Podcast Transcription

Retirement Education Series: Podcast 3

Captain Ben Douglas and Captain Rich Brown

Captain Chris Lee Welcome back to our third podcast in our retirement education series. With me today is Captain Ben Douglas, R&I Committee Chairman and Captain Rich Brown, Negotiating Committee member. With these podcasts, there's definitely going to be some overlap in information. Let's start with, can you tell me a little bit about the DB history on the property here at FedEx?

Captain Rich Brown Sure, Chris. At one point, all employees at FedEx were under the same defined benefit plan and the same formula. In the early 2000s is when the lack of a CBA allowed FedEx to move all of the nonunion employees out of the traditional benefit formula and into a cash balance formula. They actually offered us as pilots a cash balance formula, which was quickly rejected because the value of that cash balance formula was not nearly as much as what we have with our current formula. And the Company continued to try to de-risk to where they got to the point now where all new nonunion employees no longer have a defined benefit plan, they have a 401k plan with a match.

Captain Chris Lee And that certainly speaks to the benefits of us having a collective bargaining agreement.

Captain Rich Brown It definitely shows the benefit of that and it also shows that we can negotiate things that do stick. So whatever we negotiate with the Company is what we're gonna have until we give that up.

Captain Chris Lee Talk a little bit about the history of the DC plans at FedEx.

Captain Ben Douglas So, Chris, prior to 1999, the only defined contribution component we had was in a profit-sharing plan. In 1999, the new CBA brought on a money purchase pension plan that equaled 6% of contribution from the Company. The reason they went from the profit-sharing plan to the pilot money purchase pension plan was primarily due to global economics. So the benefit of the profit sharing plan was rich when they were factoring in domestic return. But when we started to go more global, those percentages diminished. So in 1999, the pilot money purchase pension plan and the pilot retirement savings plan was introduced.

Captain Chris Lee Where's all the DC contributions going now?

Captain Ben Douglas So all the DC contributions are going to the pilot retirement savings plan. The pilot money purchase pension plan was merged into the pilot retirement savings plan after the 2015 contract.

Captain Chris Lee And within that plan, is it allocated what's your money versus what's the Company money?

Captain Ben Douglas That money is sourced. So when you go into the NetBenefits website on Fidelity, you can see which bucket of money or accounts that that money lives in. What you'll see is when you go to NetBenefits, you'll have a pilot money purchase pension plan bucket of money that is no longer being contributed to. You have a employer non-elective contribution of the 9%. You'll have your 401k, either pretax or Roth. You'll have that 50% match bucket for the first $1000 dollars to give you $500 annually. And you'll have an after tax savings bucket where you are contributing those after tax contributions anywhere from 1 to 20 percent of your payroll deduction.

Captain Chris Lee So going back to the defined benefit plan, what are some advantages for the pilots?

Captain Ben Douglas Some of the advantages of the defined benefit plan is that it provides a fixed benefit. You don't have to worry about investing that money. The Company's responsible for taking on all the risk and liability of funding the trust while you're working and paying you that benefit once you're in retirement.

Captain Rich Brown And the amount of money that can be put into the defined benefit plan by the Company far exceeds that IRS limit that we have on our own defined contribution plan. So it allows us to put more tax advantage money away for our retirement.

Captain Rich Brown Are there any advantages for the Company?

Captain Rich Brown Yeah, there are tax advantages for the Company in that they get write offs for the amount of money that they put in. And the other advantage is that it attracts and retains the best pilots for the airline.

Captain Chris Lee Are there disadvantages with a defined benefit plan?

Captain Ben Douglas So for the pilot group, inflation risk is the greatest risk with respect to a defined benefit plan. Had the Company negotiated an increase in the defined benefit plan then we wouldn't have inflation risk.

Captain Rich Brown Even if we increase the cap in negotiations, inflation risk still starts eating away at that value as soon as we sign that contract. So unless there is some kind of a COLA on our defined benefit plan, which no one in the private world has, and the federal government's even trying to push people away from that COLA in a defined benefit plan. That doesn't mean that they're too expensive. It has more to do with the volatility and the risks than the actual costs up front. So we need to be careful in saying, that our defined benefit plan is too expensive. The Company can afford it. There are just problems for them and that funding and when that funding comes and their control over their budgets going forward.

Captain Chris Lee Even with increases in the cap, that's something that as a pilot group, we would have to constantly go back in future negotiations and deal with.

