

Military Retirement Systems Summary

Michael J. Meese, Ph.D., FLMI, Brigadier General, U.S. Army (Retired), COO, AAFMAA

Previous Retirement Systems: (all have been *defined benefits* programs)

Before 8 Sep 1980: **High-1** Retired Pay = 2.5% * Years * Highest salary (e.g. 50% pension @ 20)

After 8 Sep 1980: **High-3** Retired Pay = 2.5% * Years * Highest 36-months (50% pension @ 20)

After 31 July 1986: **REDUX. Option 1:** Stay with previous option (2.5% * Years * Highest 36-months)

Option 2 (Redux) At 15 years of service, get a one-time \$30,000 bonus, while accepting 40% pension at 20 years + 3.5%/year until 30 years of service. Pension remains at this reduced amount until age 62. Then is restored to what it would have been under “High 3” system.

Impetus for Change:

In Fall 2011, the Defense Business Board proposed a radical change of military retirement to a 401(k)-type for defined contributions with the defined benefits retirement payments not starting until an individual was 67 years old. This was criticized, but started thinking about retirement reform.

In January 2015, the Military Compensation and Retirement Modernization Commission (MCRMC) concluded that: “The current Uniformed Service retirement system is a useful retention tool for midcareer Service members, but does not provide retirement savings to the overwhelming majority of Service members.”

Since 83% of servicemembers do not stay until retirement, the MCRMC proposed a new system to have defined contributions, targeted career continuation pay, retention bonuses, and a reduced defined benefit pension upon retirement. This proposal is what is currently being considered by Congress.

Proposed Retirement System “Blended Plan” (from MCRMC). Most of this is in the 2016 National Defense Authorization Act, which was signed by President Obama on 25 Nov 2015. The military services must still work out details so the exact percentages may change, but this is the concept.

Defined Contribution (New):

- Military would contribute 1% of basic pay to servicemember’s Thrift Savings Plan (TSP) account.
- Servicemembers would be automatically enrolled with a 3% of basic pay contribution to TSP. (Servicemembers could raise or lower contribution or terminate individual contribution.)
- Military would match up to 5% of servicemember’s contribution, after of 2 years of service.
- Servicemembers would be vested in TSP after completion of 2 complete years of service.

Continuation Pay (New):

- At 12 years of service, active duty servicemembers who commit to 4 additional years would receive a bonus equal to 2.5 months basic pay.
- Services can increase continuation pay bonuses, if needed.

Defined Benefit (Revised):

- Retired pay is reduced to 2% times number of years of service (e.g. 40% pension at 20 years and 60% at 30 years of service.)
- Retired pay could be paid in different forms (constant pension payment; lump sum, then smaller pension until full social security retirement, then full amount; larger lump sum, then no payment until full social security retirement).

This new plan will be effective on 1 January 2018.

Current members are grandfathered, but younger service members could opt into this plan.

The following figures from the MCRMC Report (with various assumptions on next page) help justify why this program **could** be better for the servicemembers.

Figure 9. Retirement Assets of a Retiring Active-Duty O5, Current vs. Blended Retirement Plans¹⁰¹

