

CEO COMMENTARY:

Military Retirees Who Choose DoD's Lump Sum Buyout Will Likely Pay a High Price

By Scott Spiker, Chairman/CEO of First Command Financial Services, Inc.



The Defense Department is casting the lump sum feature of the new Blended Retirement System as a way to give service members new financial choices at retirement, but a detailed analysis of the program reveals that those who sign up for the cash buyout will likely pay a high price.

The lump sum program offers retiring service members the opportunity to receive upfront dollars by forfeiting a portion of their working-age retirement pay (either 25 percent or 50 percent of the monthly payment). Retirees can choose to take the lump sum as a single payment or in four equal annual installments. Either way, their monthly retired pay will remain at the reduced level until age 67 and then returns to the full amount.

Lump sum amounts will be determined using the Government Discount Rate, which is an annually approved rate that is currently 6.99 percent. Based on a detailed analysis of the future finances of two hypothetical career military members (one enlisted, one officer) who retire at age 42, First Command Financial Services, Inc. projects that lump sum amounts calculated at the 6.99 percent rate would total less than half of all the monthly payments forfeited over a 25-year period.

For the hypothetical officer example, First Command based its projections on a pay grade of O-5, an assumed retired pay of \$3,410 per month and annual cost of living adjustments of 3 percent. The 25 percent option produces a lump sum of \$157,250. That's a significant benefit, but it pales beside the \$372,978 in total monthly payments forfeited over the 25-year period. By taking the lump sum option, the service member sees the value of their retirement package shrink by \$215,728.

Enlisted personnel face similar challenges. For the hypothetical enlisted example, First Command assumed a pay grade of E-7, retired pay of \$1,770 per month and annual cost of living adjustments of 3 percent. The 25 percent option produces a lump sum of \$81,622. The monthly payments forfeited over the 25-year period totaled \$193,600. The value of the service member's retirement package shrinks by \$111,978.

In both cases, the dollar amounts are double for the 50 percent option. (For more details, see "Highlights of First Command's analysis of lump sum payment options" at the end of this article.)

These hypothetical examples suggest that service members who select the lump sum payments could put themselves at risk of a significant drop in the lifetime value of their own retirement package. The promise of a lump sum that could total in the six figures will surely appeal to many service members. They may choose to take the upfront dollars with good intentions, but there are no guarantees. Instead of investing the money for retirement, they may use it for other purposes. They may sink it into a business that fails, use

it to help out a relative or just spend it. Years later, when these retirees are attempting to turn their accumulated assets into income streams, they'll have fewer dollars to deploy.

The Blended Retirement System, which goes into effect on Jan. 1, 2018, calls for a 20 percent reduction in current retirement pay in exchange for a defined contribution program of automatic and matching Thrift Savings Plan contributions, a mid-career continuation pay bonus and the lump sum buyout option. The program will apply to all new service members starting next year, but current military members with 12 years or less of service are eligible to opt in to the new program.

When the first wave of eligible service members who opted into the Blended Retirement System start to retire in 2026, they'll likely be dealing with a different Government Discount Rate but the challenges promise to be the same.

The lump sum buyout is clear example of how the choices in the Blended Retirement System can present service members with more risk and more complexity in planning for their financial futures. The opaqueness and uncertainty associated with the lump sum buyout reinforces the value of consulting with a financial coach. Service members should plan on working with professionals who have the necessary advanced knowledge to conduct a meaningful analysis of the Blended Retirement System, help them weigh all of the information and make informed decisions.

Highlights of First Command's analysis of lump sum payment options:

Officer examples

Pay grade O-5 taking a 25% reduction in pension in exchange for a lump sum

Assumptions

- Retirement pay for BRS of \$3,410, or \$40,920 first year
- 3.0% post-retirement COLA
- Retirement pension started at age 42
- Discount Rate of 6.99%
- Discounted pension lasted through age 66

Results

- Reduced pension for the first year would be \$30,690
- First year reduction was \$10,230
- Total of the reductions over the 25 years prior to FRA at age 67 totaled \$372,978
- Lump sum at retirement in exchange for the reduced pension using the Discount Rate of 6.99% totaled \$157,250

Pay grade O-5 taking a 50% reduction in pension in exchange for a lump sum

Assumptions

- Retirement pay for BRS of \$3,410, or \$40,920 first year
- 3.0% post-retirement COLA
- Retirement pension started at age 42
- Discount Rate of 6.99%
- Discounted pension lasted through age 66

Results

- Reduced pension for the first year would be \$20,460
- First year reduction was \$20,460
- Total of the reductions over the 25 years prior to FRA at age 67 totaled \$745,987
- Lump sum at retirement in exchange for the reduced pension using the Discount Rate of 6.99% totaled \$314,500

Enlisted examples

Pay grade E-7 taking a 25% reduction in pension in exchange for a lump sum

Assumptions

- Retirement pay for BRS of \$1,770, or \$21,240 first year
- 3.0% post-retirement COLA
- Retirement pension started at age 42
- Discount Rate of 6.99%
- Discounted pension lasted through age 66

Results

- Reduced pension for the first year would be \$15,930
- First year reduction was \$5,310
- Total of the reductions over the 25 years prior to FRA at age 67 totaled \$193,600
- Lump sum at retirement in exchange for the reduced pension using the Discount Rate of 6.99% totaled \$81,622

Pay grade E-7 taking a 50% reduction in pension in exchange for a lump sum

Assumptions

- Retirement pay for BRS of \$1,770, or \$21,240 first year
- 3.0% post-retirement COLA
- Retirement pension started at age 42
- Discount Rate of 6.99%
- Discounted pension lasted through age 66

Results

- Reduced pension for the first year would be \$10,620
- First year reduction was \$10,620
- Total of the reductions over the 25 years prior to FRA at age 67 totaled \$387,197
- Lump sum at retirement in exchange for the reduced pension using the Discount Rate of 6.99% totaled \$163,245



©2017 First Command Financial Services, Inc. parent of First Command Financial Planning, Inc. (Member SIPC, FINRA), First Command Advisory Services, Inc., First Command Insurance Services, Inc. and First Command Bank. Securities and brokerage services are offered by First Command Financial Planning, Inc., a broker-dealer. Financial planning and investment advisory services are offered by First Command Advisory Services, Inc., an investment adviser. Insurance products and services are offered by First Command Insurance Services, Inc. in all states except Montana, where as required by law, insurance products and services are offered by First Command Financial Services, Inc. (a separate Montana domestic corporation). Banking products and services are offered by First Command Bank. Securities products are not FDIC insured, have no bank guarantee and may lose value. A financial plan, by itself, cannot assure that retirement or other financial goals will be met. In Europe, investment and insurance products and services are offered through First Command Europe Limited. First Command Europe Limited is a wholly owned subsidiary of First Command Financial Services, Inc. and is authorized and regulated by the Financial Conduct Authority. Certain products and services offered in the United States may not be available through First Command Europe Limited.