

WhitePaper

The GE Appliances Sale
*Understanding Employee Retirement Benefits
and Working with a Financial Advisor*
May 2016

Key Points

- The GE Appliances sale does not require that employees take action now with respect to their retirement plan balances in the previous plan
- In fact, there can be significant advantages to leaving the assets in the existing plans
- Those working with or planning to hire a financial advisor, should pay attention to cost, conflicts of interest and compensation methods and insist on working with an advisor who works in a fiduciary capacity to the client 100% of the time, meaning a clear legal duty to always put the interests of the client first - no exceptions

Overview

As GE Appliances transitions to new ownership, employees are faced with decisions regarding their retirement assets accumulated in their years of service under General Electric ownership. Their primary areas of consideration will involve their assets in the 401(k) plan known as the Retirement Savings Plan (RSP) and in the contributory portion (both mandatory and voluntary) of their defined benefit pension known as the Personal Pension Account and the Voluntary Pension Account (PPA/VPA).

This sale affects thousands of employees, and many have balances in these accounts that run well into the six figures. Consequently, some firms in the financial services industry will seek to use this sale to capture many new clients in a short period of time. Employees may be encouraged to roll over their balances in these GE-sponsored qualified plans into new IRA accounts under firm management, allowing the firm to charge fees on these assets and/or sell the employee commission-based products.

The purpose of this short white paper is to provide an objective counterpoint to the potentially conflict-laden advice that might be dispensed by some of these financial firms. As a Fee-Only financial firm made up of three Certified Financial Planner™ professionals, we are not seeking clients from this sale of GE Appliances and we provide this information only as a public service to the employees. You can read more about our firm at the end of this paper.

What has really changed?

While the sale technically causes a separation in service for employees from General Electric and ends the further accumulation of pension credits for those who hired in while the defined benefit pension was offered, it does not lead to any requirement for employees to take action on their accumulated RSP and PPA/VPA balances. GE Appliance employees are welcome to continue the use of the GE plans indefinitely. This paper will address the relevant facts surrounding each plan in detail.

Retirement Savings Plan

As employer 401(k) plans go, the RSP is significantly better than the average offering. It was greatly improved years ago after GE was sued for offering a deficient plan. It offers the advantages of low cost, oversight by a plan sponsor with a fiduciary duty to plan participants and potential tax advantages that may depend on the specific situation of a participant.

Unmatched Low Cost. With the use of just the plan's four equity index investment choices, the participant can achieve broadly diversified stock market exposure for both the US and international developed and developing markets. The RSP takes advantage of its size to offer collective investment trusts that are cheaper than even Vanguard Admiral-type shares. For instance, the US Large-Cap Equity Index Fund, which

should be the largest holding by far in a market-weighted diversified equity portfolio, has an expense ratio of just 0.01% per year (almost free), compared to the Vanguard S&P 500 Index Admiral Fund at 0.05%, which is available to retail investors with \$10,000 or more to invest. On the international side, the RSP's Non-US Equity Index Fund costs 0.10% annually compared to similar funds like Vanguard Total International Stock Index Admiral at 0.12%. On an allocation-weighted basis, a diversified global stock index portfolio in the RSP would cost less than 0.05% annually compared to a similar allocation using Vanguard Admiral funds that would cost about 0.07%. On a \$500,000 account value, the annual expense of the funds in the RSP would be just \$250 and directly in Vanguard Admiral funds, would be about \$350. Both are trivial amounts for the portfolio size and are far, far cheaper than the average mutual fund. By comparison, if these funds are rolled to an IRA under a financial advisor, there is the likelihood of higher fund expenses and, even worse, the potential for the firm to charge 1% to 2% annually as an Assets Under Management (AUM) fee.

Fiduciary Plan Sponsor. With any qualified plan, the plan sponsor (General Electric in this case) owes a legal duty to participants to construct the plan in a way that is in the best interests of participants. The sponsor must put their duty to the participants above their own interests. Once assets leave the qualified plan world, it may no longer be assumed that those who advise on the assets put a client's interests first. Few financial advisors work as a fiduciary in 100% of their dealings with clients despite the perception they are always on your side. This is a subtlety understood by very few clients of financial advisors.

