



SOCIETY OF ACTUARIES

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The Military Retirement Reform Act of 1986

by Toni S. Husted

The military retirement system is a funded, noncontributory, defined-benefit plan that includes nondisability retired pay, disability retired pay, and survivor annuity programs. The Service Secretaries approve immediate nondisability retired pay at any age with credit of at least 20 years of active-duty service. Reserve retirees must be 60-years-old with 20 creditable years of service before retired pay commences. There is no vesting before retirement. Currently, there are 2.2 million active-duty members, 1.1 million Selected Reservists, 1.4 million retirees, and 0.1 million surviving families in the system.

The Military Retirement Reform Act of 1986 created new retirement benefits for military personnel who first became members of the Armed Services on or after August 1, 1986. Consequently, there are now three distinct nondisability benefit formulas (for three distinct populations) within the military retirement system.

Military personnel who first became members of the Armed Services before September 8, 1980, have retired pay equal to (final basic pay) times (years of service), and the benefit is limited to 75% of final basic pay. If the retiree first became a member of the Armed Services on or after September 8, 1980, the average of the highest 36 months of basic pay is used instead of final basic pay. This represents an average 13% reduction in benefits for this group when compared to the "final pay" members. Benefits for members first entering the Armed Services on or after August 1, 1986, are reduced if they retire with less than 30 years of service. At age 62, their retired pay is recomputed without the reduction. The average benefits of these newest members are 17% lower than the September 1980 – August 1986 cohorts and 27% lower than the pre-September 1980 cohorts.

Retiree and survivor benefits are automatically adjusted annually to protect the purchasing power of initial

retired pay. The benefits associated with members first entering the Armed Services before August 1, 1986, are adjusted by the percentage increase in the average Consumer Price Index (CPI). This is commonly referred to as full CPI protection. Benefits associated with all other members are annually increased by the percentage change in the CPI minus 1%. At the military member's age 62, the benefits are restored to the amount that would have been payable had full CPI protection been in effect. However, after this restoral, partial indexing (CPI minus 1%) continues annually.

It will be 20 years before the Military Retirement Trust Fund disbursements are noticeably affected by the new benefit reductions. However, the Department of Defense budget (which includes only the aggregate entry-age normal cost payments as a percentage of basic payroll) will be affected much earlier. More than 13% of the total active-duty force of 2.2 million military personnel are new entrants in any one year. Each year 50% of the total basic payroll is associated with members with less than seven years of service. Consequently, 50% of the total normal cost payment will be related to the new reduced benefits by 1993. The normal cost payment in 1993 will be \$2 billion (8%) lower than it would have been before the 1986 retirement reform package.

Policymakers will be carefully watching the recruiting and retention of future new entrants. The 13% reduction implemented in 1980 has had no noticeable impact on force management. However, the total compensation system of the military is a complex system of pay and allowances making the effect of cutting benefits in one area difficult to analyze.

Toni S. Husted is Chief Actuary at the Department of Defense. She has been a contributor to the *Transactions* both as an author and a discussant.

Election Results Tabulated

The election results for Officers and the Board of Governors for 1987–88 have been tabulated. Ballots were sent to 5,832 Fellows. The number of valid ballots returned was 2,660, or 45.6% of the total sent out. The Society of Actuaries is pleased to announce the following winners:

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These new officers and members of the Board of Governors will assume their positions at the end of the closing General Session at the annual meeting in Montreal, October 18–21, 1987.

1987 Annual Meeting Exhibit Program Available

If you are unable to attend the 1987 annual meeting but would like to benefit from the many exhibits held at the meeting, send \$6.00 to the Society office, Attention: Librarian, for a copy of the exhibit program. This program lists the names and addresses of all exhibitors at the meeting and describes their products and/or services. About 60% of these exhibitors have computer software for the actuarial profession. The other 40% offer consulting and reinsurance services. Copies of the exhibit program will not be sent until payment is received in full.