



Cornell University
ILR School

Cornell University ILR School
DigitalCommons@ILR

Federal Publications

Key Workplace Documents

4-30-2015

Military Retirement: Background and Recent Developments

Kristy N. Kamarck
Congressional Research Service

Follow this and additional works at: https://digitalcommons.ilr.cornell.edu/key_workplace

Thank you for downloading an article from DigitalCommons@ILR.

Support this valuable resource today!

This Article is brought to you for free and open access by the Key Workplace Documents at DigitalCommons@ILR. It has been accepted for inclusion in Federal Publications by an authorized administrator of DigitalCommons@ILR. For more information, please contact catherwood-dig@cornell.edu.

Military Retirement: Background and Recent Developments

Abstract

[Excerpt] The military retirement system is a government-funded 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 for qualified active and reserve retirees, 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, basic pay at retirement, and is adjusted annually through a Cost-of-Living-Adjustment (COLA). Military retirees are also entitled to nonmonetary benefits including exchange and commissary privileges, medical care through TRICARE, and access to Morale, Welfare and Recreation (MWR) facilities and programs.

Currently, active component personnel are eligible for retirement or “vested” after completing 20 years of service (YOS) and have a choice between two options (High-Three or Career Status Bonus/Redux) based on career expectations and the individual’s financial situation. Reserve personnel are eligible for retirement after 20 years of creditable service based on a points system, but do not typically begin to draw retirement pay until age 60. A third category of retirement is disability retirement.

In FY2013, \$54 billion was paid to approximately 2.2 million military retirees and survivors. Given the size of the program, some have viewed military retirement as a place where substantial budgetary savings could be made. However, others have argued that past modifications intended to save money have had a deleterious effect on military recruiting and retention. Military retirees, families, and veterans’ service organizations closely monitor potential future changes to the retirement system. When considering alternatives to the current system, Congress will likely consider the balance between budget constraints and the needs and concerns of this constituent group.

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. The commission recommended substantial changes to the current retirement system from a purely defined benefit system to a blended system. The new system would allow more servicemembers to develop retirement savings earlier in their careers through contributions into the Thrift Savings Plan (TSP) coupled with government matching and early vesting, and would reduce the defined benefit multiplier for calculating the retirement annuity from 2.5% to 2.0%. The new multiplier would provide Servicemembers retiring at 20 years of service with 40% of their “pay base” at retirement rather than 50% under the current system. Under the commission’s proposed changes, existing servicemembers and retirees would be able to remain in the old system or opt into the new system.

Keywords

military, retirement, benefit system, savings

Comments

Suggested Citation

Kamarck, K. N. (2015). *Military retirement: Background and recent developments*. Washington, DC: Congressional Research Service.

A more recent version of this report can be found here: [http://digitalcommons.ilr.cornell.edu/
key_workplace/1531](http://digitalcommons.ilr.cornell.edu/key_workplace/1531)



**Congressional
Research Service**

Informing the legislative debate since 1914

Military Retirement: Background and Recent Developments

Kristy N. Kamarck

Analyst in Military Manpower

April 30, 2015

Congressional Research Service

7-5700

www.crs.gov

RL34751

Summary

The military retirement system is a government-funded 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 for qualified active and reserve retirees, 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, basic pay at retirement, and is adjusted annually through a Cost-of-Living-Adjustment (COLA). Military retirees are also entitled to nonmonetary benefits including exchange and commissary privileges, medical care through TRICARE, and access to Morale, Welfare and Recreation (MWR) facilities and programs.

Currently, active component personnel are eligible for retirement or “vested” after completing 20 years of service (YOS) and have a choice between two options (High-Three or Career Status Bonus/Redux) based on career expectations and the individual’s financial situation. Reserve personnel are eligible for retirement after 20 years of creditable service based on a points system, but do not typically begin to draw retirement pay until age 60. A third category of retirement is disability retirement.

In FY2013, \$54 billion was paid to approximately 2.2 million military retirees and survivors. Given the size of the program, some have viewed military retirement as a place where substantial budgetary savings could be made. However, others have argued that past modifications intended to save money have had a deleterious effect on military recruiting and retention. Military retirees, families, and veterans’ service organizations closely monitor potential future changes to the retirement system. When considering alternatives to the current system, Congress will likely consider the balance between budget constraints and the needs and concerns of this constituent group.

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. The commission recommended substantial changes to the current retirement system from a purely defined benefit system to a blended system. The new system would allow more servicemembers to develop retirement savings earlier in their careers through contributions into the Thrift Savings Plan (TSP) coupled with government matching and early vesting, and would reduce the defined benefit multiplier for calculating the retirement annuity from 2.5% to 2.0%. The new multiplier would provide Servicemembers retiring at 20 years of service with 40% of their “pay base” at retirement rather than 50% under the current system. Under the commission’s proposed changes, existing servicemembers and retirees would be able to remain in the old system or opt into the new system.

Contents

Overview.....	1
Retirement Systems and Pay Calculations.....	2
Active Component Retirement.....	3
Final Basic Pay System.....	4
“High Three”.....	4
Redux.....	4
Reserve Component Retirement.....	6
Disability Retirement.....	8
Military Retired Pay, Social Security, and Federal Income Tax.....	8
Change in Military Retiree Pay Dates.....	9
Retired Pay and the Cost-of-Living Adjustment (COLA).....	9
COLAs for Pre-August 1, 1986, Entrants.....	10
COLAs for Personnel Who Entered Service On or After August 1, 1986.....	10
Non-Redux Recipients.....	10
Redux/\$30,000 Cash Bonus Recipients.....	10
Bipartisan Budget Act of 2013.....	11
Reforming the Military Retirement System.....	11
10 th QRMC Recommendations.....	11
11 th QRMC Recommendations.....	12
MCRMC Proposals.....	12
Proposed Changes to the Defined Benefit System.....	14
Proposed Changes to Continuation Pay.....	15
Proposed Changes to Disability Retirement.....	16
Military Retirement Budgeting and Costs.....	16
Unfunded Liability.....	17

Figures

Figure 1. Active Duty Non-Disability (Longevity) Retirement Eligibility Flowchart.....	3
--	---

Tables

Table 1. DOD Retired Military Personnel, Survivors, and Program Costs, FY2005-FY2013.....	2
Table 2. Active Duty and Reserve Non-Disability Retirees by Category and Service.....	6
Table 3. Cost-of-Living Adjustments 2006-2015.....	9
Table 4. Comparison of Current Retirement System to MCRMC Proposals.....	13
Table 5. DOD’s Normal Cost Percentages for FY2014.....	16

Contacts

Author Contact Information..... 18

Overview

The military retirement system is a government-funded 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 for qualified active and reserve retirees, 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 at retirement. The monthly retirement annuity is adjusted annually by a Cost-of-Living Adjustment (COLA) to ensure that the annuity is protected from the adverse consequences of inflation. Military retirees are also entitled to nonmonetary benefits, which include exchange and commissary privileges, medical care through TRICARE, and access to Morale, Welfare and Recreation facilities and programs.

