

DoD Blended Retirement System Proposal

BLUF: While cognizant of proposals offered by the Military Compensation and Retirement Modernization Commission (MCRMC) and others, DoD's plan was crafted by considering ALL elements of current and potential retirement schemes and building a blended system that - in the military judgement of the Department of Defense - best enables us to maintain the readiness of the All-Volunteer Force (AVF). The Department considered retirement changes holistically in the context of the larger recruiting, retaining, and retirement continuum, and also within the context of the package of compensation reform included in the 2016 Budget. We also considered the need to retain talent in an increasingly competitive labor market.

- The Department's proposal is a blend of a 20-year cliff-vested defined benefit annuity with a defined contribution plan that allows service members to contribute to a portable Thrift Saving Plan (TSP) account.
- It also adds a new variable cash incentive that can be used to influence retention decisions and provide additional income during a service member's career.
- Under this proposal, for the first time, the Government will automatically contribute to service members' TSP accounts and institute a program for matching their contributions.
- Additionally, the proposal sustains our solemn commitments to those retired because of a medical disability and to survivors.

Background:

- The current defined benefit military retirement system is a significant incentive in retaining a career military force and has served us well for decades. Changes to the system have been infrequent and incremental; our proposal is, and will be perceived as, a momentous change to a tried and true system. For the first time, Service members will automatically, upon entry, contribute to their retirement plan from their current compensation. This change will ensure that more Service members leave the Service with retirement savings.
- The Department began seriously studying a blended retirement system in 2011. The multi-year research was shared with the MCRMC and helped inform the current Department proposal.
- While the Department was familiar with the proposals of the MCRMC and others, our proposal was crafted by examining ALL elements of current and potential retirement schemes and building a blended system that best enables our ability to recruit, retain, and retire the future AVF.
- The Joint Chiefs analyzed the details of the current and potential retirement systems and made specific recommendations to the Secretary of Defense. Those recommendations adhered to the Department's established tenets:
 - Assess impacts to the health of the AVF
 - Grandfather all currently serving (Active and Reserve) and Retired Service members

- Preserve a nearly equivalent or better retirement benefit when they reach retirement age, at neutral or cost savings
- Each component of our proposed blended system has been carefully crafted to enable the Department to best maintain the readiness of the AVF, in the context of the recruiting, retaining, and retirement continuum while recognizing the imperative to provide some retirement benefit to a greater portion of the force than today.

Key Attributes: Our recommended blended retirement system has three key attributes:

- Approximately 85% of Service members who enter the force will receive some form of a portable retirement benefit;
- Future Service members will receive 80% of the current defined benefit (pension) if they serve for 20 years as well as the opportunity to achieve nearly equivalent or better retirement benefits when they reach retirement age; and
- This plan enables us to recruit and retain our superb All-Volunteer Force in the 21st Century.

Specific Tenets of the DoD blended retirement system proposal:

DEFINED CONTRIBUTION (DC)

One element of motivation to modernize the military retirement system is to provide some retirement benefit to those who serve less than 20 years. DoD's proposal creates a defined contribution using the Thrift Savings Plan (TSP). With the addition of this element, approximately 85% of Service members will receive some retirement benefit.

- **Defined DoD contributions.** DoD will establish for each Service member a TSP account and automatically contribute an amount equal to 1% of a Service member's basic pay (or Inactive Duty Pay for a Selected Reserve member) into that account upon entry into the service until separation or retirement. Vesting would occur upon completion of 2 YOS.
- **TSP member enrollment.** Service members will be automatically enrolled in TSP upon entry, with 3% of their basic pay going into their account. Service members will be able to reduce their contributions or disenroll from TSP only after completion of financial literacy training at their first permanent duty station.
- **TSP: Roth or Traditional.** When auto-enrolled upon entry, service members would be enrolled into a ROTH TSP account, a vehicle particularly beneficial to junior members who tend to have lower income tax liabilities. Changes can be made upon receipt of financial literacy training at the first permanent duty station.
- **DoD matching contributions to TSP.** DoD will match service member contributions up to 5% of their basic pay. DoD matching would start upon completion of 4 YOS and continue to separation or retirement.
- **DC vesting of DoD contributions.** Vesting occurs upon completion of 2 YOS. This would ensure that approximately 85% of Service members would receive some measure of retirement benefit. About 15% of Service members attrite between enlistment and completion of 2 YOS.

- **TSP for cadets/midshipmen.** Cadets and midshipmen do not receive basic pay and thus would not be eligible to establish and contribute to TSP while attending a Service Academy. ROTC cadets and midshipmen, who receive subsistence stipends, not basic pay, are not eligible to establish and contribute to TSP while attending ROTC.
- **DC forfeiture.** Service members will forfeit in TSP DoD's automatic 1% contribution, matching contributions, and any proceeds derived therefrom, in case of any punitive discharge (Dishonorable Discharge, Dismissal, Bad Conduct Discharge) from the service. The member's own contributions are not affected.

