis of misleading information, would likely have been to a person’s financial benefit.

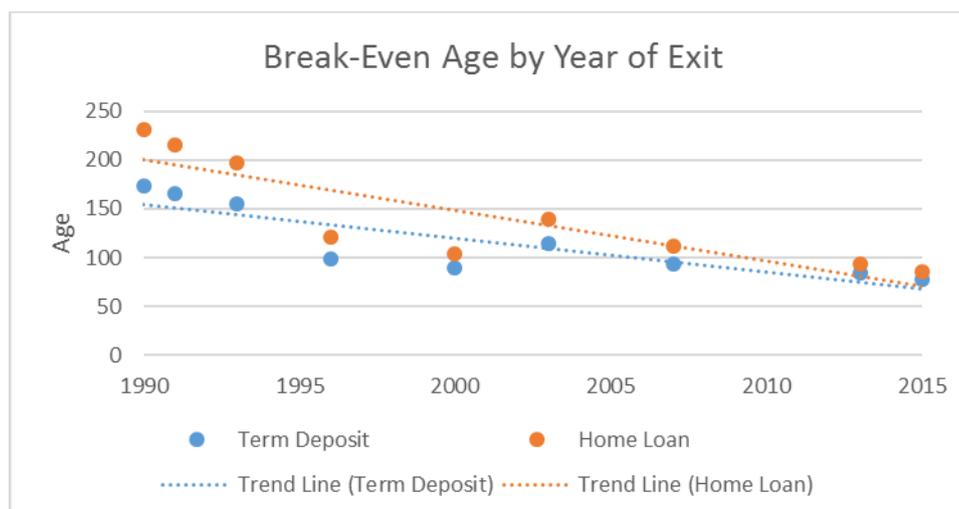
3.151. As can be seen in Figure 12, a member who discharged prior to 1990 is unlikely to ever suffer a financial detriment as a result of that decision, irrespective of whether the commuted amount was used to fund the purchase of a house or placed in a term deposit.

3.152. Figure 12 shows that a member who discharged between 1990 and 2010 may live to their ‘break-even’ age, and ultimately be better off having not commuted. This would only arise if they live well beyond current life expectancy (currently approximately 80 years for males and 84 for females).<sup>88</sup> As noted above, this is based on conservative modelling scenarios—in particular, the modelling shows that it is unlikely that any person discharging in this period would have been better off not commuting compared to using the commutation amount to fund the purchase of a house.

<sup>87</sup> AGA report, p. 28.

<sup>88</sup> Australian Bureau of Statistics Life Expectancy Tables, at <https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3105.0.65.0012014?OpenDocument>, accessed 19 September 2019.

Figure 12—‘Break-even’ age by year of exit<sup>89</sup>



3.153. It is also important to note that even in the conservative scenarios modelled, the modelling suggests the earliest *year* in which a ‘break-even’ age may be reached is 2037. While we did not model each individual who provided a submission, the modelling suggests that even if financial detriment is ever experienced, it is unlikely to occur until many years in the future (see Table 1).<sup>90</sup>

Table 1—‘Break-even’ year<sup>91</sup>

Case	Year of Exit	Age at exit	Break-Even Year (Term Deposit)	Break-Even Year (Home Loan)
1	1976	44	Never	Never
2	1976	38	Never	Never
3	1986	37	Never	Never
4	1990	48	2116	2173
5	1991	36	2120	2171
6	1993	40	2108	2150
7	1996	49	2046	2068
8	2000	52	2037	2052
9	2003	39	2078	2103
10	2007	41	2059	2078
11	2013	60	2037	2046
12	2015	56	2037	2044

<sup>89</sup> AGA Report, p. 13.

<sup>90</sup> AGA Report, p. 12.

<sup>91</sup> AGA Report, p. 12.

3.154. The modelling does show that a person who discharged after 2010 may reach their 'break-even' age at or about their current *actual* life expectancy.<sup>92</sup> However, three points are important to note here:

- First, this still involves conservative modelling, using term deposit rates rather than the home loan scenario, and ignoring any tax implications or capital gains.
- Second, by this time, CSC had included information in its publications which explicitly stated that the reduction to retirement pay would be permanent, so that the written information being relied on by DFRDB members was now clear. Even if a person did receive incorrect information from Defence personnel, the information produced by CSC and provided to DFRDB members was capable of clearly correcting any misunderstanding.
- Third, the modelling also shows the earliest *date* a person retiring in this period would reach their 'break-even' age is 2037. This would mean there remains ample time for a person to plan for their retirement based on accurate information available to them, and to take steps to mitigate the risk of financial loss, such as by seeking financial advice.

3.155. It is possible, of course, that some individuals may have made poor decisions about what to do with their lump sum. Equally, poor decisions could have been made by individuals about how to spend their fortnightly retirement pay, irrespective of whether the person commuted or not.

3.156. However, for most people, the real-life benefit from commuting is likely to far exceed the outcomes modelled, for the reasons described above.

3.157. It is true this benefit got less over time, for those who discharged more recently, and also for those who discharged at a later age. However, the modelling does not identify any cohort of people who commuted and made appropriate, if conservative, use of the benefit, who can point to both defective administration and a financial detriment relative to the only other option available under the DFRDB Act, namely to not commute.

3.158. Nevertheless, because our modelling has not considered people's individual circumstances, we cannot rule out the possibility, however unlikely, that there may be one or more individuals who can point to actual overall financial detriment caused by the defective administration. In these circumstances, we consider that the CDDA scheme is the appropriate mechanism for such cases to be considered. To avoid raising false hope and to facilitate streamlined processing of any claims under that scheme, we have included at Appendix F a list of considerations we suggest would need to be satisfied before a CDDA claim would need to be assessed.

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<sup>92</sup> Australian Bureau of Statistics, October 2018, Life tables, States, Territories and Australia, 2015-2017 at <https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3302.0.55.0012015-2017?OpenDocument>, accessed 19 September 2019.

## Part 4: ISSUES ARISING FROM THE INVESTIGATION – INDEXATION

### Overview

4.1. Indexation is the process by which pensions are increased over time, according to a statutory formula.

4.2. We received many submissions from DFRDB members who were dissatisfied with indexation arrangements. The issues fell broadly into two categories:

- concerns that the current statutory indexation formula leads to an increase in the commutation reduction over time
- concerns about the statutory formula as enacted by parliament.

4.3. Complaints that the statutory indexation formula increases the commutation reduction over time is in scope of this investigation. This is because, if the commutation reduction does increase over time it is necessary to look at whether this was clearly explained to DFRDB members so they could consider the impact before deciding to commute.

4.4. The indexation arrangements in the DFRDB Act are complex and have a complicated history. This section therefore seeks to explain the legislative framework, both what has changed over the years as well as how indexation currently works.

4.5. Concerns about the statutory formula as enacted by parliament are beyond the scope of this investigation. Nevertheless, it is clear from the submissions we received, that there is a high level of confusion and dissatisfaction with current policy settings as expressed through the statutory arrangements and many members are hoping for legislative reform. Thus, while we have made no comments or findings on the suitability of the statutory formula we have included a section summarising the concerns raised by submitters. Given uncertainty in the DFRDB member cohort, it may be appropriate for government to make its position clear on this issue.

### Legislative background

4.6. While the predecessor DFRB scheme was operating, pensions were not regularly indexed. Rather pensions were increased by government decision.