The active component retirement system provides a choice between two retirement options based on career expectations and an individual's financial situation. Eligibility is based on years of active duty, with active duty personnel generally becoming retirement eligible after completing 20 years of service. For reserve component personnel, their retirement system is based on "points," and reservists do not generally begin to receive retired pay until the age of 60. Both the active duty and reserve component retirement systems "vest," or become eligible for retirement benefits, at 20 years of qualifying service.¹ Those who separate voluntarily prior to the 20-year point generally receive no retirement benefits. However, there is a third retirement system for those who are retired with a physical disability regardless of the amount of time they have spent on active duty. Disability retirement also offers a choice between two retirement options: one based on years of service (longevity) and one on the severity of the disability.

In FY2013 \$54 billion was paid to approximately 2.3 million military retirees and survivors.² As shown in **Table 1**, the number of military retirees and the cost of their retirement benefits have increased over the past decade. Congress grapples with constituent concerns as well as budgetary constraints in considering military retirement issues. In the past, some have viewed military retirement as a place where substantial savings could be made, arguing that the military retirement compensation is overly generous relative to pension systems in the civilian sector. In particular, they note that active duty military personnel become eligible for retirement at a relatively young age. The average active duty³ enlisted retiree is 43 years old and has 22 years of service at retirement while the average officer is 47 years old and has nearly 24 years of service at retirement.⁴

Others argue that the military retirement system is fair given the unique demands of military service, pointing out the high operational tempo and repetitive tours of duty in overseas combat areas that servicemembers have endured over the past decade and a half. In addition, some have

¹ Vesting in the military retirement system is commonly referred to as "cliff vesting." Until the 20-year point, there is generally no vesting. At 20 years, the servicemember becomes fully vested. However, individuals can receive retirement benefits with fewer than 20 years of service under the disability retirement system and under Temporary Early Retirement Authority (Section 4403, P.L. 102-484, October 23, 1992).

² Department of Defense, *FY2013 DOD Statistical Report on the Military Retirement System*, Office of the Actuary, May 2014.

³ These figures are for all of DOD non-disability retirees, excluding reserve retirees.

⁴ Department of Defense, *Fiscal Year 2013 DOD Statistical Report on the Military Retirement System*, Office of the Actuary, May 2014, pp. 81 and 98.

argued that past modifications to the system intended to save money have had a deleterious effect on military recruiting and retention, particularly in times of strong economic performance.

Table I. DOD Retired Military Personnel, Survivors, and Program Costs, FY2005-FY2013

FY	Retired Pay Recipients and Total Program Cost	Retirees from an Active Duty Military Career	Disability Retirees	Reserve Retirees	Survivor Benefit Recipients
FY2013	2,284,179/ \$54.00 billion	1,470,803/ \$43.09 billion	103,106/ \$1.43 billion	383,490/ \$5.62 billion	326,780/ \$3.85 billion
FY2012	2,272,295/ \$52.61 billion	1,472,087/ \$42.1 billion	95,910/ \$1.38 billion	376,052/ \$5.36 billion	328,246/ \$3.81 billion
FY2011	2,260,112/ \$50.65 billion	1,471,219/ \$40.5 billion	94,886/ \$1.36 billion	366,823/ \$5.06 billion	327,184/ \$3.7 billion
FY2010	2,216,720/ \$50.12 billion	1,467,936/ \$40.2 billion	92,704/ \$1.38 billion	356,602/ \$4.89 billion	299,478/ \$3.65 billion
FY2009	2,201,788/ \$49.17 billion	1,468,377/ \$39.54 billion	91,460/ \$1.38 billion	344,393/ \$4.65 billion	297,558/ 3.60 billion
FY2008	2,170,812/ \$45.66 billion	1,466,706/ \$37.21 billion	85,499/ \$1.29 billion	328,664/ \$4.31 billion	289,943/ \$3.38 billion
FY2007	2,146,403/ \$43.57 billion	1,461,724/ \$35.89 billion	85,306/ \$1.27 billion	312,647/ \$4.00 billion	286,726/ \$3.28 billion
FY2006	2,116,690/ \$41.13 billion	1,452,505/ \$34.18 billion	87,232/ \$1.26 billion	293,014/ \$3.60 billion	283,939/ \$2.67 billion
FY2005	2,091,253/ \$38.79 billion	1,441,931/ \$32.44 billion	89,511/ \$1.26 billion	280,680/ \$3.32 billion	279,131/ \$2.26 billion

Sources: Department of Defense, *FY2014 Military Retirement Fund Audited Financial Report*, Office of the Comptroller, November 7, 2014.

Department of Defense, *FY2013 DOD Statistical Report on the Military Retirement System*, Office of the Actuary, May 2014. Statistical documents available by fiscal year for FY2005-FY2013.

Notes: Total Program Cost is the total obligations and expenditures for that Fiscal Year. Survivors include the spouse, children, and others with insurable interests that are entitled to survivor benefits from the DOD Military Retirement Fund.

While congressionally mandated changes to the military retirement system have been infrequent, any potential future changes are closely monitored by current servicemembers, retirees, survivors and the veterans’ service organizations that support them. In addition, there are roughly 6 million to 8 million family members, who, combined with the retirees and survivors, are generally believed to be an articulate and well-educated constituent group.

