



The Hon Dan Tehan MP
Minister for Veterans' Affairs
Minister for Defence Personnel
Minister Assisting the Prime Minister for Cyber Security
Minister Assisting the Prime Minister for the Centenary of ANZAC

Parliament House
CANBERRA ACT 2600

Telephone: 02 6277 7820

MC17-000113

Mr Herb Ellerbock
herbell@bigpond.net.au

Dear Mr Ellerbock

Thank you for your letter and submission titled '*The Gross Reduction of Benefits*' of 16 February 2017, and your supplementary clarifying correspondence of 26 February 2017, about the Defence Force Retirement and Death Benefits scheme (the Scheme). I note that you also wrote to the Prime Minister on 26 July 2017 regarding the same matter. Given the complexity of the concerns you and Mr Jim Hislop have raised, extensive research was required in order to provide you with an informed response.

Firstly, I would like to thank you and Mr Hislop for meeting with my Adviser and representatives from the Department of Defence on 21 February 2017. The effort you have given in preparing such a detailed paper is evident, and I appreciate you personally presenting the submission to them.

In considering the submission I understand your major concerns with the Defence Force Retirement and Death Benefits legislation to be:

- indexation and the use of the Consumer Price Index;
- the commutation provisions;
- reversionary spouse benefits; and
- the effect of commutation for re-entered members.

With regard to these concerns, you seek changes to the relevant Defence Force Retirement and Death Benefits legislation and restoration of perceived loss of benefits by way of one-time adjustments.

I am aware that you and Mr Hislop have previously raised these concerns with the Australian Government, both past and present, with the exception of the issue of re-entered members and the effect of the commutation provisions on their subsequent discharge from the Australian Defence Force.

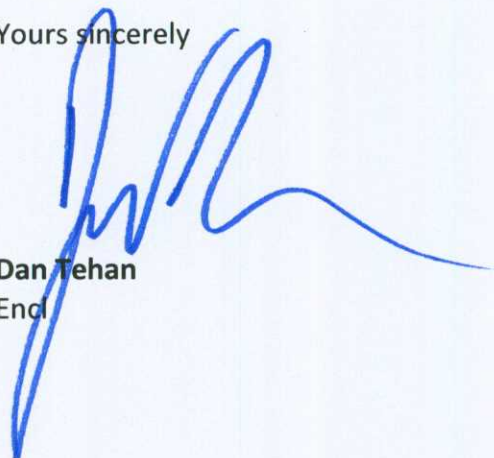
In reviewing the submission and the previous correspondence that has been sent to you and Mr Hislop, I believe you have received responses to all previously raised concerns. As you are aware, the Defence Force Retirement and Death Benefits scheme was developed as a structure of elements. In assessing the overall benefit of the Scheme, it is not reasonable to consider individual elements of the Scheme as a change to one element changes the entire basis on which the Scheme was developed. This is true for all Commonwealth defined benefit schemes. I will not re-iterate the responses that have been previously provided to you on these issues. The enclosure is intended to clarify further statements in your submission.

I can assure you that it is not the intention of the Government or administrators to deny recipients specific benefits that are provided for under the Defence Force Retirement and Death Benefits scheme legislation.

Whilst this may not be the response you would be looking for, I do acknowledge your concerns and the commitment you and Mr Hislop have personally given to bringing these issues to me on behalf of Defence Force Retirement and Death Benefits and Defence Forces Retirement Benefits pension recipients.

I appreciate you bringing your concerns to my attention; however the Government does not intend to make further improvements to the benefit structure of the Defence Force Retirement and Death Benefits scheme.

Yours sincerely



Dan Tehan

End

Response to the issues raised in the paper entitled "Defence Force Retirement and Death
Benefits Scheme - The Gross Reduction of Benefits",
dated 16 February 2017.

Indexation

The paper suggests that it is the Male Total Average Weekly Earnings benchmark which ensures that Defence Force Retirement and Death Benefits scheme pension recipients maintain a certain standard of living, relative to the rest of the population.

There have been numerous reviews of indexation of all Commonwealth superannuation schemes, as well as specific reviews that have considered military superannuation schemes as a whole, over the past two decades.

