
Retirement Choice: Lessons for Future Financial Readiness Training

Ms. Anita Hattiangadi
Mr. Robert Shuford
March 9, 2016

Financial planning can be confusing and scary!



Background: REDUX retirement

- Congress approved in 1986, effective in 2001
 - Intent was to save the government money
 - Amended law in 1999 to make it a ‘choice’
 - First REDUX retirements occurred in Aug. 2006
- MajGen Johnson (then-director of the Marine Corps’ Manpower Plans and Policies Division) asked Dr. Aline Quester (his CNA scientific analyst) to figure out the plan
- Wanted the retirement choice explained in layman’s terms so it could be clearly understood by all Marines
 - SgtMaj of the Marine Corps (ret.) Lewis G. Lee, who had recently joined CNA, helped greatly in this endeavor
- Eligibility: Date of Entry into Armed Forces (DEAF) date of Aug. 1, 1986 to Dec. 31, 2017
 - At 15 years of service, make **irrevocable** decision between REDUX/bonus or High-3

Retirement choice: REDUX/bonus versus High-3

- Both are tax deferred and fully backed by the government
- REDUX/bonus
 - \$30,000 at 15 years of active duty and agree to complete 20 with service approval
 - If retire at 20 years, **40%** of average base pay for highest 3 years
 - Extra *3.5% per year* for years after 20 (75% at 30)
 - COLA at CPI rate minus 1 percentage point
- High-3
 - If retire at 20 years, **50%** of average base pay for highest 3 years
 - Extra *2.5% per year* for years after 20 (75% at 30)
 - Full inflation protection (COLA at CPI)
- Plans set equal to each other at age 62
 - Differences past that point due solely to COLA difference

Challenge: Date of Entry into Armed Forces (DEAF)

- Other services/OSD call date DIEMS or DIEUS
- Obscure, but critical, date
 - Determines a servicemember's retirement plan
 - Appears on the Statement of Leave and Earnings
- Date first enlisted/commissioned into *any* armed forces component
 - Has no bearing on longevity for pay or years of service
 - Should never change: not adjusted for broken or lost time
- CNA found that date was incorrect for many Navy/Marine Corps officers and some enlisted
 - Academy grads had graduation, not arrival, date in records
 - Worked closely with Marine Corps to fix data and create messages urging Marines to check this date