Retirement Systems and Pay Calculations

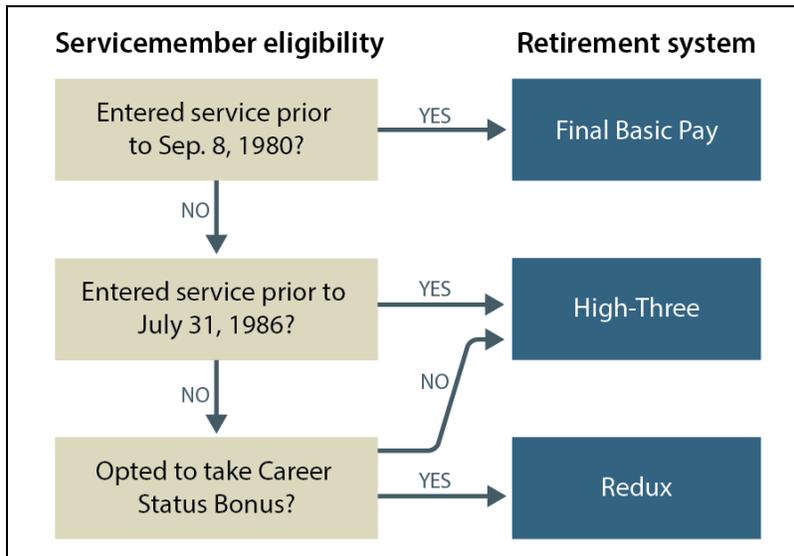
There are currently three separate but related retirement systems within the DOD: one for active duty members, one for reservists, and one for those who become medically disabled and are unable to complete a 20-year military career due to their disability. Each of these systems has distinct eligibility requirements and formulas for calculating the retirement annuity. Retirement

pay calculations are based on the date when the servicemember first entered on active duty and their “pay base”⁵ at the time of retirement.⁶ The active and reserve component retirement systems “cliff-vest” after 20 years of service, which means that servicemembers who leave the service prior to completing 20 years of eligible service typically, will not receive any non-disability retirement benefit. Vesting for the disability retiree occurs at their disability retirement date, regardless of years of service, and some individuals qualify for longevity retirement prior to attaining 20 years of service under Temporary Early Retirement Authority (TERA).

Active Component Retirement⁷

For active duty military personnel, there are three methods of calculating retired pay based on longevity: 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, their pay base at the time of retirement, their years of service, and whether they opted in to the Redux system. **Figure 1** shows how eligibility for retirement calculations is determined.

Figure 1. Active Duty Non-Disability (Longevity) Retirement Eligibility Flowchart



Source: CRS

⁵ The “pay base” is either the amount of basic pay being received at the time of retirement (for those in the Final Basic Pay System) or the average of the highest 36 months of basic pay received (for those in the High-3 System). See 10 U.S.C. §§1406 and 1407. Basic pay is the principal element of Regular Military Compensation (RMC). The other elements include the Basic Allowance for Housing (BAH) and the Basic Allowance for Subsistence (BAS), which are nontaxable allowances. Basic pay is between 65% and 75% of RMC. RMC excludes all special pay and bonuses, reimbursements, educational assistance, and any value associated with nonmonetary benefits such as health care, commissaries, and post exchanges. For additional discussion of military pay and RMC, see CRS Report RL33446, *Military Pay: Key Questions and Answers*, by Lawrence Kapp and Barbara Salazar Torreon.

⁶ Unlike some civilian retirement plans, there is currently no provision in any of the military retirement systems for a lump sum withdrawal after retirement.

⁷ This is also frequently referred to as regular non-disability retirement.

Final Basic Pay System

For persons who entered military service before September 8, 1980, the pay base is the final monthly basic pay being received by the servicemember at the time of retirement multiplied by 2.5% for each year of service.⁸ The minimum amount of retired pay to which a member is entitled under this formula is therefore 50% of the retired pay computation base (20 years of service times 2.5%). A servicemember who retires at 25 years receives 62.5% of the computation base (25 years of service times 2.5%). Historically, the maximum, reached at the 30-year mark, was 75% of the computation base (30 years of service times 2.5%). However, the FY2007 John Warner National Defense Authorization Act (P.L. 99-348 §§601 and 642) extended the previous pay table to 40 years, allowed additional longevity raises, and provided additional retirement credit for service beyond 30 years at the rate of 2.5% per year. As a result, a servicemember who retires with 40 years of service will qualify for 100% of their final basic pay⁹ in retirement.

The Final Basic Pay cohort that entered the military before September 8, 1980, had 30 years of service in 2010. They have nearly all aged out of the system, and it is expected that all members of this group will be retired by 2016.¹⁰

“High Three”

For those who entered service *on or after* September 8, 1980, the computation base is the average of the highest three years (36 months) of basic pay rather than the final basic pay. Otherwise, calculations are the same as under the Final Basic Pay method.

Redux

What is now commonly referred to as the “Redux” military retirement system was initiated with the Military Retirement Reform Act of 1986 (P.L. 99-348). The Redux formula reduced the amount of retired pay that military servicemembers who entered the armed forces on or after August 1, 1986, were eligible to receive. This system was broadly unpopular and by 1997 Congress began to take note of potential recruiting and retention problems associated with the change.¹¹ During the fall of 1998, the Clinton Administration announced that it supported Redux repeal.¹² The FY2000 National Defense Authorization Act (P.L. 106-65 §§641 and 642) contained provisions for repealing compulsory Redux; it allowed post-August 1, 1986 entrants to retire under the pre-Redux (“High-Three”) system or opt for Redux plus an immediate \$30,000 cash payment. Personnel who first enter service *on or after* August 1, 1986, are required to select

⁸ Partial years of service are credited as well, with each month equivalent to one-twelfth of a year. Military Retirement Reform Act of 1986, Section 1405(b), P.L. 99-348, July 1, 1986.

⁹ In the FY2015 Carl Levin and Howard P. “Buck” McKeon National Defense Authorization Act. (P.L. 113-291 §622), Congress reinstated a cap on retired pay of general and flag officers at the Executive Level II salary (\$183,300 for 2015). This change applies to only years served after December 31, 2014.

