The Mid-Career Challenge

Should you switch to the BRS? If you've been in the armed forces for 10 or 11 years—just slightly less than the 12 years of service that would automatically keep you in the legacy system—deciding can be complicated. Making it a career. If you stay 20 years or more, military, you may be thinking seriously about you'll be eligible for a more generous pension than the BRS will provide.

The question is whether access to tax-deferred retirement savings from a TSP account or perhaps you've been contributing. Quite possibly you'll be joining the civilian workforce with limited service before qualifying for a pension? You'll find it relatively easy to provide the anticipated pay raises or increases in the rate of inflation. If you've been contributing to a TSP account, you'll also know what your account balance is, what you're currently saving, and your average annual return over several years.

Deciding whether or not to opt-in to the blended system may come down to how confident you are that participating in a tax-deferred savings account will help you meet your long-term financial objectives.

Your strongest allies are careful analysis and good judgment.

Do the Math

The DoD's retirement calculator is a valuable tool for comparing the legacy and blended systems. It would provide under various scenarios, including length of service, changes in interest rates, and market performance.

Information the calculation requires, such as anticipated pay raises or increases in the rate of inflation. If you've been contributing to a TSP account, you could quickly enlarge the base on which earnings can accumulate. This head start on building your savings just might tip the scale in favor of the blended system.

With a decade of experience in the military, unlike colleagues who have already left the system may come down to how confident you are that participating in a tax-deferred savings account will help you meet your long-term financial objectives.

Choosing Investments

Defined Contribution Plans

Lifecycle Funds

How Matching Works

BRS or Legacy System?

BLENDED RETIREMENT SYSTEM

Guide to Military Retirement

BLENDED RETIREMENT SYSTEM: GUIDE TO MILITARY RETIREMENT is an essential guide to the Department of Defense’s new Blended Retirement System. The book describes how the BRS differs from the pension provided under the legacy system, and provides key information that servicemembers need in deciding whether to opt-in. Along with helpful explanations of BRS features, such as the tax-deferred TSP account, the guide offers insights on saving and investing for a secure retirement.
To Our Military Members and Their Families:

On behalf of the Defense Credit Union Council and our member credit unions, we would like to take this opportunity to express our sincere gratitude for your selfless service to our nation. To show our appreciation, we are pleased to provide you with this copy of Blended Retirement System: Guide to Military Retirement to help you understand the new Department of Defense Blended Retirement System and how it applies to you.

As a proud partner and charter member of the Department of Defense Financial Readiness Campaign, we felt it essential not simply to describe the Blended Retirement System but to provide insights on fundamental retirement planning as well. We also explain why saving is so important and offer practical information for meeting both your immediate and long-term financial goals. We want you to succeed in building a financially secure future!

While the booklet is designed to be informative and to answer questions you may have about the BRS, we highly recommend that you meet with a Personal Financial Manager on your installation as well as with a certified financial planner to discuss your individual financial goals and concerns. In addition, we suggest you make use of all the resources mentioned in the guide and that you look to these reliable sources to gain timely and actionable information.

We wish you all the best as you plan for your retirement. Once again, thank you for your steadfast commitment and courageous service to our great nation!

Sincerely,

Anthony R. Hernandez
Chief Operating Officer

Serving Those Who Serve Our Country

Printed copies of Blended Retirement System: Guide to Military Retirement can be customized with your logo, contact information, and personal letter. Discounts are available on quantity orders. Please email info@lightbulbpress.com or call 212-485-8822.
A Retirement Marathon

Ready, set, go on retirement savings.

If you’re up for the challenge, you can get a head start on long-term financial security from the minute you join the armed forces. The key is having the discipline to save part of your pay every month—right from the beginning—and for as long as you stay in the service.

Think of retirement savings as a race in which you’re competing against yourself. The goal is to save the money now that you’ll need after you stop earning income.

What makes the effort hard, though, is the distance. You’re probably wondering why you have to worry now about something that could be 30 or 40 years in the future? There’s a simple answer. It’s the power of compounding.

GETTING IN SHAPE

To be competitive in any race, you need to be in great shape physically and mentally. In a retirement savings marathon, it’s the mental conditioning that’s critical. You have to resist the impulse to buy extra things you’d like to have now to gain something you’ll absolutely need later. It’s a trade-off that gives you an extra edge, especially down the home stretch.

If you’re burdened by debt, saving is almost impossible and you’ll find yourself lagging behind. But if the money you’re paying in interest on credit cards and loans can go into savings instead, you’ll be prepared for the long run.

There’s just one good reason to postpone saving for a long-term goal, including retirement. That’s using some of your income first to build a nest egg that will help you meet current needs. If you find yourself in such a situation, there are other routes to the goal, such as a tax-deferred individual retirement account (IRA). For retirement savers, the big opportunity is to participate in a new employer’s plan.

ON YOUR MARK

All successful competitors have a common strategy for reaching their goals and a commitment to seizing every opportunity to get ahead. For retirement savers, the big opportunity is access to an employer’s tax-deferred savings plan that lets you postpone taxes on your earnings. That means your account can compound faster.

There are other routes to the goal, such as a tax-deferred individual retirement account (IRA). But for getting off to a fast start, an employer plan is the way to go.

HURDLES AHEAD

The perseverance that pushes you to finish a race is like the commitment it takes to be a winner in the retirement marathon. The main difference is that when you’re saving for retirement you’re apt to encounter hurdles that don’t show up on a marathon course, like high inflation and market downturns, which can slow your pace.

But if you plan ahead to deal with them, they won’t throw you off your course.

HITTING YOUR STRIDE

If you start your savings regime early and make a habit of saving during your career, your progress toward accumulating substantial assets should be right on track.

Sooner or later demands on your current income will begin to ease, at least somewhat. The mortgage may be mostly or fully paid off, and your children will strike out on their own. You’re likely to be earning more. That means you can gradually contribute a higher percentage to your long-term account through your employer’s plan, your own IRA, and other investments you might make.

In fact, the retirement system is set up so that once you turn 50, you qualify to make larger contributions to tax-deferred accounts, whether you spend your entire career in the military or transition to civilian life and participate in a new employer’s plan.

How Componding Works

As you save, your account balance grows larger when earnings on that money are added to the original amount. That means future earnings are figured on the new, larger base and then added to it, making it larger still.

Compounding is sometimes described as having a snowball effect. If an account with a balance of $1,000 gains value at a long-term average rate of 5%, it will be worth about $1,629 after 10 years, $2,653 after 20 years, and $4,322 after 30 years. And if you add $1,000, or a little over $83 a month, to the account each year, it will be worth $14,836 after 10 years, $37,373 after 20, and $74,083 after 30. *

*(Calculation based on annual growth rate of 5% with annual contribution at beginning of each year.)
You've got a fighting chance to make ends meet while you're in the armed forces because you're being paid for the job you do. That's also true if you spend part of your life in a civilian career. But where will your income come from when you're ready to stop working and want to take life a little easier?

**HOW MUCH WILL YOU NEED?**

The reason to think about retirement income now is that your cost of living—what you pay for housing, food, clothing, medical care, and all the other things you spend money on—isn't going to be much less after you retire. In fact, you're likely to need at least 80% of your preretirement income, and perhaps as much as 100%, to live comfortably.

For example, someone earning $50,000 a year will probably need at least $40,000 a year to maintain the same lifestyle after retirement. And that amount will increase a little every year thanks to inflation, which means that over time your dollars gradually buy less. So you need more income just to keep pace.

**RULE OF 72**

You can use the Rule of 72 to figure out how much inflation will increase your costs. Just divide 72 by the current rate of inflation. The result shows how many years it will take for prices to double. For example, if inflation is averaging 3%, most things will cost twice as much in 24 years.

The other thing to keep in mind is that Social Security is facing a cash crunch of its own. While the government is working to solve the problem, future benefits may be reduced and normal retirement age, which is when you're eligible to receive your full benefit, may be increased. So you have to plan with these possibilities in mind.
Employer Plans

Work-based plans are the foundation of long-term financial security.

Employers have the option—though not the obligation—to offer a retirement plan to their employees. These plans generally take one of two forms: a defined benefit (DB) plan or a defined contribution (DC) plan.