In his review findings of the 2008 Review of Pension Indexation Arrangements in the Australian Government Civilian and Military Superannuation Schemes, Mr Trevor Matthews recommended there be no change to the indexation methodology for pensions paid from Commonwealth schemes. He concluded that the purpose of pension indexation for the Commonwealth schemes should be to continue to protect indexed scheme pensions from the effects of inflation and not to provide pensioners with a share of productivity benefits. The Government of the day accepted Mr Matthews' recommendations. His review findings remain relevant today.

In undertaking his review, Mr Matthews considered whether the Consumer Price Index indexation methodology should be changed for the Commonwealth civilian and military schemes by having regard to the occupational nature of those schemes including: the form and value of the benefits payable under those schemes; indexation arrangements in similar defined benefit schemes in Australia; the interaction with Government safety net benefits; and the full cost to the Commonwealth.

Mr Matthews found that the most consistent argument made in support of change to the superannuation benefit indexation methodology was on the grounds of fairness and equity, that is, it was widely considered that pensions should be indexed on the same basis as other government pensions such as Age and Service Pensions to keep pace with changes in community living standards as well as protect against inflation. He noted that the Age and Service pensions and superannuation are two separate but supportive components of Australia's retirement income system; however they are different benefits with different purposes and are not comparable.

Governments of the day have over the years accepted some review recommendations, modified some, and not accepted others. This is a difficult choice that the Government is required to make in balancing the budget and reducing the burden of long term debt. However, careful consideration is given in making such decisions and it is the responsibility of the Government to maintain a commitment to working within the confines of the fiscal environment within which they operate.

The paper contends that the Abbott Government's change of the indexation method acknowledged that the use of the Consumer Price Index for adjusting Defence Force Retirement and Death Benefits was unfair. This is not the case. The Government chose to improve indexation for those Defence Force Retirement and Death Benefits and Defence Forces Retirement Benefits pensioners over the age of 55 in line with a recommendation of the 2007 Review into Military Superannuation Arrangements (commonly known as the Podger Review).

It is important to note that the Podger Review Team also concluded that the Defence Force Retirement and Death Benefits scheme is already a particularly generous scheme for those in receipt of pensions, that Consumer Price Index indexation does maintain purchasing power, and is generous when compared to most contemporary superannuation schemes that may only provide account-based pensions at the member's risk. Although recommending improved indexation for older Defence Force Retirement and Death Benefits pensioners, the Review Team considered there is no case to increase the generosity of benefits payable to pensioners prior to age 55, given government policy on preservation arrangements.

Commutation

With regard to the commutation provisions in the *Defence Force Retirement and Death Benefits Act 1973*, the understanding of how the provisions are to be applied is not correct. Whilst this may not be the outcome sought, evidenced by the undertaking of such extensive analysis as shown in the submission, however the choice to voluntarily commute results in a permanent reduction of the pension benefit. The Defence Force Retirement and Death Benefits lump sum payment is not a loan that is to be repaid, despite there being a misunderstanding by some that believe it to be a loan.

Notional rate of retirement pay

The paper suggests that the use of a notional rate of retirement pay should be removed from the legislation so that all of an un-commuted pension would be indexed. It should be remembered that automatic annual indexation was brought in around five years after the commencement of the Defence Force Retirement and Death Benefits scheme. In the five years prior to the introduction of automatic indexation, many retiring members commuted part of their pension to the maximum extent available to them. If indexation had been extended to the non-commuted portion of a pension, it could be perceived that these members were detrimentally affected by the introduction of indexation as they did not have the benefit of considering the value that automatic indexation brought to the Defence Force Retirement and Death Benefits scheme. This also ensures that members who exercised the commutation option are neither advantaged nor disadvantaged relative to any other member of the scheme.

Re-entered members

The claim that Defence Force Retirement and Death Benefits pension recipients who commute on discharge from the Australian Defence Force and who then re-enter for a further period of service are disadvantaged on subsequent discharge, is founded on the misunderstanding of the impact of commutation on the reduction in retirement pay.

Upon subsequent discharge from the Australian Defence Force, the initial commutation lump sum benefit is indexed to a 'future' value and then deducted from the re-calculated lump sum payable. This is to ensure that a re-entrant is not unduly advantaged or disadvantaged when compared with a member of the same rank who serves continuously.

On receipt of two signed privacy consent forms, Defence sought to review two case studies for pension recipients who re-entered the Australian Defence Force for a further period of service. After reviewing the retirement pay calculations for the first re-entrant, Defence is satisfied that the re-calculation of the commutation lump sum and pension at the date of the second discharge, has been calculated correctly by the Commonwealth Superannuation Corporation in accordance with the provisions of the Defence Force Retirement and Death Benefits Act 1973.