¹⁰ Department of Defense, *Valuation of the Military Retirement System, September 30, 2006*, DOD Office of the Actuary, November, 2007, p. 12.

¹¹ Department of Defense, *Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items, Their Purposes and Legislative Backgrounds*, April 2005, p. 707.

¹² U.S. Congress, Senate Special Committee on Aging, *Developments in Aging: 1999 and 2000, Volume 1*, 107th Cong., 2nd sess., S.Rept. 107-158 (Washington DC: GPO, 2001).

one of the following two options for calculating their retired pay within 180 days of reaching 15 years of service.

Option 1: Pre-Redux

Eligible servicemembers can opt to have their retired pay computed in accordance with the pre-Redux formula, described above as High Three.

Option 2: Redux

Eligible servicemembers can opt to have their retired pay computed in accordance with the Redux formula and receive an immediate \$30,000 cash bonus called a Career Status Bonus.¹³ Those who select the Career Status Bonus (CSB) must remain on active duty until they complete 20 years of service or forfeit a portion of the bonus.

The Redux Formula

Redux is different from the High Three formula in two major ways.

1. **Retirees under age 62:** First, for retirees under the age of 62, the retired pay multiplier will be reduced by 1% for each year of creditable service less than 30 years. Under this formula, a 20-year retiree will receive 40% of his or her retired pay computation base upon retirement (20 years of service multiplied by 2.5% minus 10%), and a 25-year retiree will receive 57.5% of the computation base (25 years of service multiplied by 2.5% minus 5%). A 30-year retiree, however, will receive 75% of the retired pay computation base (30 years of service multiplied by 2.5% minus 0%, the same as the High Three retiree). The Redux formula, therefore, is “skewed” much more in favor of the longer serving military careerist, theoretically providing an incentive to remain on active duty longer before retiring.
2. **Retirees 62 and older:** Second, when a retiree reaches the age of 62, his or her retired pay will be recomputed based on the old formula, a straight 2.5% of the retired pay computation base for each year of service. Thus, beginning at 62, the 20-year retiree receiving 40% of his or her pay base under the Redux formula will begin receiving 50% of his or her pay base; the 25-year retiree’s annuity will jump from 57.5% of the pay base to 62.5%; and the 30-year retiree’s annuity, already at 75% of the pay base under both the old and new formulas will not change.¹⁴

Table 2 reflects retirees by service and by retired pay system. There are very few now serving in the military that are eligible to retire under the Final Pay system since the junior member of that cohort who is still on active duty had at least 35 years of service in 2015. Although the numbers

¹³ 37 U.S.C. §354. The bonus can actually be paid in several annual installments if the recipient so wishes, for tax purposes.

¹⁴ Note that this change is an increase in monthly retired pay, not a lump sum at the age of 62.

for High Three and Redux should continue to increase, these figures show that Redux is the least popular retirement system with fewer current retirees selecting this option.

Table 2. Active Duty and Reserve Non-Disability Retirees by Category and Service
(as of September 2014)

	Army	Air Force	Navy	Marine Corps	Total
Final Pay	599,991	539,243	368,717	85,747	1,593,698
High Three	178,554	131,333	116,624	34,979	461,490
Redux	17,238	15,348	15,852	3,710	52,148
Total	784,548	684,924	501,193	124,436	2,107,336

Source: Department of Defense, Office of the Actuary. Data provided to CRS on March 26, 2015.

Notes: Totals include all of those eligible to receive non-disability retired pay including those who are eligible but not receiving retired pay due to 100% VA offset for disability or gray area reserve retirees.

Reserve Component Retirement¹⁵

There are many similarities between the active and reserve retirement systems. First, reserve component members¹⁶ must also complete 20 “qualifying” years of service to become eligible for retirement. Second, the reserve retirement system also accrues at the rate of 2.5% per “equivalent year” of qualifying service (explained below) at retirement eligibility. Third, the reserve retirement system uses either Final Basic Pay or the High Three to calculate retired pay; Redux is not an option for reservists. The primary differences between the two systems are the point system used to calculate “qualifying years” and equivalent years of service, as well as the age at which the retirement annuity begins.

For retirement purposes, a year of “qualifying” service is a year in which a Reserve servicemember earns at least 50 retirement “points.” Points are awarded for a variety of reserve activities:

- One point for each day of active service, which includes annual training.¹⁷
- Fifteen points a year for membership in the Ready Reserve.
- One point for each inactive duty training (IDT) period.¹⁸

¹⁵ Also referred to as nonregular retirement. For additional information on reserve pay and benefits, see CRS Report RL30802, *Reserve Component Personnel Issues: Questions and Answers*, by Lawrence Kapp and Barbara Salazar Torreon.

¹⁶ Reserve component generally describes the six reserve components of the Department of Defense: the Army National Guard, the Army Reserve, the Navy Reserve, the Marine Corps Reserve, the Air National Guard and the Air Force Reserve.

¹⁷ Annual training is a two-week period of active service that usually results in 14 or 15 retirement points.

¹⁸ A day of inactive duty for training typically includes two Unit Training Assemblies (UTAs). The normal drill weekend consists of four UTAs and therefore results in four retirement points. A year of weekend drills earns 48 UTAs/retirement points.

- One point for each period of funeral honors duty.
- One point for every three satisfactorily completed credit hours of certain military correspondence courses.

With multiple opportunities to earn points, it is relatively easy for a participating member of the selected reserve to accrue the requisite 50 points per year and thus earn a qualifying year for retirement. The maximum number of points per year, exclusive of active duty, has varied over time but is currently capped at 130 points.¹⁹ When active duty points are added to this total, the reservist cannot earn more than 365 points a year. The number of points is critical in determining both the number of years of qualifying service and the number of equivalent years of service for retired pay calculation purposes.

A reservist may retire after completing 20 years of qualifying service; there is no minimum age. However, the reservist will usually not become eligible for retired pay until age 60,²⁰ at which time he or she also becomes eligible for military medical care. Upon retirement, the individual is normally transferred to the Retired Reserve and is entitled to a number of military benefits to include commissary and exchange privileges; access to Morale, Welfare and Recreation programs and facilities; and limited space available travel on military aircraft. Reservists in the Retired Reserve and not yet retired pay eligible are referred to as “Gray Area” retirees. Time spent in the Retired Reserve counts for longevity purposes and ultimately results in higher retired pay. For example, a lieutenant colonel who transitions to the Retired Reserve at age 45 will have their retired pay at age 60 calculated on the basic pay of a lieutenant colonel with an additional 15 years of longevity.

