Podcast Transcription

Retirement Education Series: Podcast 2
Captain Ben Douglas and Captain Rich Brown

Captain Chris Lee Welcome back to our second podcast in our retirement education series. With me today is Captain Ben Douglas, R&I Committee Chairman and Captain Rich Brown, Negotiating Committee member. Guys, we hear a lot about plans being qualified and non-qualified. What does qualified mean?

Captain Ben Douglas Well, Chris, for a plan to be qualified it simply means that it receives tax preferential treatment. So for the Company, they get a tax deduction and for employees they get to delay income and receive tax-deferred treatment.

Captain Rich Brown A qualified plan is also held in trust, separate from the general assets of a corporation. And it is protected from creditors. And our current plans, our DC plan and our DB plan are both qualified plans.

Captain Ben Douglas These types of plans are deemed qualified under the ERISA Act.

Captain Chris Lee What does ERISA stand for?

Captain Ben Douglas So ERISA is the Employee Retirement Income Security Act. It was established in 1974 to put guidelines and regulations on pension plans to make them qualified. And really, it's primarily just to protect the employee.

Captain Chris Lee OK. So that's qualified. What's a non-qualified plan and do we have those?

Captain Rich Brown We do have non-qualified plans and basically the non-qualified plan is any plan that doesn't meet the ERISA requirements as a qualified plan. So it's anything else. The downsides to the non-qualified plan is that it's merely a promise to pay from the corporation. It comes out of general assets. There may not be any money saved up to pay that. It's just whatever money that they have available at the time. It's not protected from creditors and we actually have 2 non-qualified plans as part of our pension or defined benefit plan. And they are the 415 limit and the compensation limit plans. They're both attached to an IRS limit for our defined benefit plans.

Captain Chris Lee Well, it sounds like qualified is a better plan for us, for the tax preferences. If qualified is better, why do we have non-qualified plans?

Captain Ben Douglas Well, so Chris, like Rich alluded to there are IRS limits associated with these plans to make them qualified. For example, the primary driver for IRS limits is the annual compensation limit. It's also the 401(a)(17) limit and they're prevalent in defined benefit and defined contribution plans. And so what happens is when you have a plan that is above these compensation limits, you have to have a place to put that money. Sometimes Congress will lower those compensation limits to gain revenues in taxes. And so if you have a plan in place and they lower those compensation limits, then again, you're going to need a place to put that money that's outside those qualified limits.

Captain Rich Brown Or if we can raise the limits of our current plan above those IRS limits, we need to get that money back out so that we get all of our negotiated gains. One thing you have to remember about our non-qualified plans is that the Company's required to pay those out as a lump sum payment and it comes to us six months after you retire. And taxes are owed on that when that money is paid out.

Captain Ben Douglas That's a good point, Rich. So for the employer, for FedEx, they go ahead and pay those taxes in advance. So you're going to get a tax bill, if you will, for the taxes that they pay on that since they held it on your behalf.

Captain Chris Lee OK. So what plans do we have that are qualified?

Captain Rich Brown Both our DC and DB plans are both qualified plans. The rules are slightly different for defined contribution plans and defined benefit plans in terms of the limits are the same, but how they affect the different kinds plans are a little bit different.

Captain Chris Lee And then what are non-qualified plans? What are some examples of those?

Captain Ben Douglas So our two non-qualified plans would be our compensation limit plan and the 415 plan. So we're familiar with the 415(c) limit in the defined contribution, this would be the 415(b) limit for the defined benefit. So the maximum pensionable benefit is $230,000 for 2020. So, for example, if you had a $500,000 final average earning the maximum pensionable benefit is $230,000. Well if you at a final average earning of $500,000, that would equal $250,000. So you'd have to put that money in the non-qualified 415 plan to be able to effectively receive that benefit.

Captain Chris Lee So what are the qualified plan formulas?

Captain Ben Douglas For the defined benefit plan there's three qualified formulas. The first formula is the final average earnings formula. It's the high five of $260,000 X 2% X 25 years of service, which is the maximum years of service.

Captain Chris Lee And that's the formula that hasn't changed since...

Captain Ben Douglas 1999, That's right. Since 1999 and going forward into contract negotiations, the second formula would be the pilot's final average earnings formula. It's essentially the same formula, the final average earnings formula, except there were two service multipliers. One was in 1999 as a fix to the defined contribution plan that was implemented, which was the money purchase pension plan. And then the second one was an increase to the defined contribution plan.

