

REPORT TO CONGRESS

IMPLEMENTATION PLAN FOR MODERNIZING THE MILITARY RETIREMENT SYSTEM

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The estimated cost of this report is approximately \$11,000 which represents DoD labor expenses.

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OVERVIEW

Requirement for Implementation Plan

The Fiscal Year 2016 National Defense Authorization Act (NDAA FY2016) (Public Law 114-92), section 635, requires the Secretaries of the Uniformed Services to submit to the congressional defense committees the plans to implement a modernized retirement system effective January 1, 2018. This report is submitted by the Office of the Secretary of Defense (OSD) in fulfillment of the requirement on behalf of and with the full participation of the Uniformed Services.

Report Organization

This report provides the required implementation plan as well as a short background on the current military retirement system and highlights of the new modernized retirement system (hereafter referred to as the “Blended Retirement System”). It also includes the Department’s legislative proposal that seeks to amend certain aspects of the new retirement system in order to ensure that when the new system goes into effect, it meets the needs of the Uniformed Services and our members today and in the future.

Background

The FY 2016 NDAA enacted substantial changes to the current military retirement system and is applicable to all members of the Uniformed Services (Department of Defense (DoD)), United States Coast Guard (USCG), National Oceanographic and Atmospheric Organization (NOAA) and United States Public Health Service (USPHS)). For decades, Service members have had to serve 20 years before becoming eligible for any retirement benefits. Since roughly 80 percent of military personnel (which for the purposes of this Report, refers to members of the Uniformed Services) exit their service before 20 years, most leave without any retirement benefits, leaving our separating members at a competitive disadvantage as compared to their peers who chose not to serve. Under the new, blended retirement system, all separating members who complete at least twenty-four months (approximately 85% of the military Force) will have a portable retirement benefit that can be taken with them to a new employer or transferred into another retirement savings vehicle.

In the current military retirement system, any monetary retirement benefit consists entirely of monthly retired pay which is a defined benefit based upon a formula of 2.5 percent times the number of years and months served times the average of the member’s highest 36

months of basic pay. For Reserve component members, the eligible retirement points accrued during a career are converted to years and months of service.

In the Blended Retirement System (or BRS), the retirement benefit will consist of a reduced monthly retired pay benefit but will be supplemented by government contributions to a portable retirement-savings account. Under the new system, all members who separate before becoming eligible for retirement now have a portable retirement, and those members who continue to serve and become eligible to receive monthly retired pay after serving for twenty years have an opportunity to achieve a retirement benefit that is nearly equivalent or perhaps better than under the current system. The BRS has several components, which include:

- A defined retired pay benefit using a 2.0 percent per year multiplier in lieu of 2.5 percent,
- An automatic 1 percent of basic pay government contribution to a member's Thrift Savings Plan (TSP) beginning 60 days following entry,
- Government matching contributions up to 4% to a member's TSP account using the same matching plan as is used for government civilians under the Federal Employee Retirement System (FERS) although a member only receives matching contributions from the 3rd through the 26th year of service, and
- A choice to receive full monthly retired pay upon retirement or to elect to receive reduced retired pay plus a partial lump-sum payment. This lump-sum payment will be calculated as either 50 percent or 25 percent of the discounted retired pay that would be due a member from the date of retirement until the date the member would reach full Social Security retirement age. At full Social Security retirement age, all members will receive their full defined benefit retired pay, regardless of their lump-sum payment election.

In addition, the legislation that established the BRS includes a provision to provide a continuation bonus (Continuation Pay or CP) that is paid to the member at the 12th year of service for an additional 4 year obligation.

Members who join on or after January 1, 2018, as well as those who have fewer than 12 years of service on December 31, 2017, and elect to opt-in, will be covered by the BRS. All currently serving members, including those who have fewer than 12 years of service on December 31, 2017, who choose not to opt-in, will remain grandfathered under the current retirement system.