4.7. When it was passed by parliament in 1973 there was no provision in the DFRDB Act that allowed for pensions to be increased. DFRDB pension increases were authorised by separate annual Acts between 1 October 1972 and mid-1976. The indexation basis was the lesser of 1.4 times the increase in the CPI, or increases in male average weekly earnings.<sup>93</sup>

4.8. In 1977 the DFRDB Act was amended by the *Defence Force (Retirement and Death Benefits Amendments) Act 1977*, which inserted Part XA into the DFRDB Act. This change allowed the pension to be indexed from 1 July 1976. As a result, pensions were increased if

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<sup>93</sup> See *Defence Forces Retirement Benefits (Pension Increases) Act 1973*, s 4(2), and *Defence Force Retirement and Death Benefits (Pension Increases) Act 1976*, ss 6-7, for increases between 1973–74 and 1975–76.

there was an upward movement in the Consumer Price Index (CPI). Pensions were not decreased if there is a downward movement in the CPI.

4.9. The *Superannuation and Other Benefits Legislation Amendment Act 1986* temporarily reduced the annual CPI indexation by 2 per cent from 23 October 1986 until 20 October 1989, at which point the published CPI indexation was once again applied each year.<sup>94</sup>

4.10. From 1 January 2002, retirement pay indexation frequency was increased to twice a year.<sup>95</sup>

4.11. In 2014, the *Defence Force Retirement Benefits Legislation Amendment (Fair Indexation) Act 2014* added Division 3 of Part XA of the DFRDB Act. Generally speaking, the purpose of this Division, which applies to pensioners who are over 55 years of age, is to ensure DFRDB indexation arrangements for this group operates similarly to the indexation arrangements that apply to the age pension.

## How indexation works

4.12. Indexation is applied in January and July each year.<sup>96</sup>

4.13. For members who are under 55, the relevant indexation rate is the Consumer Price Index (unless the CPI is negative, in which case the pension is unchanged. This ensures pensions are not reduced if there is downward movement in the CPI).

4.14. For members who are 55 and over, the relevant indexation rate is the higher of CPI or the Pensioner and Beneficiary Living Cost Index. There is an additional safeguard which means the increase must be sufficient to ensure a hypothetical 'indicative' pension does not fall below 27.7 per cent of Male Total Average Weekly Earnings.<sup>97</sup>

### ***How does commutation impact the indexation rate?***

4.15. A member's retirement pay is not indexed in full if the person did not commute, or commuted less than four times their annual retirement pay.

4.16. The DFRDB Act provides that if a person *did not* commute (or commuted a sum which was less than four times their annual retirement pay entitlement), the amount by which their retirement pay is increased is determined by applying the relevant indexation rate *to the*

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<sup>94</sup> The Parliamentary Library observed: 'These actions were undertaken as a budget measure in response to the unusually high rates of inflation of the period combined with a shortfall in government revenue. The rates of increase in CSS pensions were also discounted in the same way during this period', January 2008, Research Paper No. 16 2007-08, Military superannuation myths and reality, at [https://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/rp/RP0708/08rp16#\\_ftn39](https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/RP0708/08rp16#_ftn39), accessed 26 September 2019.

<sup>95</sup> *Superannuation Legislation Amendment (Indexation) Act 2001*.

<sup>96</sup> DFRDB Act s 98B—Increase in certain pensions.

<sup>97</sup> DFRDB Act s 98GA provides an overview: Each 1 January and 1 July, the amount of the hypothetical pension, as indexed by the higher of CPI and LCI, is compared with what the amount of the hypothetical pension should be if it is to continue to be at least 27.7 per cent of MTAW. If the CPI/LCI result is higher than the MTAW result, the 55-plus percentage is the higher of the percentage movements in CPI and LCI. If the MTAW result is higher, the 55-plus percentage is the percentage increase needed to maintain the hypothetical pension at 27.7 per cent of MTAW.

*retirement pay they would be receiving if they had commuted four times their annual retirement pay entitlement.*<sup>98</sup>

4.17. In effect, the DFRDB Act operates to divide a person's annual retirement pay into two portions—one which is indexed and one which is not. The amount of these portions are connected to the amount the person can commute:

- The maximum portion of retirement pay which is *indexed* is the amount of retirement pay which would be payable if they had decided to commute four times their annual retirement pay entitlement. This is the case regardless of whether they:
  - actually commuted or not, or
  - commuted more, less or exactly four times their annual pension.

For the purposes of this report, this portion is the '*indexed retirement pay*'.

- An *unindexed* portion of retirement pay is only payable if the person commutes less than four times their annual retirement pay entitlement, which we refer to as '*unindexed retirement pay*' (see Figure 13).

4.18. Prior to 1983, the maximum amount a retiring member could elect to commute was four times their annual retirement pay entitlement. This means a person could commute some or all of their *unindexed* retirement pay, but commutation did not impact their *indexed* retirement pay.

4.19. This had the practical effect that a member's annual pension increased by the same dollar amount each year, regardless of whether and how much they commuted. This is because the person was receiving the same dollar amount of *indexed* retirement pay (to which the indexation factor was applied). If they commuted less than the maximum four times their annual pension, they would receive an additional amount each year, but this would be a portion of their *unindexed* retirement pay, and therefore was fixed from year to year.

4.20. Between 1983 and 2002 the maximum amount that could be commuted was increased by 0.05 times annual retirement pay each year.<sup>99</sup> However, the DFRDB Act was not also amended to increase the unindexed portion of retirement pay to align with the new maximum amount that could be commuted.

4.21. Accordingly, the indexed portion of retirement pay has remained at the amount of retirement pay which would be payable annually if a person had decided to commute four times the annual retirement pay entitlement, even though since 1983 a person can commute *more* than four times.

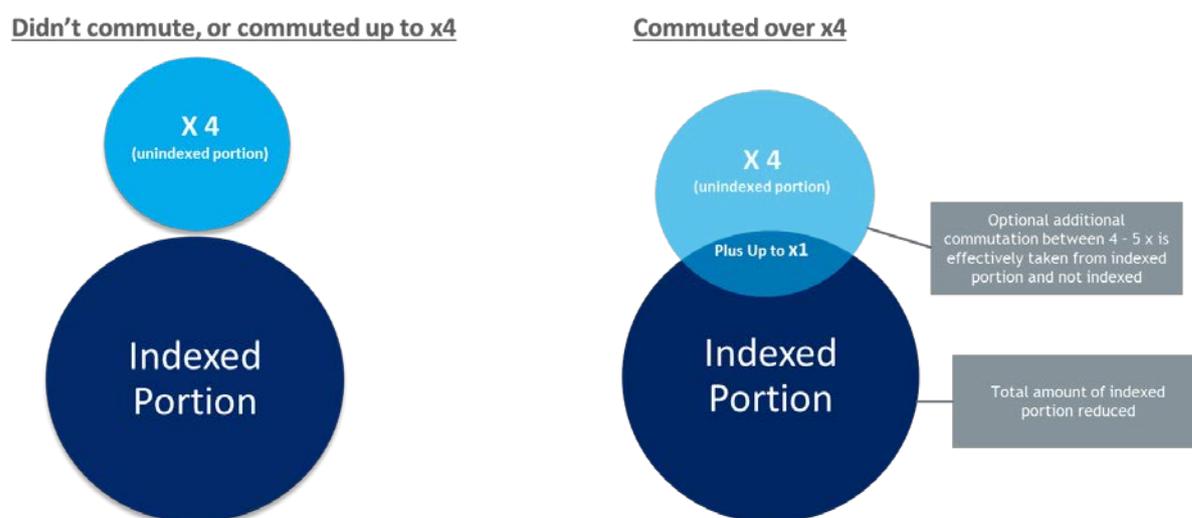
4.22. In effect, a person who elected to commute more than four times their annual retirement pay is exchanging a portion of their indexed retirement pay, as illustrated in Figure 13.

