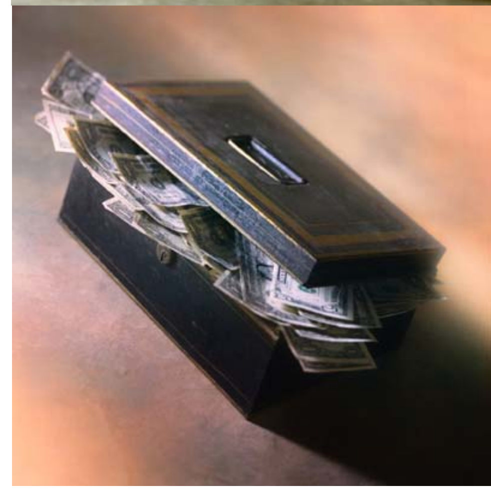
THE BASICS OF RETIREMENT PLANNING



THE BASICS OF RETIREMENT PLANNING

Top

Introduction

The following information will provide a basic introduction to retirement planning, including the military retirement system and the Thrift Savings Plan, the role of Social Security and personal savings in securing your financial future, and will wind up by discussing retirement planning resources.

Motivation

Retirement is something most service members seldom think about, particularly early in their careers. Mission priorities take precedence, work and deployment schedules are hectic and time consuming, and many service members feel what little free time they do have is best spent with family rather than worrying about an event that is many years away. That may be true – to a point. The future will be here before you know it. Decisions made now can decisively affect the quality of life for a member and his or her family later on. If retirement seems too far off to think about, don't look at it as retirement; look at it as independence. Your future financial independence is what is at stake. Financial independence means freedom - the freedom to travel, take vacations, and to do what you wish, within reason, without having to worry about money. Most of you would agree that someday, after your military career is over, it would be nice to have this freedom – to be debt free, be able to buy what you need, and not have to get up and go to work in the morning unless you want to. Now that sounds like a goal worth pursuing! Remember:

- Individuals and families that fail financially usually don't plan to fail.
- They usually fail to plan.

Top

The Changing Face of Retirement

Military personnel have always retired younger than their civilian counterparts; however, this was usually to a second career or job. Final retirement was often much like that of their civilian neighbors: a brief period, often of declining health, where they were too sick to work and too well to die. Retirement usually lasted 5-10 years at most, and was spent living with extended family members or possibly in a sparsely equipped retirement home. Limited financial resources were required. For this reason, financial counselors and advisors formerly told people that they could normally expect to need 60-70% of their final income while working after they retired. Today, however, there is a new retirement model. People are living longer and healthier lives. Many wish to retire early, and to remain independent during their retirement. They want to travel, pursue their favorite activities, and enjoy their retirement, which now could last 20-30 years or more. In the future, it may be common for a military retiree to spend more years in full retirement than he or she did while on active duty! Many financial planners are now urging people to realize they may need 100% of their pre-retirement income, at least in the early years of retirement. Some costs, those associated with work and housing, may decline, but medical and entertainment costs may very well increase.

There are actually several phases to retirement.

- In the first, the active phase, an individual or couple will want to enjoy life, doing those things that they were unable to do when both were working. This costs money; they may need 100% + of pre-retirement income during this phase, which could last 10-15 years.

- In phase two, retired couples generally tend to adopt a more modest lifestyle. They spend less time traveling and more time close to home, with nearby family. Physical condition, while remaining generally good, is such that activity slows down. Children, and even in some cases grandchildren, are already grown. In this period, expenses will normally decline over a period of time, until that individual or couple may find they are spending as little as half what they were a few years earlier. This phase can also last for an extended period of time.

- Often, however, expenses will again increase sharply in the third or final phase of retirement, which is generally defined by the costs of medical and nursing home care.

Employer-Sponsored Plans

Retirement Foundation: Retirement planning for any American, military or civilian, at least in our modern era, is based on three elements: the so-called three-legged stool of retirement. The three legs of the stool are: ***retirement pension and benefits*** from an employer, ***Social Security benefits*** from the government, and ***supplemental income*** provided by an individual's personal savings and investments. Just as the stool needs three legs to be stable, all three elements will form the cornerstones of your future financial independence. This is generally the most important leg of the stool for most people. This is particularly true for career military. There are two general categories of retirement pensions that are provided as a result of employment:

Defined Benefit Plans: First are "defined benefit plans." These are set up and funded by a person's employer. After an individual has worked for a company, usually for a long period of time, he or she becomes entitled to a monthly pension check upon retirement.

