



The New Military Retirement System: An Overview of its Development and a Review of its Features

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On Nov. 25, 2015, President Barack Obama signed into law the first major overhaul in the military retirement system in more than 64 years. For the first time, there will be no traditional 20-year, all-or-nothing retirement plan for those starting their military careers in 2018. Instead, service members will participate in a blended retirement system composed of a partial defined pension plan and a defined contribution plan.¹

This new plan was developed by a panel sponsored by Congress for the last three years.² It is the first time serious changes were considered to the military retirement system since 1948, when the current retirement system was implemented. Previous attempts to change the retirement system were resisted by Congress. In addition, although many veterans organizations opposed the plan, stating that the new pension system would affect military recruiting and retention, other veterans groups welcomed the new proposal with open arms. Yet, the Pentagon repeatedly stated that its budget is being consumed more and more each year by the military retirement system costs.³

Regardless of how we got here, we must accept the reality that the current 20-year military retirement system is untenable. Recently, the Pentagon, the president, and Congress agreed on military retirement reforms to address the current military retirement system costs. This article will discuss those reforms.

The first part of this article will cover a brief history of the military retirement system. The second part will discuss the various problems commissions and government agencies found with the current retirement system in relation to the blended military retirement system.

A History of the Military Retirement System

Prior to 1855, there was no military retirement system. Congress created the first informal military retirement system in 1855. This system was a disability-based system exclusive to the Navy and was only available to naval officers. In that system, the secretary of the Navy had discretionary power to transfer unfit officers to the Naval Reserve list. Personnel on the Naval Reserve list were entitled to receive a percentage of their base pay every month.⁴

The first formal military retirement system was established in 1861 when Congress granted the president the discretion to retire all regular officers who had served 40 or more years in the military. It further required naval officers to retire after 45 years of service or upon reaching a mandatory retirement age of 62. Congress later amended the system to allow the discretionary voluntary retirement of Army and Air Force officers with 30 years of service, the right of military officers to retire at 40 years of service, and the implementation of a mandatory retirement age of 64 for all military officers.⁵

In 1885, Congress expanded the first retirement system to include Army and Marine Corps enlisted personnel. This was also the first system with an established retirement pay model of 75 percent of base pay per month. In 1889, Congress expanded enlisted retirements to include naval personnel.⁶

Between 1908 and 1948, Congress recognized the need to standardize the different retirement systems for officers serving in the various military branches. First, Congress standardized the 30-year discretionary retirement for military officers. Second, the military officer promotion system was reformed to an up-or-out promotion system granting military officers, who had been previously passed over for promotion, retirement upon reaching a certain age or reaching the maximum number of years of service for their rank. Third, officer military retirement pay was changed to be based on years of service over a set flat percentage of base pay. Finally, Congress standardized officer retirements in 1938 and established the standard 30-year ca-

reer track for officers with a right to retire at the end of that period.⁷

In addition to the changes applicable to officers, Congress made one change in the enlisted retirement system. Congress authorized the Navy to retire enlisted personnel at 20 years of service, but all the other military branches could not retire enlisted personnel until after 30 years.⁸

In 1948, because of growing government administrative operations, Congress streamlined the criteria governing military officer retirement⁹ and formed the basis of the second military retirement system. It permitted voluntary retirement by all military officers after 20 years of service and mandated retirement of officers after 30 years of service.¹⁰ Based on considerations of fairness, enlisted personnel were granted the same benefits by Department of Defense policy.¹¹ As part of the 1948 enactments, Congress also standardized the retirement payment system to the 1938 “years of service” model we use today, paying 2.5 percent of base pay per year of service and moving military retirement away from the previous discretionary and flat percentage models of retirement pay.

The Need for Military Retirement Reform

The need for reform resulted from recent concerns of uncontrollable growth in the number of retirees and retirement system costs.¹² That growth has been seen over the last 115 years and far exceeded what anyone ever projected. The following two tables show the increase in the number of retirees each decade and the costs of the military retirement system each quarter century. Both tables reveal a continual increase. However, table 1 reveals the greatest increases occurred between 1900 and 1975. More importantly, the number of retirees doubled in 1930, 1950, and 1970.

Table 2, reflecting retirement system costs, corroborates the findings in table 1 and reveals at least a tripling of costs between 1900 and 1975, with a notable 11-fold increase in retirement costs between 1950 and 1975.

While these increases do reflect the increasing number of people who reached retirement age every year, the nondiscretionary nature of the military retirement system became the catalyst necessitating the need for this change. A brief understanding of the use of military retirement in “force shaping” will help explain how the nondiscretionary nature of this system exceeded the expectations of most military and political leaders.