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<sup>98</sup> DFRDB Act s 98B(4)(b). If the current recipient did not commute four or more times their annual retirement pay, indexation applies to the notional rate they would have received if they had commuted four or more times their retirement pay.

<sup>99</sup> *Defence Legislation Amendment Act 1984*.

Figure 13—Effect of commuting more than four times annual retirement pay



4.23. This means that a person who commuted more than four times their annual retirement pay would be left with an annual pension less than the maximum available indexed retirement pay.

**Why does this impact indexation?**

4.24. The indexation factor is applied twice a year to the *indexed* retirement pay the person is receiving.

4.25. For people who did not commute, or who commuted an amount less than or equal to four times their annual retirement pay, they are receiving the full indexed retirement pay. Therefore, the indexation factor is applied to that full amount.

4.26. However, where a person commutes more than four times their annual retirement pay, they are receiving *less* than the full indexed retirement pay. In this case, indexation is only applied to the actual pension paid. Therefore the indexation factor is applied to that lower amount.

4.27. The modelling performed by the AGA and KPMG took into account the actual indexation as described in the DFRDB Act.

4.28. The following table illustrates the operation of indexation, according to the commutation decisions made by the member:

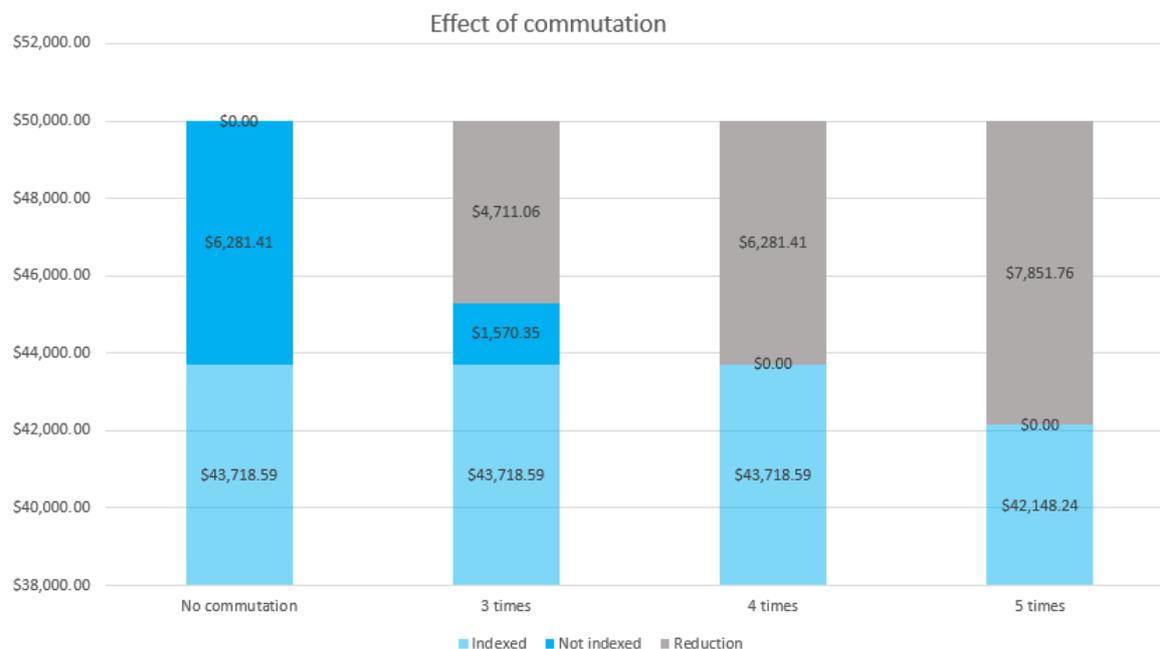
Figure 14—Commutation options

Decision	Retirement benefit comprises
Does not commute	<ul style="list-style-type: none"> <li>• No lump sum</li> <li>• Ongoing annual retirement pay is partly indexed                             <ul style="list-style-type: none"> <li>○ The amount indexed is the amount of retirement pay the person <i>would have</i> received if they commuted four times their retirement pay entitlement <i>is</i> indexed</li> <li>○ Remaining retirement pay <i>is not</i> indexed</li> </ul> </li> </ul>
Commutes less than 4 times (e.g. 3 times)	<ul style="list-style-type: none"> <li>• Receives lump sum of (e.g.) three times their annual retirement pay</li> <li>• Ongoing annual retirement pay, reduced using the statutory formula, is partly indexed:                             <ul style="list-style-type: none"> <li>○ The amount of retirement pay the person <i>would have</i> received if they commuted four times their retirement pay entitlement <i>is</i> indexed</li> <li>○ Remaining retirement pay <i>is not</i> indexed.</li> </ul> </li> </ul>
Commutes exactly 4 times	<ul style="list-style-type: none"> <li>• Receives lump sum of four times their annual retirement pay entitlement</li> <li>• Ongoing annual retirement pay, reduced using the statutory formula, is fully indexed.</li> </ul>
Commutes more than 4 times (e.g. 5 times)	<ul style="list-style-type: none"> <li>• Receives lump sum of (e.g.) five times their annual retirement pay entitlement</li> <li>• Ongoing annual retirement pay is reduced using the statutory formula</li> <li>• The reduced retirement pay is fully indexed, but is <i>less</i> than the amount indexed under each of the above scenarios.</li> </ul>

4.29. To demonstrate, the following chart shows how different commutation factors have an impact on the indexed and unindexed portions of the retirement pay. The following assumptions apply:

- Person is 40 year old male, with a commutation divisor of 31.84
- Pre-commutation retirement pay is \$50,000

Figure 15 – Effect of commutation



### What were members told?

4.30. In response to a request for information, CSC provided us with copies of approved publications about the DFRDB scheme, including brochures, booklets and letters provided to members.

4.31. Members who elected to commute a portion of their retirement pay were advised the dollar figure for the rate of retirement pay they would receive if they did not commute. They were also given the dollar figure of their new reduced rate of retirement pay if they were to elect to commute.

4.32. Brochures produced by CSC explained how the pre commutation retirement pay rates were calculated and included the methodology used to calculate the reduction to retirement pay.

4.33. Each brochure has a section explaining pension increases. The explanation provided, which varied over time, is that retirement pay increases are based on the upward movement of the Consumer Price Index.

4.34. Brochures published after 1985 explain that retirement pay increases are also based on the amount of retirement pay that would be applicable if four times the amount of retirement pay been commuted.

4.35. The brochures and booklets do not explicitly state the impact of commuting more than four times the annual dollar amount of retirement pay, and in particular, that the annual increases to the member's retirement pay will be less than if they commute four times or less.

## Analysis

4.36. We are satisfied, in the absence of any contrary information, that indexation has been properly applied to DFRDB pensions by the administrators.

4.37. For people who commute up to four times the amount of their retirement pay, the difference between what they receive and what they would have received if they had not commuted (the 'commutation reduction amount') is fixed—it remains the same dollar amount from year to year throughout their life, unaffected by indexation.