- Money is contributed by the employer.

- The amount of the pension is usually based on the individual's salary and total years of service to the company. Normally the pension is a fixed monthly amount, guaranteed for life, although some pensions may include periodic or regular cost of living increases.

- Most older, traditional corporate and government pensions fall into this category – as does military retirement.

Defined Contribution Plans: Increasingly over the last 20 years or so, defined benefit plans have found themselves being replaced by "defined contribution plans."

- With these, employees may contribute up to a certain amount from their salary each month, before tax, into a fund that they control (with some restrictions). Sometimes the employer will match a portion of each employee's monthly contribution.

- With a defined contribution plan, there are no guarantees. The worker will some day receive a lump some, often quite large, that they can invest for future income. The amount employees receive will depend on how much they invest and what their plan's investments earn.

- The most common defined contribution plans are 401(k) plans (named after the paragraph in the Federal Income Tax code that regulates them). The military has both types of employer-sponsored plans: a defined benefit plan and a new defined contribution plan.

Military Retirement: Defined Benefit Plan

The cornerstone of any career service member's retirement has always been a military pension from the government – a form of defined benefit retirement plan. There are actually three different retirement systems currently in effect, depending on your DIEMS (date of initial entry into military service.)

1. First, there is the "Final Pay" plan; this was the original post-WWII military retirement plan, actually passed with the Military Reform Act of 1936.

2. Second is the "High-Three" modification to this, which started in 1981.

3. Finally, there is the "REDUX" plan, passed in the MRRA (Military Retirement Reform Act) of 1986, and modified into the "CSB/REDUX" (REDUX plus Career Service Bonus) Plan. Which of these plans you may be covered under depends on when you came on active duty.

Top "Final Pay Plan"

"Final Pay" History and Explanation. The original retirement system, the "Final Pay" plan, applies to anyone initially entering the military prior to 8 September 1980. Individuals receive a "multiplier" of their monthly base pay, 50% (0.50) if they retire at 20 years of service. The percentage increases at a rate of 2.5% per year for each year over 20 that an individual remains on active duty; this means a retiree would get 75% of base pay after 30 years of service. All military retirees receive an automatic annual cost of living increase each year equal to the consumer price index (CPI).

Benefits of Military Retirement. There is no doubt that military retirement has traditionally been a good benefit, though not quite as good as it had often been portrayed in the civilian community. Most civilians believe everyone in the military can "retire on half pay after 20 years," without recognizing that retirement pay does not reflect bonuses, housing allowances, and many other parts of military compensation. On average, military retirees can normally expect to receive between 35 and 40% of their final total entitlement (equivalent to a civilian salary) if they retire at the 20-year mark, and probably about 2/3 if they serve 30 years.

"High Three" Plan

In 1980, a change was made to military retirement. Instead of being based on an individual's final base pay, retirement pay is now based on the average base pay over highest paid three years of service. This is normally the final three years on active duty. For some individuals, such as limited duty officers who revert back to enlisted, or those who have been reduced in rank, their highest three years may not be their final three. Some of these may be handled on a case-by-case basis.

High Three Explanation. The "High Three" plan applies to anyone who initially came on active duty on or after September 8, 1980. Furthermore, those who came on active duty on or before July 31, 1986 are covered only by this plan; they will not have the option of choosing the Career Service Bonus that we will discuss later. Most service members currently at or approaching retirement eligibility are covered by the "High Three" retirement plan.

The only change is that retirement pay is based on the individual's high three average pay instead of final pay. This represents a light-to-moderate reduction in total retirement benefits, depending on the individual's circumstances.

Top "CSB/REDUX" Plan

- **Redux Explanation**. There is one more military retirement plan to consider. Actually it is a different computation formula known as "REDUX." "REDUX" was originally passed as part of the Military Retirement Reform Act of 1986. It applied to anyone entering active duty on or after 1 August of 1986. There were some significant, and very negative, changes made. First, the multiplier was reduced for anyone retiring with less than 30 years of service; it was cut to 40% for those retiring at 20. The multiplier is increased at 3.5% for each additional year of service; the longer a service member stays in, the smaller the overall reduction under this plan. The second big change was that all annual cost of living raises are based on the CPI minus 1% each year instead of a full COLA.