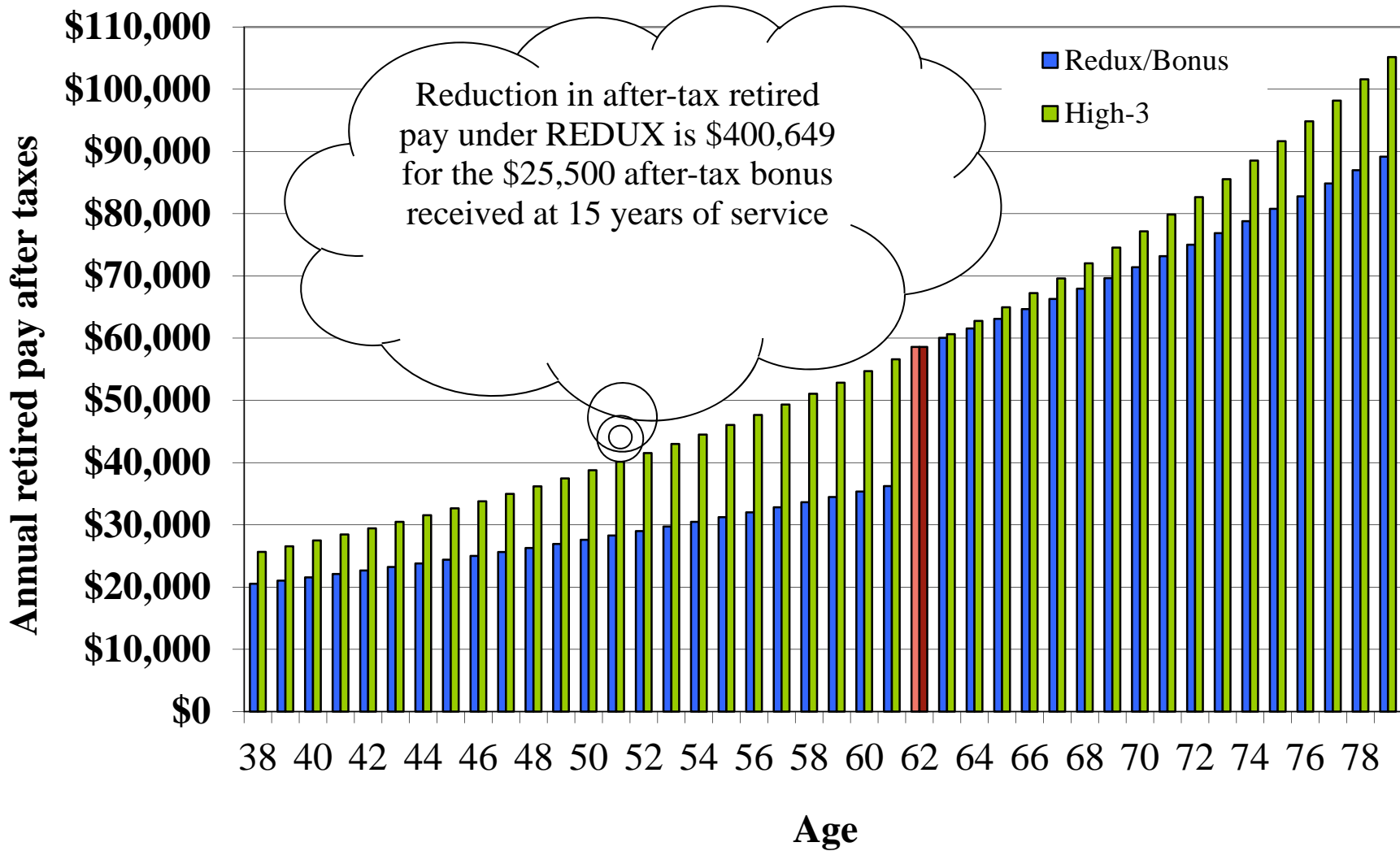
Challenge: How to explain the retirement choice?

- DOD-created calculator was complicated and misleading
 - After-tax High-3 returns were compared with a mix of pre- and post-tax REDUX returns
- Discount rates, present value, and income streams deemed too jargon-y
- Idea to explain cash-out as a “loan” to be paid back through smaller future retirement checks
 - Mortgages, car loans, and credit card debt are other examples
 - Use an annual percentage rate (APR) as interest rate to describe the transaction
- Peculiar repayment scheme
 - Pay nothing until retirement; then pay back until death