**DEFINED BENEFIT PLANS**

A DB plan, commonly known as a pension plan, pays retired employees a lifetime income, usually on a monthly basis. The amount of the pension is typically calculated using a formula that includes the number of years on the job and the employee’s final pay, or sometimes the average pay for the most recent three years. As a result, pension income varies, sometimes significantly, including those from government pensions, which are much less common than government pensions, including those from the DoD, a major corporation, or a nonprofit organization—sets up and manages the plan, invests in a general pension fund that provides income to you and other retired participants, and pays the benefits when they’re due.

As a rule, the more you earn and, even more important, the longer you remain in the job, the larger your pension is likely to be.

Even if you contribute more than 5%, your employer matches only the maximum, or 5%. But that shouldn’t stop you from contributing 10% or more if you possibly can. Larger contributions help to build your account more quickly so it can become a substantial financial resource later on.

When you’re ready to retire, the value of your account will determine the amount of income you’ll have available to withdraw. Unlike a pension, however, the amount isn’t guaranteed. Rather, DC retirement income depends on three factors:

- The combined amount you and your employer have contributed to your account
- The return, or what you’ve earned, on the investments you’ve chosen
- The number of years your money is invested and can benefit from compounding

**BEING VESTED**

When you’re vested, you have the right to a pension or to the matching funds your employer has added to your DC account. You earn that right by working at least the minimum length of time required by the plan even if you leave for any reason before you actually retire. But, if you leave before you’re vested, you forfeit your rights to the pension or to some or all of the match.

To be vested in the DoD pension plan, you must serve in the armed forces for 20 years. For pension plans offered by corporations and institutions in the private sector, federal ERISA rules require that you are either 100% vested after five years on the job or 20% vested after two years and fully vested after seven years.

The vesting period for an employer’s matching contribution varies among DC plans. That’s because employers have the right to choose one of three time frames: instant vesting, 100% vesting after three years, or 20% annual vesting starting at the end of the second year, reaching 100% vested after six years.

However, vesting isn’t an issue with the money that you contribute to the plan and any earnings on those contributions. They always belong to you, no matter how long you’re in the plan.
Defined Contribution Plans

These popular plans help kickstart your retirement savings.

Once you’re convinced you should start saving now to have the income you’ll need in retirement, it’s time to take advantage of your employer’s retirement savings plan. In your case, as a member of the armed forces, you’re eligible for the government’s Thrift Savings Plan (TSP).

While details of retirement savings plans vary, all offer essentially the same key features: tax-deferral, investment choice, and portability.

**TAX-DEFERRED GROWTH**

In all DC plans, the money you and your employer contribute to your account compounds tax deferred. This means no tax is due on your earnings until you begin withdrawing from the account years later. At that point, you pay tax on the withdrawals at the same rate you pay on your other ordinary income.

When taxes are deferred, earnings can accumulate faster since money you would otherwise have to use to pay taxes can keep growing in your account.

The only downside is that earnings in a DC account aren’t guaranteed. The means in some years the value of your account may be flat or even shrunk. But over the long term, you can expect compounding to help your account grow larger, potentially substantially larger.

There is, however, a trade-off for tax deferral. With few exceptions, you give up access to your account value until you’re at least 59½. If you withdraw earlier, the tax you’re deferred is due when you file your tax return for that year. You’ll also owe a 10% tax penalty. That’s because tax deferral is an incentive to save for retirement. So if you use the money for something else, it will cost you.

There’s another concession you make for tax-deferred growth: You must begin withdrawing from your TSP or other DC account when you turn 70½. If you don’t, you’ll face significant penalties.

**SAVING OR INVESTING?**

There’s an important distinction between saving and investing.

Saving involves putting some of your current income aside for future use. Investing uses those savings to buy assets that you expect to increase in value, provide income, or both.

In a retirement savings plan, these assets are usually mutual funds that invest in stocks for growth, bonds for income, or a combination of stocks and bonds.

**TRADITIONAL OR ROTH**

All employers that provide retirement savings plans offer traditional tax-deferred accounts. In addition to tax-deferred earnings, you benefit by contributing pretax income, or earnings before income taxes are deducted. This reduces the amount of income that’s reported to the IRS and so the income tax you owe. Think of it as a bonus for doing the right thing.

Some employers, including the DoD, also offer a tax-free Roth alternative. If you choose this option, you contribute after-tax dollars, so there’s no reduction in your current income tax. But, when you eventually withdraw from a Roth, no income tax is due on the amount you take out, provided you’re at least 59½ and your account has been open for five years or more. This means more money in your pocket later on, perhaps more than you would have saved by contributing pretax income.

The only complication in choosing a Roth is that any employer matching funds go into a tax-deferred account that’s identically invested rather than into the Roth. You won’t accumulate less, but you’ll eventually have to convert the tax-deferred account to a Roth or coordinate withdrawals from these accounts.

**PORTABILITY**

Portability—the ability to take your retirement plan assets with you when you leave the service and take a civilian job—is a major selling point for DC plans.

Portability gives you the flexibility to consolidate your retirement accounts for easier recordkeeping. All you have to do is notify your new employer (if that plan accepts transferred assets) or the trustee of an IRA into which you want to move the assets.

When you authorize a direct transfer from your existing retirement account to a new plan or IRA, the tax-deferred status of the account value remains intact. All you have to do is choose among the investment products available in the new account.

Alternatively, you can stick with your TSP account, since its investment options are hard to beat. Your account will continue to accumulate tax-deferred earnings.

What you don’t want to do is cash out. Not only will you owe taxes on the lump sum you receive and the 10% tax penalty. You’ll also have to start saving for retirement all over again, beginning with a zero balance.

**MENU CHOICES**

When you’re part of a retirement savings plan like TSP, your employer offers a menu of investment choices. This menu lets you choose a combination of investments that put your money to work in different ways. This strategy, called diversification, has the potential to help reduce the risk of losing money or falling victim to inflation while, at the same time, increasing return.

One of the menu choices is designated as the default investment for participants who are automatically enrolled in the plan. Default investments are designed to provide a diversified mix in a single package.

A target date fund, for example, includes a number of different funds under its umbrella. Some of these funds focus on growth and others on providing income. As time goes by and investors in the fund approach retirement, the balance among the funds gradually shifts from an emphasis on growth, which carries higher risk, to an emphasis on reducing risk and generating income.
If you serve in the active component of the armed forces for 20 years or more, are a member of the Reserve component with the equivalent of 20 years of service, or have a qualifying medical disability, you’re eligible for a lifetime government pension when you retire.

The income you receive depends on your retirement pay base and your length of service—common factors in calculating a defined benefit pension. In addition, you’re entitled to a COLA in years when rising inflation triggers more than a minimal increase in the Consumer Price Index (CPI).

Unlike civilian pension payments, which typically don’t begin before you reach a specific age, such as 65, military pension payments begin as soon as you leave the service. There is an exception, though. Reserve members are generally not eligible to receive their pensions until they turn 60, regardless of the age at which they retire.

**THE REDUX ALTERNATIVE**

Servicemembers with 15 years of active duty who intend to remain in the military long enough to qualify for a pension may choose an alternative system, known as Redux, for calculating their pensions.

By selecting Redux, they are eligible for a career status bonus of $30,000, paid either as a lump sum or in installments. In exchange, they agree to complete their 20 years of active duty or forfeit a portion of the bonus.

However, under this system pension payments and COLAs are reduced for servicemembers who are younger than 62 when they retire. For example, someone who retires at 45 after serving 20 years would be entitled to only 40% of his or her pay base rather than the 50% that someone 20 years would be entitled to only 40% of his or her pay base rather than the 50% that someone

The Redux alternative sunsets on **July 31, 1986**, your retirement pay base is the highest—your **High-3**

As with most pensions, those with the highest earnings and the longest tenure reap the largest benefit though there is a ceiling, or cap, at the top of the pay scale.

**IN THE VANGUARD**

Military pensions have a long history in the United States. In 1776 the Continental Congress passed a resolution to ensure that those disabled in the fight for independence would receive a pension of half their monthly pay for life or as long as the disability lasted. Over time, the program expanded to cover military widows and orphans, veterans in financial need, and ultimately all those who served for at least 20 years.

**ACCESS TO TSP**

The DoD provides access to another path to retirement income. In addition to the pension plan, it encourages you to start participating in the federal government’s tax-deferred Thrift Savings Plan (TSP) as soon as you join the uniformed services.