- **High Three vs. REDUX.** With the "REDUX" calculation, there are two major changes. First is the reduced multiplier. Second, and perhaps more significant, is the cost of living reduction: 1% less per year, every year. There is a one-time "catch up" feature: At 62, the individual's retired check is increased back up to what he would have received (including full COLA increases) – for one year. After that, the 1% less-per-year feature starts again. All this represents a significant reduction in benefits – up to a 25% loss (over $250,000 in lifetime retired pay) for anyone retiring with between 20 and 22 years of service.

Retirement Plan Choice. Under provisions of the FY2000 National Defense Authorization Act, all service members who came on active duty on or after 1 August 1986 are now back under the "High Three" Retirement Plan. However, when they reach 15 years of service, the will get a choice:

- They can remain under the "High Three" Plan OR

- They can elect instead to have their retired pay calculated under the newer, less generous "REDUX" formula – and, also receive a one-time, lump sum $30,000 CSB (Career Service Bonus), to be paid in full at the 15-year point.

"CSB/REDUX" is a package deal. Those who elect this option must remain on active duty until 20 years (or pay back a portion of the bonus – 20% for each year prior to 20 that they fail to complete). The bonus is fully taxable; for members in the 15% tax bracket, this means they will net $25,500 if they take the bonus in cash. Most military members (those above E-6, or most with working spouses) are in the 27% bracket, leaving a net of $21,900.

- This choice is a one time, irrevocable decision, to be made between the 14½ and 15-year point. Each member who entered service on or after 1 August 1986 will receive a notification on this matter at approximately his or her 14-½ year point. They then have the opportunity to make the CSB/REDUX election. They can make this election at any time within those 6 months after being notified or up to the day they hit 15 years, whichever is later. If they change their minds, they can withdraw the request. However, on the day they hit 15 years, the decision becomes irrevocable, and they are locked in for life. If they chose REDUX, they will be paid the $30,000 CSB "no later than the first month that begins on or after the day that is 60 days after the date the election is effective.

- The official position on the DoD web site is as follows: *"Both options have their own merits. Neither is universally better than the other. Which option is more advantageous can only be determined by each individual for his or her own unique circumstances and preferences."*

Advantages: There is an advantage in taking the Career Service Bonus – immediate cash, to use in any manner the service member wishes. This could be for an investment, for seed capital to start a second career business, for education, or (less wisely) to repay debts or even to purchase a new car. Each of these opportunities has limitations.

- The best potential use for the bonus would be for investment. However, the bonus money would have to be invested relatively aggressively to even come close to providing the difference in retirement pay. Most reputable financial planners will use between 10% and 11% as the maximum long-term growth rate that can be expected from a diversified all-stock portfolio for even an experienced investor. Higher returns can be achieved only by taking on a level of risk that is well above average. Even at 11%, most retirees with less than 25 years on active duty will come up short under the "REDUX plus Bonus" plan.

- Some individuals may wish to use the bonus to pay for education expenses for themselves, their spouses, or their children. In most cases, there is a possibility of scholarships; if loans are needed, there may be many better, lower cost alternatives.

- Debt repayment: Some service members may have a large amount of consumer debt at an unattractive interest rate. Even here, however, there are usually better options, ones that do not involve mortgaging the family's long-term future.

- Finally, despite the best of intentions, there will always be a strong temptation to spend at least part of the bonus. This would probably represent the least wise use of the bonus money.

Disadvantages: There are also substantial disadvantages to taking the CSB. The main disadvantage is a major, permanent reduction in retired pay. This also means a reduction in survivor benefits for a surviving spouse. Perhaps the greatest risk is the risk that an individual may spend some, most, or even the entire bonus, leaving very little to show for it. *The best way to look at the CSB may not be as a bonus, but rather as a loan* - a relatively high interest loan against your future military retirement, to be repaid out of each and every retired check for the remainder of your and your spouse's lifetimes.

Additional Information concerning selection of the CSB are as follows:

- For those who are retired from the Navy on disability, previous selection of CSB/REDUX would result in permanent reduction of tax-free disability retirement pay, just as it would for non-disability retired pay.

- In cases where retired service member received disability compensation from the VA, total compensation in retirement would be reduced by the same amount under "CSB/REDUX" as under "High Three" since there remains a dollar-for-dollar reduction in retired pay offset any VA disability payments concurrently received.