Defence was not able to undertake a review of the retirement pay benefit for the second re-entrant. The Commonwealth Superannuation Corporation has advised Defence that no final re-calculation of this person's retirement pay benefit has been undertaken as they have not yet discharged for a second time from the Australian Defence Force.

Other comments

The Defence Force Retirement and Death Benefits scheme was designed 45 years ago, prior to the introduction of some of the most significant superannuation changes in Australia. The unique nature of military service and therefore the special nature of the Scheme in meeting the requirements of the Australian Defence Force, places the Scheme outside mainstream superannuation considerations in the broader community.

It should be recognised that those Defence Force Retirement and Death Benefits scheme members who were eligible to receive a pension after 20 years of service are in the minority. The majority of Scheme members (at the time of the Scheme's closure) discharged with less than 20 years of service and receiving only a lump sum refund of their own contributions, along with a small gratuity amount for certain members.

At the time the Defence Force Retirement and Death Benefits scheme closed in 1991, the majority of Australians were not entitled to compulsory employer superannuation contributions and did not become eligible for compulsory superannuation until the introduction of the *Superannuation Guarantee (Administration) Act 1992* which took effect from 1 July 1992. The Superannuation Guarantee rate at that time was four per cent of a person's salary or wages. A Defence Force Retirement and Death Benefits scheme member at that time, had they been entitled to a pension after completion of 20 years of service, was entitled to 35 per cent of their salary as an annual pension, with the option to commute four times this amount to a lump sum. The maximum commutation amount increased progressively (by way of a formula) each year from 1982 until 2002, from a maximum of four times, to the current maximum commutation amount of five times a member's annual retirement pay.

Following the closure of the Defence Force Retirement and Death Benefits in 1991, the Military Superannuation and Benefits Scheme has provided benefits in the form of a lump sum employer benefit beginning at 18 per cent of a member's final average salary, increasing to 28 per cent of a member's final average salary, depending on the number of years a member served. These benefits can be converted to a lifetime pension on

retirement from the Australian Defence Force from the age of 55 on actuarially favourable terms. At the time of the scheme's closure in 2016, the average Australian worker was only entitled to 9.5 per cent of their salary as superannuation and can usually only receive this as a lump sum at preservation age (gradually increasing to age 60).

With the introduction of the new superannuation arrangements for Australian Defence Force personnel joining the services for the first time from 1 July 2016, the employer contribution rate of 16.4 per cent continues to be well above the current Superannuation Guarantee charge of 9.5 per cent.

As calculated for the 2014 Report of Long Term Costs, the notional employer contribution rate required to fund the defined benefits accruing for the Defence Force Retirement and Death Benefits scheme, is 35.9 per cent of member's salaries and for the Military Superannuation and Benefits Scheme, it is 33.2 per cent. (These figures are intended to apply until the release of the next Long Term Cost Report, due to be released by the end of 2017). Comparatively, the Superannuation Guarantee charge employers are currently required to pay is 9.5 per cent of an employee's ordinary time earnings.

Recent actuarial advice has provided a comparison of the value of benefits available in the Defence Force Retirement and Death Benefits scheme compared to the benefits available under the new scheme, ADF Super. The comparison was based on the assumptions of a male Australian Defence Force member who joined at age 20, served 20 years and exited age 40 on a salary of \$80,000.

The Actuary has advised that the nature of the two arrangements is very different with outcomes depending on individual circumstances which makes comparisons of them difficult. Nevertheless, the Actuary attempted to provide a fair comparison for someone who would have been entitled to receive a pension from the Defence Force Retirement and Death Benefits scheme. The Actuary found that on a comparable basis the value of the benefits from the Defence Force Retirement and Death Benefits scheme were roughly twice those from ADF Super.

The two defined benefit schemes, with their structure of benefits not normally available to the wider community without additional costs, and ADF super, with its higher than average employer contribution rate, ensure the continued recognition of the unique nature of military service.

Whilst it is acknowledged that the issues raised in the paper causes considerable concern amongst a group of the ex-service community, the Government does not intend to make further improvements to the benefit structure of the Defence Force Retirement and Death Benefits scheme.