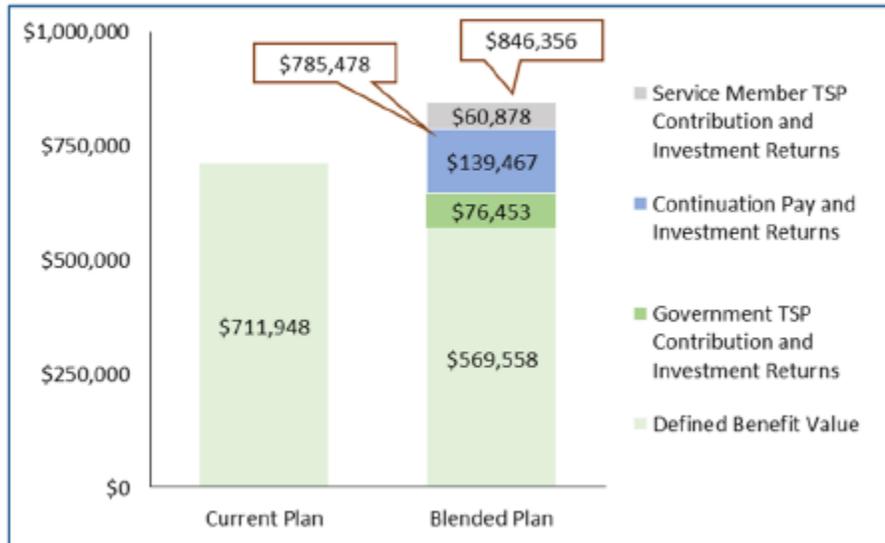
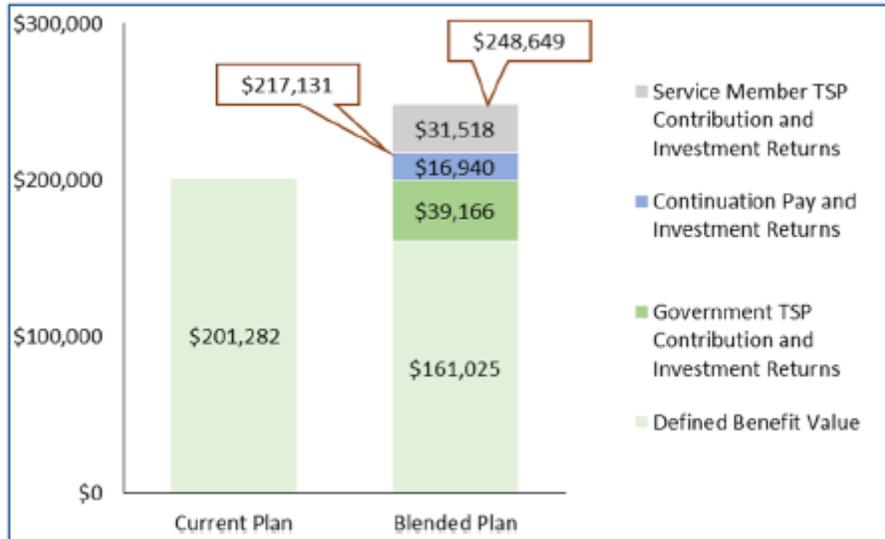


Figure 8. Retirement Assets of a Retiring Active-Duty E7, Current vs. Blended Retirement Plans¹⁰⁰



Assumptions for the illustrations above:

101 Assumes: (1) An active-duty O5 who retires at age 42 after 20 YOS and who had a standard promotion path; (2) A life expectancy of 85 years; (3) A personal discount rate of 6.4% (see RAND Corporation, *Analysis of Retirement Reform in Support of the Military Compensation and Retirement Modernization Commission Progress Report*, November 2014); (4) An automatic Government contribution of 1 percent of basic pay into the Service member's TSP account; (5) Matching Government contributions of 3 percent of basic pay into the Service member's TSP account; (6) Continuation Pay of 14 months of basic pay at 12 YOS that is invested (average of AC Officer data in Table 2); (7) Service member contributions of 3 percent of basic pay into the Service member's TSP account; (8) The accumulated value of the TSP contributions is estimated using the historical earnings data from the TSP (2001 – 2014). Assuming an asset distribution similar to the life cycle L2050 plan, the average rate of return is 7.3 percent per year. After adjusting for inflation over those years (averaging approximately 2.35% per year), the real rate of return for the L2050 plan is 4.95 percent per year. Service members would receive CP to promote midcareer retention. This comparison of retirement assets assumes CP is saved and invested for retirement.

100 Assumes: (1) An active-duty E7 who retires at age 38 after 20 YOS and who had a standard promotion path; (2) A life expectancy of 85 years; (3) A personal discount rate of 12.7 percent (see RAND report, page XX); (4) An automatic Government contribution of 1 percent of basic pay into the Service member's TSP account; (5) Matching Government contributions of 3 percent of basic pay into the Service member's TSP account; (6) Continuation Pay of 3.37 months of basic pay at 12 YOS that is invested (average of AC Enlisted data in Table 2); (7) Service member contributions of 3 percent of basic pay into the Service member's TSP account; (8) The accumulated value of the TSP contributions is estimated using the historical earnings data from the TSP (2001 – 2014). Assuming an asset distribution similar to the life cycle L2050 plan, the average rate of return is 7.3 percent per year. After adjusting for inflation over those years (averaging approximately 2.35% per year), the real rate of return for the L2050 plan is 4.95 percent per year. Service members would receive CP to promote midcareer retention. This comparison of retirement assets assumes CP is saved and invested for retirement.

Sources for more information:

Military Compensation and Retirement Modernization Commission (MCRMC): <http://www.mcrmc.gov/>

Text of the National Defense Authorization Act for Fiscal Year 2016:

<https://www.govtrack.us/congress/bills/114/s1356/text>

If you have questions, please contact:

Michael J. Meese, Ph.D., FLMI, Brig. Gen., U.S. Army (retired)
Chief Operating Officer and Secretary,
American Armed Forces Mutual Aid Association (AAFMAA)



1856 Old Reston Ave, Ste 200, Reston, VA 20190
Direct: 1-703-707-4602
Email: mmeese@aafmaa.com