IMPLEMENTATION PLAN

The Department of Defense, along with partners in Department of Homeland Security (DHS), Department of Health and Human Services (HHS), Department of Commerce, is committed to successfully implementing the blended retirement system in support of all Uniformed Service members and their families. We have a multi-front approach that includes developing policy, providing education, establishing new business processes, making changes to existing IT systems, and providing routine and consistent strategic communications. Recognizing that the blended retirement system must be afforded to all of our eligible Service members across the Uniformed Services to include the active and reserve components, the Office of the Secretary of Defense (OSD) is taking a lead role and working closely with the Uniformed Services in developing the implementation strategy and plan.

Developing Policy. The Department has several lines of operation to ensure that the necessary supporting policies are established in an appropriate and timely manner. OSD will develop the appropriate Financial Management Regulations and other directives to establish eligibility to participate in the new system, for both active and Reserve components, adjust the formula to compute the defined benefit and, establish procedures for automatic and matching government contributions as well as the continuation pay. OSD is also working closely with the Federal Retirement Thrift Investment Board (FRTIB) who is responsible for establishing necessary policy regarding the member's Thrift Savings Plan and the automatic and matching contributions and subsequent changes to the Code of Financial Regulations (CFR). Adjustments have already been made to the Fiscal Year 2017 Normal Cost Percentage (NCP), the rate used to determine the payment each Service makes per new accession from the Military Personnel Accounts into the Military Retirement Fund. Similarly, the review process is underway to understand impacts to the Fiscal Year 2018 NCP. The USCG, NOAA and USPHS fund military retirement from their annual appropriations and will program and budget accordingly.

The Uniformed Services are developing their policies and analyzing the application of the CP that may be necessary to sustain their force structure. The Services are also identifying their affected populations, both active and reserve components, to understand which members will be eligible to opt into BRS, and thus, will need detailed information and education in order to make informed decisions. A focused effort is also underway to develop necessary policy to implement the lump-sum payment option which includes: conducting an independent study by a Federally Funded Research and Development Center (FFRDC) and establishing the required personal discount rate(s); determining the appropriate interaction of a lump-sum payment with Veteran's Affairs Disability Compensation; and, determining the appropriate interaction of a lump-sum payment with the Survivor Benefit Plan premiums and benefit annuities.

Providing Education. Quality and timely financial education is key to successfully transitioning to and implementing a blended retirement system and most of the Department's education effort is scheduled to occur during calendar year 2017. DoD intends to provide sufficient, timely, and targeted information to military (officer and enlisted) and civilian leaders

of the Uniformed Services during calendar year 2016 so that they have an understanding of the upcoming change; to those eligible to opt into the blended retirement system to enable them to make an informed decision; and to new members who join on or after January 1, 2018 – both officers and enlisted members, so that they understand their retirement benefits. Education tailored to both the active and reserve components consists of four core courses: leader training, opt-in training that allows the eligible members to compare the current retirement system with the blended retirement system, new accession training targeted to those members who join the Service on or after January 1, 2018, and scenario based Personal Financial Managers and Retirement Service Officers training for those installation assets who can complement and be a resource for commanders and members with additional questions and concerns. The education curriculum will also include tools, such as online calculators, to compare the benefits under the current and blended retirement systems. We intend to deliver this education so that it reaches every Service member across the Uniformed Services.

Leader training will ensure military and civilian leaders across the force are aware of the changes to the military retirement system, that they have a basic familiarity with the components of the new system and that they understand the advantages and disadvantages given the personal situation of their members. Leaders are not expected to advocate for or against opting into the blended retirement system nor become experts in the details of the BRS. Rather, they must be grounded in the new system so they can speak knowledgably to their subordinates. Most importantly, commanders must ensure that all members who are eligible to opt-in receive training and that those installation-level trainers, such as, Personal Financial Managers and Retirement Services Officers, are available as resources for the members and their family members.