You can contribute a percentage of your pay base, up to the annual cap of $18,000, in 2017. If you do, you can also contribute a percentage of any special or incentive pay you receive. No federal income tax is due on your earnings until you begin withdrawals from your account.

As with other DC plans, the retirement income your TSP account will provide depends on how much you contribute, the return on the investments you select, and the number of years the account balance compounds. The DoD doesn’t make matching contributions, though. That’s typical of employers who offer both a DB and a DC plan.

**SURVIVOR BENEFITS**

Another feature of the military retirement system, the Survivor Benefit Plan (SBP), provides lifetime income, including a COLA, for surviving spouses of retired servicemembers. SBP also provides benefits for minor children and those who are physically or mentally disabled. If you don’t have a spouse or children, you may be able to name a SBP beneficiary with an insurable interest—that is, someone who would suffer financially at your death.

There’s a monthly premium for SBP protection, which goes into effect at retirement. That amount is determined by the percentage of a member’s pension that his or her survivors will receive.

**PENSION CALCULATIONS**

The dollar amount, known as the **retirement pay base**, on which a military pension is calculated depends on your base pay and the date you joined the uniformed services.

**Base pay** is what you earn excluding the housing and subsistence allowances that are part of your overall compensation and any additional benefits or special pay.

If you joined the military any time after July 31, 1986, your retirement pay base is determined by your average base pay during the 36 continuous months it was the highest—your **High-3**.

To find your pension, your retirement pay base is multiplied by 2.5% (0.025) for each year of service (YoS).

**Pay Base x (YoS x 2.5%) = Monthly Pension**

**EXAMPLE 1**

If your pay base was $9,000 and you had 25 years of service you’d be entitled to a monthly pension of $5,625.

$$9,000 \times (25 \times 0.025) = 5,625 \text{ a Month}$$

**EXAMPLE 2**

If your pay base was $6,000 after 22 years of service, your pension would be $3,300.

$$6,000 \times (22 \times 0.025) = 3,300 \text{ a Month}$$
The Blended Retirement System (BRS), which launches January 1, 2018, retains the strengths of the current pension-based system while incorporating a robust defined contribution plan that actively encourages—and also rewards—savings for retirement.

SAVING, FRONT AND CENTER
With its focus on tax-deferred saving, the blended system modernizes the DoD retirement package. It also makes the system more equitable by addressing the long-term needs of all service members, not just those who make the military their career.

To achieve this objective, the DoD is enhancing the role of the Thrift Savings Plan (TSP), making it a key element of retirement planning. Here’s a brief summary:

- Each servicemember who is part of the new blended system will have a TSP account established in his or her name and can make contributions from base pay.
- The DoD will automatically contribute 1% of each member’s monthly base pay to that member’s TSP account.
- After a member has completed two years of service, he or she is eligible for matching contributions from the DoD. But for anyone who opts in 2018, the matching is immediate.

WHAT’S YOURS IS YOURS
Vesting in your TSP account works differently from vesting in the military’s pension system.

The money you contribute to your TSP account and any earnings your contributions generate are always yours, regardless of how long you serve.

After two years of service, you’re fully vested in the automatic 1% contributions that the DoD has made, plus any earnings on those contributions. You also begin to qualify for matching contributions. You’re immediately vested in the matching amounts the DoD adds to your account and any earnings they produce.

All your vested assets are portable, which means you can take them with you when you leave the military. The only amount you risk forfeiting is that the DoD added to your account during your first two years of service and then only if you leave the military before beginning a third year.

But remember: To avoid owing income tax and a potential tax penalty, you have to leave the savings you’ve accumulated in the TSP or transfer them into another tax-deferred account.

TIME FOR A BONUS
As a way to encourage retention, the DoD will offer a bonus, officially known as career continuation pay, to everyone enrolled in the BRS who stays in the military for at least eight years. The only condition for receiving the bonus is that you must agree to serve a minimum of three additional years.

The size of the bonus for active duty members—your monthly base pay multiplied by at least the minimum of 2.5 and up to a maximum of 13—is determined by the Secretary of your service branch. So is the timing of this one-time extra payment, which could be at any point between your eighth and twelfth year of service.

Unsurprisingly, members with the skills the Secretary is most interested in retaining are likely to be offered higher amounts.

Similar incentive payments are available to Reserve members, though the multipliers used to figure the size of the bonus range from 0.5 to 6.

PENSION MODIFICATION
The new BRS retains the core element of the existing system: a defined benefit pension based on tenure and High-3 retirement pay base for the men and women who serve in the military for 20 years or more.

There is a change, however, in calculating the pension amount. The revised formula multiplies years of service by 2% (0.02) rather than by 2.5% (0.025) as the current formula does. So if you retire after 20 years of active duty, your retirement income will be 40% of your retirement pay base rather than 50%. Likewise, if you retire after 25 years, your income will be 50% of your pay base rather than 62.5%. After 30 years it will be 60% rather than 75%.

While the reduction in pension income is a loss, it’s important to put this change in perspective. The BRS provides, through the Thrift Savings Plan (TSP), a way for career members to build a significant supplemental source of retirement income. At the same time, it gives non-career members a strong start on their retirement savings.

It’s also relevant that private-sector pensions, where they still exist, typically calculate retirement income by multiplying an employee’s years of service times 1.5% (0.015) resulting in a pension that’s just 30% of the final salary.

TAKING A LUMP SUM
The blended system will pay retired members a pension annuity in regular monthly installments, just like the plan it’s replacing. But the BRS will also offer members the option of choosing a partial lump-sum payout at retirement.

In exchange for the cash, members taking a lump sum agree to a reduction in their monthly pension benefit until they turn 67. (That’s the age at which you’re eligible to collect your full Social Security benefit and so considered full or normal retirement age.) After 67, their full benefit is restored to the amount they would have been paid if they hadn’t taken the lump sum.

NO DECISION NEEDED
If you’ve completed 12 or more years of service (active component) or accumulated 4,320 or more points (Reserve component) by the end of 2017, there’s nothing to decide. You remain in the legacy system. Going forward, everyone who enters the military in 2018 or later will be automatically enrolled in the BRS. The legacy system won’t be an option.
BLENDED RETIREMENT SYSTEM

Making an Educated Choice

While deciding between the two retirement systems may seem daunting, especially because of the long-term consequences for your financial security, help is available. You’ll receive a lot of the essential information about the BRS during the mandatory opt-in training that everyone who is eligible to opt-in to the BRS must take in 2017.

You can work with accredited military financial counselors and educators who know both systems inside and out and can help you compare the systems’ features. If an in-person meeting isn’t possible, you can schedule a phone session or video chat through MilitaryOneSource by calling 800-342-9647.

The DoD retirement calculator (www.militarypay.defense.gov/BlendedRetirement) which lets you compare projected retirement incomes from both the blended and legacy systems, and the retirement calculator on the FINRA website (apps.finra.org/calcs/1/retirement) are useful tools in deciding whether to opt-in to the BRS.

But what will matter most in making your decision is the energy you put into learning as much as you can before you take the training session or meet with a financial counselor. This way, you’ll be ready to ask the questions you need to ask. You can also find information online from the DoD, MilitaryOneSource, and the Military Security, help is available.

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You'll receive a lot of the essential information about the BRS during the mandatory opt-in training that everyone who is eligible to opt-in to the BRS must take in 2017.

You can work with accredited military financial counselors and educators who know both systems inside and out and can help you compare the systems' features. If an in-person meeting isn’t possible, you can schedule a phone session or video chat through MilitaryOneSource by calling 800-342-9647.

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Estimating Retirement Income

You can compare potential legacy and BRS outcomes in deciding whether to opt-in.

If you’re planning to be on active duty for at least 20 years, you can use a retirement calculator to compare the potential retirement income from the blended system to that from the legacy system. The key word here is potential. That’s because while some of the information you’ll be asked to provide is factual, much of the data you enter are estimates that reflect your own best judgment rather than verifiable facts.

Specifically, what you want to know from the calculations is whether your combined pension and income from TSP under the blended system will be equal to or perhaps larger than the pension you’d receive under the legacy system. The key word here is potential. That’s why it’s important to do the calculation several times—or as many times as you like—using different assumptions to modify your inputs and experimenting with different variables, such as the years you plan to remain in the service and the rate of return you expect to realize on your TSP investments.

