Unrecognized Genetics of DFRDB and MSBS

by

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Since the preparation of the earlier article *"Nature, Form, Characteristics and Genetics of Pension Superannuation – Should Size Matter"* the judgment of the Full Court in the matter reported under the name of *Palmer & Palmer* [2012] FamCAFC 159 has become available. The PDF of the original article can be downloaded at www.brzostowski.com.au by going to the Law page and clicking the link to that article. The *Palmer* matter exemplifies how important it is to assist the Court in the fullest way possible. The Court is not to be expected to search out possible arguments in respect of each superannuation scheme.

In this paper I will identify at least some of the arguments that should have been put. For the purposes of this discussion I will confine my main observations to the DFRDB and the MSBS. I will also point to complexities in a couple of other schemes in order to illustrate how dangerous broad brush approaches can be.

What is the Court empowered to do?

Sec 90MA provides *"The object of this Part is to allow certain payments (splittable payments) in respect of a superannuation interest to be allocated"* between parties to a marriage or to a de-facto relationship.

The Court is given by sec 90MS(1) an extended power whereby it may "*also make orders in relation to superannuation interests of the spouses.*"

Sub-sec 90MT(2) requires the Court "*before making an order*" to "*determine the amount in accordance with the regulations*." Sub-sec (2A) translates "the amount" to be "*taken to be the value of the interest.*"

Sub-sec 90MT(3) says: "*Regulations for the purposes of paragraph (2)(a) may provide for the amount to be determined wholly or partly by reference to methods or factors that are approved in writing by the Minister for the purposes of the regulations*."

When a Court is making an order allocating a payment to the non-member, it is allocating a part of the "amount" determined under the approved formulae at the "relevant date". That amount represents the most recent available value of the superannuation interest. In the case of defined benefit schemes, that value is, perhaps without exception, dependent **in part** on -

(a) **the member's salary** "at the relevant date", in current "dollars" in which that salary is expressed. A sub-variable of the "salary" issue is that quite apart from movement in the value of the dollar, the member may have risen in rank and his current salary may have no relationship to the salary he was receiving a number of years ago. However the formulae used to determine the "amount" depend on that final salary, or the "final average salary (FAS)", regardless of rank, and the calculation applies to the whole period of service during which the "benefit multiple" had been accruing regardless of salary level. In other words the old, lower salary levels are irrelevant in the final calculation.

(b) **the benefit multiple** that also applies "at the relevant date", the magnitude of which is determined by accrual formulae found in the relevant Statutes or Rules, and which in turn is also in part dependent on length of service.

(c) **the member's age**, at the "relevant date" and therefore the factors that depend on that age, usually some discount factor taking into account that a member may be some time away from retirement, and also taking into account the life expectancy for a person of the member's gender.

The benefit multiple in some schemes depends on the years of completed service. Its increase may not be uniform, but it still depends on completed years of service. In some schemes it depends on age of retirement (and may in fact be treated as if it was uniform for the whole of that service eg the CSS, where a retiree at 65 years is considered to have his multiple accrue at 2%pa, or 1.5% for a person retiring at 55 years). In other schemes it may depend on rate of contribution (eg the PSS).

The statute, the regulations and "approvals" authorize the use of only one relevant determination of "amount". The process of allocating a payment is a process to be applied **to that current value** (ie the value proved closest to the time of trial). No other determination, at any earlier date is made relevant. No approved formulae translate the "amount" that might have applied at an earlier date, into something that could be compared with the amount determined for the purposes of sec 90MT.

In order to assess relative contributions to a superannuation interest, particularly where a party had accumulated an entitlement to an interest before cohabitation, the Court will need to form a view of the significance of that interest as a portion of the "amount" being split.

For this purpose there appears to have evolved a belief that the Court can be informed about the "growth" of a superannuation interest by looking at the amounts determined by application of the formulae to different points in time. That way the "valuation" performed at the earlier date has sometimes been treated as evidence of the **portion** of the amount being split. That portion is then sometimes expressed as a percentage referable to membership prior to cohabitation, or a figure for which the member is then given credit. It is respectfully suggested that this might not be a valid approach, and if it is invalid, it leads to miscarriage in the exercise of discretion.

However, in the process of assessing pre-cohabitation contributions to the "amount" that is determined for the purposes of sub-secs 90MT(2) and (2A) it is vital not to fall into a logical trap and use a figure that is not relevant to the task under sec 90MT.

