

THE BASICS OF RETIREMENT PLANNING

“Financial Readiness Means Mission Readiness”



Retirement Planning

Program will cover:

- ▶ Introduction to Retirement Planning
- ▶ Military Retirement Plan Choice
- ▶ Military Thrift Savings Plan
- ▶ The Role of Social Security and Personal Savings
- ▶ Resources



Retirement Planning

***“Individuals or families
that fail financially usually
don’t plan to fail,

they usually fail to plan!”***



Retirement Planning

Old retirement model:

- ▶ Brief period, generally of ill health (too old to work, too young to die)
- ▶ A few years (5-10) at most
- ▶ Generally with extended family
- ▶ Limited financial resources needed
- ▶ Goal: 60% - 75% of pre-retirement income



Retirement Planning

New retirement model:

- ▶ **Extended period (20-30 years), much of it in good health**
- ▶ **Starting earlier / living longer**
- ▶ **Independent living**
- ▶ **Extensive financial resources needed**
- ▶ **Goal - 100% of pre-retirement income (at least in first years of retirement)**



Retirement Planning - Three Phases

Active Phase

- 10-15 years in length
- May need 100% of pre-retirement income

Passive Phase

- Health still good
- Life slows down
- Budget needs decrease

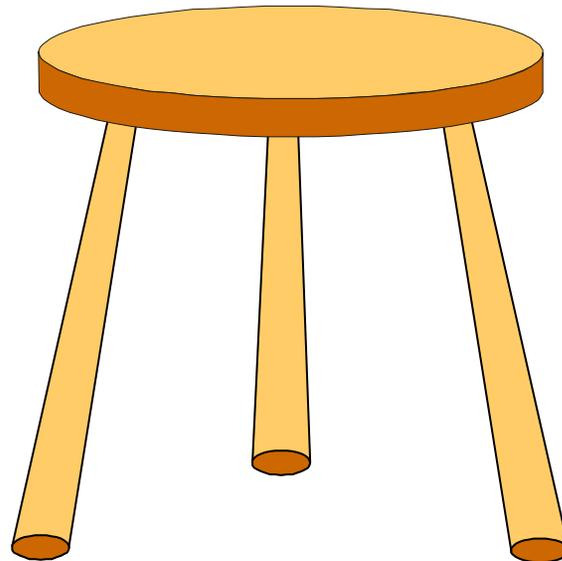
Final Phase

- Medical and nursing care
- Budget needs increase



The Three Legged Stool

Social
Security
Benefits



Investment
Income

Retirement
Benefits/
Pension Income



Employer Sponsored Plans

Defined Benefit

- ▶ Employer contributes
- ▶ Monthly pension; amount fixed - usually based on salary and years of service
- ▶ Examples: corporate or military pension

Defined Contribution

- Employee Contributes (sometimes + employer)
- Lump sum pension amount varies - based on contributions plus return on investment
- Examples: 401(k), 403(b), TSP, etc.



Military Retirement

- ▶ **Defined Benefit:**

Three systems in effect:

- ▶ **Original / “Final Pay” Plan**
- ▶ **“High 3” Plan**
- ▶ **“CSB/REDUX” Plan (REDUX plus Career Status Bonus)**



“Final Pay” Plan

- ▶ **Those entering military before 8 September 1980**
- ▶ **50% of final base pay at 20 years**
- ▶ **“Multiplier” rises at 2.5% per year of service - retirement at 75% final base pay after 30 years**
- ▶ **“COLA” increase each year based on rise in the government’s consumer price index (CPI)**



“Final Pay” Plan

- ▶ **Relatively Generous Package**
- ▶ **COLA feature important**
- ▶ **However, military retirement computation:**
 - ▶ **Does not include allowances**
 - ▶ **Does not include special duty or incentive pay**
 - ▶ **Does not include bonuses**
 - ▶ **Average military retiree (20 years) actually receives about 35% to 40% of final “salary” at retirement**



“High Three” Plan

- ▶ Those entering service on or after September 8, 1980, through July 31, 1986
- ▶ 50% of average highest three years of base pay at 20 years of service (increasing to 75% at 30)
- ▶ Full COLA each year
- ▶ Only difference: “High 3” vs. “Final Pay”



“REDUX” Plan

- ▶ Originally passed MRRA of 1986
- ▶ Affected all those entering service on or after 1 August 1986
- ▶ Retirement multiplier reduced to 40% of high three years base pay at 20 (vice 50%)
- ▶ Multiplier increases 3.5% per year (vice 2.5% -still receive 75% at 30)
- ▶ Annual pay raise based on CPI minus 1% per year (vice a full COLA)