4.38. However, a person who commutes more than four times the amount of their retirement pay has a smaller amount of indexable retirement pay (as a result of the initial reduction). This means the difference between their retirement pay and the retirement pay they would have received if they had not commuted will grow over time in accordance with the indexation factor.

4.39. The provisions for indexation in the DFRDB Act are extremely complex which is not uncommon across Commonwealth law. This is why it is good administrative practice for agencies administering those complex laws to explain them in a way lay people can understand.

4.40. The information provided by CSC did not advise the longer term consequences of electing to commute more than four times a person's retirement pay. In particular, this information could have made clearer that doing so has the effect of commuting a portion of a member's *indexed* retirement pay, which in turn would lower the amount by which their remaining annual retirement pay would grow through indexation.

4.41. While we acknowledge that the impact of indexation is unlikely to be the primary motivator to the decision to commute or not, it is still important that people have all relevant information in front of them when making a decision. The more complex a legislative scheme, the more critical it is that administrators of the scheme provide plain language explanations of how it operates.

## Part 5: POLICY ISSUES RAISED WITH US

5.1. During the course of this investigation, many people raised issues with us that go to the policy design of the scheme itself. This goes beyond matters of administration which are part of this investigation.

5.2. However, as these issues have been raised with us, this section summarises the concerns of submitters which fell outside the scope of this investigation, to bring these matters to the Government's attention.

5.3. In addition to concerns about being misled, many submitters, including those who now understand that the reduction after commutation is permanent, have expressed dissatisfaction with the fact that legislation does not permit an increase to retirement pay on reaching life expectancy factor age.

5.4. Many members also felt that the commutation divisor and indexation benchmarks used in the DFRDB Act were unfair or inadequate. This section endeavours to summarise the views of submitters on these two issues.

5.5. We also observed confusion among members about how legislative provisions relevant to the commutation divisor and indexation operate. We have provided a further explanation below to assist in understanding of these aspects of the scheme (noting indexation is also discussed in Part Four).

### Expectation of life factor—the 'commutation divisor'

5.6. The 'expectation of life factor' is better described as a 'commutation divisor'. It is the divisor for the purposes of calculating a reduction to a person's retirement pay following commutation. It is found in a table in Schedule 3 to the DFRDB Act.

5.7. In effect the formula is as follows:

$$\text{Reduction} = \text{amount commuted} \div \text{commutation divisor}$$

5.8. The 'expectation of life factor' table in Schedule 3 creates the commutation divisor using the figures in the 1960-1962 life expectancy table published by the Australian Bureau of Statistics (ABS).<sup>100</sup> The legislation does not use the ABS table itself, but rather creates its own table based on the ABS table figures.

5.9. These figures have been the same since the DFRDB Act commenced in 1973. Members submitted that this was unfair, given the considerable increase in life expectancy since 1962.

5.10. It is understandable why members would prefer the use of later life expectancy figures. If the commutation divisor had increased in line with changes to life expectancy, the flow on effect would have been increased retirement pay for those who commuted (because a higher commutation divisor results in a smaller reduction).

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<sup>100</sup> For life expectancy tables from 1881 see Australian Bureau of Statistics 3105.0.65.001 *Australian Historical Population Statistics 2019*. For 1960–1962 figures see column I in Tables 6.2 (Males) and 6.6 (Females) at <https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3105.0.65.0012014?OpenDocument>, accessed 19 September 2019.

5.11. This option was open to the government and parliament of the day. The legislation could have provided for the use of a particular external actuarial table as updated from time to time.

5.12. However this was not the path that was chosen. This suggests that the scheme drafters never envisaged use of current tables, but rather, preferred a static commutation factor. With retrospect, if it had been formally named a ‘commutation divisor’ rather than a ‘life expectancy’ factor, it is possible the misunderstanding that ensued could have been avoided.

## **Indexation arrangements**

5.13. In 2014, the *Defence Force Retirement Benefits Legislation Amendment (Fair Indexation) Act 2014* was enacted so that retirement pay for members over 55 are now indexed in the same way as aged pensions (i.e. more beneficially).<sup>101</sup>

5.14. While these changes were broadly welcomed, some of the ex-service organisations we spoke to felt the 2014 changes did not go far enough:

- Some wanted to see these more beneficial arrangements also apply to the indexation arrangements for those DFRDB members who are under 55.
- Some also wanted to see 2014 retirement pay rates reset to a higher amount (i.e. calculating the pension that would have been payable in 2014 if those indexation arrangements had been in place since 1973), rather than the actual retirement pay levels in 2014 based on the actual indexation arrangements that had applied.

5.15. In addition, we heard concerns about the overall impact of commutation on indexation arrangements, which mean a portion of the annual retirement pay of a person who did not commute is not indexed (see Part Four above).

## **Observations**

5.16. The impact of the permanency of the commutation reduction, and the impact of commutation on indexation, have been addressed earlier in this report. Indexation arrangements more generally have been the subject of numerous government reviews and inquiries. There is no reason to believe that each of these issues are not the intended policy outcome following deliberate and considered government policy decisions.

5.17. Nevertheless, many members are dissatisfied with these government decisions and are hoping for change. It is understandable why any of these steps would, if applied, leave scheme members better off financially, with commensurate expense to the taxpayer.

5.18. We have seen letters and complaint responses from Ministers, Defence, CSC and local MPs sent to individual members which provide insight into the Government’s policy position to date. For example, in June 2018 the Office of the Hon Darren Chester MP wrote to one member noting the Government had enacted beneficial changes to indexation in 2014 and stated ‘*there are no plans to make further changes to the DFRB and DFRDB schemes*’.

5.19. Other correspondence draws attention to the fact that, if further changes are made to DFRDB, this may cause unfairness to members who decided not to commute. A temporary retirement pay reduction was never an option at law, so if the law were changed now to make it available, it could place commuters at an unfair advantage over those who understood the

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<sup>101</sup> How indexation works is explained in detail in Part 4 of this report.

scheme properly and chose not to commute. It may also cause unfairness to other current and former ADF members, for example those who chose to move to the MSBS scheme in the early 1990s based on the understanding the scheme was closing and would not be significantly reformed.

5.20. However, given the breadth of concern about these issues, it may be appropriate for the Government to publicly clarify its policy position to the broader DFRDB member cohort. In saying this, the Office makes no comment on the appropriateness of these policy settings, which are rightly the domain of government and parliament. We do, however, note that if changes are to be considered, the Government should have regard to the potential impact on other members, namely those who did not commute or transferred to other schemes.

## Part 6: CONCLUSION AND RECOMMENDATIONS

6.1. We have found historical deficiencies by Defence which warrant remedial action. While we have not found any errors by CSC, we have identified actions that may further improve communication about the long term effects of commutation on retirement pay.

### Defective administration by Defence

6.2. Defence personnel in administrative positions of authority provided incorrect information to DFRDB members about their retirement benefits. Many DFRDB members, likely numbering in the thousands, were misled to believe that the commutation related reduction to their retirement pay would cease upon reaching life expectancy factor age.

6.3. This information was misleading, and providing it amounted to defective administration by the ADF.

6.4. This defective administration resulted in disappointment, distress, anger and frustrated expectations for many DFRDB members. We consider remedial action is appropriate. Defence should acknowledge the wrong that was done and the impact this has had on some members of the scheme. The Secretary of Defence and Chief of Defence Force should issue an unreserved apology to DFRDB members.