With respect it would be a logical error to adopt a figure thrown up by the formula that applied at least three factors that are no longer relevant at the time of trial, and then to use that outcome as a means of informing an assessment of the significance of pre-cohabitation contribution.

Any attempt to use the old, or "backdated" valuations, is not authorized by Statute. They are not made relevant by Statute. They cannot be relevant as a matter of logic.

Once salary moves in dollars terms, and once value of the dollar changes, and once the age which determines other factors also changes, the whole assumed validity behind any comparison, must break down.

It may be a common, but with respect, incorrect, practice to deduct the "old dollar" value from the sole value that is made relevant by Statute, in order to say "this is the growth" during the marriage.

Likewise, it may be a common, but with respect, also incorrect, practice to conclude that the "old value" can be treated as a percentage of the current value, and thereby treated as the member's sole pre-cohabitation contribution.

With respect, that is like trying to evaluate the percentage of oranges in a bucket full of apples. There is no logical connection.

The misleading impression such beliefs create is not only of no guidance to a judicial officer, but worse than that, there is a serious risk of adverse impact on the exercise of discretion.

The units which do not change their value with inflation, although their number will be related to years of service, (or service and contribution) are the figures representing the accrual of the benefit multiples (however they are called under the different schemes). A comparison of the magnitude of this multiple at, say, the start of a relationship, may in a number of schemes, have a logical link a logical link to the value that is being allocated between the parties under sec 90MT. Yes, it is also related to a "time served" approach, but that is inherent in most defined benefit schemes, and certainly to the DFRDB, the MSBS, the CSS and upon closer examination, one may find this link in a number of other defined schemes. As a corollary, the increase in this multiple during the period of cohabitation, may also be of assistance is assessing how much of the current value of the "amount" can be referable to the period of cohabitation.

It pays to note that no legislation, no regulations, and no "approvals" pretend to authorize the ascertainment of growth of a superannuation benefit simply by taking the "old value in old dollars at an age gone by" from the value of the interest "at the relevant date" that is being split under 90MT.

Back to the problem in *Palmer & Palmer*

The case involved a serving member who had been in the DFRDB since 1982 until he opted to join the MSBS. By operation of Schedule 6 of the *MSBS Rules*, his service under the 1973 Scheme also counts as service under the MSBS Scheme. The commencement date therefore remained the same, and the counting of years of completed service applied to the determination of the benefit multiple under the MSBS.

His service until the date of marriage in 1993 was 11 years (date of "old value"). His total service till date of separation in 2009 was 27 years. He was self-represented on appeal where he came agonizingly close to drawing the Court's attention to some really important considerations.

One of his arguments, at least upon appeal, was that "on a time basis" the period of cohabitation corresponded to 62% of the total period of membership. Therefore, on a time basis, 38% of the total period of membership was referrable to membership preceding cohabitation. That argument was rejected because of prior cases that proceeded on the basis that, with the advent of the super valuations formulae, the "time basis" was of not much assistance. That view no doubt arose from the assumption that was formed without any

assistance of argument – at least so far as the judgments reveal – that the outcome of an earlier valuation is capable of being logically compared with the later valuation.

However his second argument might have aroused interest if only he had set the grounds for it, or at least referred the Court to the MSBS Rules, of which the Court could then take judicial notice. That argument is quoted at [60] in the judgment, namely that his "*FAS multiple was 6.618 in 2009, the year of separation, and 2.308 in 1993, the year of marriage*". The problem with this was that, quite apart from some inaccuracy of calculating those figures, he had not adduced evidence of those multiples. It was a "*submission without evidentiary foundation*", and was therefore rejected. Although it was not stated as a reason used for rejecting that submission on appeal, it is probable that it had not been raised before the Federal Magistrate. Therefore the *Suttor v Gondowda* principle might have also defeated him. The effect of the Rules is a question of law, and therefore had there been a reference to the Rules upon appeal, the result might have been very interesting.

Schedule 8, Part 1, Items 2 and 3 of the MSBS Rules shows that there are three periods of eligible service, each one of which invokes a specified percentage multiple for each completed year of service, which is applied to the member's FAS (final average salary). The first period of eligible service (FPES) attracts 18% per completed year. The second period of eligible service (SPES) attracts 23% per completed year, and the third period of eligible service (TPES) attracts 28% for each completed year.