The opt-in training course will cover both retirement systems in much greater detail than the leader course and thus enable eligible members to understand and make a comparison between the current system and the BRS. The knowledge gained from this training, combined with the member's personal assessment of career goals and financial situation, and discussions with family members will enable them to make an informed choice in 2018 between remaining under the current retirement system or opting to move under the blended system.

The third course in development is the new accession training course which will be targeted at those members who join the Uniformed Services on or after January 1, 2018. It will look similar to the opt-in course in that it will cover the new system in greater detail to include introducing members to decisions about TSP contributions and fund allocations, but will focus solely on the BRS. In both the opt-in and new accession courses, there will be appropriate check points along the way, to ensure that members understand key information. The opt-in and new accession courses will also include calculators to assist with decision making. These calculators will have the ability to compare the current system to the blended retirement system (for those making an opt-in decision) and include projections of the value of future earnings from the government contributions, both for active and Reserve component members (for both the opt-in and new accession courses).

The fourth course is targeted to the Personal Financial Managers and Retirement Services Officers who are located at installation level. The intent for this course is to use scenario-based training with more detailed information to better equip this cadre of professionals to serve in an advisory role (especially the Personal Financial Managers) for Service members and their families. These experts are in the best place to assist commanders in their training mission, provide reinforcement training to Service members and their family members, as well as answer specific questions and address concerns about the blended retirement system.

The delivery platform for these four courses for DoD is the Joint Knowledge On-line portal which currently provides Department-wide training on various personnel and command related topics to include Transition GPS (Goals, Plans, Success). Additional tools to help educate members and their families will include more traditional products such as pamphlets, posters and pocket cards, etc. For example, attached to this report as Appendix A, is a one page information graphic the Department is currently using to introduce members and other interested individuals to the highlights of the new system. OSD is partnering closely with the FRTIB to ensure that their TSP products are also made widely available to Service members and their family members. OSD has also developed a series of retirement and financial survey questions for inclusion in the annual Status of Forces active and Reserve component surveys. These questions will be introduced in the Fall of 2016 to establish the baseline of knowledge and awareness across the force. Overtime, surveys in subsequent years will enable DoD to assess member awareness as well as progress in learning about and understanding the new retirement system.

Establishing Business Processes. The Uniformed Services will establish supporting business processes that enable Uniformed Service members to make an election to opt-in to the BRS during the 2018 “election period” as well as establish new processes for those joining the military on January 1, 2018 and beyond. Processes will also be developed and augmented to ensure the Uniformed Services allocate appropriate TSP contributions, both automatic and matching, based on the member’s eligibility and contribution decisions. And at the point of retirement, processes will be designed to enable the member to make a lump-sum payment option.

Changing Information Technology (IT) Systems. Several Defense Finance and Accounting Service (DFAS) systems in coordination with the each Uniformed Services’ specific personnel systems will need to be revised to support the new BRS and the associated adjusted business processes. Specifically, DFAS is developing requirements to ensure that MyPay, Marine Corps Total Force System (MCTFS), the Defense Retiree and Annuitant Pay System (DRAS), the Defense Joint Military Pay System (DJMS) for both active component and Reserve component are updated, properly reprogrammed and ready to support the changed business processes upon implementation of the new system by January 1, 2018.

The Defense Retiree and Annuitant Pay System (DRAS), which is scheduled to be replaced by the modernized (DRAS2) in January of 2019, will be updated to reflect retirement

percentage changes but manual workarounds may be required for lump-sum payment calculations. Requirements are being written to ensure DRAS2 is fully capable of supporting all required changes in BRS. The MCTFS will also be programmed to support system as well as business process changes for Marines. The USCG, NOAA and USPHS will also be updating their financial accounting and payment IT systems to meet the implementation date as will the FRTIB make necessary modifications and adjustments to the TSP IT systems and supporting call centers.