The date the reservist became a member of the armed forces determines whether their retired pay is calculated based on the Final Basic Pay or High Three system. Those entering before September 8, 1980, will retire under the Final Basic Pay system while those entering after September 8, 1980, will retire under the High Three system.

The actual calculation parallels the active duty system but requires adjustment to reflect the part-time nature of reserve duty. For example, consider a reserve component lieutenant colonel with 5,000 points who joined the military in January 1980, and transferred to the Retired Reserve in 2000 after completing 20 qualifying years of service. In 2015, he turned 60 years of age and became eligible for retired pay. The process for calculating his retired pay is to divide the total points by 360 to convert the points to years of equivalent service ($5000 / 360 = 13.89$). Next multiply the equivalent years of service by the 2.5% multiplier ($13.89 \text{ times } 0.025 = .3472$). Using the Final Basic Pay option, the 2015 pay base²¹ for a lieutenant colonel with 35 years of service (20 years of qualifying service plus 15 years in the Retired Reserve) is \$8,762.40 per month. Multiplying the pay base by the retired pay multiplier ($\$8,762.40 \text{ times } 0.3472$) produces a monthly retirement annuity of \$ 3,042 per month.

¹⁹ P.L. 110-181 §648

²⁰ Section 648 of the FY2008 National Defense Authorization Act reduced the age for receipt of retired pay by three months for each aggregate of 90 days of specified duty performed after January 28, 2008 (the date of enactment of the FY2008 NDAA). This authority was not made retroactive to September 11, 2001. The retired pay eligibility age cannot be reduced below 50 and eligibility for medical benefits remains at age 60.

²¹ 2015 Military Pay Chart at <http://www.dfas.mil>.

Disability Retirement²²

Servicemembers determined to be unfit for continued service and who have a permanent and stable disqualifying physical condition may qualify for disability retirement, commonly referred to as a Chapter 61 retirement. Eligibility is based on having a permanent and stable disability, rated at 30% or more by DOD, and the disability was not noted at the time of entrance on active duty.²³ As a result, some disability retirees are retired before becoming eligible for longevity retirement while others have completed 20 or more years of service.

A servicemember retired for disability may select one of two available options for calculating their monthly retired pay.²⁴

1. **Longevity Formula.** Retired pay is computed by multiplying the years of service times 2.5% and then times the pay base (either final pay or high three, as appropriate).
2. **Disability Formula.** Retired pay is computed by multiplying the DOD disability percentage by the pay base.

The maximum retired pay calculation under the disability formula cannot exceed 75% of basic pay; however, it can be higher under the longevity formula.²⁵ Retired pay computed under the disability formula is subject to federal income tax unless the disability is the result of a combat-related injury or if the individual was a member of the Armed Services or eligible to receive disability payments prior to September 25, 1975.²⁶ Retired pay under the longevity formula (for those entering after September 24, 1975) is taxable only to the extent that it exceeds what the individual would receive for a combat related injury under the disability formula.

Military Retired Pay, Social Security, and Federal Income Tax

Military personnel do not contribute a portion of their salary to help pay for military retirement benefits. However, they have paid taxes into the Social Security trust fund since January 1, 1957, and are entitled to full Social Security benefits based on their military service. Military retired pay and Social Security are not offset against each other; military retirees receive full Social Security benefits in addition to their military retired pay.

Military retired pay is not subject to withholding for Social Security tax. However, all non-disability retired pay is subject to withholding of federal income tax. A portion of the Social Security benefit may also be subject to federal income tax for individuals who have other income.

²² For additional information on DOD's disability process, see CRS Report RL33991, *Disability Evaluation of Military Servicemembers*, by Christine Scott and Don J. Jansen.

²³ 10 U.S.C. §1201 (b) (3) (B). Prior to the FY2008 NDAA (P.L. 110-181 §1641), disability retirement required at least eight years of service or a disability that resulted from active duty or was incurred in the line of duty during war or national emergency.

²⁴ 10 U.S.C. §1401.

²⁵ 10 U.S.C. §1401.

²⁶ 26 U.S.C. §104.

Change in Military Retiree Pay Dates

Monthly pay for most military retirees has been accomplished through direct deposit to a financial institution on the first day of the month. However, if the first day of the month was a weekend or national holiday, the pay would not be deposited until the first business day of the month, which could actually be the second or third day of the month.

In response to numerous complaints from military retirees about not receiving their pay on the first and with support from veterans' service organizations, the FY2011 Ike Skelton National Defense Authorization Act (P.L. 111-383 §646) required that military retiree pay be processed on the first day of the month. When that day falls on a weekend or holiday, the pay date is moved to the previous business day. This change resulted in calendar year 2011 having 13, rather than the normal 12, military pay dates and the potential tax implications associated with increased annual income. From tax year 2012 and beyond, military retirees will receive their normal 12 payments.

Retired Pay and the Cost-of-Living Adjustment (COLA)

Military retired pay is protected against inflation by statute (10 U.S.C. §1401a). The Military Retirement Reform Act of 1986, in conjunction with changes contained in the FY2000 National Defense Authorization Act (P.L. 106-65), provides for COLAs as indicated below. Congress has not modified the COLA formula²⁷ since 1995. However, COLA modifications are regularly discussed among policymakers, typically with the aim of reducing costs and hence the payments to retirees.