Captain Rich Brown That's correct. Every negotiation we would have to fix that cap and even fixing that cap every time you still leave some people behind. The people that retire between raising the cap still end up with a smaller value for their retirement.

Captain Chris Lee In the unlikely event FedEx were to go bankrupt, what happens to our defined benefit plan?

Captain Ben Douglas So as a part of the normal servicing costs, which accounts for attorneys and money managers and actuaries, the Company is also liable in that normal servicing cost of paying premiums to the PBGC, which stands for the Pension Benefit

Guaranty Corporation. They are a governmental insurance agency. The Company has to pay premiums on covering the benefits in the event that the Company goes into bankruptcy, causing termination of the defined benefit plan. There's really two premiums that are paid. There is a fixed premium and then there is a variable premium based on the level of funding that goes into the trust. And so that's another part of that volatility or uncertainty in managing that trust.

Captain Rich Brown And that variable amount depends upon the funding level within the defined benefit plan, and that funding level varies year to year based on congressional mandates and current interest rates in the market. If you look at our current retirement mailing that we get every year that tells us how our retirement plan is doing, there are a couple different numbers on there if you look at it. And the difference between those two numbers has to do with the IRS requirements for funding versus the Pension Benefit Guaranty requirements for funding. One of them will show you 100% funded right now. The other one shows 80% funded. And that difference is very important to us because the Pension Benefit Guaranty variable rates apply to that 80%, which means FedEx still owes a lot of money, both in terms of fully funding the retirement and in terms of those variable rates for the Pension Benefit Guaranty Corporation. If the Company were to go bankrupt, that's when the Pension Benefit Guaranty Corporation would take over the retirement plan and then the Pension Benefit Guaranty limits would apply, which are far lower than our $130,000 a year maximum now.

Captain Ben Douglas So a schedule comes out on an annual basis based on a percentage on your age. And so based on if you've retired and where you fall age wise, that would dictate what your payment would be in the event that Company went into bankruptcy and terminated the plan.

Captain Chris Lee So it affects active and retired pilots.

Captain Ben Douglas Correct.

Captain Chris Lee Well, it's pretty clear that FedEx and other corporations aren't big fans of defined benefit plans. What are some of the disadvantages to FedEx?

Captain Ben Douglas So the primary disadvantage to FedEx is the volatility that it presents on its balance sheets and the liability in the normal servicing costs that are incurred with having a plan like this. Primarily the greatest risk to FedEx is the interest rate risk. FedEx has to account for the liabilities in the future to pay that benefit out and that's all based on actuarial cost, accounting and mortality tables. And the Company has to take those future costs and discount it backwards into a present value dollar amount that's in the trust. They have to figure out some sort of required rate of return to meet those obligations. And so that moves on an annual basis for a whole host of reasons, regulatory compliance and legislative compliance. And so it presents a volatile situation for the Company to manage those assets. Recently, the Company just borrowed 1.5 Billion dollars to fund the trust to actually front load the trusts for future minimum funding requirements.

Captain Rich Brown And they've also actually sold some of their liabilities. They spent a billion dollars to get rid of six billion dollars of liability in the plan. They paid MetLife basically a billion dollars to take on liability of six billion dollars out of our current trust. So they're willing to spend money to de-risk their plan. And as we go into negotiations, we need to remember that they are willing to spend money to get rid of that risk.

Captain Chris Lee Even with this volatility, we believe FedEx can afford to improve our pension plan.

Captain Ben Douglas Yeah, absolutely. They can rework the formula. There's several formulas. There's a variable accrual plan. There's a variable benefit plan. There is a cash balance plan option. There are other types of plan designs in the defined benefit world that would allow us to protect and maintain and possibly increase that defined benefit.

Captain Rich Brown While still satisfying, the Company's want to reduce their risk and reduce their volatility of payments into the plan.

Captain Chris Lee What about PBGC premiums?

Captain Ben Douglas As the funding levels are less, the variable portion of the premium goes up. And so if the Company is to a point to where they're at a 100 percent level funding, then the variable premium rates are low. When the fair market value of the assets equal the liabilities that lowers the volatility and the risk premiums associated with managing the trust.

Captain Chris Lee Another disadvantage I hear sometimes is along the lines of longevity, longevity risk. Can you talk about that a little bit?

