Podcast Transcription

Retirement Education Series: Podcast 5

Captain Chris Lee My guests today are R&I Committee Chairman, Captain Ben Douglas, R&I Committee Vice Chairman, Captain Kevin Biggins, Negotiating Committee Chairman, Captain Pat May and Negotiating Committee Member, Captain Rich Brown. Thanks for coming, guys.

Captain Chris Lee As we continue with our retirement education series, in this podcast, we're going to discuss defined contribution plans, also known as DC plans. We'll also discuss the pros and cons of those plans. We'll explain the impact of the IRS limits on the DC plan and ways to circumvent those IRS limits. And finally, we'll discuss a type of defined benefit plan or DB plan that has the features of a DC plan, and that's called a cash balance plan. So let's start with what is a defined contribution plan?

Captain Ben Douglas Defined contribution plans consist of employer and employee contributions, and so these contributions are accumulated and invested on the employee's behalf. The benefit at retirement is dependent on a number of things. One would be the years that the individual is in the plan, the level of contributions and the investment gains and losses. Contrast that to the defined benefit plan, there's no determinable benefit amount. So the annual contribution of these plans are limited by the IRS. FedEx pilots have one DC plan, it's called the Pilot Retirement Savings Plan. It's also known as the PRSP and FedEx pilots may contribute to this plan through their 401(k). And they receive a 9% Company contribution based on eligible earnings up to the IRS compensation limit.

Captain Pat May Yeah, and so there's a couple of different avenues that Ben's talking about getting money into the PRSP. And you'll see if you read through the pilot benefit book or the CBA terms used of elective deferrals or nonelective deferrals. And that's essentially what he's talking about. The nonelective deferral, of course, being the Company 9% contribution up to the IRS limit.

Captain Chris Lee Now is that money guaranteed to me as a pilot?

Captain Kevin Biggins Yeah it is. Nonelective means you don't have to elect any money of your own through payroll deduction into the plan. It will come in automatically from the Company at a level of 9%.

Captain Chris Lee Well, let's talk a little bit about some advantages and disadvantages of the DC plan. What can you tell me about that?

Captain Ben Douglas So some advantages, is one, all the contributions to the plan belong to the employee. So at FedEx, you're immediately vested in any Company contributions.

Captain Chris Lee And what are the Company contributions?

Captain Ben Douglas So there is a 9% employer, nonelective contribution. There is a 50% contribution on the first $1000 that you put into your 401(k). And then there are sick bank contributions once you hit a certain maximum limit of disability sick account.

Captain Chris Lee And our DC plan is a qualified plan?

Captain Ben Douglas The DC plan is a qualified plan. Also in the pilot retirement savings plan, the employee is able to control how those contributions are invested and those benefits are portable.

Captain Chris Lee Now, what do you mean by portable?

Captain Ben Douglas So the employee can either roll that plan into another employer's plan or into a rollover IRA?

Captain Kevin Biggins Another benefit is you don't need to worry about bankruptcy with the Company. Worst case scenario, that's your money in your name and you will not lose it under any scenario whatever happens to FedEx in the future.

Captain Rich Brown So some of the disadvantages involved with the DC plan include accepting some of the risks. Although the DC plan does reduce your risk in bankruptcy, it causes the employee to bear all the investment risk, the longevity risk, and the inflation risk. If you have questions about what those risks are, there is an additional video and podcast as part of this series that addresses those risks. Lastly, the IRS does limit the amount of individual and total annual contributions that you can put into defined contribution plans.

Captain Chris Lee And we believe having both a DB and a DC plan is a strength to our retirement portfolio.

Captain Rich Brown That's right, Chris. In terms of just the DC plan, having the DB plan and that negotiated benefit allows us to accept more investment risk within our DC plan, which may increase your returns in the long run.

Captain Chris Lee There are some airlines that only offer pilots a DC plan. What do some of these plans look like currently?

Captain Ben Douglas So many passenger airlines used to have a defined benefit plan. Due to past financial turmoil, the DB plans were either frozen or terminated, leaving only an active DC plan in place. Over time some of these legacy passenger airlines have negotiated back some of that value of their lost pension plan with an increased Company contribution up to a certain percentage.

