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WhitePaper

The GE Lump Sum Pension Offer

Evaluating the Attractiveness of this Limited-Time Offer

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Key Points

- **General Electric is offering a limited-time option for most GE pension plan participants who have previously separated service to take their entire company-provided benefit as a lump sum. This option expires November 25,2019.**

- **Participants who have separated service have always had the option to withdraw the cash balance of their PPA/VPA account and this option will not change in the future.**

- **Our view is that the limited-time offer GE has made for the lump sum value of the company provided benefit is not attractive and most participants should probably decline the lump sum offer and wait for their unreduced "early" monthly benefit at age 60.**

- **The cash balance for the PPA/VPA will continue to earn interest credits based on Treasury Bond rates (currently 3.47% for 2019), which is an exceptional rate in the current interest rate environment, meaning there is no rush to roll over this account either.**

- **Be very wary of any "financial advisor" who encourages cashing out either of these plans at this time. Consider that their motivations to earn additional commissions and/or fees may cloud their views on whether you are being offered fair value today for your future pension benefits.**

Overview

We all know that GE has struggled financially for some time and one of their many challenges is a large unfunded pension plan liability. Accordingly, GE has now made a limited-time offer for most of their previous employees to accept a lump sum cash offer in lieu of the promise of a monthly pension benefit from the age of 60 for life.

After decades of what some would term mismanagement in the executive suite in Fairfield, many ex-employees could be forgiven for adopting a "take the money and run" attitude now regardless of the competence of current senior management in the leaner and now Boston-based company. Sure, it would feel good to cash out of all ties to GE after enduring years of bad news about the company. However, cashing out actually just gives GE a win after all the damage the company has done to the finances of their employees.

This offer affects approximately one hundred thousand employees, and many have balances in these accounts that run high into the six figures. Consequently, some firms in the financial services industry will seek to use this offer to generate significant new commissions and/or fees. Participants may be encouraged to roll over their balances in these GE-sponsored pension plans tax-deferred into IRA accounts under firm management, allowing the advisor to charge fees on these assets and/or sell the participant 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 GE lump sum offer and we provide this information only as a public service to the employees. More information about our firm is included at the end of this paper.

How the Lump Sum Offer (Choice A) Works for the Company-Provided Benefit

Let's understand the inputs that go into the lump sum offer (Choice A). Each participant has been promised a company-provided monthly retirement benefit for life based on their years of service and their pay levels while working at GE. The normal retirement age for this benefit is age 65 but the company allows the participant to begin the benefit at age 60 with no reduction of the benefit to account for the extra years of payments – a very valuable early retirement subsidy. Both of these benefits are shown as options in Choice C in the participant pages.

The company is offering a limited-time option to take a cash lump sum (Choice A) in lieu of those monthly benefits that would be paid for life. The value of this cash lump sum is determined by taking all the monthly payments the participant is expected to receive over their life expectancy, with the value of those payments discounted back to the dollars of today using assumed interest rates over that life expectancy. The life expectancy is determined by a 2019 mortality table required by the Pension Protection Act. The interest rates to be used are selected from a limited option set sanctioned by the IRS under the Pension Protection Act and the ones GE selected are 3.43% for the first 5 years, 4.46% for the following 15 years and 4.88% for 20 years or more in the future.

How GE has its Thumb on the Scale

There are two ways of which we are aware that GE is low-balling their lump sum offer to participants.

First, and this is clearly disclosed in the package sent to participants, the early retirement subsidy, where the participant can collect an unreduced benefit at age 60, same as the monthly benefit at age 65, is not included in the lump sum calculation value, though it would be permissible for GE to include it. However, they chose not to do so. The additional 5 years of benefits represents free money with no penalties for taking it whatsoever. This means the first 5 years of benefits out of what might be a 20 to 25-year pension are totally excluded from the lump sum calculation. As one might imagine, excluding this much of the lifetime retirement benefits results in a huge reduction in the offered lump sum, a cut of perhaps 1/3 for a participant age 50, 10 years away from starting the unreduced early retirement benefit at age 60.

Second, GE chose from the option set of permissible interest rates the ones that are most in their favor to minimize the value of the lump sum, which appears to be totally legal, but we wonder if it is consistent with their fiduciary duty to pension participants. The rates they picked are the IRS applicable interest segment rates from November 2018. This combination of interest rates appears to be the highest seen in several years. Remember, the higher the interest rates they can use, the lower the amount they have to pay a participant in a lump sum. Reviewing recent interest rate history, rates were trending up through most of 2018, peaking in November and then dropped dramatically this year. For comparison, the most recent segment rates (September 2019) compared with the November 2018 rates used in the calculation were as follows:

First 5 years dropped from 3.43% in November 2018 to 2.13% in September 2019

Following 15 years dropped from 4.46% to 3.07%

20 years or more in the future dropped from 4.88% to 3.61%

Needless to say, in a world where the current 10 year US Treasury yield is below 1.8% and the 30 year US Treasury is below 2.3%, the rates GE is allowed to use are totally unrealistic and nothing even close is available in the private sector if you took the GE offered lump sum and tried to buy an annuity with it that would match the promised age 60 GE pension amount. You won’t even get close.

