White Paper

The Blended Retirement System: Continuation Pay Comes at a High Price for America's Career Military Families

First Command Financial Services, Inc.

December 2017

The new Blended Retirement System (BRS) presents big risks for our Nation's service member families who make the military their career. That risk has been heightened by a recent decision by the military services to roll out the new system with one of its key features locked in at the lowest level allowed by law.

Continuation pay for the 2018 launch of BRS is set at the very low end of the original range specified, at 2.5 months of basic pay – significantly less than the maximum 13 months approved in the FY2016 National Defense Authorization Act (NDAA) by lawmakers. A detailed analysis of the financial impact of this decision (as well as other elements of the BRS) reveals that career service members who opt into the new system could see future retirement pay of roughly 15 percent to 19 percent less than under the legacy system.

The foundation of the BRS is a 20 percent cut in the traditional pension, which has provided guaranteed monthly retirement pay to generations of career military families who completed 20 years of service. This 20 percent reduction pays for a new defined contribution program that includes automatic and matching Thrift Savings Plan (TSP) contributions, mid-career continuation pay and a lump sum buyout option. The program applies to all new service members starting Jan. 1, 2018, but military members with 12 years or less of service on Dec. 31, 2017, are eligible to opt in to the new program during 2018.

Terms of the continuation pay feature of the BRS have continued to evolve – and not to the benefit of service members. As recently as May 2017, the Department of Defense stated that the benefit was an amount equal to between 2.5 and 13 times regular monthly basic pay and payable between the completion of eight and 12 years of service in return for a commitment of a minimum of three years of service.[1] But by the end of 2017, the services had shrunk continuation pay to the smallest amount allowed by law (2.5 months) and increased the years of service to 12 and bumped up the commitment to a minimum of four years. . Under the 2016 NDAA, the secretaries of the military services are given discretion to set the continuation pay rate as high as 13 months. . For 2018, all five services set the continuation pay at 2.5 months. And importantly, each of the services is now characterizing it as a Continuation Bonus, which will make the allure of spending it upon receipt even more likely.

Even at 2.5 months, the continuation pay has been promoted as a valuable benefit for eligible service members. Some proponents of the program have even portrayed the continuation pay as a signing bonus, or as an incentive for service members to opt into the new system rather than stick with the legacy pension.

A payment equal to 2.5 months of basic pay may be a tempting offer for someone who plans to leave the military before qualifying for a pension (typically at 20 years). They have an opportunity to walk away with money they wouldn't otherwise receive. But for service members who make the military their career and therefore expect to qualify for the traditional pension, the continuation pay comes at a high price.

Based on a detailed analysis of the future finances of two hypothetical career military members (one enlisted, one officer), First Command Financial Services, Inc. projects that the smaller, 2.5 months of continuation pay can have a significant negative impact on the long-term value of the military retirement benefit.

For the hypothetical officer example (pay grade of O-5), First Command projects that the value of retirement pay generated over 20 years by 2.5 months of continuation pay is $31,556. That compares to $164,077 for 13 months of continuation pay. At 20 years, the difference is $132,521.

For the enlisted example (pay grade of E-7), the dollar amounts are $17,845 and $92,789 – a difference of $74,944.

Long-term value of BRS continuation pay (13 months versus 2.5 months)

	Enlisted (E-7) at 20 Years	Officer (O-5) at 20 Years
Continuation pay at 13 months of basic pay	$92,789	$164,077
Continuation pay at 2.5 months of basic pay	$17,845	$31,556
Difference between 13 months and 2.5 months at 20 years	**$74,944**	**$132,521**

How do those results play out in monthly retired pay generated by BRS versus the traditional military pension? First Command projects that even financially disciplined BRS participants (that is, those who invest their 2.5 months of continuation pay and make optional contributions to the TSP that are sufficient to capture the maximum 5 percent in matching funds) will see total retirement pay that is almost 15 percent less than they would receive under the legacy system.

For the hypothetical officer example, First Command projects that total monthly retired pay under BRS is $4,267, down 14.7 percent from $5,001 under the legacy system.

[1] Frequently Asked Questions Regarding the New Blended Retirement System (As of May 1, 2017) - http://militarypay.defense.gov/Portals/3/Documents/BlendedRetirementDocuments/BRS%20Frequently%20Asked%20Questions%205.01.2017.pdf?ver=2017-05-02-095830-163

For the enlisted example, total monthly retired pay under BRS is $2,195, down 14.7 percent from $2,572 under the legacy system.

Total monthly retired pay under BRS versus legacy system		
	Enlisted (E-7) at 20 Years	Officer (O-5) at 20 Years
BRS		
TSP Automatic 1 percent	$5,180	$10,109
TSP Matching 4 percent	$20,720	$40,438
TSP Participant 5 percent	$25,900	$50,547
Continuation Pay (2.5 months)	$9,918	$19,095
Total Lump Sum	$61,718	$120,189
Equivalent Retired Pay from Lump Sum (based on 4% first year withdrawal rate)	$206	$401
Blended Retirement System Retired Pay	$1,989	$3,866
Total monthly retired pay under BRS	**$2,195**	**$4,267**
Legacy system		
TSP Participant 5 Percent	$25,900	$50,547
Equivalent Retired Pay from Lump Sum (based on 4% first year withdrawal rate)	$86	$168
Legacy Retired Pay	$2,486	$4,833
Total monthly retired pay under legacy system	**$2,572**	**$5,001**
Difference in total monthly retired pay between BRS and legacy system	-$378 **-14.7%**	-$735 **-14.7%**

Notably, this 14.7 percent difference represents a best case scenario. Service members who do not exercise good savings and investment behaviors face a starker future. First Command projects that BRS participants who spend their continuation bonus and do not invest in the TSP (and therefore do not earn matching funds) will see total retirement pay that is 19 percent less than under the legacy system.