- Implications of CSB/REDUX in cases of divorce are still unclear. Presumably if a career service member were to divorce after receiving the bonus, any division of retired pay with the former spouse would be based on the reduced REDUX computation. However, if a service member were to divorce prior to the 15 year point under a decree that stipulated an eventual division of retired pay, that division could obviously be affected by the decision to elect CSB/REDUX, and would have to be taken into account. Issues involving divorce and retired pay tend to be complicated and emotional, and are definitely beyond the scope of this presentation. If there are questions, state, " that many of these issues have not yet been resolved, and refer the individual to legal for additional information." Comparing Options: The Department of Defense has provided a web site with important information on the two retirement plans. It includes the details of each plan, sample case studies, and even a personalized calculator to assist individuals in making their decision. A 2002 study by two West Point professors was very revealing in showing the problems with choosing the Redux with the Bonus plan over the High-3 Plan. The study showed that in order to get the same or better value from the Redux decision as you would from High-3, the entire bonus would need to be invested tax-deferred (the study used $10,000 per year for three years invested in the TSP) and would need to earn a rate of return between 13% and 21%, depending on pay grade at retirement. Since the average historical rate of return on the stock market has been around 10% for the last 78 years, these returns appear unreasonable if not impossible to sustain over the long term. Although the study noted some exceptions, in the vast majority of cases, the High-3 retirement plan will provide service members more retirement benefits than the Redux retirement plan, even after including the $30,000 Career Status Bonus.

- Included on the DoD web site are the stories of two brothers, Harry and Richard; identical twins, they came on active duty at the same time and are now facing the decision of "High Three" or "CSB/REDUX." It is a good comparison, one you should read before making your decision. Rather than repeat their stories here, however, we're going to introduce two other service members: Chief Fastrack and Petty Officer Independence.

- Chief Fastrack has been in the Navy 15 years and is a stellar performer; he has already been selected for promotion to senior chief. He has his college degree, is on track for future promotion; he plans to remain in the Navy a full 30 years, and his family concurs with that decision. In addition the family is in good shape financially: they already have IRAs and other investments, and have some investment knowledge. Chief Fastrack's uncle is a licensed Certified Financial Planner. Chief Fastrack would like to take the bonus and invest all of it. This is an example of an individual who might want to consider electing to take the CSB and invest the proceeds to replace the retired pay he would lose under REDUX retirement calculation.

- Petty Officer First Class Independence also has 15 years on active duty, and is also a good performer; he would like to make Chief, but it's a long shot – promotions in his rate are pretty scarce. Whether he makes Chief or not, he definitely wants to get out of the Navy at 20. He is planning to initially work and go to school. He has never invested and the family has no savings. Although he wants to start investing, his family's main goals are to pay off all existing consumer debts prior to retirement, and save up for a down payment on a home. The family has two older cars, one of which is overdue for repairs; they would like to replace it with a new one. This is the perfect example of an individual who should *no*t, for one moment, *ever* consider taking the bonus. Remaining under "High Three" would definitely be the best option for Petty Officer Independence and his family.

Retirement Plan Choice - For review, here are a few points to consider:

- This is a one time, irrevocable decision.

- The bonus, if chosen, will be taxed.

- The biggest difference in retiring under the "REDUX" formula is not that you start out with less money at 20 years; it is, rather, the 1% less cost of living raise you receive each year. (That 1% difference will "eat you alive" in the long run!)

- Those who get the worst deal, if they take the bonus are those who retire at 20. The longer you remain on active duty, the better deal (relatively) the bonus becomes.

Top

Survivor Benefit Plan

It would not be appropriate to continue the discussion about retirement planning without talking a little bit about the Survivor Benefit Plan, or SBP as it is commonly referred to. SBP is a program that allows a spouse to continue receiving a portion of retired pay after the retiree dies. A member must enroll prior to retirement, and will pay a premium in return for guaranteed continuation of a portion of retired pay to an eligible beneficiary. Active duty members who are eligible for retirement and any active duty member killed in the line of duty are automatically enrolled in SBP.