Potential Tax Advantages. Assets that are kept inside a qualified plan such as RSP and PPA/VPA assets are walled off under IRS rules from retirement assets that may be held inside a Traditional IRA, which is not considered a qualified plan. Under current tax law, maintaining that separation could allow an annual creation of a "Backdoor Roth IRA" to get around income restrictions on direct Roth IRA contributions. This could be very beneficial to many higher income GE Appliance employees.

If GE stock is owned inside the RSP, there is an opportunity to execute a Net Unrealized Appreciation (NUA) strategy. This maneuver distributes the entire share holdings of the stock into the taxable world via a lump sum distribution while paying income tax only on the original cost basis, allowing a deferral of any gain until the stock is actually sold, at which time the gain would be taxed at more favorable long-term capital gains rates. An investor would generally not want to perform this NUA maneuver until at least age 59 ½ to avoid a 10% penalty. Once the assets are rolled over to an IRA, the potential to take advantage of the NUA strategy is lost.

Turning to the age 59½ requirements to avoid a 10% early distribution penalty, for GE employees who turn age 55 or older this year, leaving assets in the RSP should allow for an exception to the 10% penalty early withdrawal penalty. This age 55 to 59½ penalty exception is not available for withdrawals from an IRA.

Finally, the RSP will still allow taking GE stock dividends as a distribution under the GE Stock Fund Dividend Payout option. This income is penalty-free no matter the participant's age and is taxed as federal ordinary income but is free of Kentucky income tax up to the annual \$41,110 pension exclusion (there is no such tax break in Indiana, however).

All potential tax advantages detailed above are permanently lost when assets are rolled over to an IRA.

PPA/VPA Balances in the Pension Plan

While the base defined benefit pension plan is funded entirely by GE, employees are required to contribute a portion of their pay to the Personal Pension Account when their pay exceeds a certain threshold and they also have the option of voluntarily contributing a portion of their pay below the income threshold to the Voluntary Pension Account. Both the PPA and the VPA balances receive interest annually at a very competitive rate (they use different benchmarks but both rates have been good relative to the general interest rate environment) and can either be taken out as a lump sum (for rollover or distribution) or can be converted to a monthly payment at retirement.

Since the RSP does not have the greatest fixed income offerings, these PPA/VPA accounts provide a wonderful fixed income option for diversification of one's retirement assets. The interest rates are set annually and for 2016 are 2.17% for the PPA and 2.36% for the VPA. These rates are as good or better than the best 5 year FDIC-insured Certificate of Deposit offered by any bank in the country. The yield on the VPA should always track the 10 year US Treasury bond and the yield on the PPA should not be far behind it. Investment options that offer long-term rates with annual re-pricing are a very rare commodity and not something one should walk away from without significant thought. Some may see this as a boring investment but most investors need a fixed income allocation in their portfolio and this is one of the best combinations of return for minimal risk in the fixed income arena that our firm is aware of.

Additionally, maintaining the account provides the option of converting the balance to an annuity for life at retirement to supplement the base pension. While the amount of the annuity will depend on interest rates at the time of conversion, based on GE-provided estimates today and compared to what is available from an insurance company, it appears the annuity payouts through GE could, at times, exceed those from insurance companies. Based on the recent experience of our firm, current GE annuity payouts seem to exceed insurance company payouts by more than 10% but there is no guarantee this will always be the case.

Where does this leave you?

Our firm has worked with a number of GE clients over the years and we have seen few circumstances where we would advise any client who has separated service from GE mid-career to roll over their retirement funds to an IRA upon separation. On the other hand, if the client is of retirement age upon leaving GE, we have generally rolled over the assets to either take advantage of the GE stock NUA opportunity or better fixed income investments (which are more important after retirement) or for both of those reasons.

