1 GE’s Pension Freeze: Will it Help – or Hurt?

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3 General Electric’s recent decision to freeze and otherwise alter pension benefits for employees is in some ways symbolic of the decades-long march by major companies away from traditional defined benefit plans, where employers guarantee a specific retirement nest egg for each employee.

4 Those plans have been steadily replaced by defined contribution plans, where financial responsibility for retirement shifts significantly to employees.

5 In defined contribution plans, employees set aside a portion of their salaries, often with matching employer contributions. ¶¶¶

6 GE [froze](#) the defined pensions of 20,000 workers with salaried benefits, supplementary pension benefits for some 700 executives, and offered buyouts to another 100,000 former employees who haven’t yet started receiving monthly pensions.

7 GE expected the move, effective January 1, 2021, to reduce its pension deficit by $5 billion-8 billion and net debt by about $4 billion-6 billion.

8 It will not affect those already receiving pension payments. ¶¶¶

9 GE’s pension plans have been closed to new enrollees since 2012.

10 The latest freeze marks GE CEO Larry Culp’s continued efforts to try and reduce company debt, which stood at about $55 billion at the end of 2018.

11 Last June, it set out a target of reducing that to $25 billion by the end of 2020. ¶¶¶

12 “Back in 1980, there were about 146,000 single-employer pension plans in the U.S., [but] today we’re down to about 44,000,” said Olivia S. Mitchell, Wharton professor of business economics and public policy.

13 “What’s taken place instead is that defined contribution plans have grown from about 340,000 to 655,000 [over that period].”

14 Defined contribution plans are popularly known as 401 (k) plans and as 403 (b) plans in the nonprofit sector. ¶¶¶

15 “What may have shocked GE into rethinking their pensions finally is a double whammy,” said Marshall W. Meyer, Wharton emeritus professor of management.

16 The first was a report in August by accounting expert Harry Markopolos, where he accused GE of “Enronesque fraud” in its accounting practices, saying that its long-term care insurance business was underfunded by $29 billion.

17 GE defended its accounting practices and said it had “a strong liquidity position” in a statement at the time.

18 The second blow came when ratings agency Fitch “basically validated” those concerns, Meyer added.

19 “So, GE is not out of the woods yet.” ¶¶¶

20 Mitchell and Meyer discussed the fallout of GE’s pension freeze on the

Knowledge@Wharton radio show on SiriusXM.

21 (Listen to the full podcast at the top of this page.) ¶¶¶

22 GE's pension and post-employment benefits programs were underfunded by some $27 billion at the end of 2018, according to a *Wall Street Journal* report.

23 It had funded 76% of its projected pension obligations, the report added, citing data from consulting firm Milliman, Inc. The latest Milliman report noted that "despite … the worst asset performance since 2008," the private single-employer defined benefit plans for the 100 U.S. public companies with the largest pension plans were funded to the extent of 87.1%, an improvement from the year-end 2017 funded ratio of 85.8%. ¶¶¶

24 Lump sum payments of the kind GE is offering may make sense for two reasons, said Mitchell, who is also executive director of the Pension Research Council and director of the Boettner Center for Pensions and Retirement Security.

25 "First of all, people love lump sums," she noted.

26 "They don't really understand annuities, which is part of the problem here.

27 And second of all, the GE pension is still 80% funded, meaning 20% underfunded.

28 If for some reason GE were to go into bankruptcy, then the pension plan would be transferred to the federal government's insurance agency, the Pension Benefit Guaranty Corporation (PBGC).

29 And the PBGC itself is 23 years away from having a cash insolvency problem.

30 Taking the odds into account, I can understand [why] some people might really value the lump sum." ¶¶¶

31 GE could offer buyouts to more employees as it attempts to reduce its pension liabilities.

32 Mitchell noted that the terms are not yet clear for the lump sum payments offered to 100,000 employees who have left the company and are no longer on the payroll, but are not yet retired.