Captain Ben Douglas Sure. The Company has to pay these fixed benefits in perpetuity. And so there is a mortality table that the IRS creates that is actually projected out to age 120. There could quite possibly be a scenario where your spouse outlives you and they live well past 100. Well, they have to figure out the probability from an actuarial standpoint of what the Company would have to pay those future benefits at. And so it's not as simple as saying the average age is 79, we're going to pay it out to 79 and everything's fine. So the liability runs into perpetuity. It runs forever. It's like having a credit card that doesn't have a max limit to it. But you're going to have to pay that entire balance at some point.

Captain Rich Brown And you have to fund the trust in order to cover that cost going out into the future. It's money that they may or may not end up spending. And that's another thing that the Company really doesn't like about the current plan design is that they might end up with trapped money, money that they put into the trust that they can't get out to use for other things, but they don't really need to have in the trust.

Captain Chris Lee OK, so let's shift gears a little, what are some of the advantages of having the PRSP which is our pilot retirement savings plan, which is our defined contribution plan?

Captain Rich Brown Well, the defined contribution plan is just another way for us to balance our risk. We take on a certain amount of risk in the defined benefit plan and mostly in terms of inflation risk and the defined contribution plan allows us to mitigate that risk by having our own money that we can invest on our own and provide for that extra inflation amount not contained in our defined benefit plan.

Captain Ben Douglas For the defined contribution plan, while it is a great plan you are exposed to systematic and non-systematic risk. And so you're taking on all the market risk. You're taking the investment risk. You're taking the longevity risk. You're taking the inflation risk. If you are not tolerant for risk or volatility, when you're managing your own assets, you may find your portfolio in an inflation disadvantage. And so really all the liability and risk is on the employee to manage.

Captain Rich Brown It does provide us tax advantages, but it does put a lot of that pressure on us to invest our own money.

Captain Chris Lee So a pilot having the ability to manage his own assets could be a pro or con.

Captain Ben Douglas It's a blessing and a curse. Absolutely, depending on how well you are versed in the financial and investment world. We have a diverse group of pilots. We have over 5000 pilots, and there are some people that are intimately involved in everything that we're talking about. And then there's some that may need a little handholding. So we have a very diverse pilot group.

Captain Rich Brown So a professional investment of our retirement might be a better plan for a lot of us.

Captain Ben Douglas Yeah, we have those options through Fidelity with Executive Services if you meet that threshold.

Captain Chris Lee So we've talked about some of the pros and cons to the pilots. What are the advantages and disadvantages of a DC plan, defined contribution for the Company?

Captain Rich Brown Well, for the Company, we've talked about the volatility involved with the defined benefit plans, defined contribution plans, take out all of that volatility for the Company. They know exactly how much they're putting in each year so they can plan ahead for that amount. It also puts more of the risk on the employee in terms of interest risk, longevity risk that the Company picks up in the defined benefit plan. With the defined contribution plans they don't have those risks involved with their money that they're putting in. It's not necessarily cheaper than a defined benefit plan, depending on how much money, what percentage of income they're actually putting in. What the Company likes better about it is that it's the surety of those payments and knowing and being able to plan ahead on those payments.

Captain Chris Lee It's obvious to me that one of the strengths of our retirement is having both a defined benefit and a defined contribution plan. What can you tell me about that?

Captain Rich Brown There's several advantages to having both. The defined benefit plan allows you to have a fixed benefit that you can count on, whereas the defined contribution plan allows you to invest that money to increase the replacement value of your retirement plan while taking some level of risk that's acceptable to you. And that fixed portion from the defined benefit plan actually allows you to take on more risk for potentially more gain in your defined contribution plan, because you do know you have that value coming out of your retirement plan.

Captain Ben Douglas So simply put, mitigates the risk, creates diversification from the fixed and variable income component in retirement. It facilitates savings goals and it enhances your retirement planning flexibility.

Captain Rich Brown It also helps us as a Negotiating Committee because there's different portions of the plan that we can negotiate benefits to. For instance, we haven't been able to negotiate an increase in the defined benefit plan up to this point but we have gotten increases in the defined contribution plan to mitigate some of that lack of increase in the defined benefit plan. But the bottom line is that we believe that the Company needs to increase both parts of our plan, in particular at this time, the defined benefit plan, because they have let that value languish and we have earned that increase in that defined benefit plan.

Captain Chris Lee Well, thanks again for coming, guys. And 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.