For non-Redux retirees from 2006 to 2009, COLA increases averaged 3.9% annually. However, there was no COLA in 2010 as a result of negative inflation from the third quarter of 2008 to the third quarter of 2009. This trend continued in 2011 with no COLA increase being paid. For both 2010 and 2011, negative inflation did not result in a decrease in retired pay but kept it the same as the previous year. However, 2011 saw a 3.6% COLA increase paid beginning January 1, 2012 and from 2013 to 2015 COLA has remained fairly steady around 1.6% as shown in **Table 3**.²⁸

Table 3. Cost-of-Living Adjustments 2006-2015

Year	COLA	Year	COLA
2006	4.1%	2011	0.0%
2007	3.3%	2012	3.6%
2008	2.3%	2013	1.7%
2009	5.8%	2014	1.5%

²⁷ The actual index used to adjust COLA is the CPI-W; the index for urban wage earners and clerical workers. It represents the buying habits of approximately 32% of the noninstitutional population of the United States, *Military Compensation Background Papers*, Seventh Edition, November 2011, p. 637.

²⁸ For a discussion of proposed and actual COLA changes from FY1983 to FY2005, see CRS Report 98-223, *COLAs for Military Retirees: Summary of Congressional and Executive Branch Action, 1982-2004 (FY1983-FY2005)*.

Year	COLA	Year	COLA
2010	0.0%	2015	1.7%

Source: Office of the Under Secretary of Defense (Comptroller), DOD 7000.14-R Financial Management Regulation, Vol. 7B, Chapter 8, February 2015

COLAs for Pre-August 1, 1986, Entrants

For military personnel who first entered military service before August 1, 1986, each December a COLA equal to the percentage increase in the Consumer Price Index (CPI) between the third quarters of successive years will be applied to military retired pay for the annuities paid beginning each January 1. For example, assume that the CPI rises from 400.0 in the period July through September 2010 to 414.4 in the period July through September 2011, an increase of 14.4 points or 3.6% of 400.0. The monthly retired pay that accrues beginning December 2011, that will actually be paid to retirees on January 1, 2012, would be increased by 3.6% above that amount paid the previous month.

COLAs for Personnel Who Entered Service On or After August 1, 1986

For those personnel who first entered military service on or after August 1, 1986, their COLAs will be calculated in accordance with either of two methods, as noted below.

Non-Redux Recipients

Those personnel who opt to have their retired pay computed in accordance with the pre-Redux (High Three) formula will have their COLAs computed as described above for pre-August 1, 1986, entrants.

Redux/\$30,000 Cash Bonus Recipients

Those personnel who opt to have their retired pay computed in accordance with the Redux formula, and receive the \$30,000 cash bonus, have their COLAs computed using a different formula. Annual COLAs are held one percentage point below the actual inflation rate. Retirees covered by this COLA formula thus receive a 2.6% increase (rather than 3.6%) in their military retired pay under the hypothetical example described in the preceding example for Pre-August 1, 1986, entrants. When a retiree reaches the age of 62, there is a one-time recomputation of his or her annuity to make up for the lost purchasing power caused by the holding of COLAs to the inflation rate minus one percentage point. This recomputation of COLA, in combination with the recomputation of the retired pay multiplier (discussed earlier), restores the member's retired pay to that of a similarly retired member who did not take the Bonus/Redux option. After the recomputation at age 62, however, future COLAs continue to be computed annually on the basis of the inflation rate minus one percentage point.

Bipartisan Budget Act of 2013

The Bipartisan Budget Act of 2013 (P.L. 113-67 §403) modified how COLAs are computed for current and future retirees under the age of 62. Under the new formula, if the CPI used in computing the COLA is 1% or greater, then that CPI amount is reduced by 1% during each year the retiree is under age 62. For example, if the CPI is determined to be 2.5%, a CPI of 1.5% would be applied. If the CPI in any year is 1.0% or less than 1%, it is considered to be 0 and no COLA occurs (i.e., there cannot be a negative COLA). Upon reaching age 62, for the purposes of computing future retired pay, retired pay is re-computed as if the full CPI had been used each year while the retiree was under age 62. This formula was intended to go into effect on December 1, 2015 for all current and future servicemembers.

However, in response to concerns about potential effects, Congress first restored full CPI COLA adjustments for disabled military retirees and survivors in the Consolidated Appropriations Act of 2014 (P.L. 113-76). Congress has since amended the provision twice; first in 2014 (P.L. 113-82 §10001; formerly known as South Utah Valley Electric Conveyance Act) to apply only to servicemembers joining on or after January 1, 2014, and then again in the Carl Levin and Howard P. “Buck” McKeon National Defense Authorization Act for Fiscal Year 2015 (P.L. 113-291 §623) to apply only to servicemembers joining on or after January 1, 2016.

For more information on military retirement COLAs and the Bipartisan Budget Act of 2013 see CRS Report R43393, *Reducing Cost-of-Living Adjustments for Military Retirees and the Bipartisan Budget Act: In Brief*, by Amy Belasco and Lawrence Kapp.

Reforming the Military Retirement System

There have been several recent efforts to modify the military retirement system. A number of these previous studies have noted that the military retirement system should be more flexible, equitable, and efficient.

10th QRMC Recommendations

Every four years, the President is required by law²⁹ to direct a comprehensive review of the military compensation system and to forward the review, along with his recommendations, to Congress. In the 10th Quadrennial Review of Military Compensation (QRMC), one of the directed areas of assessment was “the implications of changing expectations of present and potential members of the uniformed services relating to retirement.”³⁰ To accomplish this, the QRMC suggested a major revision of both the active and reserve retirement systems highlighted by the following:

1. A defined benefit plan similar to the current “High Three” system but that would “vest” at 10 years of service and not be payable until age 60 for those who retired with less than 20 years of service or at age 57 for those with 20 or more years of

²⁹ 37 U.S.C. §1008(b)

³⁰ Presidential memorandum, Subject: Tenth Quadrennial Review of Military Compensation, August 2, 2005.

- service. Retirees could opt to receive the retirement annuity immediately upon retirement but the annuity would be reduced by 5% for each year under age 57.
2. Combined with the above defined benefit plan would be a defined contribution plan that would require the services to contribute up to 5% of annual base pay into a retirement account for each servicemember. The contribution would start at 2% for those with two years of service and increase incrementally until it reached 5% for those with five or more years of service. This plan would also vest at 10 years of service but withdrawals could not begin until age 60.
 3. A system of “gate” pays would be established at specified career points to retain selected personnel in specified skill areas.
 4. Separation pay would be used to encourage personnel in over-manned skills to separate prior to qualifying for a normal 10- to 30-year retirement.