“REDUX” Plan

Years of Service	“High 3” Multiplier %	“REDUX” Multiplier %
20	50	40
21	52.5	43.5
22	55	47
23	57.5	50.5
24	60	54
25	62.5	57.5
26	65	61
27	67.5	64.5
28	70	68
29	72.5	71.5
30	75	75



High 3 vs REDUX

**Retirement early 2001 –
Approximate initial retired check:**

	<u>High 3</u>	<u>REDUX</u>
E6 @ 20	\$1020	\$ 860
E7 @ 20	\$1235	\$ 988
E7 @ 22	\$1440	\$1230
E8 @ 24	\$1860	\$1670
E9 @ 30	\$2760	\$2760
04 @ 20	\$2260	\$1810
05 @ 24	\$3240	\$2920
06 @ 30	\$4790	\$4790



“REDUX” Formula

- ▶ Remember two major changes in REDUX
 - ▶ Reduced multiplier (40% vice 50% at 20)
 - ▶ COLA 1% below inflation rate each year
- ▶ One time “catch up” at age 62 (to where retiree would have been under High 3)
 - ▶ Then COLA minus 1% continues - permanently
 - ▶ A significant reduction in retirement benefits (up to a 25% cut for those retiring at 20!)



Retirement Plan Choice

- ▶ **All Service members who came on active duty on or after 1 August 1986 now get a choice:**
 - ▶ **Option 1: Remain in “High-Three” Plan OR**
 - ▶ **Option 2: Elect “CSB/REDUX” Plan -
Have retired pay calculated under the less generous REDUX formula and receive a one-time \$30,000 Career Status Bonus at the 15 year point**



- ▶ **Reduced retirement plus retention bonus - both are together in one “package”**
- ▶ **Must remain to at least 20 (or pay back a portion of the bonus)**
- ▶ **Bonus is taxable (for most members means they net \$21,900 if they take all cash)**



Retirement Plan Choice

- ▶ One time, irrevocable decision, to be made between the 14 1/2 and 15 year point
- ▶ Becomes irrevocable at the 15 year point

“Both options have their own merits. Neither is universally better than the other. Which option is more advantageous can only be determined by each individual for his or her own unique circumstances and preferences.”

- DOD Web site



Advantage of taking the Bonus: Immediate cash for:

Investment	Rates of return may vary
Start a business	Very high risk
Education	May have other alternatives
Debt repayment	Less costly methods available
Consumer Purchase	Zero rate of return (the most unwise choice)



- ▶ **Disadvantages of taking the Bonus**
 - **Substantially reduces retirement benefit**
 - **Reduces benefit for surviving spouse**
 - **Risk of Spending the bonus!**

“It’s not a bonus, it’s a loan!”



Comparing Options

- ▶ **Master Sergeant Fastrack:**
 - ▶ 15 years in, selected for promotion to E8
 - ▶ Has bachelors degree/taking advanced courses
 - ▶ Outstanding service record
 - ▶ Plans to stay in the Air Force as long a possible - family concurs with decision
 - ▶ Spouse has career with 401(k); family is financially stable, no consumer debt; both have IRAs and other investments

Might Consider “CSB/REDUX”



Comparing Options

▶ Technical Sergeant Independence:

- ▶ 15 years active duty; good record - hopes to make master, but promotions are scarce in his AFSC
- ▶ Plans to get out of the Air Force at exactly 20 years and start a second career
- ▶ Two children; spouse works part time
- ▶ Few savings, no investments; main financial goal before retirement is paying off consumer debt and saving for first house; family needs a new car

“High Three” Definitely Best Option



Retirement Plan Choice

Review: a few considerations:

- ▶ One time, irrevocable (at 15 year point) decision
- ▶ If CSB/REDUX is chosen, bonus will be taxed
- ▶ Biggest difference in REDUX is not the 40% at 20 - it is the “Minus 1% COLA” feature
- ▶ CSB/REDUX looks better the longer you remain on active duty



Survivor Benefit Plan

- ▶ Provides inflation-protected portion of retired pay to eligible beneficiaries
- ▶ Ensures at least 55% of retired pay continues upon death of retiree
- ▶ Voluntary program
- ▶ Monthly premiums depend on base amount chosen by member



Retirement Planning



**Questions on Defined
Benefit Plan?**



Employer Sponsored Plans

Military will now offer both types:

- ▶ **Defined Benefit:**
 - ▶ High Three or CSB/REDUX

- ▶ **Defined Contribution:**
 - ▶ Thrift Savings Plan



The TSP: What is it?