Captain Pat May You know, we've seen the legacy carriers and what their pre 9/11 pre-bankruptcy or merger retirement benefits package look like. And it looks substantially different today than it did back then. The fact that a lot of them have close to 16% DC plans still doesn't make up the difference in the total loss of their pensions. They're looking into unique and creative ways to try and capitalize on cash over the cap. They're looking into other types of pension plans as well. But these are all developing areas and they face an uphill challenge in trying to regain or re-establish some of these benefits.

Captain Rich Brown You mentioned the cash over cap, and the reason that comes into play is because at higher earning levels and higher percentages, those IRS limits that we spoke about earlier do come into play quite a bit. So in order to capture that extra cash, to bring back some of the value of their lost defined benefit plans, they needed to capture the value of that spillover in their plan.

Captain Chris Lee So are there ways to mitigate the impact of the IRS limits and capture Company contributions in excess of the IRS limit?

Captain Kevin Biggins As Rich alluded to, we referred to these excess amounts as spillover. Currently, other airlines are employing one of two avenues to capture the spillover. So the first way to receive spillover is to receive it as taxable income, also known as cash over cap. It's important to note this income cannot be held in a tax advantaged retirement plan, and because of that, it risks not being saved for retirement.

Captain Chris Lee Would this be qualified or non-qualified at this point?

Captain Kevin Biggins So that cash over cap would be considered non-qualified dollars. And then the second way would be to capture some of this excess contribution into a retiree health reimbursement account or HRA. Important to know about this is that money that would go in there would be into a qualified plan. It would have tax advantages. There's a couple of things to remember about those funds in that in using them, you can only use any funds in there to provide reimbursement for eligible medical expenses as defined by the IRS. Other airline pilot groups are exploring other alternatives at this time, such as using spillover as a funding source for a hybrid like defined benefit pension plan. Another point to note here is that the retiree HRA and any pension plan alternatives does protect your money from bankruptcy and also ensures that pilot will receive the full negotiated Company contribution that they have in their contract.

Captain Chris Lee Prior to the PRSP, FedEx pilots had a profit-sharing plan. Talk to the pilots a little bit about what a profit-sharing plan is and maybe some history of the profit-sharing plan at FedEx.

Captain Ben Douglas So, Chris, simply put, a profit-sharing plan shares in the profits that the company makes. They're typically designed as DC retirement plans and they're used to supplement company retirement contributions. All FedEx employees at one time used to be under a profit-sharing plan. However, in 1999, the profit-sharing plan was closed to those pilots in exchange for a more consistent Company contribution through the defined contribution plan that was known as the money purchase pension plan. The accrued benefits of the profit-sharing plan again are now under that PRSP but it's important to note that that change occurred primarily due to the inconsistency in the dwindling of that benefit. So at one time it was a robust benefit but as the company grew and started to combine the domestic and international profitability the profit-sharing plan diminished in value.

Captain Chris Lee So both the profit-sharing plan and the defined contribution plan are together now in our PRSP?

Captain Ben Douglas That's correct. So yeah, now they're both merged into one DC plan, the pilot retirement savings plan, has its own bucket that it lives in, which is a source inside your benefit that you can see on NetBenefits through Fidelity.

Captain Chris Lee Now, other airlines, do they have profit-sharing plans?

Captain Ben Douglas So other airlines do have profit-sharing plans. They use those plans a little bit differently than what it's designed for. They're using it to capture value and income and compensation. So legacy passenger carriers took a significant loss during bankruptcy. And so to recapture that lost compensation, they have had somewhat of a paradigm shift moving away from using a profit-sharing plan as a retirement benefit and using it as a compensation plan. But keep in mind, profit-sharing plans should be typically designed as a retirement investment vehicle.

Captain Chris Lee Let's switch gears here a little and discuss cash balance plans. We hear a lot about cash balance plans. What is a cash balance plan and how do they work?

