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Proposed Changes to the Military Retirement System

Background

The military retirement system is a noncontributory, defined benefit system that has historically been viewed as a significant incentive in retaining a career military force. The system currently includes monthly compensation upon completion of an active or reserve military career, disability benefits for those deemed medically unfit to serve, and a survivor annuity program for the eligible survivors of deceased retirees. The amount of compensation is dependent on time served, and basic pay around the time of retirement. Retired pay is adjusted annually through a Cost-of-Living-Adjustment (COLA).

The costs of the military retirement program have been rising modestly each year, due to a predictable slow rise in the number of retirees and survivors and COLA increases. In FY2013, \$54 billion was paid to approximately 2.2 million military retirees and survivors. When considering changes to the retirement system Congress grapples with both budget constraints and constituent concerns.

Current Retirement System

There are currently three separate military retirement systems: one for Active Component (AC) members, one for Reserve Component (RC) members, and one for those who become disabled and are unable to complete a military career due to their disability. For active duty military personnel, there are three methods of calculating retired pay: the Final Basic Pay System, “High Three,” and Redux. The applicable retirement calculation is based on the date when the servicemember first entered active duty and his/her basic pay at the time of retirement, and, in the case of Redux, a voluntary election regarding a \$30,000 Career Status Bonus (CSB). A comparison of these three methods and proposed changes are summarized in **Table 1** on the following page. Reserve Component personnel are able to calculate retired pay under the Final Basic Pay or “High Three” systems only. Disability retirement for the AC and RC is calculated in a different way depending on years served and the DOD’s disability rating.

The current retirement system includes “cliff-vesting” after 20 years of service (YOS) for active members, and 20 years of qualifying service (as determined by a points system) for reservists. This means that under a regular non-disability retirement, service members who leave the service prior to fulfilling the 20-year requirement are typically not eligible to receive any retirement annuity. Servicemembers have the option of making contributions to the Thrift Savings Plan (TSP); however the Services do not provide any contributions to the individual’s account.

MCRMC Recommendations

The National Defense Authorization Act (NDAA) for FY2013 established a Military Compensation and Retirement Modernization Commission (MCRMC) to provide the President and Congress with specific recommendations to modernize pay and benefits for the armed services. In terms of retirement the Commission was mandated to provide recommendations to:

Modernize and achieve fiscal sustainability for the compensation and retirement systems for the Armed Forces and the other Uniformed Services for the 21st century.

The Commission delivered its final report and recommendations to Congress on January 29, 2015. The report is also being considered by the President, and its recommendations may be subject to revision. The recommendations, if implemented, would substantially change the military retirement system. Under the MCRMC’s proposals, current service members and retirees would be “grandfathered” into the current retirement system; however they would also have the opportunity to opt into the new system.

The Commission found that under the current system of “cliff-vesting,” 83% of enlisted and 51% of officers do not receive any retirement compensation for their service. This is at odds with retirement benefits in the private sector where firms increasingly offer a variety of defined contribution packages and are required by law to vest employees within a much shorter time period.

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Shift from Defined Benefit to a Blended System

The Commission recommended changing the current system from a defined benefit system to a blended system that includes a defined contribution element. The defined benefit would remain similar to the “High Three” system but the multiplier would be reduced from 2.5% to 2.0% per year of service. Thus, under the MCRMC proposal, an active duty servicemember with 20 years of service would receive 40% of base pay (2.0% x 20) rather than 50% (2.5% x 20) under the current system. For the RC, the same calculation would be used except that eligible years of service would be computed by dividing Reserve points by 360.

Table 1. Comparisons Between Current Retirement Systems and MCRMC Recommendations

	Final Basic Pay	High Three	Redux	MCRMC Recommendations
Applies to	Servicemembers entering before September 8, 1980	Servicemembers entering from September 8, 1980, through July 31, 1986, and persons entering after July 31, 1986, but opting not to accept the 15-year CSB	Servicemembers entering after July 31, 1986, and accepting 15-year CSB with additional 5-year service obligation	Future servicemembers with all current members and retirees able to opt in
Basis of Computation	Final rate of monthly basic pay	Average monthly basic pay for the highest 36 months of basic pay	Average monthly basic pay for the highest 36 months of basic pay	Average monthly basic pay for the highest 36 months of basic pay
Defined Benefit Multiplier	2.5% per YOS	2.5% per YOS	2.5% per YOS, less 1% for each year of service less than 30 (restored at age 62)	2.0% per YOS
Defined Contribution	Individual contributions to TSP, no matching	Individual contributions to TSP, no matching	Individual contributions to TSP, no matching	1.0% minimum contribution into TSP from Service with up to 5.0% matching contributions
Lump Sum Option	Monthly annuity only	Monthly annuity only	Monthly annuity only	Option for full or partial lump sum payment at retirement with full annuity restored at eligibility age for full social security payments
Additional Continuation Benefit			\$30,000 CSB payable at the 15-year anniversary with 5-year obligation to remain on active duty	Continuation pay at least 2.5 times monthly base pay for AC and 0.5 times monthly base pay for RC with a 4-year duty obligation

Source: Adapted by CRS from *Military Compensation Background Papers*, Department of Defense, Sixth Edition, April, 2005.

The proposed defined contribution element is intended to make up the shortfall incurred with the new multiplier and would be deposited through the TSP. The Services would begin automatic monthly contributions of 1% of the member's basic pay into their TSP account upon service entry date up until 20 years of service. The servicemember would be fully vested after 2 complete years of service and would be able to take ownership of the 1% contributions as well as any individual or matching contributions.

The Services would also automatically enroll new servicemembers into the TSP program at an amount of 3% of their basic pay unless the service member opted out, with automatic enrollment at 3% every year up to 20 years of service. The Service would also make matching contributions up to 5% of monthly basic pay. Matching payments would cease at 20 years of service.

New Options for Receiving Annuity

Another change proposed by the MCRMC is that Active and Reserve members could choose to receive their retirement annuity in various forms. For AC members the recommended options are:

- Monthly payments beginning at retirement date;
- A partial lump sum amount at retirement, combined with a reduced monthly payment with full monthly annuity restored at eligibility age for full social security payments; or

- A larger lump sum payment with no monthly payment with full monthly annuity restored at eligibility age for full social security payments

Members of the RC would be eligible to receive the lump sum options above upon retirement from the Reserves which would generally be before their retirement annuity begins at age 60.

Continuation Pay

In order to provide mid-career retention incentives under the new system, the Commission proposed basic continuation pay for all members who reach 12 years of service in return for a 4-year obligation. Active duty members would receive basic continuation pay equal to at least 2.5 times the Service member's monthly basic pay while RC members would receive continuation pay equal to at least 0.5 times the basic pay of an AC member.

In addition, the Commission proposed that the services should budget additional funds for continuation pays above the basic amounts to allow the Services some flexibility in adjusting force profiles to meet future changes in manpower requirements.

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