- ▶ **Retirement savings and investment plan sponsored by the Federal Government**
- ▶ **Available to civilian employees of Federal Government since 1987**
- ▶ **It is a defined contribution retirement plan-- Same type of savings and tax benefits as 401(k)**
- ▶ **It is optional--you must sign up to participate**
- ▶ **You make the contributions, you choose the investments from five investment options**
- ▶ **The purpose of the TSP is to provide a source of retirement income. It is NOT a savings account that can be withdrawn at any time.**



Who is eligible?

- ▶ **Open to all members of the Uniformed Services**
 - ▶ Air Force
 - ▶ Army
 - ▶ Navy
 - ▶ Marine Corps
 - ▶ Coast Guard
 - ▶ Public Health Service, NOAA
- ▶ **Active Duty and Ready Reserve**



Enrollment Dates

- ▶ **Two “open seasons” per year**
 - ▶ **15 April through 30 June**
 - ▶ **15 October through 31 December**

- ▶ **If deployed during Open Season**
 - ▶ **Have 60 days upon return to enroll**



Contribution Amounts

- ▶ **1% to 7% of base pay per month in 2002, 8% in 2003 (FORM TSP-U-1)**
- ▶ **Total amount of any incentive and special pays (including bonuses)**
- ▶ **Annual Limits: \$11,000 in 2002, \$12,000 in 2003**
- ▶ **If tax-exempt 'combat zone pay' received, can put up to the lesser of \$40,000/year or 100% of pay (2002).**
- ▶ **Must be currently enrolled to contribute any incentive, special or bonus pays**



Thrift Savings Plan

- ▶ **Can only elect to contribute Base, Special or Incentive (Not Bonus) during open seasons. Bonus pay can be contributed at any time.**
- ▶ **No current plans to match**
- ▶ **All money belongs to YOU: Your Contributions plus any growth of your contribution**



Investment Options

- ▶ **Five investment options (FORM TSP-U-50)**
 - ▶ **G Fund (government securities fund)**
 - ▶ **F Fund (bond index fund)**
 - ▶ **C Fund (common stock index fund)**
 - ▶ **S fund (small cap stock index fund)**
 - ▶ **I fund (international stock index fund)**
- ▶ **Can put all in one fund, or ALLOCATE your contribution to some or all funds.**
- ▶ **You Decide How Much to Contribute and How your Contribution is Invested**



Fund Performance Histories

1991-2001 Compound Annual Rate of Return

<u>FUND</u>		<u>INDEX</u>	
G	6.47%	Related Securities	6.51%
F	7.19%	LBA Bond	7.23%
C	12.88%	S&P 500	12.94%
S*	10.71%	Wilshire 4500	10.67%
I*	4.38%	EAFE	4.44%

*Since inception in May 2001



Make a Decision

- ▶ **How much should you invest, and which Fund is right for you?**

- ▶ **It Depends:**
 - ▶ **How much you are investing now**
 - ▶ **How much of your investable dollars you can commit to retirement investment**
 - ▶ **If you have a Roth IRA**
 - ▶ **How long you will keep the money invested**
 - ▶ **Your age**
 - ▶ **When in Doubt, MAX it Out!!**



Withdrawals

- ▶ **When you separate from the service:**
 - ▶ Receive a single payment.
 - ▶ Request a series of monthly payments based on a dollar amount, a number of months, or your life expectancy.
 - ▶ Request a TSP Annuity. Must have at least \$3,500 in your account.
 - ▶ Leave your money in the TSP.
 - ▶ Transfer to a Rollover IRA or a new employer's plan.



Withdrawals (Cont.)

- ▶ Some options for borrowing against plan while still on active duty (financial hardship, loan program)
- ▶ Substantial penalties for withdrawing money prior to age 59 1/2 (10%)
- ▶ 20% mandatory withholding for direct payments
- ▶ It is a Retirement Saving and Investment Program



Thrift Savings Plan Benefits

- ▶ **Contributions set up to occur automatically**
- ▶ **Contributions are BEFORE TAX:** They reduce your annual tax bill
- ▶ **Contributions grow TAX-DEFERRED:** You're not taxed until you withdraw the money
- ▶ **Very low administrative costs and expenses**
- ▶ **Easy to start, easy to move your money around**
- ▶ **You CAN take it with you ...**
- ▶ **You designate beneficiaries (Form TSP-U-3)**