11th QRMC Recommendations

The DOD submitted the 11th QRMC final report in June 2012. While this QRMC did not have the same focus on the entire retirement system as the previous QRMC, DOD recommended more closely aligning active and reserve retirement systems with the goal of eventually transitioning to a “total force” single-system approach for both the active and reserve components. The report recommended the following modification to the reserve retirement system³¹:

Reserve component members who have attained 20 qualifying years for retirement benefits could begin receiving retired pay on the 30th anniversary of their service start date or at age 60, whichever comes first. Reserve members would receive one retirement point for each day of service, and the points needed for a qualifying year would be reduced from the current 50-point requirement to 35.

Neither the executive branch nor Congress has taken any action to modify the military retirement system based on the recommendations of the 10th or 11th QRMC.

MCRMC Proposals

The National Defense Authorization Act (NDAA) for FY2013 (P.L. 112-239) 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.”³² Notably, Section 674 of P.L. 112-239 mandated that the commission comply with conditions that would grandfather existing servicemembers and retirees into the existing retirement system, stating:

- (i) For members of the uniformed services as of such date, who became members before the enactment of such an Act, the monthly amount of their retired pay may not be less than they

³¹ Report of the 11th Quadrennial Review of Military Compensation, June 2012.

³² National Defense Authorization Act for FY2013, P.L. 112-239 subtitle H, 126 Stat. 1632, 1787 (2013).

would have received under the current military compensation and retirement system, nor may the date at which they are eligible to receive their military retired pay be adjusted to the financial detriment of the member.

(ii) For members of the uniformed services retired as of such date, the eligibility for and receipt of their retired pay may not be adjusted pursuant to any change made by the enactment of such an Act.

The commission delivered its final report and recommendations to Congress on January 29, 2015. The recommendations, if implemented, would substantially change to the military retirement system.

Table 4 summarizes the systems currently in use alongside the proposed changes. The commission found that under the current system of “cliff-vesting,” which is contingent on a 20-year career, 83% of enlisted and 51% of officers do not receive retirement compensation for their service.³³ 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.³⁴

Table 4. Comparison of Current Retirement System to MCRMC Proposals

	Final Basic Pay	High Three	Redux	MCRMC Proposal
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 Career Status Bonus	Servicemembers entering after July 31, 1986, and accepting 15-year Career Status Bonus with additional five-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

³³ Military Compensation and Retirement Modernization Commission Final Report, January 2015. p. 23.

³⁴ The Employee Retirement Income Security Act (ERISA) requires firms to vest employees in company-provided defined benefit retirement plans either gradually over a period of seven years or by five years for cliff-vesting. In addition, a defined contribution plan must cliff vest within three years or up to six years for gradual vesting.

	Final Basic Pay	High Three	Redux	MCRMC Proposal
Additional Continuation Benefit			\$30,000 CSB payable at the 15-year anniversary with a five-year obligation to remain on active duty	eligibility age for full social security payments Incentive pay of 2.5 times monthly base pay for AC and 0.5 times monthly base pay for RC with a four-year duty obligation

Source: Adapted by CRS from *Military Compensation Background Papers*, Department of Defense, Seventh Edition, November 2011, and *Military Compensation and Retirement Modernization Commission Final Report*, January 2015.

Proposed Changes to the Defined Benefit System

The commission recommended changing the current system from a defined benefit system to a blended system which includes a defined contribution element. The defined benefit would remain similar to the Final Basic Pay system but the multiplier would be reduced from 2.5% to 2.0% per year of service. Thus, an active duty servicemember with 20 years of service would receive 40% of base pay (2.0% times 20) rather than 50% (2.5% times 20) under the current system. For reserve component, the same multiplier would be used although reserve years of service would continue to be calculated under the points system mentioned earlier in this report.

The proposed defined contribution element is intended to make up the shortfall incurred with the new multiplier and would be deposited through the Thrift Savings Plan (TSP). The services would begin monthly contributions of 1% of the members' basic automatically into the servicemember's TSP account upon service entry date until 20 years of service. The servicemember would be fully vested after two complete years of service and would be able to take ownership 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 servicemember opted out. The servicemember would automatically be enrolled every year at the 3% amount unless they actively opt out. The service would also make matching contributions up to 5% of monthly basic pay. Matching payments would cease at 20 years of service.

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

- a monthly payment beginning at their retirement date;
- a partial lump sum amount at retirement, combined with a reduced monthly payment until eligibility for full social security payments, at which point the full monthly annuity would begin; or
- a larger lump sum payment with no monthly payment until eligibility for full social security payments, at which point the full monthly annuity would begin.

Under the commission proposals, members of the reserve components would be eligible to receive the lump sum options above upon retirement from the reserves which will generally be before they are eligible to receive the monthly annuity at age 60.

The MCRMC did not make any recommendations changing the 20-year eligibility for retirement; however it recommended that the Secretary of Defense be given authority to modify the year of service requirement to shape the force profile as long as it does not impose involuntary changes on existing servicemembers. Any proposed change by the SECDEF would require notice to Congress and a one-year waiting period prior to implementation after Congress has received notice.

Existing service members in active duty, reserve status, and retirees would be “grandfathered” into whatever retirement system they currently have selected; however, they would have the opportunity to opt into the new system. The commission recommended removing the Career Status Bonus component of the Redux system at the date of enactment for reforms; however, those had already received the bonus could stay in the Redux system. For most mid- and late-career servicemembers eligible for retirement under the current system, opting into the new system would put them at a financial disadvantage as they would see a reduction in their multiplier at 20 years of service, but have not had the benefit of matching government contributions into the TSP system. However, servicemembers at the beginning of their career, particularly if they are unsure of whether or not they will complete a 20-year career, may benefit from opting in to the new system.

Proposed Changes to Continuation Pay

In order to provide mid-career retention incentives under the new system, the MCRMC proposed continuation pay for members who reach 12 years of service in return for a four-year obligation. Active duty members would receive continuation pay equal to at least 2.5 times the Servicemembers’ monthly basic pay while reserve component members would receive continuation pay equal to at least 0.5 times the basic pay of an active component member of similar rank and longevity. Therefore an active duty O-4 with over 12 years of service would receive a continuation pay of at least \$17,476.50 (2.5 times monthly base pay of \$6,990.60).³⁵ A reserve component O-4 with over 12 years of service would receive a continuation pay of at least \$3,495.30 (0.5 times monthly base pay of \$6,990.60).