#### Recommendation 1

1.1 The Secretary of Defence and Chief of Defence Force should issue an apology for the incorrect advice provided to some DFRDB members about the long term effects of commutation on retirement pay, and for the distress it caused.

1.2 The apology should be published on the Defence and CSC websites and be available to DFRDB members on request to Defence.

### Consideration of separate compensation scheme

6.5. Not all defective administration results in a compensable financial loss. Modelling has shown that the early access to capital provided by commutation is generally to the substantial benefit of DFRDB members, relative to the lawfully available alternative of not commuting. It also indicates that, where a person is not better off overall for having commuted, this is likely to be due to the member's subsequent choices about how to spend or invest the lump sum.

6.6. This means that a separate compensation scheme for all people who commuted is not appropriate, even if that incorrect or insufficient information may have caused a person to commute where they otherwise would not have.

### Outlying cases

6.7. We considered whether there could be outlying cases with circumstances that may warrant compensation under the CDDA scheme. We did not identify any cases where compensation would be appropriate (although our investigation has not involved review of the personal circumstances of each individual DFRDB member).

6.8. It would do a disservice to falsely raise hopes of compensation among the members. Futile claims result merely in further inconvenience and frustration to the member, and an

unnecessary use of public resources for assessment processes. However, as with any modelling process, we cannot rule out that an outlying case may exist.

6.9. We have therefore set out the criteria (Appendix F) that we think should be satisfied for a CDDA claim to have any chance of success. This may assist members to self-assess prior to lodging a CDDA claim, and may assist Defence to determine whether a claim needs to be fully assessed.

6.10. The principle underpinning these criteria is that, in the absence of evidence to the contrary, our report stands as a finding in relation to two of the core elements of a CDDA claim – that there *was* defective administration by Defence, and that the defective administration *did not* cause financial detriment.

6.11. These findings could be rebutted by a person being able to point to, with some evidence, specific financial detriment based on their individual circumstances.

6.12. This could be to explain why the modelling assumptions do not apply to their personal circumstances, or that there is another financial detriment directly caused by their reliance on the misleading information provided by Defence. Financial disappointment due to the scheme operating differently to how people were told, and loss due to the person's subsequent investment decisions or life events, would be unlikely to meet this test.

6.13. In our view, Defence decision-makers would be entitled to finalise any claim, without further detailed assessment, that does not clearly show on its face why the person's circumstances differ from the findings in this report.

### **Improvements to CSC information**

6.14. The information CSC provided was accurate and people could obtain information and confirm their understanding prior to making an election to commute. However, CSC messaging was not sufficiently explicit to correct the misunderstanding that had originated from within the ADF, because the nature of the misunderstanding meant that many:

- did not realise they needed to seek clarification from CSC and/or
- inadvertently read an alternative meaning into CSC's written materials which fitted with their understanding derived from ADF sources.

6.15. While CSC's information could have been clearer, it was accurate and cannot be said to have been defective.

6.16. However, while CSC's brochures have been improved on numerous occasions since 2004, we have identified some additional improvements to current forms and letters that may further assist to remove any doubt for DFRDB members that the commutation reduction is permanent.

6.17. While a lesser issue than the permanence of the reduction in pension, we have also identified that CSC's brochures could more clearly explain the impact of commutation on indexation arrangements :

**Recommendation 2**

2.1 Commutation election forms and standard letters (sent to members in advance of their retirement and immediately after commutation) should clearly explain commutation will result in a permanent reduction to retirement pay.

2.2 CSC should also identify whether there are any members who have discharged and have already received the existing standard letter, but who are still in time to either commute, or ask CSC to reverse their commutation election. CSC should write to this cohort to explain that commutation will result in a permanent reduction to retirement pay.

**Recommendation 3:**

3.1 CSC should amend its DFRDB About Your Scheme and Retirement Benefits publications to clearly explain there may be longer-term indexation related consequences of commuting more than four times the annual amount of retirement pay.

## **APPENDIX A—MINISTERIAL CORRESPONDENCE**



## The Hon Darren Chester MP

Minister for Veterans' Affairs  
Minister for Defence Personnel

Minister Assisting the Prime Minister for the Centenary of ANZAC

MS19-000686

Mr Michael Manthorpe PSM  
Commonwealth Ombudsman  
GPO Box 442  
CANBERRA ACT 2601

Dear Mr Manthorpe

On 25 March 2019, I announced, together with the Assistant Minister for Treasury and Finance, Senator the Hon Zed Seselja, an independent inquiry into the Defence Force Retirement and Death Benefits (DFRDB) superannuation scheme.

I intend that the inquiry will examine the accuracy of the information provided by scheme administrators and relevant departments to members of the DFRDB scheme.

The DFRDB scheme, which was established in 1972 and closed to new members in 1991, allowed members to commute (exchange) part of their pension for a lump sum.

There are different views within the veteran community about certain provisions within the scheme and the accuracy of information provided to members, particularly in relation to commutation.

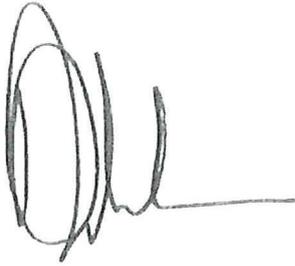
The current scheme administrator is the Commonwealth Superannuation Corporation. Prior to 1 July 2015, CSC was the Trustee and ComSuper was the administrator. ComSuper was previously known as the Australian Government Retirement Benefits Office and the Board was the DFRDB Authority. Commonwealth Superannuation Corporation took on the Board function in 2011 following the establishment of the *Governance of Australian Government Superannuation Schemes 2011*.

Noting your independent role as both Commonwealth Ombudsman and the Defence Force Ombudsman, I consider you would be well placed to investigate these issues under the own motion powers of the *Ombudsman Act 1976*, and this view has been supported by the members of the Ex-Service Organisations Round Table held by the Department of Veterans' Affairs. Accordingly, I ask that you consider undertaking an investigation to bring resolution to this important matter.

My Department will be available to assist you as needed. My contact in the Department is Mr Patrick Hetherington, First Assistant Secretary, People Policy and Culture Division. Mr Hetherington can be contacted on [REDACTED]

I thank you for considering my request.

Yours sincerely

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

**DARREN CHESTER**

Encl

0 5 APR 2019

File ref: qA32890

18 April 2019

The Hon Darren Chester MP  
Minister for Veterans' Affairs  
Minister for Defence Personnel  
Minister Assisting the Prime Minister for the Centenary of ANZAC  
Parliament House  
CANBERRA ACT 2600

Cc: Mr Greg Moriarty, Secretary of Defence  
Ms Liz Cosson AM CSC, Secretary of Department of Veterans' Affairs

Dear Minister

**Investigation into the Defence Force Retirement and Death Benefits superannuation scheme**

Thank you for your letter of 5 April 2019 requesting that I commence an own motion investigation into the Defence Force Retirement and Death Benefits (DFRDB) superannuation scheme.

Following consultation with the Department of Defence and having considered your request, I have decided, under paragraph 5(1)(b) of the *Ombudsman Act 1976* to commence an own motion investigation into the accuracy of information provided by scheme administrators and relevant departments to DFRDB scheme members in relation to commutation.

Prior to commencing the investigation, my officers will engage with the Department of Defence to reach agreement on appropriate funding arrangements for this investigation. We will also consult with the Department of Defence and the Commonwealth Superannuation Corporation (CSC), as the scheme administrators, on the scope of the investigation.