Military Use of the Military Retirement System

The Department of Defense needed a means by which to encourage youthful and vigorous people to join and remain in the service on a long-term basis. This was the original intent of the military retirement system; to encourage longevity and retention of personnel until reaching retirement eligibility. However, the nondiscretionary nature of the current military retirement system made the system inflexible and unbending to the needs of the Department of Defense in incentivizing youth, vigor, and longevity in the military. In fact, it typically had the opposite effect; that is, incentivizing people to retire between the 21- and 24-year marks when they were at their peak performance levels. This made the military retirement system very inefficient and unresponsive to the needs of the Department of Defense.¹⁵

Additionally, the Department of Defense had challenges in retaining experienced military personnel in technical and operations fields that do not require youth and vigor. Those personnel typically leave the military because of the lure of higher civilian pay that makes it more enticing to retire than serve beyond 20 years.¹⁶ That results in the military’s need to fill those vacated positions while paying retirement to the individuals who retired from those positions.¹⁷

Unlike circumstances existing in the late 19th and early 20th centuries, many positions in today’s military no longer require the same degree of youth and vigor. The Government Accountability Office (GAO) found that, as early as the 1970s, most service members

Table 1: Number of Retirees by Decade¹³

Year	Number of Retirees	Increase	Year	Number of Retirees	Increase
1900	3,029	-	1960	255,089	92.0%
1910	5,405	78.4%	1970	764,898	199.9%
1920	10,035	85.7%	1980	1,264,525	65.3%
1930	32,838	227.2%	1990	1,472,129	16.4%
1940	48,374	47.3%	2000	1,701,218	15.6%
1950	132,828	174.6%	2015	1,982,184	16.5%

Table 2: Retirement Costs by Quarter-Century¹⁴

Year	Cost Unadjusted for Inflation	Cost Adjusted for Inflation - 1913 Dollar Estimate*	Increase
1900	\$3,514,000.00	\$3,514,000.00	-
1925	\$24,877,000.00	\$14,073,274.29	300.49%
1950	\$229,966,000.00	\$94,467,361.00	571.25%
1975	\$6,238,000,000.00	\$1,147,884,758.36	1115.11%
2000	\$32,857,000,000.00	\$1,888,991,289.20	64.56%
2015	\$56,491,000,000.00	\$2,359,581,380.24	24.91%

* CPI Data is only available as far back as 1913. While not as accurate as 1900 dollars, it still provides the context necessary here for the purpose of this paper.

-serving 20 years spent 90 percent of their enlisted career and 66 percent of their officer career in nonphysically demanding roles. Yet, all service members received the same retirement benefit regardless of their duties. The GAO found that this resulted in more early retirements for noncombat roles rather than the youth and vigor positions as intended by the military retirement system.¹⁸

Finally, our society and military have changed. First, the military transitioned from a draft force to an all-volunteer military force in 1973.¹⁹ Second, the millennial generation desires to be more mobile, as evidenced by more frequent job changes, while the military still holds true to the “join and stay mentality.”²⁰ Third, recent wars revealed that most veterans will not serve long enough to reach mandatory retirement age.²¹ With the drawing down in the conflicts in Iraq and Afghanistan, Congress and the Pentagon felt it was time to address these retirement system concerns.²²

The New Military Retirement System: Controlling the Retirement Costs in the Changing Societal Structure

In order to fix the increasing military costs, the Military Compensation and Retirement Modernization Commission (Commission) was established to recommend solutions to modernize our nation’s military compensation system, including military retirement benefits.²³ The Commission made its findings public in January 2015²⁴ and, for the most part, Congress adopted them in the National Defense Authorization Act of 2016,²⁵ which will go into effect for all troops entering service on and after Jan. 1, 2018.²⁶ The following changes were made to the military retirement system:

1. All troops now receive a retirement benefit;
2. Troops serving 12 years receive a continuation bonus;
3. Troops serving 20 years or more still receive a reduced traditional pension plan; and
4. Retiring service members can receive a partial lump sum of their retirement benefit.

These changes also go a long way to addressing the inflexibility of the current military retirement system. While individual costs under the new retirement system may increase, the cost savings will be greater over time because of the increased flexibility.

All Troops Receive a Retirement Benefit

Currently, only 17 percent of all service members will become eligible for and receive any retirement benefits.²⁷ Most combat veterans who deploy do not become eligible and do not receive any military retirement benefit.²⁸ This is because most combat veterans are non-career soldiers who are more likely to become injured in combat-related training, receive combat injuries, or, in contrast to peacetime veterans who typically join for the benefits, face harsh environments. Very few combat veterans in this circumstance will be granted a medical evaluation board opening the door to disability retirement.²⁹ Consequently, most combat veterans will choose to get out of the military before they reach their 20-year mark and also will never be granted a medical board. That system is inherently unfair to those who serve in combat roles and who do most of our nation’s fighting but receive little in return for their service.³⁰

Recognizing that disparity, the new retirement system requires the Department of Defense to annually pay 1 percent of every service member’s base pay into a Thrift Savings Plan (TSP) account on the service member’s annual anniversary.³¹ Additionally, the Pentagon now matches a service member’s TSP contributions up to

an additional 4 percent of his or her base pay that vests at two years of service. This means all service members under the new system will receive an employer paid 1 percent of base pay in a retirement account and can receive an additional 4 percent TSP matching contribution if they contribute 5 percent of their base pay.³²