INVESTMENT EXPECTATIONS
One critical way in which the blended system differs from the legacy system is the much greater role your TSP savings play in determining your retirement income. Just how much will your account be worth at the time you retire? That depends on:

- How much you contribute to your account, both as a percentage of base pay and from any incentive or other special pay you receive
- The automatic and matching contributions the DoD makes to your account
- The average annual rate of return on the investments you’ve selected
- How soon you start making contributions and how consistent you are in making them

A good place to start is by contributing 5% of your base pay beginning at the time you opt-in, which means you qualify for the maximum match of an additional 5% from the DoD. Any contributions you make on top of that base will only strengthen your long-term financial security.

What’s more difficult to nail down is the average annual rate of return, though it’s essential for estimating your retirement income under the BRS.

ALL IN THE TIMING
As you do your calculations, you’ll want to think ahead to how you’ll handle your pension income, which begins when you retire from the military. You’ll also want to consider when to start withdrawing from your TSP account.

If you’re earning enough at a civilian job to cover your living expenses, you might invest your pension income to help you meet future goals, such as building a substantial net worth on which you can draw to pay your living expenses when you finally leave the workforce.

Similarly, if you can delay withdrawing from your TSP account—ideally until you turn 70½ when withdrawals become mandatory—you can also enhance your long-term financial security. That’s because the longer your account is fully invested, the greater its growth potential is. For example, if you retire at 50 when your TSP account is worth $350,000 and you leave it untouched for 20 years, it could be worth $1,158,572 if it compounded monthly at an average annual rate of 6%.

ESTIMATING RETURN
It goes without saying that the higher your average annual return on your investments, the higher your TSP account balance will be. While it would be nice to project a return of 15% a year, that’s frankly pie in the sky. But if you’re not going to pick a number out of the blue, how do you determine a reasonable rate of return? Though you should heed the caution that past results don’t guarantee future returns, you might start by looking at what returns have been in the past.

You can check the TSP website for the average annual return on its index mutual funds and lifecycle funds, particularly the ones in which you’re already invested or plan to include in your portfolio. You can find that information at www.tsp.gov/InvestmentFunds/FundPerformance/annualReturns.html

DON’T FORGET TAXES
Some retirement calculators ask you to estimate the rate at which you expect to pay income tax in retirement. Keep in mind that if you select a Roth TSP account and a Roth IRA, any money you withdraw will be tax free provided you’re at least 59½ and your account has been open at least five years. This means more money to cover your retirement expenses than if the withdrawal came from a taxable account.

CAREER EXPECTATIONS
From a career perspective, the important factors for calculating your potential pension under both the legacy and blended systems, but which you can only estimate, include:

When you plan to retire, which determines years of service—a key factor in calculating your retirement pay base
The rank you expect to achieve by the time you retire
The annual pay raises you expect, which, combined with projected rank, will project your High-3 base pay, another component of retirement pay base
The career continuation pay you anticipate receiving, which is calculated by multiplying your base pay by a factor between 2.5 and 13

Figuring out the rate of return that will produce enough retirement income to meet your goals could be a guide to the TSP funds you might choose.
The Mid-Career Challenge

Your strongest allies are careful analysis and good judgment.

Should you switch to the BRS? If you’ve been in the armed forces for 10 or 11 years—just slightly less than the 12 years of service that would automatically keep you in the legacy system—deciding can be complicated.

Unlike colleagues who have already left the military, you may be thinking seriously about making it a career. If you stay 20 years or more, you’ll be eligible for a more generous pension than the BRS will provide.

On the other hand, what if you leave the service before qualifying for a pension? You’ll be joining the civilian workforce with limited retirement savings from a TSP account or perhaps an individual retirement account (IRA) to which you’ve been contributing. Quite possibly you’ll have no savings at all. Catching up will be a serious challenge since you’ll be off to a late start.

**DOING THE MATH**

The DoD’s retirement calculator is a valuable tool for comparing the legacy and blended systems. It projects the retirement income that each system would provide under various scenarios, including length of service, changes in interest rates, and market performance.

With a decade of experience in the military, you should find it relatively easy to provide the information the calculation requires, such as anticipated pay raises or increases in the rate of inflation. If you’ve been contributing to a TSP account, you’ll also know what your account balance is, what you’re currently saving, and your average annual return over several years.

You may also be able to make a realistic assessment about the rate that might be used to calculate your career continuation pay if you decide to move to the blended system. If you were to add part or all of that incentive payment to your TSP account, you could quickly enlarge the base on which earnings can accumulate. This head start on building your savings just might tip the scale in favor of the blended system.

**IT’S ALL ABOUT TSP**

Deciding whether or not to opt-in to the blended system may come down to how confident you are that participating in a tax-deferred savings account will help you meet your long-term financial objectives.

The question is whether access to tax-deferred savings plus the ability to take your account value with you when you leave the military provides a better safety net than the possibility of a somewhat larger pension. To derive the greatest benefit from the BRS, you would probably need to contribute at least 5% of your base pay so that you qualify for the full DoD match. You’d also have to choose investments with the potential to grow in value. It’s smart to discuss the TSP alternatives with a certified financial counselor.

**WEIGHING THE ODDS**

What’s harder to quantify is the probability of reaching the 20-year service mark that makes you eligible for a pension.

**COMPETING PRIORITIES**

It is true having money deducted from your pay as retirement savings means you may have to adjust your spending, even sacrificing some things if it would be nice to have, like a new car.

And, if you’re also saving to buy a home or trying to put money away for your children’s education, you may worry that adding retirement savings could be a financial strain. But even if you contribute less now than you’d like to, you’ll have a foundation on which to build.

Of course, if you decide to stay in the legacy system, contributing to a TSP account is still a sound idea. While you won’t be eligible for the DoD match, your own contributions will have the potential to gain value throughout your military career and supplement your pension and Social Security.

**WHY 12 YEARS?**

You might wonder why you’re facing a hard choice when colleagues with the same rank and perhaps as little as an extra year of service aren’t. The 12-year dividing line was established to avoid the possibility that career members would end up with less retirement income by moving to the new system than they’ll have under the old system. That concern was based on the relatively short period these members would have to build substantial TSP accounts.
Early Career Options

You can’t be sure what the future holds, but you can hedge your bets.

It’s easier to make an important decision when you have the facts you need. When it comes to choosing between the legacy and the Blended Retirement System (BRS), though, some things aren’t certain.

Perhaps the biggest unknown is whether you’ll make the military your career. If that’s your plan, you may think you should stick with the legacy system. If you choose the BRS, though, some things are certain.

Even if you did serve for 20 years, consider this: Could the investment assets you accumulate by contributing to a Thrift Savings Plan (TSP) account and qualifying for the DoD’s matching contributions make up for the reduced pension under the BRS? Or, could the BRS actually provide even more retirement income than the legacy system would?

To help estimate your potential retirement income, you have the facts you need. When it comes to choosing between the legacy and the Blended Retirement System, you have the facts you need. When it comes to choosing between the legacy and the Blended Retirement System (BRS), you can get an estimate by visiting the retirement calculator that’s accessible at www.militarypay.defense.gov/BlendedRetirement. Though they don’t guarantee the actual results, these projections can help guide the choice you make.

THE ADVANTAGES OF OPTING-IN
Advocates of the BRS point to a number of features that they believe make opting-in an attractive choice for servicemembers in early or mid career:

- **You’ll still be eligible for a lifetime pension if you serve on active duty for at least 20 years or combine your active duty with enough time in the Reserve component.**

- **You’ll receive a lump-sum payment known as career continuation pay at some time between your eighth and twelfth year of service. If you prefer, the total you qualify for can be paid in installments to reduce the income tax you might owe if it were paid all at once.**

- **The DoD will make an automatic 1% contribution to your TSP account every pay period starting with the first one after you opt-in. It will also match your contributions up to 5% of your base pay, which could double the amount that’s deposited into your account.**

- **You’re immediately vested in the contributions made by the DoD as well as those you make yourself, plus any earnings on the account balance. This means you can take the full value of your account with you, if you wish, when you leave the force.**

- **Of course, if you stay in the legacy system, you can still contribute a percentage of your base pay along with some or all of your bonus, combat, or similar pay to a TSP account to accumulate tax-deferred earnings. But unlike the BRS, there are no matching contributions.**

- **Whether you decide on the legacy system or the BRS, contributing regularly to your TSP account helps to build your retirement savings and long-term financial security.**

<br>

MAKING A COMMITMENT
To realize the full benefit of the BRS you have to be willing to channel some current income into your TSP account and take some investment risk. Making regular contributions and choosing equity investments can get you off to a quick start in the retirement marathon.

