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MILITARY RETIREMENT UPDATE

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A Landmark Overhaul

Last year, Congress enacted a major overhaul of the military's retirement system. The new approach moves away from the 20-year, all-or-nothing pension arrangement that has characterized military retirement. In its place comes a more balanced approach in which new service members begin saving for their own retirement -- and receive matching contributions -- upon entering the military. Now the process of implementing the new system and educating service members about it is under way.

 (Cover) Petty Officer 2nd
Class Patrick Kelley/
Department of Defense Photo

CONGRESS TAKES ACTION

In late 2015, Congress and the Obama administration reached agreement on a defense authorization measure that fundamentally overhauled the military retirement system.

The fiscal 2016 National Defense Authorization Act included a series of proposals modeled on recommendations made by the Military Compensation and Retirement Modernization Commission in 2015. New troops will now be automatically enrolled in the government's 401(k)-style Thrift Savings Plan and receive 1 percent matching contributions from their employer.

Military members currently can contribute to the TSP, but are not enrolled automatically and do not receive a matching

The new system really benefits the 83 percent who do not stay in the military long enough to draw a pension.

contribution from the government. Under the new law, the government match could go as high as 5 percent, if the service member contributed that amount.

Service members who stay in the military for 20 years, and are thereby entitled to a retirement pension, would receive a less generous calculation for their annuity.

The new system moves away from the 20-year, all-or-nothing pension system that has been in place for military

members. Only about 17 percent of troops serve for 20 years and become eligible for the benefit. To encourage members to stay in the military, they would receive "continuation pay" after 12 years of service.

The new blended retirement system would only affect new service members. Current service members are grandfathered into the current system, but could opt into the new one. The legislation also calls for a program to educate troops about the modified retirement system.

The provisions "would modernize the current uniformed services retirement system by blending the current defined benefit, cliff-vesting retirement plan with a defined contribution plan, lump sum career continuation pay, and retention bonuses paid at defined career milestones, while continuing a 20-year defined annuity," the legislation said.

ADOPTING THE COMMISSION'S RECOMMENDATIONS

The nine-member Military Compensation and Retirement Modernization Commission in January 2015 recommended increasing the role of the TSP in troops' retirement benefits, along with several other proposals to overhaul the military's compensation system. The commission argued for a more blended retirement plan for a better mix of benefits and improved retention rates. The authorization act aims to help both new career and non-career service members accrue more retirement benefits as a result of the increased role of the TSP.

Personnel who serve less than 20 years—about 83 percent—currently do not receive a defined retirement benefit, which some believe is unfair given their multiple deployments during the wars in Iraq and Afghanistan. Those who do spend a career in the military, on the other hand, can hit the 20-year mark relatively early, retire from service in their 40s or 50s, draw a pension and work elsewhere.

Now, service members will be fully vested in their retirement plans after two years of service.

The White House had expressed reservations about the commission's plan last year, saying in the spring of 2015 that it was "still evaluating how the more complex recommendations – such as the blended retirement system and reserve component duty statuses – would affect the all-volunteer force."

Lawmakers debated whether more study was necessary over the summer, but proponents argued there was no sense in further delaying the changes. "There's always going to be an excuse for delay, and we've been hearing that for years. I think this is the time to act," said House Armed Services Committee Chairman Rep. Mac Thornberry, R-Texas.

"The choices we face about military compensation are both vexing and critically important," Defense Secretary Ash Carter said in a statement in May. "DOD will continue to work closely with the Congress and the commission to achieve the goals we share: ensuring the long-term strength and vitality of our all-volunteer force, and honoring all our service members – past, present, and future."

The new blended retirement system affects only new service members. The Pentagon must provide Congress with a detailed plan for implementing the new approach.

IMPLEMENTATION BEGINS

In December 2015, the organization that administers the Thrift

Savings Plan began the process of implementing the portion of the law it is responsible for.

The Federal Retirement Thrift Investment Board has roughly two years to put in place a system for auto-enrollment of new troops into the TSP. The FRTIB manages a program that has approximately 4.7 million participants, 700,000 of whom are service members, so it's already big. Auto-enrolling service members could add up to 250,000 new participants each year.