In short, the GE lump sum offer might be the worst we have seen in the 20-year history of this firm. Every Fee-Only financial planner we are aware of who has looked at the numbers agrees it is a poor offer and participants should run away from it unless there are extenuating circumstances.

Deriving a Hurdle Rate for the Lump Sum

Let’s assume a participant opts for the lump sum anyway, despite the lowball amount, on the theory that she can make up any shortfall through outsize future returns. Going back to our 50-year old participant example, we think the average annual return needed to break even with the pension payment over a lifetime assumed to last 82 years would be around 6.5%. This is what we would define as a hurdle rate – the required rate of return that would need to be achieved when investing the lump sum in a retirement account to be as well off as if the participant had just taken the pension benefit and lived an average life expectancy.

Given where we are with stock market valuations, the long-in-the-tooth economic cycle and with historically low bond rates, it is a real challenge to think a participant could beat that return over a 25 to 35-year horizon. Assuming a mix of 50% fixed income and 50% equities, one would need a 4% fixed income return and a 10% equity return to get a blended 7% return and beat the hurdle rate. However, a 4% return in fixed income is not currently possible without taking on a lot of risk and most experts expect equity returns over the next decade to be more like 2% to 7% annually on average. Then you must factor in the headwinds from fees that could run well over 1% annually in some instances. Even achieving a 5% blended return could be a challenge.

According to a recent *Washington Post* article, GE's pension plan generated roughly a 5% average annual return for the years 2000 to 2018. Their current expected return for the plan is 6.75%, according to its latest annual report, which still receives criticism for being too optimistic. The *Post* notes the average expected return for hundreds of other underfunded pensions is 6.1%. If these highly paid experts don't think they can beat the 6.5% hurdle rate, it is doubtful that any of us could on our own or with the help of an advisor.

Offer of a Monthly Benefit Starting 12/1/19 (Choice B)

Choice B is a terrible option because it is heavily discounted. It seems actuarially equivalent to taking the age 65 benefit after missing out on 5 whole years of unreduced monthly benefits that are available starting at age 60. It is highly unlikely we would ever recommend that anyone take this early benefit option.

The Telling Case of the PPA/VPA Benefit

Here is another lesson in how pension plans can be tilted in favor of the plan provider. We are not lawyers and we certainly are not experts in pension plan administration but it is pretty clear that in the eyes of the law, the company-provided pension is legally separate from the PPA/VPA portion funded by employee dollars such that GE is allowed to use assumptions completely independent of each other when valuing these plans. Rest assured, they take advantage of this apparent flexibility.

With the company-provided benefit, GE starts with the given of a defined monthly benefit based on pay and years of service and then uses a life expectancy and some assumed interest rates to calculate a lump sum value in today's dollars. With the PPA/VPA benefit, GE starts with a given lump sum value in today's dollars, made up of employer contributions plus some interest earned. They convert that cash balance into a future projected monthly benefit based on a life expectancy and some assumed interest rates. The two benefits are coming from opposite directions in terms of what inputs are fixed and what are variable but in both cases, they must select interest rates from the same monthly segment rates as approved by the IRS.

Remember that GE used the highest possible interest rates allowed to minimize the value of the company-provided lump sum they would offer participants. If they used these same highest rates to calculate the value of participant PPA/VPA balances when expressed as a future projected monthly benefit, this would lead to higher calculated future monthly payments for participants. Naturally, they didn't use these highest rates. Instead, it appears they used the lowest interest rates they could get away with, as allowed by the Pension Protection Act, which are 2.09% for the first 5 years, 3.0% for the following 15 years and 3.61% for 20 years or more in the future. These are the rates allowed from August 2019 and they seem to be the lowest IRS-approved segment rates seen in many years.

This insight does not matter from a current decision perspective on taking the PPA/VPA cash balance since the cash balance itself is not impacted. However, it is informative of how GE is likely to lowball the conversion of your PPA/VPA lump sum into a pension benefit at a future date. If they continue to offer the lowest monthly benefit they can get away with, it is possible that most participants will ultimately want to cash out their PPA/VPA lump sum rather than annuitize it.

However, this account pays an interest rate, adjusted annually, based on Treasury yields and the rate for 2019 is a very healthy 3.47%. We have used this account as a valuable component of the fixed income portion of client portfolios. Rolling this account balance to a retirement account is always available to ex-

employees at any time except for the month of December 2019, so there is no urgency to act on this. The rate offered will likely drop tremendously for 2020 given that 10-year Treasury rates have plummeted this year, however, but it can always go back up again if rates rebound.