INDICATING YOUR CHOICE
If you decide to stay in the legacy system, you don’t have to do anything. You’re grandfathered in. If you decide to opt-in to the BRS, and you use the Defense Finance and Accounting Service (DFAS), you indicate your choice through MyPay. If you don’t use DFAS, you can opt-in through your branch’s personnel pay system.

BALANCING GOALS
The only good reason to contribute less than 5% of base pay to your TSP account is if you’re putting money aside to create or replenish an emergency fund that will provide a cushion against unexpected problems, such as a serious illness or loss of a spouse’s job, which can strain your finances.

Another resource you can tap if you’re facing a financial challenge is a loan from your TSP account. In the first few years, when your account balance is small, the amount you can borrow may not be enough to meet your need. But as your balance grows, borrowing this way may be preferable to taking a commercial loan. Loans do have to be paid back with interest, and, while a loan is outstanding, growth in your account value is stalled. But so long as it’s just a temporary interruption, you should be able to get your savings back on track.

PROTECTED SAVINGS
Though it’s not a happy thought, it’s possible to encounter financial hardship and even face the threat of bankruptcy.

It may be a relief to know that federal law protects the money in your TSP account against your creditors, which means you can’t be forced to withdraw from your account to pay off debt. However, the money in your account is not protected against federal tax liens.

And, if you roll over your TSP balance to an IRA, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 protects up to $1 million in your account in case of bankruptcy. Some, but not all, states provide unlimited IRA protection.
New to the Force
Savings for retirement just got a lot easier.

If you join the armed forces after January 1, 2018, you’ll be automatically enrolled in the Blended Retirement System (BRS). After 60 days—about the length of basic training in most branches—regular contributions will begin to flow into a Thrift Savings Plan (TSP) account that’s been established in your name.

Part of the contribution comes from a payroll deduction from your base pay each pay period, and 1% comes automatically from the DoD.

TWO FOR ONE
The BRS combines two retirement plans in a single package: a pension component and a retirement savings component. You’ll benefit from the savings starting on the 61st day you serve in the military, and you’ll be eligible for a lifetime pension if you stay in the active component a minimum of 20 years.

EYES ON AUTOMATIC ENROLLMENT
When you’re automatically enrolled in a retirement savings plan, your employer chooses the rate at which contributions will be deducted from your pay. That’s called the default rate.

The employer also chooses how your contributions will be invested. That’s called the default investment. In the BRS, the default rate is 3% of base pay, and the default investment is a TSP lifecycle (L) fund.

For example, if your base pay is $1,500 a month, or $750 each pay period at the time you’re initially enrolled, you’ll contribute $22.50 ($750 x 0.03) twice a month. That’s $540 a year. Then, as you move up in rank over the years, and your pay increases, the amount you contribute will increase as well.

For the first two years you’re in the BRS, the DoD contributes an automatic 1% of your base pay. Using the same $750 per pay period, the DoD would add $7.50 ($750 x 0.01 = $7.50) twice a month to your account. As you begin your third year of active duty, the DoD will also begin to match your contribution at a rate of 100% of the first 3% of base pay and 50% of additional contributions up to 5% of base pay.

For example, if, at the two-year mark, your base pay has increased to $1,900 a month, or $950 per pay period, and you’re still contributing at the 3% rate, you’d be adding $28.50 twice a month ($950 x 0.03 = $28.50) and the DoD will be adding a match of $28.50 plus the automatic 1% ($950 x 0.01 = $9.50). That’s a combined total of $66.50 a pay period or $1,596 a year.

INVESTING MADE SIMPLE
One of the great benefits of automatic enrollment is that it simplifies retirement saving. The initial rate at which you contribute and the way your money is invested are set. Choices like that, especially if you’re making them for the first time, can be intimidating. And if you’re afraid of making a mistake, you may decide it’s easier to do nothing—which is the worst thing you can do.

But it’s also good to know that with the BRS, you’re not locked in to either the default contribution rate or investment choice. You have the right to contribute at a higher or lower rate. Of course, if you want your account value to grow larger, higher is the way to go. Similarly, if you would rather put your money into the individual funds offered in the TSP, you can make the switch whenever you’re ready.

CHOOSING A ROTH
One change you might want to consider sooner rather than later is having your new contributions go into a tax-free Roth account rather than into the default tax-deferred account. All you have to do is authorize the change on the TSP website, using the automated ThriftLine, or by speaking to a TSP representative.

Unlike contributions to a traditional tax-deferred account, those you make to a Roth don’t reduce your current taxable income, so they don’t reduce the income tax you owe. But what a Roth account does let you do is make tax-free withdrawals after you’re at least 59½ and your account has been open at least five years. Chances are your income and your tax rate will be higher in the future than it is now. So tax-free income could mean substantially lower taxes, and more money in your pocket, during retirement.

OPTING OUT
You do have the right to opt out of participating in the TSP and not make contributions—but only after you complete financial literacy training. But you will be automatically re-enrolled every year at the default rate. If you’re still unwilling to contribute, you’ll have to opt out again.

And this: If you had used the $28.50 to buy pizza, you’d have an empty box.

INCOME FOR TOMORROW?

* This simplified hypothetical example assumes 45 years of equal-dollar contributions. The DoD matches contributions through 26 years of service but not longer.
Spotlight on TSP

You can drill down to the nuts and bolts of the Thrift Savings Plan.

The federal Thrift Savings Plan (TSP) provides access to an easy-to-use retirement savings plan for members of the armed forces and other government workers. But it’s up to you to take full advantage of the plan by participating actively and making regular contributions.

Your contributions are calculated at a rate you choose. For example, if your base pay is $4,000 a month, and you decide to contribute at a 5% rate, $200 is automatically subtracted from your pay and added to your TSP account. As you move up in the ranks, if you continue to pay in at the same percentage or at a higher rate, your contribution will increase as well.

After the BRS goes into effect on January 1, 2018, the DoD will match contributions up to 5% of your base pay. So if you contribute 5% and the DoD adds a total of 5%, you’re doubling the contribution rate and adding thousands of dollars to your account value each year.

**WHAT THE INVESTMENTS ARE**

As your contributions and the government’s matching contributions are credited to your TSP account, they’re deposited, on a percentage basis, into the investment funds you select from among five individual funds (G, F, C, S, and I) or one of the four lifecycle (L) funds, designated L2020, L2030, L2040, and L2050 that TSP offers.

The G (government) fund invests in a portfolio of US Treasury securities.

Four funds (F for Fixed Income, C for common stock, S for small and mid-sized company stock, and I for international stock) are index funds.

An index fund is designed to mirror the performance of a specific stock or bond index by owning all, or a representative sample of, the securities in the index.

The L funds, which are funds of funds, include all five individual funds in a single package. But each L fund holds the five funds in different proportions, or weights, depending on its objective—growth or income.

**TRADITIONAL OR ROTH**

As a TSP participant, you decide whether to use a traditional TSP account or a Roth TSP account—or both.

With a traditional account, both your contributions and your earnings are tax-deferred until you begin to withdraw, usually after you turn 59½.

With a Roth account, your contributions aren’t tax-deferred but your earnings are. But what really differentiates Roth savings from other retirement savings is that you can take tax-free withdrawals when you’re at least 59½ provided your account has been open at least five years.

If you want to take advantage of both tax-deferred and tax-free withdrawals, you can split your contributions between a traditional and a Roth account any way you choose—for example on a 50-50 or 25-75 basis, or using some other proportion. The only limitation is that the combined total you contribute to your accounts cannot exceed the annual cap, or dollar limit, that applies to TSP contributions. That cap is $18,000 in 2017 and increases from time to time to reflect increases in inflation.

TSP offers significant flexibility. You can change the way your contributions are divided between traditional and Roth accounts at any time, stop contributing to either account, or convert your traditional account to a Roth account by paying the taxes that are due. The one thing you can’t do is convert a Roth account to a traditional account.