Captain Kevin Biggins A cash balance plan is like a hybrid defined benefit plan in that it shares some characteristics of a defined benefit and some of a defined contribution. So a cash balance plan provides a guaranteed benefit for life at retirement like a traditional defined benefit plan but the benefit is based on a fixed annual contribution, which is like a defined contribution plan. So unlike a true defined contribution plan, the cash balance plan, there is a hypothetical or what's called a notional account for each participant. And that notional account is credited annually with a notional contribution, which is usually defined as a percentage of pay, which is like a DC plan and also a notional interest on the prior year's cash balance account at an assumed interest crediting rate. Like traditional DB plans, assets are also placed in a trust. They're managed professionally, and they are often in a kind of fairly conservative/safe investment portfolio. However, there is significant flexibility that will exist in these plans to what these plans can be invested in. In addition, like in a traditional DB plan, participants may elect an annuity payment upon retirement and then also a key difference with these cash balance plans is there is usually a lump sum benefit available for those participants to select if they desire to do so.

Captain Chris Lee Well talking about the cash balance plans, can you talk some about the pros and cons?

Captain Kevin Biggins Yes, certainly. So first off, for a pro, a big one is that it's portable and that means, quite simply, that money can be rolled over into a new employer plan or into an IRA. Another advantage is like defined contribution plans, a cash balance plan defines the benefit in terms of a growing account balance. This balance is usually available as a lump sum benefit, which means you must be aware of some of the risks that you would take in an environment which would include investment and longevity risk. Another point to mention about these plans are, similar to DB plans, the employer does bear all the investment, funding, and longevity risk. And additionally, like traditional DB plans, there is inflation and bankruptcy risk, which is borne by the participants.

Captain Chris Lee FedEx moved all the non-pilot employees to a cash balance plan back in 2008. Has FedEx ever offered a cash balance plan to the pilot group?

Captain Ben Douglas So yeah, Chris, they did. They have offered cash balance plans in previous contract negotiations. The company offered in the 2015 round, they offered to keep the current pilots in the traditional pension plan with no improvements to the benefit and then move all the new hires after the signing of the contract into a cash balance plan and the MEC opposed having two separate retirement plans for the pilot group.

Captain Pat May So a lot of these plan designs and these plan features have been looked at, discussed and evaluated in previous negotiations. We'll continue to evaluate those options moving forward. But as you mentioned, the MEC at the time didn't want to separate out the new hires. And, you know, since 2015, we've hired about one-third of all our pilots. So one-third of all our pilots are new to the property. Had that been approved and that path gone forward, they would have come under a different set of retirement benefits. So that's just something we need to be aware of, and what we're likely to face in the next round of negotiations. We plan for all those outcomes and we'll look at all these options moving forward but the deal has to be right and the retirement benefit has to be an improvement upon what we have right now. So we haven't ruled anything out. We'll look at all our opportunities as we move forward in negotiation based off the MEC priorities, based off of survey data that the pilots are providing to us and based off of our SME support from the national and local level.

Captain Chris Lee Thanks again for coming. Any final thoughts?

Captain Pat May Chris, from a negotiating perspective, why we're providing all this information is historical in context when we provide the information as to what we previously faced and challenges in negotiations where we've gotten to today under our 2015 agreement from 1999 moving forward. And what you see over the history is originally an emphasis on the defined benefit plan and now through the years of negotiation, you see more and more heavier weighting on the defined contribution side. And the reason that's been necessitated is because the Company has continually pushed back on any improvement, any long term permanent improvements on the defined benefit. Now we've been successful in targeting let's call them Band-Aid fixes in our pay service multipliers that we see in the '99 and the '06 agreement and that has worked out well. However, it only improved the benefit for those pilots in that pay service multiplier. And the reason that was targeted for them was because they were not going to get the benefits of the long term DC improvements. So as we move forward, we want to continue to try and make these improvements equitably across our generational pilot demographic right from the new hire all the way up to the pilot that's getting ready to retire. And that's a very challenging feat for us in negotiations. But we feel we can do it successfully. We have to continue to keep our eyes open for new and innovative ways that we see the other airlines and other ALPA Negotiating Committees and Retirement and Insurance Committees and we have the appropriate SMEs involved. We have consultants helping us out along the way as we move forward into preparation for the 2021 negotiations but I'm sure we'll be successful with this.

Captain Chris Lee Thanks again for coming, guys. If you have any questions, go to fdx.alpa.org and utilize the PDR link. There you can send either the R&I Committee or the Negotiating Committee any of your questions. Thanks again for listening and as always, be safe out there and we'll see you next time.