- The purpose of the SBP is to provide an inflation-protected portion of retired pay (in the form of an annuity) to eligible designated beneficiaries of military retirees at a reasonable cost. SBP, in conjunction with Social Security, can ensure that at least 55% of a member's retired pay will go to an eligible beneficiary. SBP participation is voluntary, however, the decision made by the member and spouse will have a profound effect on the family in the years ahead.

- The decision concerning participation must be made 45– 60 days prior to retirement.

- Spousal written consent is required to elect less than the maximum base amount for a spouse.

- The SBP annuity is an annuity paid monthly to eligible beneficiaries after the member's death, provided they remain eligible and the member enrolled in the Plan prior to retirement.

- Payment to eligible beneficiaries and monthly premiums depend on the base amount chosen by the member. The base amount is the amount upon which any payable annuity is based.

- A common sales technique practiced by many life insurance agents is to try to sway members into declining SBP and buying life insurance instead. Studies conducted by unbiased life insurance experts show that no life insurance policy can guarantee equal or greater benefits for equal or less cost than SBP. The reasons are: SBP is subsidized by the government at approximately 40%—over the course of a lifetime, a member can expect to pay 47% less for SBP than comparable term life insurance; SBP premiums are not considered taxable income; SBP provides a lifetime benefit protection against inflation through annual cost of living (COLA increases); age and health factors are irrelevant to participation; and SBP annuities cannot run out.

Top Military Retirement: Defined Contribution Plan

- **The Military Thrift Savings Plan:** There are two broad types of plans: defined benefit, and defined contribution. The military now has both types of plans available:

  - **A defined benefit plan -** regular military retirement. This is either the "High Three" or "CSB/REDUX" for most service members.

  - **A defined contribution plan** - the new TSP (Thrift Savings Plan).

- The TSP—What is it? The TSP is a retirement savings and investment plan sponsored by The Federal Government. It has been available as part of Civil Service Retirement for a number of years. It is a defined contribution plan; therefore it has the same type of savings and tax benefits as a 401(k)-type of plan. Participation in the TSP is optional; a member must sign up to participate. The member will make contributions directly out of the paycheck, and the member will choose the investment options. The purpose of the TSP is to provide a source of Retirement Income. It is *not* a savings account that can be withdrawn at any time.

- Who is Eligible? The TSP is open to all members of the Uniformed Services, Active Duty and Ready Reserve.

- Enrolling in TSP: There are two open seasons each year, *15 April through 30 June* and *15 October through 31 December*. Members who are deployed and miss open season are given 60 days upon their return to enroll.

- Contribution Amounts: Members can contribute from 1% to 8% of their base pay each month to the TSP in 2003. This will rise to 1-9% in 2004. The contribution limit will increase by one percentage point each year through 2005, after which participants' contributions will be limited only by the IRS's annual limits.

- Members can also contribute the total amount of any incentive and special pays (including bonuses) up to an annual limit of $12,000 in 2003. This limit is called the elective deferral limit. The limit will rise by $1,000 each year until 2006, when it will be $15,000. It may be increased in later years by cost-of-living adjustments. The TSP cannot accept contributions that exceed the elective deferral limit.

- If a member receives tax-exempt "combat zone pay," he can contribute up to the lesser of $40,000 (2003) each year or 100% of pay. Members must be currently enrolled in the TSP in order to contribute any incentive, special or bonus pays.

- Elections to contribute base, special or incentive pays can only be made during open seasons. Bonus pay can be contributed at any time. A government match may be available in the future, but there are currently *no* plans for a match. Remember, in the TSP all money belongs to the member—the contributions the member makes as well as any growth of the contributions.

TSP Investment Options. TSP has several investment options. They include:

- ***"G" Fund*** (The Government Securities Investment Fund, which invests in special, non-traded US Treasury securities guaranteed against any loss).

- ***"F" Fund*** (The Fixed Income Investment Fund, which invests in government and corporate bonds and is designed to track the Lehman Brothers US Aggregate (LBA) bond index).

- ***"C" Fund*** (The Common Stock Index Investment Fund, which invests in stocks in the S&P 500 Index).

- ***"S" Fund*** (The Smaller Company Stock Index Fund, which will invest in small and medium size companies in the U.S., which is designed to track the Wilshire 4500 index).

- ***"I" Fund*** (The International Stock Index Fund, which will invest entirely in non-U.S. companies, which is designed to track the EAFE index).

The TSP is participant directed; each individual will be able to choose which of these 5 funds they wish their monthly contribution to go to. They will also be able to transfer money from one fund to another on a periodic basis.