The commission also proposed that the services budget additional funds for continuation pays in addition to the recommended basic continuation pays to maintain the current force profile and to allow flexibility in adjusting force profiles to meet future changes in manpower requirements. Based on the retention model used by the commission, it projected a need to offer continuation pay of up to 4.8 times basic pay for active component enlisted personnel and up to 15.9 times basic pay for officers.³⁶ The commission also recommended that all base and additional continuation pay should be paid from an authority used only for the purpose of continuation pay and should be budgeted as a new budget line item.

³⁵ 2015 Military Pay Chart at <http://www.dfas.mil>.

³⁶ MCRMC Final Report, pp. 29-30 and Table 2. The commission projected the Navy would require the highest multiples of continuation pay for enlisted personnel (4.8 times monthly basic pay) and the Air Force would require the highest multiples of continuation pay for officers (15.9 times monthly basic pay) to maintain their active component force profiles.

Proposed Changes to Disability Retirement

The commission recommended lifting the 75% cap on disability retirement when a servicemember uses his or her disability rating as a multiplier. The multiplier for disability retirement when a servicemember uses years of service (longevity formula) as the multiplier would be 2.0 instead of 2.5. There were no other changes proposed to the disability retirement system.

Military Retirement Budgeting and Costs

Military retirement costs, which include all payments to current retirees and survivors, have been rising modestly each year, due to a predictable slow rise in the number of retirees and survivors coupled with cost of living increases. All DOD budgets through FY1984 reflected the costs of retired pay actually being paid out to personnel who had already retired. That is, Congress appropriated the amount of money required to pay current retirees each year as part of each annual defense appropriations bill, commonly referred to as “pay-as-you-go.”

Since FY1985, the “accrual accounting” concept has been used to budget for the costs of military retired pay. The unfunded liability resulting from the change in accounting practices is discussed in the next section. Under the accrual accounting system, the DOD budget for each fiscal year includes not the amount of retired pay actually paid to retirees, but rather, a contribution to the military retirement fund sufficient to finance future retirement payouts to current uniformed personnel when they retire. These annual “accrual” contributions accumulate in the military retirement fund, along with interest earned on them.

The amount that the Defense Department must contribute each year to cover future retirement costs is determined by an independent, presidentially appointed, Department of Defense Retirement Board of Actuaries, which decides how much is needed to cover future retirement costs as a percentage of military basic pay. Once military personnel retire, payments to them are made from the accumulated amounts in the military retirement fund, not from the annual Department of Defense budget.

Estimated future retirement costs are modeled based on the past rates at which active duty military personnel stayed in the service until retirement, and on assumptions regarding the overall U.S. economy, including interest rates, inflation rates, and military pay levels. The model helps determine the level percentage of basic pay for each active servicemember that must be contributed from the DOD budget every year to cover future retirement costs. This is called the normal cost percentage (NCP) shown in **Table 5**.

Table 5. DOD’s Normal Cost Percentages for FY2014

Benefit Formula	Full-Time	Part-time
Final Pay	36.6%	23.8%
High-3	33.3%	22.5%
CSB/Redux	32.2%	NA

Source: DOD Office of the Actuary, *Valuation of the Military Retirement System*, September 30, 2013, rev. January 2015.

DOD budget authority and outlays in each fiscal year that pay for the estimated cost of future retirees are transferred in a paper transaction to a Military Retirement Fund, located in the Income Security Function of the federal budget. The Military Retirement Fund also receives (paper) transfers from the General Fund of the Treasury to fund the initial unfunded liability of the military retirement system. This is the total future cost of military retired pay that will result from military service performed prior to the implementation of accrual accounting in FY1985. Money is disbursed from this Military Retirement Fund to current retirees. Individual retirees receive their retired pay from the Defense Finance and Accounting Service (DFAS). Technically, however, because this money paid to individuals comes not from the DOD budget, but from the fund, it is paid out of the Income Security function of the federal budget function. Actual payments to current retirees thus show up in the federal budget as outlays from the federal budget as a whole, not from DOD. Under accrual accounting, therefore, total federal outlays for each fiscal year continue to reflect only costs of payments to military members who have already retired, as was the case before accrual accounting began. Accrual accounting only changes the manner in which the federal government accounts for military retired pay; it does not affect actual payments to individuals in any way.

Unfunded Liability

Current debates over both federal civilian and military retirement have included some discussion of the “unfunded liability” of both. As noted above, the military retirement system’s unfunded liability consists of future retired pay costs incurred before the creation of the Military Retirement Fund in FY1985. The initial unfunded liability as of September 30, 1984 was \$528.7 billion.³⁷ The unfunded liability at the end of FY2013 was \$885.1 billion, or 35% of total liabilities. These obligations are being liquidated by the payment to the fund each year of an amount from the General Fund of the Treasury and are now expected to be fully amortized by FY2026.³⁸

Some concerns have been voiced about the amount of unfunded liability. However, (1) the hundreds of billions of dollars of unfunded liability is a cumulative amount to be paid to retirees over the next 50 years, not all at once; (2) the population of retirees who served under the pre-accrual system is slowly declining due to deaths; and (3) unlike the private sector, there is no way for employees to claim immediate payment of their future benefits. An analogy would be that most homeowners cannot afford to pay cash for a house, so they get a mortgage. If the mortgage had to be paid in full, almost no homeowners could afford to do so. However, spread out over 30 years, the payments are affordable. Similarly, the unfunded liability of federal retirement programs is considered to be more affordable when federal retirement outlays are spread over many decades.

³⁷ Department of Defense, *FY2013 Valuation of the Military Retirement System*, Office of the Actuary, May 2014.

³⁸ Department of Defense, *FY2013 Valuation of the Military Retirement System*, Office of the Actuary, May 2014.

Author Contact Information

Kristy N. Kamarck

Analyst in Military Manpower
kkamarck@crs.loc.gov, 7-7783