Captain Chris Lee Now, these service multipliers, is that what we also hear are the bumps?

Captain Ben Douglas That's correct. Yep. So the bumps, it's charted bump that takes into account the vested years of service and the pilots age when the contract was implemented. They're in Section 28 you can look up where the pilot would lie based on the date of signing for those contracts.

Captain Rich Brown So those bumps actually show us some of the problems in changing our retirement benefit plans in that if we increase the defined contribution plan, that benefit does not apply equally to the whole crew force. So in order to fix that inequality, we had to bump up some people's defined benefit plans so that they could capture the same value as our younger pilots for their defined contribution plan.

Captain Ben Douglas The final qualified formula is the flat dollar formula, and that's simply just the annual benefit amount times those two service multipliers times years of service with a maximum of 25 years, which effectively is $5200 a year in accrued benefit. So after 25 years of service, you have $130,000 of benefit.

Captain Chris Lee OK. So from what I'm understanding here, our DB plan, our defined benefit plan has three formulas.

Captain Chris Lee Why three formulas? Why wouldn't one work?

Captain Ben Douglas You have to take into account those two bumps. So those pilots that weren't able to enjoy the increase in the defined contribution plan saw those increases in their formula with those service multipliers. With the flat dollar formula there may be those that don't reach the maximum benefit on those two final average earnings formulas that we just talked about. So another way of capturing maximum benefit would be through a flat dollar formula design.

Captain Chris Lee So it's a protection for the pilot.

Captain Ben Douglas Correct.

Captain Chris Lee OK. So what are the formulas under the DC plan?

Captain Ben Douglas There's three ways the Company provides money into the plan. First, they put in 9% of the pilots' eligible earnings up to the IRS limits. Next, they provide a 401k match, of 50% of the first $1000, which the pilot contributes for a maximum of a $500 dollars benefit. And finally, the Company puts in money in the plan through sick bank contributions. So that 686 of DSA, you accrue your sick bank during the year. So they front load your RSA, your regular sick bank, 72 hours. And then when you get to the end of the year, if you don't use any of that 72 hours then they take your end of year pay and then they pay that out once you're above the 686. Now, if you haven't maxed out your 415(c) limit of $57,000 then the default is that money would go into your sick bank account pretaxed. If you were doing after tax savings, then you would receive any overages and a check and then that would be realized as ordinary income. So that's important to know.

Captain Chris Lee How can the employee contribute to these plans?

Captain Ben Douglas So for the employee, there's three ways as well. So the first way is just through the 401k contributions, either pretax or in a Roth. The maximum for this year is $19,500 for 2020. The second option is through a catch up, which if you're 50 and older, you can add an additional $6500 to that account. And then the third way is through after-tax savings. You can deduct 20% of your paycheck into the after-tax savings account. You have to be careful that you don't put too much in your after-tax savings account in the goal of getting to $57,000 for the 415(c) limit. You can overcrowd that bucket of money or that account and you can get to $57,000 and then lose out on the Company money. So you just have to be careful in your strategy.

Captain Rich Brown And that basically comes down to how the Company accounts for that money. They look at the amount that you put in post-tax first before they look at the amounts that they're supposed to put in.

Captain Chris Lee So that bucket gets filled up with your money first.

Captain Rich Brown Exactly. And then instead of getting the excess money as cash or some other way, it just, that money just goes away. The computer doesn't have to pay it.

Captain Chris Lee Now, all these limits, these are IRS limits. Are they indexed? Do they go up every year?

Captain Ben Douglas They typically do go up, Chris, every year based on inflation. And then something that I didn't allude to earlier that I need to stress is the money that you put in up to the $57,000 limit, that 415(c) limit for 2020, if you have catch up the 50 and older catch up with $6500 that does not affect that 415(c) limit.

Captain Rich Brown That's a totally separate limit of $6500.

Captain Chris Lee So we have two plans. We have a defined benefit plan and a defined contribution plan. Since 1999 our defined benefit plan has not improved, short of the bumps.

Captain Ben Douglas That's correct.