If any financial advisor advises a rollover of retirement assets, the client should challenge the advisor on the reasons. How is this in the client's best interest when there is no requirement to move the assets? The client should be sure that the main reason to do a rollover is not so the firm may collect more AUM fees. As explained in this white paper, the cost of the investment options under the current GE plan is unmatched anywhere else and there could be tax advantages if assets are kept in a qualified plan for an indefinite period of time, at least until the work career ends. If an advisor asserts there are other investments available that will perform better, challenge the advisor to provide substantive details.

When working with a Financial Advisor

Does an investor need an Advisor? If an investor is disciplined and does not mind investing significant time educating themselves, perhaps the investor can go well into their working career without ever needing to seek financial advice from a professional. A great resource to get started is *The Index Card: Why Personal Finance Doesn't Have to be Complicated* by Heliane Olen and Harold Pollack. There is a great Chris Arnold NPR report on the book from January 2016 called 'Can the Best Financial Tips Fit on an Index Card?' available at <http://n.pr/1rvowLD>. However, as investors approach the second half of their career with substantial assets, as many GE Appliances employees will, even the most devoted do-it-yourselfer will probably find that a good financial advisor could repay the cost involved many times over.

Investors should approach hiring a financial advisor as if buying a used car. Be skeptical, ask questions, ask follow up questions and don't let the personal warmth of the advisor cause you to suspend your critical thinking skills. It is usually said that the biggest expense most of us face in life is the purchase of a home but it is quite possible that the choice of financial advisor is an even bigger expense over time.

Get the disclosure documents and client service agreement and read the fine print. Ask questions about the meaning of anything that is not clear. Make sure you understand where your best interests and the interests

of the advisor could diverge and a conflict of interest could emerge. Does the advisor earn commissions, seen or unseen? Every advisor gets paid somewhere, somehow and the universal source of all advisor compensation is ultimately from the client, whether direct or not. Are “products” being sold that are like black boxes and hard to understand? Does the firm tout proprietary strategies that “beat the market” even though studies have shown such efforts are largely a fool’s errand? Does the advisor own an insurance company so there is even more incentive to use the captive agency to sell something to the client? Read the Form ADV Part 2 and look for potential red flags that might indicate a conflict of interest. Advisors are required to provide the ADV Part 2 to any potential client and also to provide an updated version each year to the client. It is also available for any advisor at <http://www.adviserinfo.sec.gov>.

How much should the investor pay the Advisor? When it comes to paying the advisor, consider how innocuous paying a fee as a percentage of assets sounds but how much more impactful it really is when converting the small percentage to a dollar figure. For instance, if an advisor wants to charge 2% annually to manage a \$500,000 portfolio, consider that this is \$10,000 the first year! Even if it is 1%, the cost is still \$5000 and it will grow in proportion to the portfolio size. Will the client get their money’s worth?

The focus on fees cannot be over-emphasized. Assuming a portfolio grows by an average of 7% annually before fees, paying an advisor 2% annually off the top means that over a 30 year period, the growth of a portfolio will be 43% less than without the fee. In other words, a \$500,000 portfolio growing at 7% annually would be worth \$3.806 million after 30 years but if subjected to a 2% annual fee over that period, would only be worth \$2.161 million. The advisor’s fees coming off the top have stunted the growth of the portfolio to the tune of \$1.645 million!

Are advisors worth some level of fee? Absolutely! Objective studies from entities like Vanguard have shown that a good advisor who is capable and truly working in the interest of the client 100% of the time might add up to around 3% in net returns annually for their clients. While this suggests paying an advisor 2% annually could still allow the client to come out ahead by working with an advisor, the objective data shows that 2% is an above average fee percentage for an advisor who charges Assets Under Management.

To get a better idea of how advisor fees work and what is being charged today, look for articles such as the one at <http://bit.ly/1rvnm2L> on Advisoryhq.com that reports that the average fee for a \$500,000 account is 1.06%. Our firm has seen other surveys that are in the same ballpark.