33 The company has said that there will be no increase in the pension plan underfunding as a result of those payments.

34 "What that suggests to me is that the lump sum buyouts will probably be less than the expected value of the lifetime income payments that the retirees would get if they accepted the long-term payments," said Mitchell.

35 "But how much less?

36 We just don't know yet." ¶¶¶

37 **Culp's Challenge: Focus and Trim** ¶¶¶

38 GE has been firing on other cylinders as well in trying to reduce its obligations.

39 Mitchell noted that GE last year also cut retiree health benefits.

40 "Instead of covering continued health care for people after they left, they decided to give retirees only a $1,000 a year and essentially issue them a happy hunting permit," she said.

41 “So, they’re trying to cut along all dimensions possible.

42 But obviously this is giving employees and retirees a great deal of pause.” ¶¶¶

43 Culp has his task cut out as he tries to sharpen the focus of the company on profitable businesses.

44 Meyer noted that his predecessor, John Flannery, was replaced in the wake of weak performance of its power business.

45 The company expected to take an impairment charge of $23 billion on account of that. ¶¶¶

46 “Culp has tried to focus [the company] by trying to move what was a sprawling conglomerate into a business focused in two or three areas,” said Meyer.

47 “One of them still is power generation.

48 Another is aviation.

49 It’s less clear what they’re going to do with health care and a couple of other businesses.

50 Ultimately, it’s going to be a much smaller, much leaner and hopefully more profitable company.” ¶¶¶

51 Meyer recalled that “GE at its peak was a brilliant acquirer of other companies,” with that trend peaking in the Jack Welch era.

52 “Over time, it got harder and harder for GE to acquire promising companies, largely because of the growth of the private equity market,” he said.

53 “It is no longer possible to operate as a conglomerate, looking for attractive assets and getting rid of those which don’t perform very well.

54 As a consequence, the company has got to focus.” ¶¶¶

55 **The Coming Disenchantment** ¶¶¶

56 GE will also have to find ways to placate its executive ranks after it freezes their supplementary pension benefits if it has to retain them.

57 Mitchell pointed out that supplementary pensions typically provide management ranks a retirement benefit above what the typical pension would pay.

58 However, frequently, those supplementary pensions for executives are not pre-funded, she noted.

59 “It’s really up to the health of the company to make good on those promises,” she said.

60 “Now, GE’s decision to cut those supplementary benefits will mean that to keep top management, they’re going to have to make it up somehow, either with higher cash compensation or maybe more stock.” ¶¶¶

61 Meyer agreed that the supplementary pensions issue would become a major issue for GE.

62 “They are a promise, but they’re not legally guaranteed,” he said.

63 “And so, GE is really in a bind.

64 They can pull back substantially on them, but with the consequence that Olivia outlined.” ¶¶¶

65 However, Meyer expected “the real pressure” to be so not much at the executive ranks, but in the middle management ranks.

66 “GE was run for many years like a bureaucracy … and its compensation system was not thoroughly up-to-date,” he said.

67 “Everyone within the individual businesses was on the same escalator based on the performance of that business.

68 The amount of variation in compensation based on individual performance was not very large.

69 And so, one of the things they are going to have to do is focus much more on compensating exceptional performance as well as retaining [talent], which they did do a good job of.

70 That compensation, I think, will allow people some cushion for accumulating retirement benefits.” ¶¶¶

71 GE’s stock performance has been underwhelming in recent times, which makes stock-based compensation to retain management executives less attractive.

72 “In that sense, management is in the same boat as the rank-and-file employees, who during the heyday of the company put essentially all of their retirement money when they had the option into GE stock, thinking it could never shut down,” said Mitchell.

73 “And here we see that stock is down.”