Fund Performance Histories. Remember, the past performance is never a guarantee of future returns, and that the market overall did extraordinarily well during this period.

Make a Decision. How much you should invest in the TSP, and which fund to invest in, depends on several factors:

- How much you are investing now: If you already have an aggressive investment plan in place, the TSP may or may not fit into it. If you are new to investing, the TSP may offer an excellent way to get started on an automatic investment plan.

- How much of your investable dollars you can commit to retirement investment. It may not be wise to commit all of the available investment dollars to the TSP since you need to consider this money 'tied up' until age 59 ½.

- If you have a Roth IRA. If contributing to the TSP means you have to decrease the amount going to your Roth IRA, it may not be a good alternative.

- How long you will keep the money invested. The TSP is designed to help achieve long-term retirement planning goals. If you are going to use the money you put into the TSP for anything other than retirement, it may not be the best alternative.

- Your age. The younger, the more likely TSP should be a part of your retirement plan.

- There is a general rule in retirement planning that states 'when in doubt, max it out.' This is true for any tax-deferred investment opportunities.

Withdrawals. When members separate from the service they have several withdrawal options with their TSP money. They can choose to receive a single lump-sum payment, request a series of monthly payments, request a TSP annuity, choose to leave the money in the TSP to continue growing (but they cannot contribute any longer), or they can transfer the money in the TSP to a rollover or conduit IRA or to their new employer's plan (if the plan accepts the money).

There are some options for borrowing against the plan while still on active duty, but bear in mind there are substantial penalties for any withdrawal prior to age 59 ½, and there is mandatory 20% tax withholding on certain withdrawals. The TSP is meant to be a retirement saving and investment program. If you need a loan, look to other resources rather than tapping into your retirement funds. Any loan must be repaid or it will be counted as taxable income.

Benefits of the Thrift Savings Plan. The benefits of participating in the TSP include:

- Contributions can be set up to occur automatically, which presents the opportunity for dollar cost averaging.

- Contributions are before tax. This means that the contribution amount is deducted from gross pay BEFORE federal income taxes are calculated, thereby reducing your taxable pay, and your annual tax bill.

- Contributions grow tax-deferred — you are not taxed on the earnings in the Plan until you make withdrawals.

- The TSP has very low administrative costs and expenses. High costs and expenses can reduce the rate of return.

- The TSP is easy to start and to allocate and reallocate money. Most of the transactions can take place over the phone, at the TSP website, www.tsp.gov or via E/MSS.

- You can take the TSP with you. With the Defined Benefit Plan, you have to stay in the Navy 20 years to get it. With the TSP, the money always belongs to you, and if you leave the service prior to serving 20 years the money is still yours.

- You can designate beneficiaries who you would like to receive the funds in the TSP in the event of your death.

- The TSP has an automated telephone service (the "Thriftline") and a website that make it simple to transact business.

- Through tax-deferred investing you can take advantage of the magic of Compound Interest and Time. The TSP can be a great deal for service members — just $50 per month invested at 8% can result in $30,000 of savings over a 20-year career.

Top Social Security

Retirement Planning is based on a three-legged stool. There are still two other legs that need to be considered.

- **Review.** The second leg of retirement is Social Security. Although some may worry about Social Security, it will remain an important part of retirement planning for most Americans. Military personnel contribute to Social Security, and are eligible for benefits upon final retirement. The age for receiving full benefits is gradually being increased from 65 to 67 years old, and at least some Social Security benefits will be taxable for most military retirees.

- **Earnings Benefit Statement/Government Website.** Every individual should obtain a copy of his or her personal Social Security Benefits Statement as part of his or her long range retirement planning. The Social Security Administration is in the process of mailing this out to all Americans over the next few years. You may request one by phone or by logging on to www.ssa.gov/retire. You can also get a rough estimate of your future benefits from this web site, as well as general information about Social Security.

Top Personal Savings

- **Key Third Leg to Retirement Planning.** Personal savings and investments represent the critical third leg to a financially successful retirement. Individuals have many options, including both taxable and tax-deferred opportunities. Let's focus on the most popular form of personal retirement savings, the Individual Retirement Account, or IRA. There are two basic types of IRA's, one that is used for your own retirement funds, and the Education IRA, which is used to save for education funding for family members. We will focus in on the retirement IRAs, which would include the traditional deductible and non-deductible IRA, the Rollover IRA, and the popular Roth IRA.