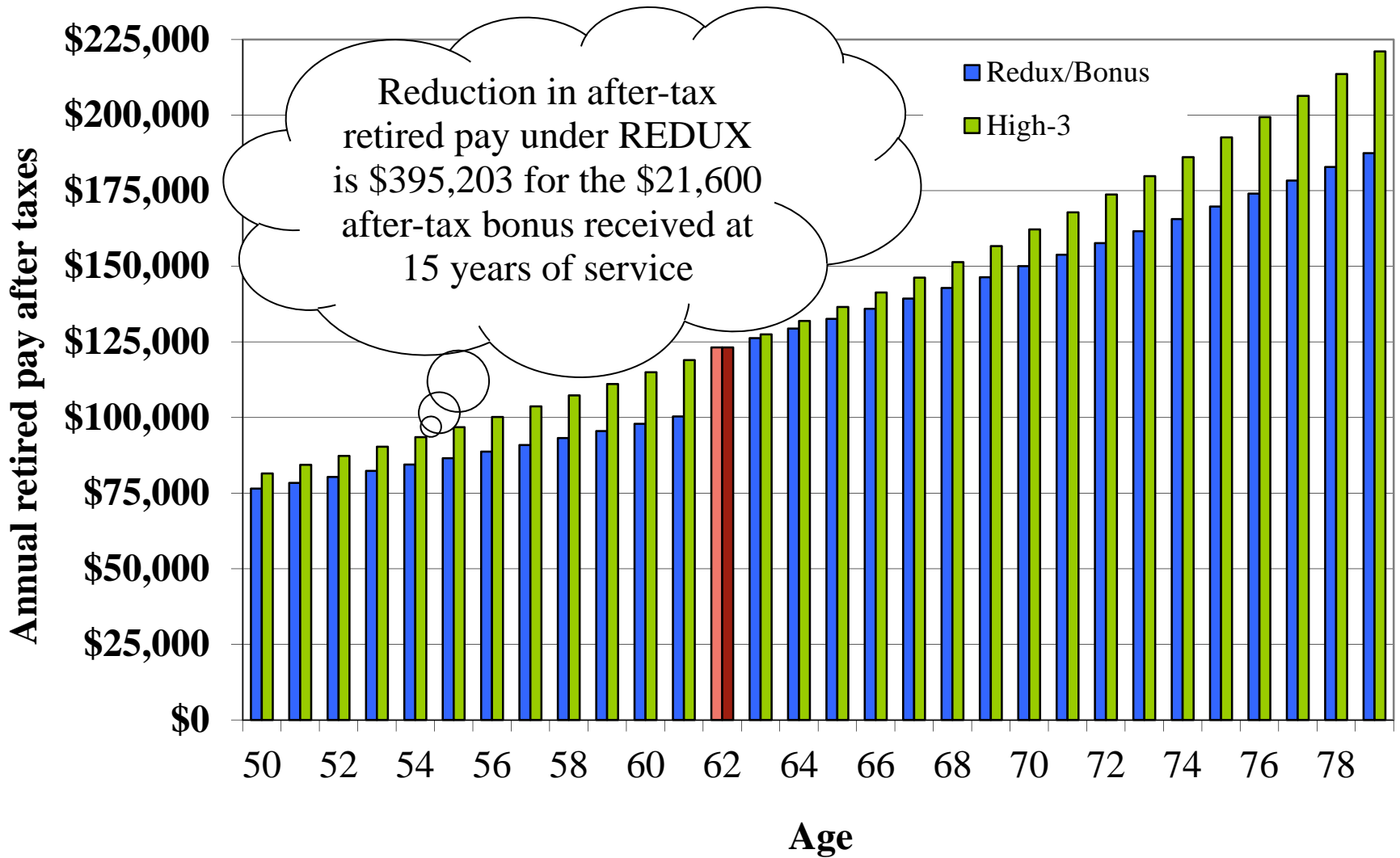
How do the terms of this “loan” compare with a 30-year mortgage?

- \$30,000 continuation bonus has
 - Higher interest rate or APR
 - Much larger repayment amounts
- Assumptions
 - Military pay grows at same rate per year as CPI (3.5%)
 - Servicemember lives to age 79 (can be varied)
 - Tax brackets: 15% for enlisted, 25% for warrant officers, 28% for officers (can be varied)
- E-7 retiring at age 38 with 20 years of service
 - \$30,000 REDUX bonus has 15.2% APR and \$400,649 repayment amount
 - \$30,000 30-year mortgage has 4.0% APR and about \$52,000 repayment amount

E-7 retiring at age 38 with 20 years of service, 15% tax bracket



O-6 retiring at age 50 with 26 years of service, 28% tax bracket



After-tax repayment amounts for the \$30,000 bonus

- Retiring at 20 years of service, age 38
 - \$343,288 for E-6s
 - \$400,649 for E-7s
 - \$438,223 for E-8s
 - \$501,095 for E-9s
 - \$461,733 for CWO-3s
 - \$448,256 for O-4s (retirement age 42)
 - \$496,835 for O-5s (retirement age 42)
- Enlisted stand to lose as much as officers
- If live to 85 years, add another \$100,000 to \$200,000

Why do some servicemembers still select REDUX/bonus?