DEFINED BENEFIT (DB)

To resource the costs associated with the new DC benefit, DoD's proposal includes a modified DB. Consistent with the other existing proposals, this affects 20% of the existing DB or – said another way – 80% of the existing DB is unchanged. The combination of the DC and DB provides the opportunity for every Service member to achieve the same or better total retirement benefit when compared to the current military retirement system.

- **DB vesting.** 20 YOS. No change from the current DoD retirement system and no different than other proposals under consideration.
- **DB multiplier.** 2% (compared to 2.5% today) - no different from various proposals under consideration.
- **DB working-age annuity.** Full annuity. DoD's proposal does not provide for a lump sum option; in addition to being a smart financial decision in very limited circumstances, the interaction between a lump sum and both Survivor Benefit Plan and Disability Retired Pay is complex. Recognizing that a lump sum option may provide earlier access to the defined benefit for Reserve Component (RC) members, it remains a smart financial choice in very limited circumstance. Proposed computation methodologies (i.e., using discounted present values) result in relatively small lump-sums, while forgone annuities are significant.
- **DB retirement age.** N/A for Active Component (AC). 60 years of age for RC.
- **DB COLA.** The Department's plan provides for restoring the full Cost of Living Adjustment (COLA) for working-age retirees, as part of comprehensive retirement reform. As the law exists with the current retirement system, real savings over the next 10 years from COLA-1% are modest for DoD accruals and zero for mandatory outlays. Even in the steady state (a hundred years from now), COLA-1% will only save \$1.1B (in FY16 \$) per year in outlays. In contrast, the DoD's proposal with *full* COLA will achieve real tangible savings in DoD accruals over the 10 years (\$8.1B, FY17-26) and \$14.1B in annual mandatory outlay savings in steady state (2118).
- **DB vesting flexibility.** Vesting in the DB would be 20 YOS in all cases. DoD's proposal does not provide flexibility to allow the Department to change the 20 year requirement for specified career fields. While the Department generally views flexibility favorably, none of the Services foresee using this authority, the potential difficulties in execution outweighed any perceived benefit, and bonus authority is seen as better able to meet unique needs of specific career fields.

- **DB Disability Retired Pay.** DoD proposes no change to the current disability retired pay. For disability retirement, with a minimum 30% disability rating required, service members may choose between their disability rating (capped at 75%) or the existing DB 2.5% multiplier, multiplied by YOS. This prevents more senior members (those with greater than 12 YOS) from receiving less in a disability retirement annuity (based on the drop in the defined benefit multiplier) than the current system; and does so at the same cost as the current system.

CONTINUATION PAY (CP)

DoD modeling and experience indicate that any reduction to the defined benefit, and particularly one of this magnitude, will have negative retention impacts. To counter these impacts, DoD created Continuation Pay, a form of retention pay. While not part of a Service member's retirement benefit, CP is essential to restore existing force retention profiles and maintain the current AVF.

- **CP multiplier (months of basic pay).** The Services will each determine when, to whom, and how much continuation pay is offered, and the additional service obligation required. The maximum CP multiplier shall be 22 for AC, 11 for RC; the minimum required additional service obligation shall be 1 year.
- **Continuation Pay YOS.** Services may offer continuation pay anytime between 8-16 YOS.

OTHER ELEMENTS

- **Opt-in.** All members serving on the day before the effective date of the new retirement system will be "grandfathered" into the current system, but will also have the opportunity to "opt-in" to the new, blended retirement system. All service members must opt-in within 2 years of the effective date of the new system. This allows for adequate financial literacy training, and completion of any deployments. Reentrants will have the remainder of the opt-in period, or 60 days, whichever is later, to opt-in. A decision to opt-in is not reversible.
- **Cadets and midshipmen** attending a Service Academy before the effective date of the new blended system, would be treated as reentrants and allowed 60 days from the date of their commissioning to make a decision whether to opt-in to the new system or remain in the current system. ROTC cadets and midshipmen would be treated similarly.
- **Effective date.** The effective date is January 1, 2018. This allows for adequate education and training of the force (especially career counselors), as well as the time required to develop and field additional financial training programs and tools (e.g., retirement calculators), and, to plan, program, test, and deploy a host of complex changes to myriad pay and personnel systems.
- **Percent of force receiving benefit.** Approximately 85% of the force would receive some retirement benefits under DoD's proposal and start long-term retirement savings, which would put them on par with their peers in the broader American workforce.

- **Savings (steady state, 4% match).** DoD's proposal will achieve real tangible savings to DoD over 10 years (\$8.1B, FY17-26) and \$14.1B in annual mandatory outlay savings in steady state (i.e., in 2118). Annual DoD budget savings in steady state (2048) are projected to be \$1.19B.

The change to a blended retirement system is a key step in modernizing the Department's ability to recruit, retain and maintain the talent we require of our Future Force. We know future service members will require more choice and flexibility in compensation and retirement. Furthermore, these changes provide additional options for the Department to attract and manage a military force that requires ever increasing diverse and technical skill sets in an evolving global economy.