Item 3 of the Schedule sets out the durations of the three periods of eligible service. Paraphrasing, they are –

(a) For each of the first 7 years (FPES), 18%, ie 7 x 18% = 1.26 x FAS

(b) For each of the next 13 years (SPES), 23%, ie 13 years x 23% = 2.99 x FAS

(c) From 20 years (TPES) onward, the entitlement grows annually at 28% = 0.28 x FAS pa.

The multiples for each period are then aggregated.

Therefore on having completed 11 years prior to the 1993 date of marriage, the FAS multiple would have been –

(a)	For each of the first 7 years, 7 x 18%	1.26 times FAS
(b)	For the next 4 years till completing year 11, 4 x 23%	0.92 times FAS
	Total multiple as at 1993	**2.18 times FAS**

Now, for the 2009 date of separation after 27 years of service we see:

(a)	For each of the first 7 years, 7 x 18%	1.26 times FAS
(b)	For each of next 13 years till year 20, we see 13 x 23%	2.99 times FAS
(c)	For remaining 7 years till year 27, we see 7 x 28%	1.96 times FAS
	Total multiple as at 2009	**6.21 times FAS**

Comparing the relevant multiples at each of 1993 and 2009 dates, we see that as at 1993 he had already accrued a benefit multiple of 35.1% of the 2009 figure. It was the 2009 multiple which was multiplied by the 2009 salary to arrive, with some other factors, including his 2009 age, at the 2009 FLV. The figure thrown up by the valuation purported to reflect value in 1993 was irrelevant, but for the curious, it has as much value as a historical footnote.

It is not just mere coincidence that his argument based on a "time served" basis was that 38% would have been preferable to the period of service prior to marriage. The magnitude of the difference between 35.1% above and 38% is negligible.

Introduction of error

The Court had before it the FLV as at 30 June 1993 (which was close to the date of marriage) and another as at separation in March 2009. It did not have one close to the date of trial or appeal. Although not available as part of the report, one can infer that the 1993 calculation must have used the 1993 accrual multiple, the 1993 salary in 1993 dollars, and his age in 1993 with the significant 1993 discount factor because he was then a long way away from the age of 65. It yielded $92,450. The 2009 figure was $864,386, and presumably used the 2009 accrual multiple, the 2009 salary in 2009 dollars, and the reduced age factor because he was now much closer to retirement.

The Court had identified a number of errors by the Federal Magistrate, but then endeavoured to assist the parties by looking at what evidence there was that could allow the Court to re-exercise discretion.

It looked at the calculated FLV as at 2009 and the calculated FLV as at 1993, then took the latter from the former and treated that amount as the purported "value" of the husband's sole contributions to the MSBS that it then split at its 2009 value. The Court was clearly not assisted adequately.

At first glance, it might be thought there was a "growth" of $771,936. However upon reflection, logic tells us that before we can call that "growth" during the marriage, it would be necessary –

(a) for the "dollar" to have maintained its buying power and value;

(b) for the salary to have remained constant;

(c) and for his age to have stood still so as to avoid the distorting effect of those factors that depend on age.

We know that this was not the case.