**CONTRIBUTION POWER**

If you contribute as little as 1% of base pay to your TSP account, you’re entitled to contribute up to 100% of any special, incentive, or bonus pay you receive whether you’re part of the BRS or remain in the legacy system. If you’re part of the BRS, you can also add all or part of your career continuation pay. There’s no match for these contributions, but lump-sum cash infusions increase the amount on which earnings can accumulate.

Special rules apply to tax-free combat pay deposited to your TSP account. If the money goes into a traditional account, the contribution remains tax free when you withdraw. But earnings on the contribution are tax deferred, so they’re taxed when you withdraw. If the money goes into a Roth account, both the contribution and any earnings on the contribution are tax free at withdrawal.

If you contribute combat pay, though, you’ll probably want to consult an experienced tax adviser to assure that you contribute only as much as you’re legally allowed and report withdrawals correctly when you file your tax return.

**TAKING AIM AT A TARGET**

Lifecycle funds, including the TSP’s L funds, may also be called target date funds—a phrase that may provide a clearer sense of what they’re designed to do.

Each L fund is focused on a particular target date that’s part of its name. For example, the L2050 is appropriate for members who won’t turn 62 until 2045 or later. That’s because the 2050 fund puts more money into the funds that are most likely to provide growth—C, S, and I—and less into funds designed to provide regular income—primarily G and also F.

In contrast, the L2010 fund, which reached its target in 2010, and converted to an income fund, puts greatest weight on the G fund to preserve account value, since some servicemembers who’ve invested in this fund are already withdrawing retirement income.
Investing Basics

Strategic choices help you meet your goals.

If you’re new to investing or need a quick refresher before contributing to your TSP retirement savings account, you might start by thinking about your investment goals. For most people, it’s a combination of growth and income. Seeking growth means you want the value of your investments to increase over time. Seeking income means you’re interested in investments that pay interest or dividends that are reinvested to build your account’s value. With a combination of growth and income you can expect to have an account that’s large enough to help pay for necessities, such as your living expenses after you stop working, plus the things that make life satisfying.

RISK AND RETURN
What keeps many people from achieving their financial goals is that they’re reluctant to invest because they’re afraid of losing money. All investments do, in fact, carry some risk. For one thing, return, or gain on amounts you invest, isn’t guaranteed like interest on a certificate of deposit (CD) or savings accounts. Return can be negative in some years. But you have to balance this risk against the long-term history of positive results provided by stocks, bonds, and cash equivalents—the primary types of investments. While past performance doesn’t guarantee future returns, you can be sure that if you don’t put your money to work by investing it, it won’t grow.

As you make investment choices, it also helps to understand the direct relationship between risk and return. As with other things in life, the more risk you’re willing to take, the greater the return it’s possible to achieve.

ALLOCATING ASSETS
The problem is that there’s no way to predict market performance. But if you’re invested across asset classes:

1. You’ll benefit from the class or classes that are providing a stronger return.
2. Your potential losses from a class with a weaker return will be limited to the percentage of your account value that’s invested in that class.

Diversification is the next step in managing risk. You diversify by including a variety of stocks and bonds in your portfolio, or roster of investments that you own. For example, on the stock side, you might include both large-company and small-company US stocks as well as international stocks.

You diversify a portfolio for the same reason you allocate across asset classes. That’s because, while all stocks put your money to work in the same way, different categories respond differently to what’s happening in the stock market and the overall economy. Big companies do better in some periods while small ones do better in others. That’s true, too, with stocks in US companies and stocks in international companies.

INDEX FUNDS
An index fund—which is passively managed—typically charges lower fees than an actively managed fund that makes similar investments. That’s because an index fund’s portfolio changes only when the securities in the underlying index change. That can be as infrequently as once a year. The bottom line is that the lower a fund’s fees, the more of its return goes toward building your account value.

For example, stock tends to carry more investment risk than either bonds or cash, primarily because stock prices can be volatile. This means they can change quickly and sometimes dramatically, which bond prices don’t tend to do. But stocks as a group—though not every individual stock—have a long-term average annual return that’s significantly larger than either bonds or cash have produced.

WHY YOUR AGE MATTERS
When you make investment decisions, your goals are a major factor. But so is your age. The younger you are, and the longer you have until reaching retirement age, the more investment risk you may want. This means emphasizing stock. In your TSP account you can do that by investing in the C, S, and I funds or opting for the L2050 fund.

• You can afford to take the greater risk because you have a long time to make up for the negative returns you’re likely to experience from time to time.

• Equally important, the added risk has the potential to increase your return, which builds the value of your account.

On the other hand, as you grow older, you may want to reduce your exposure to risk and preserve your account value by shifting your emphasis from growth to income. But it’s often a good idea to continue to hold stock funds, since the growth they can provide is one way to replenish the amounts you withdraw. You don’t want to outlive your money.

DIVERSIFYING A PORTFOLIO
One way to diversify is to buy mutual funds instead of individual stocks and bonds. Mutual funds give you access to the performance of a broad market or specific market segment by holding portfolios of individual securities. This provides the variety you’re looking for in a single package.

That’s one reason that mutual funds are the most common investment option in retirement savings accounts, including the TSP. It offers a choice of three stock funds and two bond funds.

• Large Company Stock
• Small-Company Stock
• International Stock
Choosing Investments

The key to successful investing is balancing risk and return.

Opting-in to the Blended Retirement System (BRS) kicks off a storm of activity. Before your next paycheck, when the DoD's automatic contributions and matching funds take effect, you'll need to decide a host of things: the percentage of base pay you'll contribute to the Thrift Savings Plan (TSP), whether to open a tax-deferred or Roth account, and the TSP funds in which you'll invest.

The first two are probably easier choices. Unless there's a compelling financial reason, you'll want to contribute at least 5% to qualify for the full match. The choice between a tax-deferred and a Roth account boils down to the difference between the limited tax saving now and tax-free income later.

But choosing investments can present a greater challenge since there are a number of factors in play, including your attitude toward risk. The simple alternative is to select the lifecycle (L) fund, specifically the L2050 fund, which provides diversification and adjusts for risk over time. The other option—which requires hands-on involvement but gives you more control over your assets—is assembling a portfolio of individual funds from among those available through the TPS.

FIRST, YOU ALLOCATE

Before you make your investment choices, think about whether you agree with these statements:

- The primary goal of saving for retirement is building an account value that’s as large as possible.
- You can increase an account’s value over time by investing regularly and concentrating on equities—basically stocks or mutual funds that invest in stocks.
- You can manage much—though not all—investment risk by allocating a percentage of your portfolio to each of the three main asset classes (stocks, bonds, and cash equivalents), and diversifying within asset classes.
- If your answer is yes, you’ll want to allocate as large a percentage of your total contribution to equities as you’re comfortable with, perhaps 80% to 90%. The next step is to diversify, or divide the total, among the three TSP stock funds: large-company US stocks (C), small and medium-sized company US stocks (S), and international (I) stocks.
- The diversification ratio you use is up to you. You might start out using the L2050 fund, which assigns 84% to stocks, as a model: 44% in C, 15% in S, and 25% in I.
- Remember, you’re not locked into your choice. As you become a more experienced investor, you can easily change the equity portion of your portfolio as well as your overall allocation. One thing you don’t want to do, though, is to try to outsmart, or time, the market by shifting money among your funds based on speculation about what will happen next. That’s a losing game.

WHAT ABOUT INCOME?

Compared to equity funds, interest-paying investments provide limited growth in value. Yet, when you’re within ten years or so of leaving the work force for good—which may be a number of years after you’ve left the armed forces—you’ll probably want to reallocate portions of your portfolio to F and G funds to reduce market risk.

But having too much in these funds, especially the G fund, early in your career exposes you to too much inflation risk and can undermine your best efforts to increase your account value.

A Wells Fargo study released in October 2016 compares the effect of allocation on portfolio growth between January 1, 1976, and September 30, 2016. A $10,000 portfolio allocated 70% to stocks and 30% to bonds grew to $581,295 while one allocated 30% to stocks and 70% to bonds was worth $336,715.

PERFORMANCE MEASURES

Good information is essential to good investment decisions initially and also in deciding whether and when to make changes in your portfolio. With TSP funds, performance information is readily available on the individual Fund Information Sheets you can access from the Investment Funds section of the TSP website (www.tsp.gov). You’ll also find links to the underlying indexes.