Is GE Acting like a Fiduciary to Participants?

With any qualified plan, the plan sponsor (GE) 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. Are the actions we laid out here, where GE always used the most extreme assumptions that favored the company, consistent with their fiduciary duty? If GE's actions are found troubling by a participant, the participant may consult an attorney versed in this area of the law to determine if there are grounds for legal action. We couldn't possibly comment further on this question except to say that we take our fiduciary duties to our clients very seriously, and we expect the same of other fiduciaries.

Risks of Passing on the Lump Sum

The message of this paper is that GE may well be in compliance with the letter of the law, but they are clearly going to extremes to minimize the payouts to participants. Most participants with many years of service should think seriously about declining the lump sum offer.

On the other hand, younger participants with, at most, 10 or 15 years of service, with a much smaller benefit at stake and far longer to go to reach the age 60 start point may well decide to take their chances with the lump sum given that their longer time horizon makes for a murkier picture of future events and gives them longer to participate in equity markets to try to maximize their returns. They may deem the benefit not all that material in the big picture and opt for simplifying their future retirement income components.

Certainly, there are risks to staying in the plan and we will lay out several here for consideration, though this is not an exhaustive list.

- GE could go bankrupt and default on payment of their pension benefits. While the pension plan has a significant level of unfunded liability and the company has struggled financially in recent years, it is a stretch to say that future bankruptcy is likely given the viable portfolio of businesses the company still operates. If the company goes bankrupt, the pension would be paid in full via the Pension Benefit Guaranty Corporation up to the insured amount, which is currently $3645/month for a pension started at age 60, for instance. This amount also increases annually for inflation. Even if the insurance level leaves 10% or 20% of one's pension exposed, given that this is a low probability event compared with the certainty of taking a grossly discounted lump sum today, the future monthly benefit could still be appealing. Yes, we realize the PBGC is itself a bit shaky. However, any shortfall there would almost certainly be bailed out by Congressional action.

- GE could transfer its entire pension plan liability to an insurance company, much as other companies such as GM and Verizon did in the past. This kind of maneuver at some future date seems very plausible for a company like GE. It would transfer the entire risk of the pension to the insurance company and the payment of the pension would then depend on the solvency of the insurance company, as the PBGC would no longer insure the payments. However, previous arrangements, such as the GM deal with Prudential, appear to have been done with some care. In that deal, GM actually overfunded the pension before transferring it and the terms provided that the pension assets were to be maintained in a separate account that is not subject to the claims of general creditors and that the insurer's general account is to be used to make payments if needed. Additionally, state association funds do provide some level of default protection as well.

- If we experienced higher future inflation, the value of the future monthly benefit could be eroded more than we currently anticipate. Remember, the benefits do not ever receive adjustment for inflation.

- The participant may not live long enough to collect an actuarially expected amount of benefits. Certainly, those with health problems, who expect their lifespans to be shortened accordingly, may want to consider a lump sum benefit, or at least select a survivor benefit when annuitizing.

Conclusion

We think most former GE employees who have received a lump sum offer would be wise to pass on this poor offer and plan to take Choice C, the monthly payments at retirement, at least for the company-provided benefit. It would not be prudent to let your feelings about the company cloud your judgment in assessing what makes long-term financial sense. If you have an advisor telling you to take the lump sum, you should challenge the advisor to provide detailed reasons for why this is in your best interest. If the advisor relies on arguments such as “GE is going under and you’ll never receive that benefit”, then they are not serving you well. If they use this as an opportunity to sell you on putting the lump sum into some sort of complicated annuity product with “lifetime income” and a high bonus crediting rate, you should be very cautious. It may not work like you think it will work.

Most workers today do not have the advantage of looking forward to collecting a traditional monthly pension benefit when they retire. They are left with only two legs of the classic three-legged stool of retirement income – Social Security, employer pension and other savings such as 401k accounts. While former GE employees mostly did not get the chance to fully develop that employer pension leg of the stool, many still will have the opportunity to draw a significant monthly benefit that can be part of the foundation of their retirement income, reducing overall volatility surrounding their retirement picture. The pension is a nice diversifier.

Working with an Advisor

Our firm would suggest those who want to talk to a financial advisor 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/.

Additionally, to confirm fiduciary responsibility and evaluate an advisor, an investor should ask the advisor to complete a Financial Advisor Diagnostic, which includes signing the NAPFA Fiduciary Oath that all Fee-Only NAPFA-Registered Advisors adhere to in all client relationships. This is available here. Few advisors are going to be willing to sign that oath.

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 19 years ago. 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 are not looking to gain clients from the GE pension lump offer (after all, we said don’t take it), but we hope that this document will be beneficial to former GE employees who are seeking some answers at this time and might appreciate hearing from experts who are not motivated by personal financial gain. Our website is located at www.coatsfinancialplanning.com.