Throughout the course of the investigation, my Office will work closely with your department, DVA and the relevant scheme administrators. We will also invite affected DFRDB members to provide information to contribute to our investigation. I anticipate the investigation will be completed by the end of 2019.

If you would like to discuss the DFRDB investigation, you are welcome to contact me directly on [REDACTED]. Alternatively, officers from your department can contact Mr Paul Pfitzner, Senior Assistant Ombudsman, on [REDACTED].

Yours sincerely



Michael Manthorpe PSM  
Commonwealth Ombudsman

*Influencing systemic improvement in public administration*

## **APPENDIX B—DVA RESPONSE**



Australian Government

Department of Veterans' Affairs

OFFICE OF THE SECRETARY  
PRESIDENT REPATRIATION COMMISSION

EC19001015

Mr Michael Manthorpe PSM  
Commonwealth Ombudsman  
GPO Box 442  
CANBERRA ACT 2601

Dear Mr Manthorpe *Michael,*

Thank you for your letter of 8 July 2019, about your Own Motion investigation into the administration of Defence Force Retirements and Death Benefits (DFRDB) commutation. I welcome the opportunity to provide information about any commutation advice given to DFRDB members by the Department of Veterans' Affairs (DVA).

There are a significant number of veterans who have received or currently receive DFRDB benefits. Many of these veterans would be in receipt of DVA entitlements, and some of these entitlements require means testing, which includes income from defined benefit superannuation schemes, such as DFRDB.

From time to time delegates from our income support area provide information to a veteran, or their representative, regarding how a DFRDB income stream or commutation may affect the rate of a means tested pension. These delegates do not, however, provide advice to DFRDB members regarding the operation of commutations. If a specific query is raised, a delegate would direct the client to the Commonwealth Superannuation Corporation (CSC) for advice.

Searches of our system records also suggest that any information given to clients about DFRDB and commutation is limited to general information. We have noted various Ministerial Correspondence documents that contain references to DFRDB and commutation. From the sample undertaken, the information provided in responses from DVA is limited to general statements about the effect of DFRDB on certain pensions and entitlements.

In the 1990s, DVA operated a Veterans Affairs Financial Information Service (VAFIS), which provided a financial advice service similar to the Department of Human Services' (DHS) Financial Information Service. The service was set up to assist veterans in understanding legislative changes to income and assets tests, but was eventually abolished. Unfortunately information about VAFIS and how it recorded client engagement is no longer available due to the passage of time. However, it is my understanding that, like the DHS Financial Information Service, which our clients are also entitled to use, the service provided information about the impacts of financial decisions but did not provide tailored financial advice.

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*Saluting Their Service*

While it is not possible to unequivocally state that DVA has never provided advice to clients about DFRDB commutation, our investigations show that the departmental approach has been to direct specific enquiries to CSC or Defence.

I hope this information assists your office with its investigation. If you require any additional information from my department, you are welcome to contact me directly, or alternatively your investigation team can contact [REDACTED] Assistant Director, Portfolio Assurance Coordination and Reporting section, on [REDACTED].

I thank you for the ongoing commitment from your office in working with us towards positive outcomes for our veterans and their families.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Liz Cosson', with a stylized flourish extending to the right.

**Liz Cosson AM CSC**  
Secretary

13 August 2019

## **APPENDIX C—DEFENCE RESPONSE**



**Australian Government**

**Department of Defence**

PO Box 7900 CANBERRA BC ACT 2610

EC19-005771

Mr Michael Manthorpe PSM  
Commonwealth Ombudsman  
GPO Box 442  
CANBERRA ACT 2601

Dear Mr Manthorpe

Thank you for your letter of 25 October 2019 regarding your investigation into the administration of the Defence Force Retirement and Death Benefits (DFRDB) Scheme.

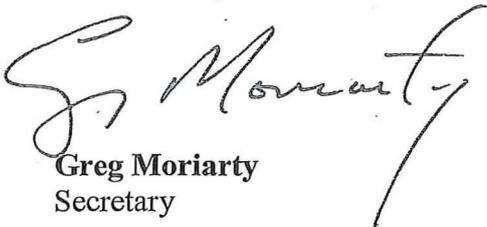
We thank you for the opportunity to comment on your report.

Defence notes that the investigation examined a large number of historical cases regarding the DFRDB Scheme and steps have been taken by the Department in recent years to minimise the likelihood of incorrect information being disseminated about commutation of retirement pay. It was encouraging to see that the report was unable to identify any cases where a financial loss occurred as a result of any inaccurate information having been provided to DFRDB Scheme members. We acknowledge, however, that some information provided to members in the past may have caused confusion and distress amongst members.

Defence values its workforce and veterans highly and seeks to provide the highest level of support, particularly on transition from the ADF to civilian life. Defence will continue to work with the Commonwealth Superannuation Corporation (CSC) to ensure that our members and veterans are well informed about their retirement options.

A letter to DFRDB members is at Enclosure 1 for publication in your final report and it will also be posted on both the Defence and CSC websites, and available to DFRDB members on request.

Yours sincerely



Greg Moriarty  
Secretary



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

18 November 2019

18 November 2019

**Enclosure:**

1. Letter to DFRDB members

## **APPENDIX D—DEFENCE APOLOGY TO DFRDB MEMBERS**



**Australian Government**

**Department of Defence**

PO Box 7900 CANBERRA BC ACT 2610

EC19-006342

**DFRDB Members**

Dear DFRDB member

On 10 April 2019, the Commonwealth Ombudsman, Mr Michael Manthorpe PSM, decided to commence an own motion investigation into the accuracy of information about commutation of retirement pay provided to members of the Defence Force Retirement and Death Benefits (DFRDB) by scheme administrators and relevant departments. The scope of the investigation was limited only to the administration of the DFRDB scheme.

The Ombudsman found that, on occasions in the 1980s and 1990s, information that was disseminated to some DFRDB members on the long term impact of commutation was incorrect. From the early 2000s onwards Defence has provided members with the correct information regarding commutation and all Commonwealth Superannuation Corporation (CSC) publications were rectified in 2004. Drawing on expert actuarial examination, the Ombudsman also found that the incorrect information was unlikely to have caused financial detriment to members.

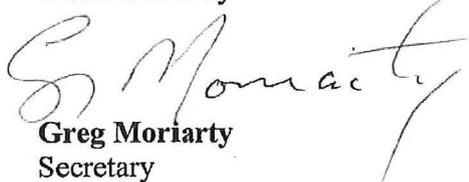
While it would have been provided by well-meaning administrators and managers, it was incumbent on Defence to ensure the accuracy of the information provided. We apologise for providing incorrect advice to some DFRDB members and for the confusion and emotional impact that it may have caused.

Defence values its workforce and veterans highly, and always seeks to provide the highest level of support, particularly on transition from the ADF to civilian life. As superannuation is a complex subject, members have been encouraged to seek the most accurate information from CSC (or its predecessors), and Defence also continues to educate our administrators and managers on such matters.

While the Ombudsman found that a decision to commute was unlikely to have resulted in overall financial detriment, should you believe you experienced an actual loss due to your reliance on information that was incorrect, you may apply for Compensation for Detriment caused by Defective Administration (CDDA). Guidance for applying under the CDDA scheme is available at <https://www.defence.gov.au/Legal/Directorates/dsfc.asp>.