You want to investigate the specific risks that each fund carries as well as its recent and long-term performance. Performance is measured in several ways:

- **Return on investment (ROI)** measures what you accumulate on the amount you invest, or principal.
- **Total return** calculates increase or decrease in value plus any dividends or interest that were reinvested in the fund.
- **Percent return** is the total return divided by the principal. Percent return is the most accurate way to compare the performance of different investments.

You’ll find that each of the stock funds will have strong performances in some years and weaker performance in others. That’s why you want to diversify across all three funds: When some are up, others may be down, and vice versa.
Lifecycle Funds

An L fund provides a turn-key approach to retirement investing.

Each fund that the TSP offers has an investment objective—whether growth, income, or preservation of principal. But no funds are more specific about their objective than the family of lifecycle, or L, funds. Their collective goal is to build and then preserve an account value that will help provide the income that fund investors need for a financially secure retirement.

Each L fund’s time horizon is the number of years until the fund’s investors plan to begin withdrawing from the fund, usually after they turn 62 but sometimes later. The time horizon largely determines how the portfolio is allocated—specifically the weights assigned to the five individual TSP funds it holds.

For example, in the L2050 fund, 84% of the assets are in stock funds (C, S, and I), 12% in the government fund (G), and 4% in the fixed income (F) fund.

But in the L2020 fund, with its short time horizon, the emphasis has shifted so that 47% of the assets are in the C, S, and I funds, 48% in the G fund, and 5% in the F fund.*

*Allocation targets as of January 2016

SHIFTING THE FOCUS

An L fund’s portfolio is typically adjusted in a gradual, planned reallocation four times a year, at the end of each quarter. The fund is also rebalanced each business day to ensure its assets are in line with the allocation it intends. Rebalancing occurs in response to changes in market conditions, such as an exceptionally strong stock market performance or an increase in interest rates.

The pace of the reallocation is known as the fund’s glide path and determines the allocation at the designated, or target, date.

The logic for adjusting the allocation is that a stock-heavy portfolio, even if it is well diversified, at the designated, or target, date.

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*Allocation targets as of January 2016

BEYOND THE TARGET DATE

When your retirement is years in the future, one question you may not think to ask is what happens when your L fund reaches its target date. The answer is that it converts to an income fund and keeps your assets invested as you and other fund owners withdraw money over time.

For example, the current TSP Income fund, formerly the L2010 fund, has 80% of its assets in fixed income and government securities and 20% in stocks. Even more conservative lifecycle funds eliminate stock holdings entirely at the target date. On the other hand, some more aggressive lifecycle funds maintain substantial stock holdings for 30 years or more beyond the target date, only gradually reducing the allocation to 20%.

It’s an important difference, since the way a fund is invested has a major impact on the amount that’s likely to be available each year for the rest of your life.

MAKING SMOOTH MOVES

If you change your mind after investing your assets, you can move money out of an L fund and into individual TSP funds at any time by making an interfund transfer (IFT) request. The only exception is that after you’ve made two IFTs in a month, additional transfers in that month must go into the G fund. However, making multiple changes in quick succession rarely if ever improves the performance of your portfolio.

Transfers work the other way as well. If you allocate your contributions to individual funds when you begin to contribute to your TSP account, you can always move your account balances into an L fund at any point in your career.

Any transaction fees you incur for an IFT are nominal, unlike the high fees and significant penalties charged by some other retirement investments you may be offered, such as fixed, variable, or index annuities.

A STANDALONE CHOICE?

The customary approach to investing in an L fund is to make it your only TSP investment. Because the fund is regularly and professionally reallocated to suit the approximate number of years until you begin withdrawing, you avoid the responsibility of having to do the reallocation yourself.

As an alternative, you might want to use an L fund for part of your portfolio while diversifying into other funds. For example, suppose you’re willing to take on more investment risk to realize a potentially higher return than the L fund may provide, especially as it nears its target date.

In that case, you might allocate part of your contribution to the appropriate L fund and the rest to a combination of stock funds.

It’s a good idea to discuss investment decisions with an experienced professional, such as an accredited military financial counselor, who can help you evaluate the risk involved so you can determine what’s best for you.
Powering to the Finish

Retirement saving provides the extra kick you need to reach your goal.

You should expect a flurry of financial decision-making when you transition from military life to the civilian world, which could happen in your 20s, 30s, 40s, or 50s.

Whether you resign or retire from your branch of service, you’re likely to begin a new job where you can build on the retirement savings you’ve accumulated in your TSP account.

A SERIOUSLY BAD IDEA

It’s legal to withdraw your vested account value from the TSP when you leave the military. But if you do, you’ll pay the income tax that’s due, plus a 10% tax penalty if you’re not yet 59½, and wipe out your savings for the future. So it’s never a good idea.

Option 1: If your balance is at least $200, you can leave it in the TSP. Your balance will continue to compound, and you can reallocate your account holdings just as you could when you were contributing. And you’ll still benefit from being part of an extremely low-cost plan. However, you won’t be able to make additional contributions unless your new job is with the federal government.

Option 2: You can roll over your account value to an individual retirement account (IRA) when you leave the military or at any point in the future. The preferable method is to authorize a direct transfer from the TSP to the IRA trustee or custodian. You’ll want to choose a custodian that offers the types of investments you want to make and charges modest fees.

Option 3: You can have your account value transferred from the TSP to a new employer’s plan, but only if that plan accepts transfers. You’ll want to be sure the new plan offers comparable investment alternatives at comparable cost.

Look for an adviser who holds the CFP designation from the Certified Financial Board or Standards, the CFP designation from the American College, or is a fee-only adviser who is a member of the National Association of Personal Financial Advisors (NAPFA). The advice won’t be free, but it can be invaluable.

The lump-sum question

There’s one feature of the BRS that doesn’t require an immediate decision, but which you’ll need to address if you serve long enough to qualify for a pension. That’s the option of taking a lump-sum payment at the time you retire of either 25% or 50% of your pension benefit. In exchange, you agree to a reduced monthly benefit until you turn 67.

To calculate your pension benefit, or the total of the monthly amounts you would receive in retirement, the DoD uses your pay base, determined by your High-3 base pay and years of service, and your projected lifespan.

The lump sum you are entitled to will be 25% or 50% of that projected benefit reduced by a factor called the discount rate, which the DoD sets. If the discount rate is high, your lump sum will be less than if the discount rate is low. But either way, the actual lump-sum amount you receive will be smaller than the percentage of your pension benefit you’ve selected.

One downside of taking the lump sum is that you’ll owe income tax on the full amount you receive, which could jump you into a higher income bracket and increase the rate at which the tax you owe is calculated. However, you may choose to take the payout in installments over several years, which would reduce the tax due each year and perhaps the total tax you owe.

As in other cases where you’re making an irrevocable decision about a retirement option, you’ll probably want to seek professional advice from a military financial counselor or a private-sector adviser with comparable credentials.

The time will come when you must start withdrawing from your tax-deferred TSP account, or from the IRA or employer plan into which you have rolled your TSP assets. In nearly every case that will be by April 1 of the year following the year you turn 70½. From a tax perspective, though, it almost always makes financial sense to take the first withdrawal in the year you actually turn 70½. That way, you avoid having to take two withdrawals in the second year and pay tax on the combined amount.

Generally, your retirement plan administrator or custodian will notify you of the amount you need to withdraw for the year. That amount is based on a formula that divides your account balance at the end of the previous calendar year by a factor called the distribution period, which is determined by your age. You can find this information in Table III of IRS Publication 580.
In the Reserves

The winds of change are picking up speed.

As a member of the US military’s Reserve component—the Army, Navy, Air Force, or Marine Reserves or the Army or Air National Guard—you’re entitled to a retirement pension if you complete 20 years of qualifying service by participating in enough reserve activities, including active duty training and continuing education, to accumulate at least 50 points a year.

You’ll be able to begin collecting your pension, in most cases, when you turn 60 rather than when you retire from the military, as active duty members are able to do.