- Want money now
 - Car, boat, or house
 - Debt repayment
 - Won't live past 60 and no spouse
- Think they'll make it to 30 years of service
- Think they can do better by investing money (TSP)

Thrift Savings Plan (TSP)

- Timing coincided with REDUX legislation
- Terrific vehicle for saving for older years
 - Tax-sheltered
 - Penalties for withdrawal before age 59½
- But cashing-out **tax-sheltered** High-3 to put money in **tax-sheltered** TSP makes no sense
 - Even if you get the bonus tax free in a combat zone
 - Need to earn much higher than normal returns *every* year to break even
 - Unlike TSP, High-3 pension is inflation-protected and risk free

Challenge: How to explain that investing the bonus won't make up for loss?

- What rate of return would you need to break even between REDUX and High-3?
- Invest the bonus and each year in retirement draw out exactly the difference between the REDUX and High-3 retirement plans
 - Do this until age 79
 - At age 79, would have exhausted the account
- Note that Marine must obtain the breakeven rate of return for *every year* until age 79
- For E-7 retiring at age 40 with 20 years of service, breakeven rate of return is 17.6 percent
 - Unattainable
- 2008-09 stock market crash (when Dow lost over half its value) may have helped to discourage this

Tool for servicemembers: the Retirement Choice Calculator

- User can input tax rate and expected lifespan
- Originally distributed on disc/CD; later on internet

Dissemination of REDUX information

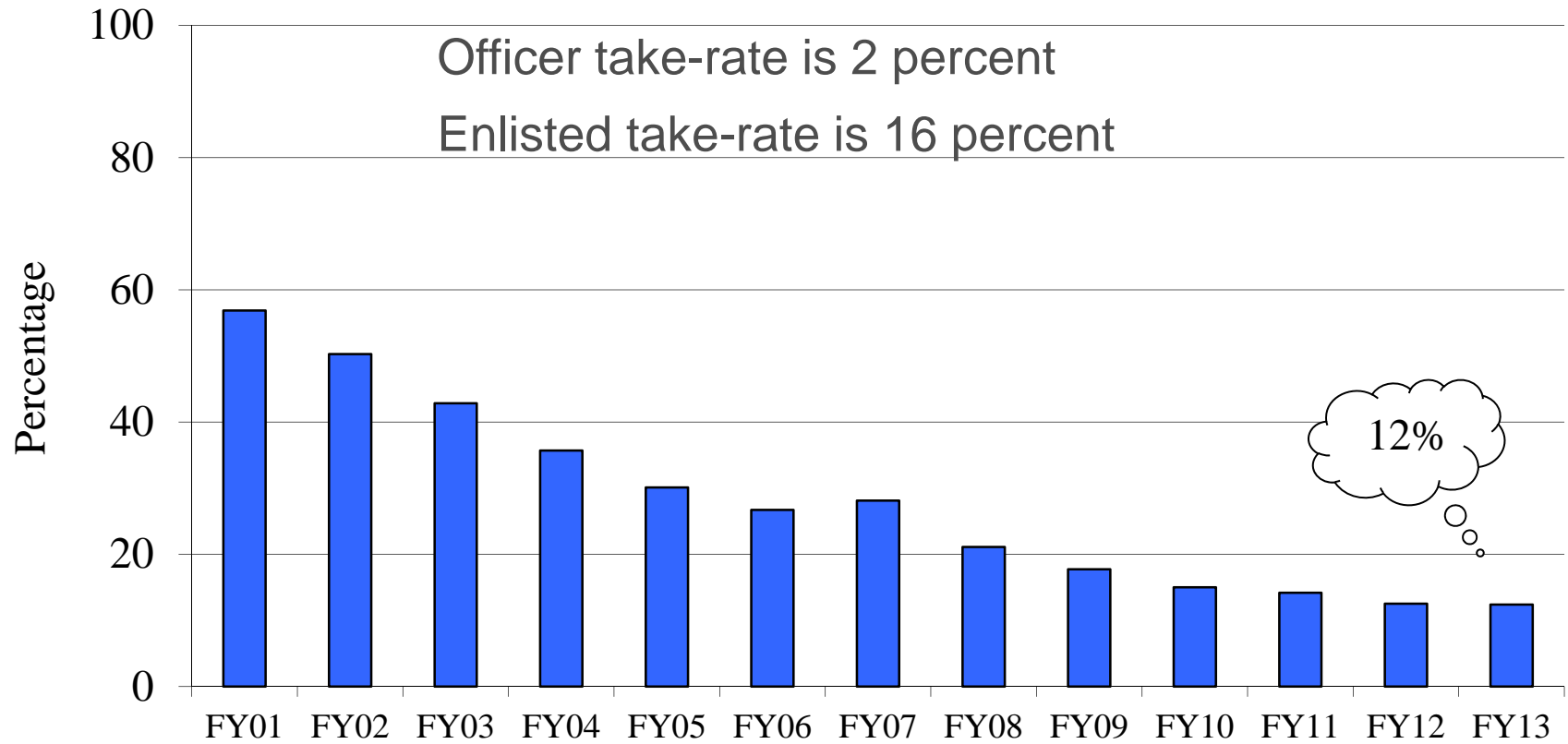
- General Officers' Symposium
- Marine Corps University
- Commanders' Courses
- SgtsMaj Symposia
- Career Planners' Symposia
- NCO schools/academies
- Commanders (by request)