Benefits of the TSP

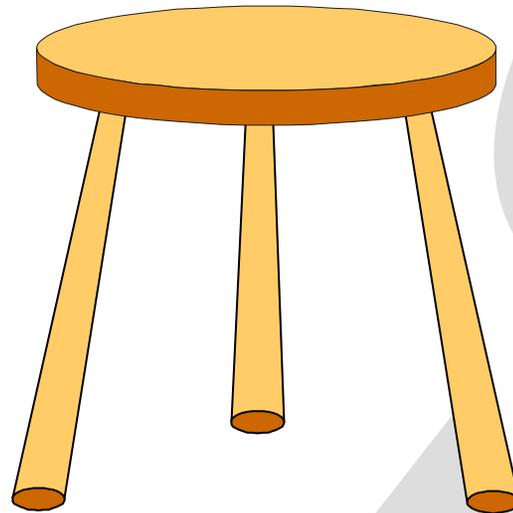
- ▶ **Web site and automated telephone service (the “Thriftline”)**
- ▶ **COMPOUND INTEREST AND TIME WORKS FOR YOU**
- ▶ **Great deal for all service members**
 - ▶ **Just \$50 per month @ 8% = \$30,000 at 20 years**



The Three Legged Stool

Retirement Planning

Social
Security
Benefits



Investment
Income

Retirement
Benefits/
Pension Income



Social Security

- ▶ **Remains an important part of retirement planning**
- ▶ **Military contribute while on active duty, and will be eligible for benefits**
- ▶ **Retirement age is increasing (67 vice 65)**
- ▶ **Benefits will be taxable in some circumstances**
- ▶ **Social Security Benefits Statement**
www.ssa.gov/retire



Personal Savings

- ▶ **Personal savings and investments are the key “3rd leg” to the 3 legged stool**
- ▶ **Potential tax credit for retirement plan contributions**
- ▶ **IRA’s**
 - ▶ **Traditional: Deductible and Non deductible**
 - ▶ **Rollover**
 - ▶ **Roth**



Traditional IRA

- ▶ **Deductible or Nondeductible**
- ▶ **Contribute up to \$3,000/year (2000-2004)**
(+\$3,000 for spouse if married)
- ▶ **Tax-deferred earnings**
- ▶ **Gains taxed upon withdrawal**
- ▶ **Penalty if withdrawn prior to 59½**
- ▶ **Contribution may be deductible**



Rollover IRA

- ▶ **A special IRA that holds money transferred from other retirement plans**
- ▶ **TSP, 401K, 403B all can be rolled over into an IRA**
- ▶ **Do not co-mingle funds from pre-tax plans with those from tax-deferred plans**



Roth IRA

- ▶ **No deduction for contribution**
- ▶ **Tax-exempt earnings**
- ▶ ****Tax-free withdrawals****
- ▶ **Penalty-free withdrawals after 5yrs in some cases**
- ▶ **Can convert traditional IRA to Roth**



Retirement Planning

- ▶ **Can be long and detailed... but**
- ▶ **Easy to get started**
- ▶ **Many resources**
- ▶ **American Saving Education Council (ASEC), www.asec.org**
“Ballpark Estimate”



Retirement Planning

Resources:

- ▶ **Your First Sergeant**
- ▶ **Your Unit Financial Specialist**
- ▶ **Family Support Center**
- ▶ **Commercial Financial Planners**
- ▶ **Commercial Web Sites**



Retirement Planning

Commercial:

- ▶ **Stockbrokers, insurance agents, independent financial planners**
- ▶ **Commissions, fees, or a combination**
- ▶ **Professional designations (CFP)**
- ▶ **Check at least two - compare recommendations**



Retirement Planning

- ▶ **Commercial web sites - retirement planners**
- ▶ **Use caution, many do not accurately reflect inflation adjusted retirement pensions**
- ▶ **Use realistic assumptions**
- ▶ **Inflation: 3% to 4% (long term, 20+years)**
- ▶ **Long term rates of return:**
 - ▶ **9% to 10% maximum before retirement**
 - ▶ **7% to 8% maximum during retirement**



Retirement Planning

▶ **Disclaimer:**

The commercial web sites listed in this brief are provided for educational purposes only; no warranty is made regarding their accuracy or quality. This information does not constitute an endorsement of any site, or of any products or services that may be offered on those sites. Other sites with similar information are available, and may prove equally useful.



Selected Web Sites

<http://militarypay.dtic.mil>

www.tsp.gov/uniserv

www.ssa.gov (and www.ssa.gov/retire)

Retirement Calculators:

www.asec.org (“Ballpark Estimate”)

www.smartmoney.com

www.financialengines.com

Retirement Education:

www.vanguard.com

www.morningstar.com

www.aoa.dhhs.gov/retirement/fpfr.html



Military Retirement Planning

Summary:

- ▶ Retirement foundation (3 legged stool)
- ▶ Military retirement - three plans (Final Pay, High-Three Plan, and CSB/REDUX)
- ▶ Thrift savings plan
- ▶ Retirement planning/resources
- ▶ Remember: It's your future and your choices

Questions/Comments?