2018 USHERS IN A NEW DAY

In 2018, when the new Blended Retirement System (BRS) goes into effect, if you’re in the Active Guard or Reserve, Full-Time Support, or Selected Reserve and have fewer than 4,320 accumulated points, you can decide whether to remain in the legacy system or opt-in to the BRS. That’s the case even if you have more than 12 years of service. In contrast, active-duty members with 12 years or more of service are able to do.

MATCH POINT

Matching retirement savings through the government’s Thrift Savings Plan (TSP) is designed to help all servicemembers accumulate retirement savings whether or not they remain in the military long enough to qualify for a pension.

Here’s how it works: DoD will open a TSP account for each servicemember who opts-in to the BRS and automatically contribute 1% of his or her base pay or inactive duty pay to the account beginning the first pay period after the opt-in.

The DoD will also match members’ contributions to their TSP accounts, up to 5% of base pay, beginning with the first contribution.

SOMETHING TO CONSIDER

In deciding whether to opt-in to BRS or stay with the legacy system, you’ll want to weigh the likelihood of qualifying for a pension and whether the assets you could accumulate in your TSP account might equal or exceed the difference between the size of a legacy pension and a BRS pension. Those are the same issues facing an active-duty member.

But as a Reserve member who may be part of a civilian employer’s 401(k) or similar plan, you’ll want to weigh the potential advantage of participating in the TSP. That’s because you’re allowed to contribute up to the cap that Congress sets for each year—$18,000 for 2017—across all TSP, 401(k)s, 403(b)s, or 457 plans you’re enrolled in, but no more.

CALCULATING YOUR PENSION

The amount of your pension as a Reserve member depends on your equivalent years of service and is calculated in three steps.

1. Equivalent years are determined by dividing the total points you accumulate over the 20 or more years of qualifying service by 360.

2. The result is multiplied by the pension multiplier—2.5% under the legacy system and 2% under the BRS—to find your retired pay multiplier.

3. Your retired pay multiplier is multiplied by your retirement pay base to find your monthly pension amount.

You can increase your pension if you join the Retired Reserves when you retire. That way the base pay for your rank that applies when you turn 60 will be higher than the amount for your rank at the time you retired. Remember, though, that as a member of the Retired Reserves you could be called back to active duty or the Ready Reserves.

OTHER BRS FEATURES

If you’re a Reserve member who opts-in to the BRS, you’ll qualify for career continuation pay at some point before your eighth and twelfth years of service, at the discretion of your branch. To collect the pay, you’ll have to agree to serve an additional three years.

The incentive payment could range from half (0.5 or 50%) of your monthly base pay to 6 times your base pay—a range that’s substantially less than what will be available to active-duty members.

If you qualify for a pension, when you turn 60 you have the option of taking a lump-sum payment of 25% or 50% of your projected pension income, reduced by a discount rate determined by the DoD. To offset the payment, you agree to take reduced monthly income until you turn 67, when the full amount to which you’re entitled is restored.

(Employers’ matching contributions don’t count against the cap.) If you add more than the allowed amount, you face a potential tax penalty for each year the excess remains in your account. And keeping track of your contributions is strictly your responsibility. Employers don’t monitor what you may be adding to another retirement account.

You may want to consult a qualified financial professional to analyze whether it makes more sense to have two accounts or fully fund just one.

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Asset allocation is a strategy for investing in different asset classes, such as stocks and bonds, to help manage investment risk without sacrificing the potential for a strong return. But asset allocation does not guarantee investment gains or protect against losses in a falling market.

Base pay is the amount you earn each month. It does not include housing and other allowances that are part of your total compensation or any additional benefits or special pay. Base pay is also known as basic pay.

Blended Retirement System (BRS) is the new military retirement system that takes effect on January 1, 2018. It combines a pension with a retirement savings plan that features an automatic contribution of 1% of base pay for all service-members plus a matching contribution of up to 5% of base pay for servicemembers who contribute to a Thrift Savings Plan account.

Career continuation pay is an incentive payment available to all BRS participants at some point between your eighth and twelfth year of service at the discretion of the Secretary of your service branch. As a condition of the payment, you agree to serve three additional years.

Compounding occurs when investment earnings are added to investment principal, creating a new, larger base on which future earnings are calculated.

Diversification is a strategy for managing risk that involves buying a number of different investments within each asset class. But diversification does not guarantee a profit or protect against losses in a falling market.

Individual retirement account (IRA) is a retirement savings plan you set up with a financial institution. Your IRA earnings grow tax-deferred and are reinvested to help build your account value. You can choose between a traditional tax-deferred account and a tax-free Roth account.

Legacy retirement system provides a lifetime pension to servicemembers on active duty for a minimum of 20 years and to Reservists who accumulate 20 years of qualifying service. While members may also contribute to a retirement savings plan, there is no DoD match.

Lifecycle funds are intended to provide a source of retirement income starting at a specific future time, such as 2040 or 2050. Each lifecycle fund gradually shifts its investment emphasis from growth to income as the target date approaches.

Portability means that you can move investment assets you have accumulated in one retirement savings plan to another plan without losing their tax-deferred status. For example, when you retire or leave the service for any reason, you can move assets in a TSP account to an IRA or to another employer’s plan if the plan accepts transfers.

Retirement pay base is the amount on which your pension is calculated in both the legacy and Blended Retirement System. It depends on your High-3, or average base pay during the 36 continuous months it was the highest and when you joined the armed forces.

Return is the gain or loss on your investment principal. It is determined by the change in an investment’s price over a specific period, such as a year, plus any earnings the investment provides.

Tax-deferred means that any taxes that would otherwise be due on earnings in a retirement savings account are postponed until you withdraw money from the account. In some accounts, taxes are also deferred on contributions you make to the account. Annual withdrawals are required from tax-deferred accounts after you turn 70½.

Tax-free Roth is a retirement savings account in which earnings are tax deferred and withdrawals are tax free provided you are at least 59½ and your account has been open at least five years. Contributions are never tax-deferred. Withdrawals are required after 70½ from an employer plan Roth account but not from a Roth IRA.

Vesting means you are eligible to receive income from your employer's retirement plan or plans, based on having completed the required years of service. Vesting periods differ in different types of plans.

Blended Retirement System: Guide to Military Retirement was developed in collaboration with and funded by the Defense Credit Union Council, a non-profit, niche trade association supporting credit unions operating on military installations worldwide.

As a chartered member of the Department of Defense Financial Readiness Campaign, the DCUC maintains a close and constant liaison with the DoD, coordinating on matters impacting financial quality of life, financial capability, and financial products and services, including financial education offered by on-base credit unions to military and DoD civilian personnel and their families.

DCUC is the primary spokesperson at DoD for federal and state chartered credit unions operating on base, functioning in this capacity and serving in this role since 1963.

www.dcuc.org
GUIDE TO MILITARY RETIREMENT

BLENDED RETIREMENT SYSTEM: How BRS or Legacy System? Why 12 YEARS? The mid-career challenge. DOING THE MATH. The question is whether access to tax-deferred retirement savings from a TSP account or perhaps an individual retirement account (IRA) to which you've been contributing. Quite possibly you'll be joining the civilian workforce with limited service before qualifying for a pension. You'll need to adjust your spending, even sacrificing some savings to buy a home or gain value throughout the base on which earnings can accumulate. This could tip the scale in favor of the blended system. Better safety net than the possibility of a pension? You'll have a foundation on which to build. Job satisfaction is one consideration, both for yourself and for your family. If you're excited about the next 10 or 15 years of career challenges and opportunities as you rise through the ranks, you might decide to stick with the legacy system. But if you've started to think seriously about your retirement, you might decide to join BRS. The blended retirement system may come down to how confident you are that the new system than the old system. That concern was based on the possibility that career continuing pay if you were to add part or all of that incentive payment to your TSP account, you could quickly enlarge the base on which earnings can accumulate. This head start on building your savings might tip the scale in favor of the blended system. BRS would probably need to contribute at least 5% of your base pay so that you qualify for the full DoD match. You'd also have to choose investments with the potential to grow in value. It's smart to discuss the TSP alternatives with a certified financial counselor. Deciding whether or not to opt-in to the blended system is an essential guide to the Department of Defense's new BRS. The book describes how the BRS differs from the pension provided under the legacy system, and provides key information that service members need in deciding whether to opt-in. Along with helpful explanations of BRS features, such as the tax-deferred TSP account, the guide offers insights on saving and investing for a secure retirement. 

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