- Each active duty service member and spouse should strongly consider making an IRA a part of his or her retirement plan. An IRA is a tax-sheltered vehicle that is used to save for retirement. The funds contributed to an IRA grow tax-deferred. Sometimes the amount contributed can be deducted from income taxes (if you are below certain income levels—as in a traditional deductible IRA). If you are above certain income levels the contribution cannot be deducted (traditional non-deductible IRA), but the growth is still tax-deferred. In both traditional IRA's you are not taxed until withdrawal. In a Roth IRA you can never deduct the contribution (therefore it is considered "after-tax" money), but you are also never taxed on the growth upon withdrawal. In most cases a Roth IRA is the best option.

- **Traditional IRA.** As we just mentioned, for members of the military who are covered by an employer-provided pension plan, a Traditional IRA can be either deductible or nondeductible, depending on your income level. Accounts are individual; there are no 'joint' IRA's. You can, however, have one for yourself and one for your spouse. Contributions for traditional and Roth IRA's are limited to $3,000 per year for 2002-2004. (That would be $6,000 total if making maximum contributions to you and your spouse's IRA.) Earnings grow tax-deferred, and the gains are taxed upon withdrawal. If the earnings are withdrawn prior to age 59 ½ there is a tax penalty assessed and taxes are due. You choose which investments you will put your money into, in other words, the investments are 'self-directed.' IRA contribution amounts are increasing as follows: 2002-2004 $3,000/year, 2005-2007 $4,000/ year, 2008 and beyond $5,000/year (will be adjusted for inflation in $500 increments).

- **Rollover IRA**. A rollover IRA is a special type of IRA that holds money transferred from other retirement plans. You will recall from our discussion on the TSP that one of your options for withdrawal is to "roll" the money over into a 'rollover' IRA. Money from 401ks and 403bs, in fact from any type of tax-deferred pension plan that allows it, can be rolled over into this type of IRA. Typically the money will stay in the account, separate from other retirement funds. You cannot make regular contributions to a rollover IRA, but you can add funds from other qualified tax-deferred pension plans. It is important to separate tax-deferred funds into a rollover IRA so that the money will maintain its tax-deferred status. A rollover IRA is a self-directed IRA, you choose the investments.

- **Roth IRA.** Each active duty service member and spouse should strongly consider opening a Roth IRA. Although you receive no tax deduction when you contribute, the money grows tax-exempt (the money grows non-taxed, since taxes are never due on the growth of Roth funds.) At retirement all the money can be withdrawn tax free, forever. Although designed for retirement, some money can be taken out of a Roth IRA after as few as 5 years, with no taxes or penalties due. Traditional IRA's can be converted to Roth IRA's, but all taxes are due and payable in the year of conversion. Roth IRAs are great deals for just about everyone.

Top

Retirement Planning Resources

"Ball Park" Estimate. Retirement planning has definitely become more complicated. It can be long and detailed. However, it is easy to get started, and there are many resources available to help. One is ASEC: the America Savings Educational Council, a non-profit organization dedicated to promoting saving and investing among Americans. At their web site at www.asec.org they have a two-page interactive version of the "Ballpark Estimate" form, a highly simplified but surprisingly accurate way to get an initial estimate of whether you are saving enough for retirement.

This ASEC form is only a ***rough*** estimate for ***initial*** planning – to get you started. Later on, particularly as you approach transition, you may want to begin detailed planning. Try to complete the form and schedule time with your CFS if you need assistance.

Top

Other Retirement Planning Resources

- **Government/Non-Profit Agencies.** There is a wide range of resources available to help. Your Command Financial Specialist should be your first stop. Financial Education Specialists and the TAMP staff at the Fleet and Family Support Centers are excellent resources. The RAO (Retired Affairs Office) may have information on other resources. The Navy Mutual Aid Association often provides assistance with some aspects of estate planning. Commercial financial professionals in the civilian world, including those at DoD affiliated credit unions, may offer comprehensive financial planning services. With the advent of the Internet, there is now a wide range of retirement planning assistance available via computer. Some on-line services charge fees of up to $500 or more; others have do-it-yourself planning tools available at little or no cost.