"We are very excited to have the opportunity to play a larger role in uniformed services retirement," said Kim Weaver, director of external affairs at the FRTIB.

Weaver said the agency has pulled together an intragency team to gear up for implementing auto-enrollment for service members, and is working with Defense to "make sure we are not out of sync." This is not entirely new territory for the FRTIB. In 2010, the agency launched a program that automatically signs up all new civilian government hires to allocate 3 percent of their basic pay to the G (government securities) fund, unless they choose to end their contributions or change the amount.

In December 2014, President Obama signed into law the Smart Savings Act, which changes the default enrollment fund in the TSP for new hires from the G Fund to the lifecycle (L) funds, which are designed to move investors to less risky portfolios as they near retirement. TSP enrollees apparently are happy with their retirement options: a 2013 survey of federal

At a Glance

Key elements of the new military retirement system:

- ▶ Shifts away from the 20-year, all-or-nothing pension system that has been in place for military members.
- ▶ New troops automatically enrolled in government's 401(k)-style Thrift Savings Plan, with 1 percent matching contributions from their employer.
- ▶ Government match can go as high as 5 percent of salary.
- ▶ Current service members grandfathered into existing system, but can opt into new one.
- ▶ Those who stay in the military for 20 years or more can now take a lump-sum retirement payout.



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DEFENSE SECRETARY ASH CARTER

employees found that respondents were most satisfied with the TSP among other benefits.

The new system really benefits the 83 percent who do not stay in the military long enough to draw a pension, said Michael Meese, a retired Army brigadier general and the chief operating officer of the American Armed Forces Mutual Aid Association. Those in the current system who opt into the new one could accrue more retirement savings or come out even, though it really depends on the individual's situation and choices, Meese said. "But it does unequivocally help those people who stay shorter than the length of retirement (at least 20 years)," he said.

Meese's group is a nonprofit that helps educate service members on their benefits and financial planning. Financial education is a big component of the new law, and Defense will have to make sure service members understand their options and the risks associated with them.

Meese praised the commission for its recommendations on expanding retirement benefits to those non-career members. Its goal was to make the military "more effective in terms of recruiting and retention, recognizing that defense is critical to what the federal government does. When you come at it from that perspective, you may be able to save money, but

more importantly, you can adjust incentives to get the right force mix our nation needs."

Choices are good, said Meese, whose background is in economics, but "we're notoriously bad at knowing what we want to be when we grow up." Service members, like everyone else, don't always accurately anticipate how long they will remain in their current careers, which makes financial education and planning vital. Another upcoming change to the military retirement system allows those who stay in 20 years or more to take a lump sum or a continuous payment upon retirement. Lump sum payouts are a new option, and have attracted some controversy.

A lump sum payout looks like "a giant payday," Meese said, but unless you invest it wisely, it could backfire.

"I can certainly imagine a 45-year-old taking \$150,000 and starting up a brand new business and really becoming a great entrepreneur," Meese said. "I could also imagine someone taking that \$150,000 and not spending it as productively, and then not having any income coming in until age 67," when the pension checks restart. An eligible service member also could opt for a partial lump sum, as opposed to the entire payout, under the new option. **D**

About the Authors



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Eric Katz joined *Government Executive* in the summer of 2012 after graduating from The George Washington University, where he studied journalism and political science. He has written for his college newspaper and an online political news website and worked in a public affairs office for the Navy's Military Sealift Command. Most recently, he worked for *Financial Times*, where he reported on national politics.



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Kellie Lunney covers federal pay and benefits issues, the budget process and financial management. After starting her career in journalism at *Government Executive* in 2000, she returned in 2008 after four years at sister publication *National Journal* writing profiles of influential Washingtonians. She has appeared on C-SPAN's *Washington Journal*, NPR and Feature Story News, where she participated in a weekly radio roundtable on the 2008 presidential campaign. She is a graduate of Colgate University.