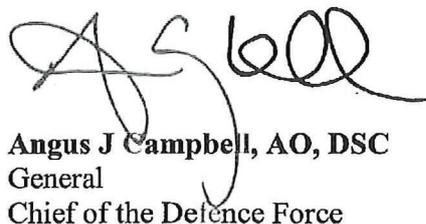
We thank our veterans for their service, and their families for the support provided to them.

Yours sincerely



**Greg Moriarty**  
Secretary

3 December 2019



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

3 December 2019

## **APPENDIX E—CSC RESPONSE**



20 November 2019

Mr Michael Manthorpe PSM  
Commonwealth Ombudsman  
GPO Box 442  
Canberra ACT 2601

Dear Mr Manthorpe

Thank you for providing your Office's draft report on the Administration of the DFRDB Scheme. CSC is pleased the Ombudsman conducted an investigation, as we understand DFRDB commutation is a key concern for our customers.

CSC acknowledges the issues raised in the report and appreciates your recognition of CSC's unique operating environment, as an entity that received responsibility for DFRDB administration relatively recently, in 2015.

Noting that your report does not find any defective administration by CSC, CSC accepts the recommendations from your report in full and will implement these opportunities for improvement as soon as practicable. CSC is determined to continually improve the way we administer the superannuation funds for which we are the trustee, and we are committed to striving for the best possible outcomes for all of our valued customers.

CSC is committed to being open and transparent. During this investigation, we have fully co-operated with your staff, sourced complex data from multiple systems and provided historical documents spanning five decades. I acknowledge the CSC staff who have at all times exhibited their professionalism, expertise and commitment to the task of providing your office with the information that was sought.

We appreciate you providing CSC the opportunity to comment on the draft report and for the professionalism of your staff throughout the investigation process. Please contact me at any time if you would like to discuss this important issue.

Yours sincerely

for  
Peter Carrigy-Ryan  
Chief Executive Officer



Commonwealth  
Superannuation  
Corporation

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## APPENDIX F—CDDA CONSIDERATIONS

### Purpose of this Appendix

Despite the finding of defective administration in this report, modelling indicates that compensation is unlikely to be payable to many (if any) DFRDB members, because a decision to commute is unlikely to have resulted in financial detriment.

However, because modelling does not consider a person's individual circumstances, it is theoretically possible that a person may be able to demonstrate financial detriment in their own specific circumstances.

If such a case exists, the Scheme for Compensation for Detriment caused by Defective Administration (CDDA scheme) is an appropriate avenue for assessing whether compensation may be payable.

Some DFRDB members have already experienced financial disappointment due to defective government administration. Given our view that few, if any, would be likely to qualify for CDDA compensation, we are concerned that the possibility of futile claims may lead to further inconvenience and disappointment to DFRDB members.

Decisions under the CDDA scheme are ultimately a matter for authorised decision-makers (in this case, within Defence) applying the CDDA guidelines published by the Department of Finance.<sup>102</sup>

We have outlined below our views on how the findings in this report might assist in the assessment of CDDA claims against these guidelines. Our hope is it will help members understand what might realistically be required for a successful claim and facilitate streamlined assessment of any CDDA claims by Defence.

### Considerations for DFRDB members

The following is not an exhaustive list of the requirements for a successful CDDA claim, but rather our view on matters you should consider before making a claim.

In our view, for a claim to have any chance of success, you would need to demonstrate (supported by evidence) why your circumstances are different to the outcomes modelled in this report.

This means you either need to demonstrate that:

- your **decision to commute** resulted in an **overall** financial detriment (based only on the options permitted under the legislation) **in your particular circumstances**, or

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<sup>102</sup> Department of Finance, November 2018, *Scheme for Compensation for Detriment caused by Defective Administration*, Resource Management Guide No 409 <https://www.finance.gov.au/individuals/discretionary-financial-assistance/scheme-compensation-detriment-caused-defective-administration-cdda-scheme> accessed 8 November 2019.

- you made a **later decision** which resulted in a financial detriment ***directly caused by*** the misleading information provided by Defence.<sup>103</sup>

**Important:** financial detriment:

- *must* be shown to have been caused by the misleading information
- *must not* be the result of other factors, such as subsequent spending and investment decisions, unforeseen life events or poor financial advice.

You would also need to meet all the criteria set out in the CDDA guidelines to qualify for compensation and you may be required to provide evidence to support your assertions.

### **Considerations for CDDA decision-makers in Defence**

In our view, this report can be treated as a starting point for CDDA decision-makers. This means decision-makers can be satisfied, in the absence of evidence to the contrary, that both:

- **there *was* defective administration** due to misleading information about commutation benefits (further evidence of the misleading statement should not generally be required)
- unless the member is able to provide a plausible explanation of why their circumstances fall outside the circumstances modelled in this report, the defective administration **did *not* cause financial detriment**.

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<sup>103</sup> For later decisions, it must also have been reasonable to still rely on the original misrepresentation, despite the passage of time.

## APPENDIX G—GLOSSARY

<b>Australian Defence Force (ADF)</b>	The military organisation which is responsible for the defence of Australia and its national interests. It consists of three branches, including the Australian Army, the Royal Australian Air Force and the Royal Australian Navy.
<b>Commonwealth Superannuation Corporation (CSC)</b>	The agency which currently manages and administers the DFRDB Scheme, as well as other superannuation funds designed specifically for Australian Government and ADF members.
<b>Consolidated Revenue Fund (CRF)</b>	A fund established by s 81 of the Constitution, consists of all revenues and moneys raised or received by the executive government of the Commonwealth. The CRF is self-executing in nature, which means that all money received by the Commonwealth automatically forms part of the CRF. <sup>104</sup>
<b>Consumer Price Index (CPI)</b>	The CPI measures the changes in the price of a fixed basket of goods and services, acquired by household consumers who are resident in the eight State/Territory capital cities. <sup>105</sup>
<b>Defined Benefit Scheme</b>	A scheme where entitlements are set by a predetermined formula and does not depend solely on contributions and investment returns.
<b>Department of Defence (Defence)</b>	Australian Government department which is responsible for defending Australia and its national interests. The department serves the government of the day through efficiently and effectively carrying out the government's Defence policy. <sup>106</sup>
<i>Defence Forces Retirement Benefits Act 1948</i> (DFRB Act)	The Act of Parliament which established the DFRB scheme. The DFRB Act specifies requirements for eligibility to and administration of entitlements under the scheme.
Defence Forces Retirement Benefits scheme (DFRB scheme)	A scheme to provide retirement benefits, including a defined benefit pension, to certain members of the Australian Defence Force who met minimum length of service requirements (ordinarily, 20 years). Eligible members could, in limited circumstances, commute a portion of their defined benefit pension to a lump sum when they discharged. The scheme commenced in 1948 and closed to new entrants from 30 September 1972.

<sup>104</sup> Department of Finance—<https://www.finance.gov.au/resource-management/pgpa-glossary/consolidated-revenue-fund>, accessed 21 October 2019.

<sup>105</sup> Australian Bureau of Statistics—<https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/6467.0Feature+Article1Mar+2017>, accessed 21 October 2019.

<sup>106</sup> Department of Defence—<https://www.defence.gov.au/AboutUs.asp#role>, accessed 21 October 2019.