74 GE’s current stock price of about $8 is about half of what it was two years ago and a quarter of its price three years ago. ¶¶¶

75 **Pension Backstop Choking** ¶¶¶

76 Across the broader arena, the safety net for employees to protect their pension benefits is also underfunded.

77 In the U.S., corporate defined benefit plans have to, by law, pay an insurance premium to the PBGC.

78 “That is supposed to be the backstop against the possibility of the corporation itself going bankrupt and having insufficient money in the defined benefit plan,” said Mitchell.

79 However, over the past 15-20 years, “the price of those insurance premiums has been going up and up and up, to be able to cover the shortfalls of bankrupt companies from the past,” she added.

80 “The underlying problem is that the government insurance entity (PBGC) simply can’t raise enough money to be able to backstop those defined benefit plans.

81 So, it’s a huge problem we have.” ¶¶¶

82 GE, on its part, has said it will fund $4 billion-5 billion of its estimated minimum ERISA funding requirements for 2021 and 2022.

83 The Employee Retirement Income Security Act of 1974, or ERISA, sets minimum standards for private sector retirement and health plans to protect beneficiaries.

84 Those funds will come from the $38 billion it will raise from the three recent deals.

85 They are the sale of its biopharma business, the merger of its transportation division with Westinghouse Air Brake Technologies, and the sale of a quarter of its holdings in its group company Baker Hughes. ¶¶¶

86 **Shift to Employees** ¶¶¶

87 After January 1, 2021, for salaried employees, GE will contribute 3% of employee compensation and matching contributions (of 50%) up to 8% of salaries to its 401(k) plan.

88 GE will also offer an additional 2% pay to help with the transition.

89 Executives affected by the freeze on supplementary pension benefits will be offered an installment retirement benefit.

90 For employees who become executives after January 1, 2021, the company will offer a new defined contribution plan benefit.

91 "This is a common benefit offering as companies shift from traditional defined benefit plans to defined contribution plans," the company stated. ¶¶¶

92 "What this does is it requires employees to start taking control of whether or not that's enough saving, how much saving to do and how to invest their money," Mitchell said.

93 They also have to figure out how to manage their money at retirement, so that they don't run out through retirement, she added.

94 "This is a huge problem given the widespread level of financial illiteracy in America.

95 The advent of the defined contribution plan has put more burden on our own shoulders to be smart about retirement savings." ¶¶¶

96 The shift towards defined contribution plans reflects broader changes underway in employee compensation trends.

97 "Defined contribution plans provide the opportunity to reward people as a function of their compensation," said Mitchell.

98 "This really speaks to the changing labor force we have and people's changing expectations.

99 In the old days, you would start a job at GE or IBM or the old auto companies and you would expect to spend the next 30 years there and retire with a cushy pension.

100 People don't do that anymore.

101 They're expecting to change jobs over their careers several times.

102 They want control over their investments.

103 Sometimes, when they invest too much in company stock, they are reasonably concerned about underfunding in defined benefit plans." ¶¶¶

104 In that changing environment, the 401 (k) model is "more modern" and "more democratic," Mitchell said, "because it rewards people even if they spend a short time at the company, whereas defined benefit plans penalize people who left after a short time." ¶¶¶

105 The few employers who have continued to offer defined benefit plans are finding "they're just getting more and more expensive," said Mitchell.

106 "The insurance [by the PBGC] is getting expensive.

107 Low interest rates have plagued pension markets, meaning that more and more assets have to be set aside to fund those future promises.

108 So, it’s not a pretty picture.

109 In fact, in the U.K., there essentially is no large company that still offers a defined benefit plan.”

110 She noted that at last count, 16% of companies still have a defined benefit plan compared to nearly 60% two decades ago.

111 Apart from GE, Lockheed is also set to freeze its defined benefit pension plan by 2020.

112 “It’s on the path to extinction in the corporate sector.” ¶¶¶

113 ***The problem extends to the public sector, where the majority of state and local workers have defined benefit plans, said Mitchell.***

114 ***“But those are underfunded to the tune of about $4 trillion.”***