Captain Rich Brown Which as we said earlier, are not really improvements. Those are just balancing out the improvements in the defined contribution plan. So in reality, those are actually improvements to the defined contribution plan that we pushed into the defined benefit plan for some of our pilots.

Captain Chris Lee That's a big reason for the result of the last TA ratification. The pilots are just not happy that the defined benefit portion of our retirement has not improved.

Captain Ben Douglas Yeah, that's correct, Chris. So basically, the Company did not increase the defined benefit plan. So what they have done in previous contract negotiations, they've either created or added a percentage of contribution to the defined contribution plan for that offset.

Captain Chris Lee And we believe the Company can improve our defined benefit.

Captain Ben Douglas Absolutely, absolutely.

Captain Rich Brown Yeah, the pilots are right in that the Company should have been improving our defined benefit plan all along. Now, the Company has reasons that they don't want to do that. But it doesn't excuse them to increase our benefit plans to match what we're providing to this Company.

Captain Chris Lee So with no improvements to our DB plan, the Company is essentially hibernating that portion of our retirement.

Captain Ben Douglas That's right, Chris. There's really three ways of getting rid of or mitigating the risk in a defined benefit plan. The first is terminating the plan. If you're not under a collective bargaining agreement then what companies can just simply do is terminate the plan and then shift you onto a different plan design.

Captain Chris Lee Which is what they did to some of the other employees.

Captain Ben Douglas That's correct. Although they initially gave them a choice they did it through a series of moves. First, we were all under the same defined benefit plan formula. And what the Company did is they moved to that cash balance plan, which is still a defined benefit plan but what it did is it reduced the longevity risk and the liability in that model in that cash balance model. And then from there, they have since recently moved all new hires into a straight defined contribution plan. The second option is to freeze the plan and merge over into a different style plan, rather it be a cash balance plan or a defined contribution plan. The third thing that companies can do is hibernate the plan, just as you mentioned. And when they hibernate the plan, that just means they simply do not increase the benefit of the plan. They create some sort of fix or regularity to the liability by not increasing the liability. So since 1999, they haven't improved the plan, but they've at least held the costs in the liabilities in check because they haven't made any of those improvements on the defined benefit.

Captain Chris Lee Simply $130,000 back in 1999 is not worth $130,000 purchasing power now.

Captain Ben Douglas That's correct. So, Chris, $130,000 in 1999 equals about $200,000 in purchasing power today. And so out of all the risk, that's riskiest to the pilot group, inflation risk is real and it's the most insidious without any improvements. What I'd like to do is just back up and say, how did we get to the $130,000? Well, the $260,000 average was $130,000 in our formula based on 1999, which was the maximum pensionable benefit under the 415 plan. So during 1999, $130,000 was driving the boat for the final average earning of $260,000. Well the compensation limit was actually below $260,000 that's how those non-qualified plans came into existence. And so in the spirit of trying to put together a retirement plan and retirement planning in general, the Company was shooting for a 50 to 60 percent work replacement income need. So now you fast forward to 2020 where the top pay rates are $335 an hour you can see without any improvement to our defined benefit plan, our income replacement ratios are decreasing year over year.

Captain Rich Brown So that move to the cash balance plan for the Company kind of shows us that what the Company doesn't like about the defined benefit plan has to do with volatility, risk and things like this just as much as it does with the overall cost. So one of the things that we were exploring when we looked at different retirement plans is how can we increase the value for our pilots and help the Company by reducing that risk and their liability. Because in the end, the easier it is for the Company to fund our retirement plan, the more likely it is we're going to keep it.

Captain Ben Douglas I agree Rich. You know, at the end of the day, the more qualified plans you have in retirement, the better. We don't necessarily want an all DC plan and we don't necessarily want an all DB plan. So having the hybrid mix of the two really is beneficial to us as a pilot group.

Captain Chris Lee Well, guys, any final thoughts?

Captain Rich Brown We just need to remember that we believe the Company does have a responsibility to continue to increase the value of our defined benefit plan. It is a large portion of our retirement that we earn every day when we're moving the boxes around the world and just bumping our defined contribution plan does not satisfy the requirements that we have in retirement.

Captain Chris Lee Well, thanks a lot for coming. And thanks for listening. If you have any questions, topic ideas, please send me an email to fdxpodcast@alpa.org and as always, be safe out there and we'll see you next time.