For the hypothetical officer example, total monthly retired pay under BRS is $3,900, down 19.3 percent from $4,833 under the legacy system.

For the enlisted example, total monthly retired pay under BRS is $2,006, down 19.3 percent from $2,486 under the legacy system.

Total monthly retired pay under BRS versus legacy system for service members who do not save and invest their continuation pay and earn matching funds in the TSP

	Enlisted (E-7) at 20 Years	Officer (O-5) at 20 Years
BRS		
TSP Automatic 1 percent	$5,180	$10,109
TSP Matching 4 percent	$0	$0
TSP Participant 5 percent	$0	$0
Continuation Pay (2.5 months)	$0	$0
Total Lump Sum	$5,180	$10,109
Equivalent Retired Pay from Lump Sum (based on 4% first year withdrawal rate)	$17	$34
Blended Retirement System Retired Pay	$1,989	$3,866
Total monthly retired pay under BRS	**$2,006**	**$3,900**
Legacy system		
TSP Participant 5 Percent	$0	$0
Equivalent Retired Pay from Lump Sum (based on 4% first year withdrawal rate)	$0	$0
Legacy Retired Pay	$2,486	$4,833
Total monthly retired pay under legacy system	**$2,486**	**$4,833**
Difference in total monthly retired pay between BRS and legacy system	-$480 **-19.3%**	-$933 **-19.3%**

These findings strongly suggest that career service members who are attracted to the idea of the continuation pay as a bonus for opting in to BRS should carefully consider the broader financial impact of all aspects of the program on their lifetime retirement pay.

Similar risks await service members in the future via the lump sum buyout feature of the BRS. This program offers retiring service members the opportunity to receive upfront dollars by forfeiting a portion of the working-age retirement pay they receive from their guaranteed pension (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. First Command 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.

Service members who choose to take continuation pay or lump sum buyout dollars may do so 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. When these retirees are attempting to turn their accumulated assets into income streams, they'll have fewer dollars to deploy.

Turning present day income into future wealth is a challenging undertaking for most middle-class Americans. That's particularly true for service member families. The stressful, demanding military lifestyle greatly impacts their ability to accumulate wealth. They are challenged by combat deployments. Frequent relocations make it harder to accumulate home equity, and they impact the ability of spouse to find meaningful work.

Switching to an environment of putting away monthly dollars and earning matching funds under the TSP will be challenging for service members, just as it has been for the rest of America. For decades, Americans have not participated adequately in 401(k) programs. Their retirement planning and savings have suffered. Among military families, less than half (45 percent) participate in the TSP. Their most popular investment choice is the G Fund, a low-risk, low-yield government securities fund. It offers protections against loss, but delivers returns that may not equal the rate of inflation.

Even in the best case scenario, with service members diligently saving their military pay and properly investing it for long-term growth, future retirement income under BRS will likely lag behind what they could receive by sticking with the legacy system. The decision by all five of the services to lock in the continuation pay at the lowest amount allowed by law serves to further depress potential monthly retirement pay – and it underscores the value of the traditional pension. For service members who have determined they will make the military their career, the guaranteed lifetime income of the legacy system remains an appealing benefit and a smart choice.

Service members who enter the military under the BRS do not have a choice, and they face significant challenges. Those who want retirement income that compares to the legacy system will need to work hard to offset the 20 percent reduction in guaranteed pension payments. They will need to develop disciplined savings behaviors and make informed investment choices. These behaviors and choices can be most effectively shaped and sustained through financial coaching.

First Command's financial behavior research has revealed that millennial military families want and need help to develop positive financial behaviors. Financial coaching is universally appealing and working face to face with a financial coach matters. Career military families who work with a financial advisor are more likely than their go-it-alone counterparts to:

- Contribute to retirement and savings accounts,
- Participate in TSP, and
- Feel confident in their ability to retire comfortably.

Even so, many service members today are not working with a financial coach. What is holding them back? Access. The Department of Defense limits the financial products and services available on-installation to service members and their families – products and services that are available to every other American. BRS should present an opportunity for the DoD to expand access to on-installation financial institutions, to enable active-duty service members to easily secure financial advice and coaching.

Under BRS, the next generation of military families face more risk and more complexity in planning for their retirement. That doesn't mean BRS is bad, but service members have to make the right decisions at every step of their careers in order to be successful. They are more likely to navigate successfully through planning, saving and frequent financial coaching.

Compiled by Sentient Decision Science, Inc., the First Command Financial Behaviors Index® assesses trends among the American public's financial behaviors, attitudes and intentions through a monthly survey of approximately 530 U.S. consumers aged 25 to 70 with annual household incomes of at least $50,000. Results are reported quarterly. The margin of error is +/- 4.3 percent with a 95 percent level of confidence. Sentient Decision Science was commissioned by First Command to compile the Financial Behaviors Index®. SDS is a behavioral science and consumer psychology consulting firm with special vertical expertise within the financial services industry. SDS specializes in advanced research methods and statistical analysis of behavioral and attitudinal data.