- **Selecting a Professional.** If you are seeking professional assistance you should use caution. There are many good stockbrokers, insurance agents, and independent financial planners, but not all are fully knowledgeable about retirement planning. Most should provide a free initial consultation; beyond that, some work on a fee basis, while others are paid through commissions on products they sell. Find out how the professional you work with will be paid; remember, you do not get something for nothing. Ask what education, training, or special credentials your planner might have. A licensed CFP (Certified Financial Planner) for example, has been through a detailed advanced program (generally lasting two years), passed a rigorous examination, and agreed to abide by a comprehensive set of planning standards and a code of ethics. It might be worth seeking out a CFP when it comes time to do your retirement planning. In any event, if you are seeking a financial professional, always check at least two and compare their recommendations. Give yourself time to make the best decision. Remember, it's your money; don't be pressured into anything.

Internet Resources

- There are many retirement planning calculators on the Internet that enable you to do at least some of your planning on your own. Use caution dealing with these sites. Remember, the results will only be a good as the data you input. Many of these calculators do not accurately reflect the impact of an inflation adjusted employer pension, such as a military retirement check. Always use realistic assumptions. The calculators will usually ask, at a minimum, that you enter a rate of inflation and an expected rate of return on your investments. A rate of inflation between 3% and 4% per year will accurately reflect most time periods of 20 years of more. For long-term rates of return on your investments, a reputable financial planner would use, at a maximum, 9% to 10% per year before retirement, and 7% to 8% during retirement. The calculator on the government web site "defaults" to a 3.5% rate of inflation and 8% rate of return. These are good starting points.

    - The disclaimer.

    - The following are web sites you may find useful. They are only a few of the literally hundreds that deal with issues relating to retirement planning. The DoD web site, http://dod.mil/militarypay/.

    - The DOD site includes an explanation of the new "CSB/REDUX" retirement plan, and compares it with the older "High Three" plan. It includes sample case studies and a calculator to enable you to do personal planning. The site also has information about the military TSP.

- Two other government sites – one for the Thrift Savings Plan www.tsp.gov and the other for the Social Security Administration www.ssa.gov will enable you to find important information on these programs.

- Many sites have retirement calculators. The very basic one at www.asec.org we have already mentioned. One relatively accurate (and free) commercial planner is offered at http://www.smartmoney.com/ and www.kiplingers.com. This is the web site for Smart Money, the personal finance magazine from Dow Jones Company, which also publishes the Wall Street Journal. For sophisticated investors, the planning tool at www.financialengines.com will allow them to plan their financial future in more detail. This site, started by a Nobel Prize winning economist, offers fee-based services; however, their retirement planner is free of charge.

- There are many commercial sites that provide retirement planning education. Virtually all of the major mutual fund companies have such information available. (If you currently own a mutual fund you may wish to check their site). One such site is www.vanguard.com, which has a subsection know as "Vanguard University," a free site with information on retirement planning and a wide range of other financial topics. Another site is www.morningstar.com. Morningstar is the largest commercial mutual fund rating service. Some of their services are available only for a monthly fee; however, they still have much of value that is free. They offer a number of bulletin boards, on which investors may ask questions and receive answers from other more experienced investors or, occasionally, Morningstar Analysts. While one must always evaluate with skepticism any information received over the Internet, these boards appear to have a higher quality of content. Investment Basics, Investing for Retirement, and Investing During Retirement, are forums that often contain valuable information.

- Finally, there a final government site, www.aoa.dhhs.gov/retire-ment/fpfr.html. This site provides links to other web sites sponsored by government, non-profit, and commercial organizations, which deal with all aspects of retirement financial planning and other retirement related issues. Sites listed include, most of those we have already mentioned. This site, run by the US Department of Health and Human Services, appears to be updated only sporadically; a number of links are no longer current. Still, it remains valuable reference.

Top

Summary and Conclusion

We first introduced retirement planning, and explained how, financially, retirement is based on a 3-legged stool: Employer Sponsored Pensions, Social Security, and Personal Investments. We then discussed military retirement - the three different retirement plans for service members, including the new "REDUX plus Bonus" plan. We discussed the pros and cons surrounding the one time decision to take that plan plus the bonus or remain under the "High Three" plan. And, finally, we introduced the Thrift Savings Plan/TSP.

- ***It is important to remember; those who fail to plan are really planning to fail.***

- ***It's your choice and your future.***