Required REDUX training

Marine Corps issued MARADMINs between 2007 and 2011 that directed it was the commander's responsibility to:

- *Ensure* that all affected Marines receive appropriate counseling
 - *Certify* that Marine electing REDUX is recommended and qualified to continue to 20 years of service
 - *Verify* that a CO, XO, or SgtMaj witnessed election in block 13 of DD form 2839
-
- All Marines electing to receive REDUX must complete an online tutorial (a version of CNA's briefing) through Marine Online and present completion certificates

Marine Corps take-rates for REDUX/bonus



Source: CNA calculations.

Lessons for future financial readiness training

- Ensure that eligibility criteria information is accurate
- When providing information:
 - Put it in layman’s terms
 - Explain it multiple ways at multiple times
 - Provide it through a variety of outlets and methods
 - Have both those who will receive the training and experts in the field review it in advance
 - Do pilot testing with Q&A sessions
 - Work with services to broadly disseminate information
 - Target information to subgroups if possible and make examples relevant
 - Include spouses in information sessions if possible
 - Anticipate (and collect info) on reasons why servicemembers may make a particular choice
 - Determine how to avoid “Gunny logic”

Retirement Choice 2016

Retirement Choice 2016

Anita Hattiangadi, Lewis G. Lee, Robert Shuford, and Aline Quester

March 2016



CNA
ANALYSIS & SOLUTIONS

Distribution limited to DOD agencies only

Questions?

Ms. Anita Hattiangadi
Research Team Leader

hattiana@cna.org

703-824-2522

Backup

FY13 non-disability retirements: Who's retiring?

- Enlisted Marines, about 1,700
 - 50 percent of them at 20 years of service
 - Only 12 percent of them after 25th year of service (about 100 make 30 years of service)
 - Most are E-6s, E-7s and E-8s
- Marine Corps officers, about 700
 - 30 percent at 20 years; 10 percent at 30+ years of service
 - Ranks are O-4, O-5, and O-6
- Chief warrant officers
 - About 130/year; 50 percent between 20 and 22 years of service