

The New Military Retirement

By Scott Spiker, Chief Executive Officer

“Our only security is our ability to change.”

—American physician, scientist, philosopher, writer and inventor John Lilly

On Nov. 25th, 2015 the long anticipated, much discussed and hotly debated new military retirement system was officially signed into law by the president as part of the 2016 National Defense Authorization Act. The final product, which mirrors the recommendation made by the Military Compensation and Retirement Modernization Commission last year, is a blended program that includes a reduced pension in exchange for the matching of service members’ Thrift Savings Plan (TSP) contributions, a “continuation pay” bonus at 12 years of service and options to receive a lump sum payment of a portion of one’s retired pay.

The early reviews are mixed. In our most recent First Command Financial Behaviors Index survey, about two-thirds of all active duty service members indicated they are in favor of the new system because they like the fact that it will “increase the number of people who will be eligible for benefits” and believe it will “provide more financial benefits” for service members.

There’s no doubt about the first assumption. In the current all-or-nothing “cliff vesting” system, only 17 percent of all service members reach the 20 years of service necessary to qualify for lifetime retirement pay. Once the new plan goes into effect on Jan. 1, 2018, officials estimate that at least 75 percent of active duty military members will receive some form of retirement benefit. I would hasten to add, however, that exiting active duty with a few thousand dollars in one’s TSP is not equivalent to earning a guaranteed lifetime pension.

There’s more doubt about whether the second assumption – that the new retirement plan will provide more financial benefits – is true for most service members. In fact, 70 percent of those service members who say they are likely to serve to full retirement say they would prefer to stay in the current system, which allows them to earn a higher guaranteed lifetime pension.

The good news is that those service members who have more than 12 years of service when the new retirement plan goes into effect in 2018 will be grandfathered into the current retirement plan. And those with less than 12 years of service will be able to choose between remaining in the current plan and converting to the new plan.

Longer term, however, I believe there are legitimate concerns about whether this structural reform of military retirement will really be in the long-term best interests of future service members. The reform almost assuredly will *not* be in the long-term best interests of those service members who fail to grasp the importance of taking full advantage of the Thrift Savings Plan (TSP) and making smart, informed decisions about the new lump sum bonus opportunities and other key military benefits. This is not, in other words, a time for service members and their families to passively assume that their financial future is set.

Unfortunately, there are signs that is what many are doing now. The current participation rate in the TSP across all branches of the service is a discouraging 42 percent.¹ And the most popular TSP investment selection is the conservative G Fund², a stable return fund comprised of short-term U.S. Treasury securities (think bonds or T-Bills) specially issued to the TSP³. The good news is that this fund is protected from loss of principal. The potential downside is that it may not offer the rate of growth that many investors need to reach their long-term goals.

Will the incentive of matching contributions – in the new plan the DOD will match the first 3 percent service members contribute dollar for dollar and the next 2 percent 50 cents on the dollar – be sufficient to increase TSP participation? Will service members recognize the need to invest a bit more aggressively in order to give themselves a better chance to offset the planned 20 percent reduction in military pensions? Those things remain to be seen.

I can assure you, though, that our financial advisors will be prepared to provide current and future service members with the information, motivation and advice they need to make smart decisions about how much to invest in the TSP, how to allocate those contributions among the various investment options and what factors retiring service members should consider in determining whether it makes sense for them to take a portion of their retirement in the form of a lump sum payment.

Make no mistake. Military retirement is about to get more complicated and less guaranteed. But we don't believe that's necessarily a cause for anxiety or hand-wringing. The decision has been made. Now it's up to us to help our clients adapt and thrive in the new system.

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¹ Federal Retirement Thrift Investment Board (FRTIB)

² According to tsp.gov, 37.5% of all TSP assets were invested in the G Fund as of Dec. 31, 2014.

³ tsp.gov – Investment Funds Overview

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