How does the investor make sure that the Advisor is truly on their side? Finally, to confirm fiduciary responsibility, an investor should ask the advisor to sign the NAPFA Fiduciary Oath that all Fee-Only NAPFA-Registered Advisors adhere to in all client relationships. This is attached as an Exhibit. If you want a detailed guide to selecting a financial planner, you can also download the NAPFA Field Guide “Pursuit of a Financial Advisor” at <http://bit.ly/1q0UbDg>.

Conclusion

While most GE Appliances employees would probably benefit from working with a good financial advisor at some point in their life, the sale of GE Appliances alone imposes no requirement to take action on the retirement accounts. Rolling the retirement accounts to an IRA could be costly both in terms of paying for management (AUM) and in terms of lost future opportunities.

The GE retirement plan makes available the investment vehicles needed to construct a diversified portfolio at rock bottom cost to participate in the equity markets for the foreseeable future. It is important to note that there are financial advisors who will work with clients who leave their retirement assets with their former employer’s plan, incorporating those assets into investment and financial planning without rolling them over to an IRA to make them expensive Assets Under Management.

Any advisor who claims to have products or a unique investment strategy that can consistently outperform (net of all expenses) what a diversified portfolio inside the GE plan could earn over a long period of time would be arguing a position contradictory to the findings of most objective recent studies surrounding investment performance (active vs. passive investing).

Any employee who seeks the help of a financial advisor should consider that many of the best advisors are the ones that must be sought out rather than the ones doing the most marketing. A little sleuthing will go a long way to finding a good advisor and there is plenty of time in this situation to allow waiting a few weeks or months to get a meeting scheduled.

For an experienced financial planner, there is nothing particularly complicated about GE's benefit structure. One does not need an army of GE experts to competently advise on what to do. What is far more rare is finding an advisor without any conflicts of interest so that the investor can be confident about the advice received. In addition, the new Haier benefits are so similar to the old GE benefits that there is little new to discern or understand.

Our firm would suggest those who want to talk to a financial advisor over the next several months or years should seek out the services of a Fee-Only financial planner, which means someone who has no products to sell and cannot receive commissions of any kind. Their compensation comes directly from the client in an amount and manner that is totally transparent to all parties. These planners work as fiduciaries to their clients 100% of the time. You can find planners like this at <http://www.napfa.org>, <http://www.garrettplanningnetwork.com> and at <http://www.xyplanningnetwork.com>

About Coats Financial Planning, Inc.

We are a Louisville-based Fee-Only financial planning firm of CFP® professionals and NAPFA-Registered Financial Advisors working as a fiduciary to the client 100% of the time. We work with clients under an ongoing retainer relationship, which is priced based upon the client's net worth and overall complexity rather than assets under management. Our firm was founded by ex-GE Appliances employee Stuart Coats over 15 years ago (his wife, Anna, continues to work there). The firm has always been able to find clients without the need to conduct seminars or otherwise market itself. Most of our clients come via referral from existing clients or from others who have read the many articles in the press about the benefits of the Fee-Only model and who will settle for nothing less than an advisor who does not sell products or have other conflicts of interest. We only take on one or two new clients per month so we are not looking to gain clients from the sale of GE Appliances but we hope that this document will be beneficial to GE employees who are seeking some answers at this time and might appreciate hearing from experts who are not motivated by personal financial gain.

FIDUCIARY OATH

National Association of Personal Financial Advisors

The advisor shall exercise his/her best efforts to act in good faith and in the best interests of the client. The advisor shall provide written disclosure to the client prior to the engagement of the advisor, and thereafter throughout the term of the engagement, of any conflicts of interest, which will or reasonably may compromise the impartiality or independence of the advisor.

The advisor, or any party in which the advisor has a financial interest, does not receive any compensation or other remuneration that is contingent on any client's purchase or sale of a financial product. The advisor does not receive a fee or other compensation from another party based on the referral of a client or the client's business.

Following the NAPFA Fiduciary Oath means I shall:

- * Always act in good faith and with candor
- * Be proactive in disclosing any conflicts of interest that may impact a client
- * Not accept any referral fees or compensation contingent upon the purchase or sale of a financial product



Signed this _____ of _____

NAPFA-Registered Financial Advisor