Providing Strategic Communications. OSD has already started the steady drumbeat of information using a Military Compensation website that contains and provides information papers as well as a first series of Frequently Asked Question (FAQs) and airing a Public Service Announcement on the Armed Forces Networks. The Department expects to carry out a concerted education outreach campaign during calendar year 2017 that will leverage numerous communication channels to educate members and their families, including print and electronic media, social media, the Armed Forces Radio and Television Service, command channels, and town hall meetings, as well as the network of Personal Financial Managers and Retirement Services Officers at each installation. DoD and the FRTIB intend to increase their current call center capabilities as well. These strategic communication efforts will also be extended to the USCG, NOAA and USPHS. Services have already taken measures to disseminate basic information such as the USCG who has published a video on You-Tube and all of the Services who have widely shared the BRS Information Graphic. Our intent over the coming years is to spread the word throughout the depth and breadth of the Uniformed Services.

Partnering efforts. We intend to capitalize on already existing relationships and partner with the FRTIB to develop and collaborate on all policy changes and education materials, especially those involving contributions to the TSP. The Uniformed Services also plan to partner with external entities such as Military Service Organizations and Veteran Service Organizations to further educate and inform the force.

PROPOSED LEGISLATION

At the time of enactment of the NDAA FY 2016, it was recognized that some changes to the blended retirement system, as enacted, might be necessary or desirable to increase the probability for long-term success. Since enactment of the NDAA, the Department has identified and is proposing some legislative changes that are included with this Report. The highest priority and of greatest importance to the Department is the ability to have more flexibility regarding continuation pay to maximize its efficiency and effectiveness. The Department views continuation pay as a retention incentive and thus a force management tool, and desires to have additional flexibility in when, to whom, and how much to pay beyond what is provided for in the current statute. We want to ensure that continuation pay works cooperatively with our other existing force management tools, as we face the realities of periods of growing and shrinking of the force in the years to come. Continuation pay flexibility is essential to the Department's ability to shape the force effectively in the future.

Two other high priorities for the Department are to change the default account for the member contributions from the Traditional to the Roth account and to repeal the automatic reenrollment for members who disenroll from TSP. The DoD agrees with the automatic enrollment into the TSP but believes the member is better served by having their contributions directed into a Roth TSP account. In a Traditional account, the member deposits pre-tax contributions whereas in a Roth account, the member deposits post-tax contributions. Because junior members are in low tax brackets, having the member contributions automatically directed to a Roth account is more advantageous to the member. It is also important to the Department to simplify the requirements to automatically reenroll members annually in January, should they disenroll during the previous year. We intend to emphasize the ramifications and disadvantages of disenrollment during the financial readiness education, especially before members make their opt-in elections. Further, members of the Reserve components may have civilian plans that already maximize their employer retirement plan contributions to the Internal Revenue Service limits and thus may intentionally choose not to be part of the Thrift Savings Plan.

We appreciate the Congress' consideration of these three proposals in particular, as well as the other seven enclosed legislative modifications and technical adjustments to the modernized retirement system.

CONCLUDING COMMENTS

The implementation of the Blended Retirement System presents the Uniformed Services with enormous opportunities and challenges. Modernizing the current retirement system into the Blended Retirement System will not only ensure that the vast majority of all uniformed members receive a portable retirement benefit, but it will also help make Uniformed Service a more attractive option for those who would like to serve but do not plan to stay for an entire career. Similarly, implementing a historic change to the retirement system requires a similarly scaled, massive implementation effort. The Department will need to conduct ground breaking studies to estimate personal discount rates for members with between twenty and thirty years of service. It will also provide financial education, within a very compressed period of time, to approximately 2.3 million active and Reserve component members on the importance of saving for retirement, and help a subset of these members make an informed, educated, irrevocable decision in choosing a retirement system. As monumental as the tasks to conduct groundbreaking research and educating the force are, the requirements to modify, update, and test numerous computer systems to ensure a smooth and seamless transition are similarly daunting.

The Uniformed Services are committed to implementing the new Blended Retirement System seamlessly and on time. The Department of Defense also looks forward to working with the Congress to continue to support our Service members and their families.

Appendix
Information Graphic
DoD proposed legislation