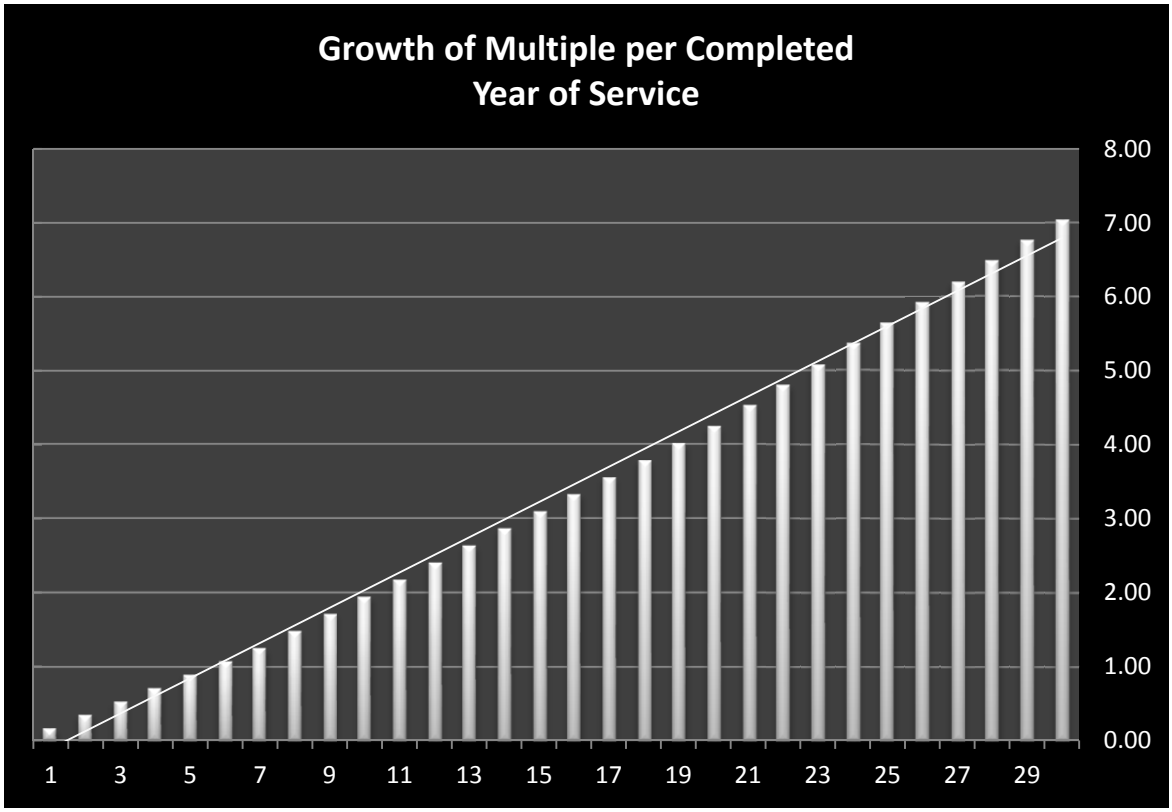
For this reason the 1993 figure of $92,450 is not only irrelevant, but capping his pre-cohabitation contributions to that figure, must have risked the validity of the exercise of discretion.

If you are involved in such a case, it will be crucial to go to the genetics of the relevant scheme, and take the Court to those genetics to show how the benefit multiple grows.

The growth of the employer benefit lump sum component in an MSBS interest is in large measure determined by the product of the FAS (ie the most recent final average salary) and the accrued benefit multiple. Yes, there are various factors also at play, and yes, there is also a member's benefit consisting of contributions plus interest accrued at the Fund crediting rate. The magnitude of those components tends not to be as significant as the employer component. It therefore pays dividends to understand how this works.

From the terms of Schedule 8 we can construct the following table and graph.

Years serviced	Percent accrual	Growth in Multiple
1	0.18	0.18
2	0.18	0.36
3	0.18	0.54
4	0.18	0.72
5	0.18	0.9
6	0.18	1.08
7	0.18	1.26
8	0.23	1.49
9	0.23	1.72
10	0.23	1.95
11	0.23	2.18
12	0.23	2.41
13	0.23	2.64
14	0.23	2.87
15	0.23	3.1
16	0.23	3.33
17	0.23	3.56
18	0.23	3.79
19	0.23	4.02
20	0.23	4.25
21	0.28	4.53
22	0.28	4.81
23	0.28	5.09
24	0.28	5.37
25	0.28	5.65
26	0.28	5.93
27	0.28	6.21
28	0.28	6.49
29	0.28	6.77
30	0.28	7.05



Note that the growth in the benefit multiple factor follows closely the straight trend line.

The husband could have been forgiven for advancing his "time-served" argument as well as to his attempt to draw attention to the multiples that applied to "FAS" both as at 1993 and as at 2009.

Does that not remind one of *West v Green*? I say no more.

Note that this process can be applied to assessing not just the real significance of pre-cohabitation contributions, but also to assessing the significance of post-separation contributions.

It is beyond the scope of this paper to examine each scheme. However it is the purpose of this paper to alert practitioners and, with respect, all those involved in the process under 90MT, to the importance of getting material before the Court which will then inform the Court on a valid basis how to assess the real value of a person's contribution to an interest that is being split. Just having a value, or a series of FLVs, is, with respect, not good enough.

En passant, the part of the appeal in *Palmer* that was based on *Kennon* was not pursued, even though members of the Family Court have applied it in various cases in Canberra.

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