<p><b>Defence Force Retirement and Death Benefits Act 1973 (DFRDB Act)</b></p>	<p>The Act of Parliament which established the DFRDB scheme. The DFRDB Act specifies requirements for eligibility to and administration of entitlements under the scheme.</p>
<p><b>Defence Force Retirement and Death Benefits scheme (DFRDB scheme)</b></p>	<p>A scheme to provide retirement benefits, including a defined benefit pension, to certain members of the Australian Defence Force who met minimum length of service requirements (ordinarily, 20 years). Eligible members had an unfettered option to commute a portion of their defined benefit pension to a lump sum when they discharged. The scheme commenced in October 1972 and closed to new entrants in October 1991.</p>
<p><b>Defence Force Retirement and Death Benefits Authority (DFRDB Authority)</b></p>	<p>The authority which was responsible for managing and administering the DFRDB Scheme prior to the Commonwealth Superannuation (CSC) assuming responsibility in 2011.</p>
<p><b>Funded Scheme</b></p>	<p>A funded scheme must be able to meet all of its current and future obligations to retirees, and must have sufficient assets to provide for all accrued benefits. A funded scheme depends on capital contributions and returns on its investments to achieve stability</p>
<p><b>Government administration</b></p>	<p>The steps taken by government departments and agencies to implement:</p> <ul style="list-style-type: none"> <li>• the laws passed by parliament</li> <li>• departmental policy</li> </ul> <p>The Ombudsman’s role is to investigate government administration.</p>
<p><b>Departmental policy guidelines</b></p>	<p>Guidelines developed by departments to guide officials in how to apply the legislation and laws created by parliament and the courts.</p> <p>These ‘policy guidelines’ may be published publically or may be internal. They are subordinate to legislation and are part of the administration of the legislation, so they can be investigated by the Ombudsman.</p> <p>Officials must also apply departmental policy guidelines, except where to do so would contravene legislation, or there are cogent reasons not to do so.</p>
<p><b>Government Policy Decisions</b></p>	<p>The approach a government has decided it will take in dealing with a particular issue. A government will often use legislation to implement a policy. Government policy decisions are not investigated by the Ombudsman.</p>

## Commonwealth Ombudsman—Investigation into the DFRDB scheme

<b>Living Cost Index</b>	A living cost index reflects changes over time in the purchasing power of the after-tax incomes of households. It measures the impact of changes in prices on the out-of-pocket expenses incurred by households to gain access to a fixed basket of consumer goods and services. <sup>107</sup>
<b>Male Total Average Weekly Earnings (MTAWE)</b>	A measure of average before tax earnings of all male employees including any overtime payments. It is calculated by dividing an estimate of male gross—before deductions—weekly total earnings by the number of male employees. MTAWE is a standard measure for wage levels and is enshrined in a range of legislation. For example, MTAWE is used as a benchmark in setting pensions. <sup>108</sup>
<b>Own Motion</b>	The Commonwealth Ombudsman in accordance with s 5(1)(b) of the <i>Ombudsman Act 1976</i> may, of his or her own motion, investigate any action, being action that relates to a matter of administration, by a government department or by a prescribed authority.
<b>Scheme administrator</b>	An administrator is responsible for the overall operation of a fund including investment, fund performance, taxation and legislative requirements. The administrator’s responsibilities are typically defined in legislation.
<b>Trust</b>	A trust is an obligation imposed on a person or a company to hold property for the benefit of beneficiaries. Trusts are widely used for investment and business purposes. A trustee is responsible for managing the trust's affairs. <sup>109</sup>
<b>Unfunded scheme</b>	In unfunded pension schemes, no contributions are made to the scheme in advance and no investment fund is built up. A member’s benefits are not financed until just before they become payable. The benefits are generally paid by the employer. Unfunded defined benefit funds mostly cover government employees and are paid from the Australian Government's Consolidated Revenue Fund. <sup>110</sup>
<b>Statutory entitlement</b>	An entitlement enshrined in law. A person who meets the statutory criteria for payment cannot be refused it.
<b>Statutory formula</b>	A set of mathematical rules or equations set out in legislation.
<b>Discharge</b>	For DFRDB purposes, discharge includes transfer to Reserves.

<sup>107</sup> Australian Bureau of Statistics—

<https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6467.0Explanatory%20Notes1Sep%202018>, accessed 21 October 2019.

<sup>108</sup> Parliament of Australia—

<https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:%22library/prspub/WUKX6%22>, accessed 21 October 2019.

<sup>109</sup> Australian Taxation Office—<https://www.ato.gov.au/General/Trusts/>, accessed 21 October 2019.

<sup>110</sup> Australian Taxation Office—<https://www.ato.gov.au/Individuals/Super/In-detail/Growing-your-super/Super-contributions---for-defined-benefit-funds-and-untaxed-funds/?page=4>, accessed 21 October 2019.

## APPENDIX H—CHRONOLOGY

Year	Significant Events	Communication
1972	DFRDB Scheme Commenced	<b>Transfer to the new scheme brochure</b> published stating <i>‘the annual rate of retirement pay is reduced by an amount which is calculated by dividing the lump sum amount received, by the retired member’s life expectancy’</i> .
1973	Pollard Review	<b>DFRDBA Circular</b> issued to all agencies <i>‘full retirement pay is not restored should the member live beyond normal life expectancy’</i> . <b>DB55A commutation election form published.</b> Extracts commutation reduction s 24 (3)(b) in full. Requires acknowledgement <i>‘I realise that under the provisions of s 24 future retirement pay payments will be reduced as a consequence of this election on and from the date the election is received by the Authority’</i> . <b>Retirement benefits brochure</b> published, describes commutation as the option to <i>‘receive a lump sum prepayment of future retirement pay’</i> .
1976	Indexation in line with CPI introduced	
1978		<b>DB55A commutation election form updated</b> – s 24 (3)(b) and acknowledgement removed. New explanatory notes state <i>‘Commutation is a conversion of a portion of future retirement pay payments to a one time lump sum. Once the conversion is made the portion commuted cannot be restored during the member’s lifetime’</i> .
1983	Maximum commutable amount increases	<b>Internal AGRBO DFRDB Manual</b> states <i>‘A member who commutes has his or her pension reduced. The reduced pension cannot be restored during the member’s lifetime.’</i>
1985		<b>Retirement Benefits brochure</b> updated – no substantive changes in relevant text.
1988	Elections permitted in 3 months prior to retirement	<b>D20 commutation election form replaces DB55A.</b> No substantive changes in relevant explanatory notes text.
1991	DFRDB Scheme closes to new members MSBS Scheme commences	
1994		<b>About Your Scheme booklet</b> published. No substantive changes in relevant text.
1995		<b>Retirement Benefits brochure</b> updated. No substantive changes in relevant text.
2001	<i>Reynolds and Defence Force Retirement and Death Benefits Authority (2001) AATA 599</i>	<b>D20 (commutation election) and D21 (retirement benefits) forms merged,</b> members referred to DFRDB booklet and other literature. No substantive changes in relevant explanatory notes text.
2002	Maximum commutable amount reaches 5 times annual retirement pay	
2004		<b>Retirement Benefits brochure</b> updated to include clearer information about commutation reduction - <i>‘once the conversion has been made the portion you commute cannot be restored regardless of you exceeding your life expectancy’</i> .
2007	Podger Review	<b>About Your Scheme booklet</b> updated to clearly state reduction is <i>‘permanent’</i> .
2010		<b>About Your Scheme booklet</b> updated to include further clarifying information – <i>‘your retirement benefit will not be set to the pre-commutation rate, even if you exceed life expectancy’</i> .
2014	Current indexation arrangements introduced	