Another benefit of using the TSP in the military retirement system is increasing the financial security for survivors of military retirees. The current system is based solely on a traditional pension plan that terminates upon the retiree’s death. The Survivor Benefit Plan is designed to address the issue by continuing a portion of the payments to the survivors, but it had some flaws, mainly that it could decrease other government benefits, such as some Department of Veterans Affairs survivor programs.³³

This problem was compounded by the fact that most service members were unlikely to invest in inheritable retirement options, like the TSP, because they believed their pension benefit would be enough to meet living expenses during retirement.³⁴ That shortsighted view of retirement left most retirees with no inheritable assets to leave to their survivors. The new military retirement system will at least partially prevent that inequality by giving all service members an inheritable asset upon retirement.³⁵ Therefore, the financial security of survivors of retirees is improved under the new military retirement system.

A 12-year Continuation Bonus

The current military retirement system failed to retain qualified personnel beyond the 20-year mark. Most service members leave, on average, after 10 years of service when their qualifications command higher pay in the civilian sector. The only incentive initially for service members to remain in the service until the 20-year mark was the pension system. Congress added a 15-year flat \$30,000 bonus retention bonus called REDUX, but it required the service member to serve another five years and to take a reduction in retirement pay, thus making it unenticing. REDUX failed because it targeted those who were already 90 percent likely to commit to serving 20 years, not those who the military needed to remain in the service either before or after the 20-year mark.³⁶

REDUX was also very unpopular among service members in general. Only 11 years after its inception, Congress took notice, and instituted provisions to modify the program. There are numerous articles on how REDUX is a very poor deal for service members.³⁷

The new system resolves those problems by moving the bonus to a more effective duration of service, 12 years, requiring only four years of additional service instead of a reduction of retirement benefits. This makes the bonus more enticing than the current REDUX bonus. It also provides more flexible options in the bonus, thus allowing to entice service members in critical positions by providing a greater bonus for a commitment to remain in the service. Furthermore, the bonus provides a critical benefit to the Pentagon as it propels service members to the 16-year mark, at which time they are more likely to remain in until at least the 20-year mark.³⁸

A Reduced Traditional Pension Plan

The current military retirement system is a defined pension plan. Retirees are paid a percentage of their base pay, which is tied to the number of years of service. The amount of retirement pay for most retirees ranged from 40 percent to 75 percent of his or her base pay. That is based on a 2.5 percent of base pay per year of service minus

any REDUX penalty. The new military retirement system reduces the defined pension plan benefit from 2.5 percent of base pay per year of service to 2 percent.³⁹ Also, there is no REDUX penalty under this new system.

In exchange for the reduction, the service member receives TSP contributions annually and an employer match similar to a 401(k). This will make up for the decrease in retirement pay with proper investment. In some cases, the overall retirement benefit under the new military retirement system could exceed the current military retirement system payout. More importantly, as noted above, this is an inheritable asset that can produce monthly income long after the retiree dies.⁴⁰

Partial Lump Sum Payment Option

The current military retirement system had only one payment option: a monthly pension amount. Civilian pension systems typically include a lump sum option that allows a retiree to convert several monthly pension payments into an immediate discounted lump sum payment. The difference between the two options is that in one option, the employer held the risk but, in the other option, the retiree held the risk.⁴¹

Where the employer held the risk, the typical system was to continue the monthly payments until the death of the retiree whenever that may happen, regardless of the value of employee contributions into the pension system at the time of death. The current military retirement system is no different. The value of a military pension could be worth more than \$700,000, but could pay out more or less than that value by time of the retiree's death. This made the value of the current military retirement system more valuable if you lived a longer life.⁴²

A military retiree who needed immediate cash or wanted to manage his or her own retirement income stream was without an option to alter the manner of the payout. Some civilian companies would convert the present value of the pension into a discounted lump sum, but the retiree waives his right to the monthly payments. The problem is that civilian companies may not have the best interests of the retiree in mind and could take advantage of a military retiree.⁴³

The new military retirement system gives retirees the option to convert all monthly pension payments from the day of retirement until age 65 into a discounted lump sum payment within 90 days of retirement. Retirees can elect either a single payment or installment payments.⁴⁴ Upon reaching age 65, the monthly pension payments will resume. This is better than using civilian companies which would take all payments for the rest of the retiree's life.⁴⁵

Retirees can use this lump sum payment to buy a house, pay down bills, invest for the future, pay their child's college tuition bill, or any other purpose they desire. This benefit will be immensely helpful to many military retirees who desire or need the cash for immediate needs, while preserving the safety net of military retirement later.⁴⁶

Conclusion

The current military retirement system was designed for a different era. The new military retirement system provides important new benefits and options for both existing service members and those who will serve in the future, and it provides more retirement options for those who serve for years to come. More importantly, its design allows the Pentagon to achieve the goals for which the pension

system was originally designed: to encourage service members to remain in service until they are proficient in their jobs. All in all, the new system represents a much needed, and welcome, change. ☺



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