Podcast Transcription

Retirement Education Series: Podcast 6

Captain Chris Lee My guests today are R&I Committee Chairman, Captain Ben Douglas, Negotiating Committee Chairman, Captain Pat May, and Negotiating Committee Member, Captain Rich Brown. As we continue our retirement education series, we're going to focus on the Pilot Stabilized Pension Plan in this podcast. Pat, provide some history on how we arrived at the Pilot Stabilized Pension Plan or the PSPP.

Captain Pat May So, Chris, after the 2015 contract, the FedEx MEC, the leadership at the time, through information with post ratification surveys, saw that the pilots were least satisfied with the outcome in their retirement benefits area. One of the items, of course, was the pension. But in order for us to take a look and do a deeper dive into what the issues were associated with that dissatisfaction, we needed to understand the accounting and what areas FedEx had pushed back on or continue to push back on in negotiations. And it wasn't just the 2015 agreement, there were previous contract negotiations in which FedEx was actually going the opposite direction of the pilots. They want to freeze and they've shown through numerous proposals they wanted to freeze the current traditional benefit plan. So the Negotiating Committee, along with the R&I Committee and ALPA staff began a retirement research project which included consulting firm Segal. We had discussions with Milliman, Cheiron and a private consultant, David Blitzstein. We brought them in as external consultants to our project. Ultimately, we had to do a full evaluation and break down the actuarial data from our pension plan. With that, we focused on improving the pension plan and part of the improvement in the pension plan also included developing alternative pension plans. One of the plan designs that we focused on was the variable benefit plan design. And that term, again, is used in general context, and that's how we referred to it initially from the R&D project. But it really became very specifically the Pilot Stabilized Pension Plan and that's because of the stabilization features that were introduced and why the plan became a really great avenue for us to gain improvements or to at least develop improvements was due to regulatory action that occurred with additional stabilization features on these variable benefit plans. So it is a pension plan and ultimately, we developed with our consultants, Cheiron, the plan itself that became known as the PSPP or the Pilot Stabilized Pension Plan.

Captain Chris Lee So what is a variable benefit plan design?

Captain Rich Brown Well, Chris the variable benefit plan, it's an industry-standard name for a kind of retirement plan, and it is a defined benefit plan. It has all the same legal protections and backstops as any other kind of defined benefit plan, like the defined benefit plan we currently have. It has an accrued benefit which increases or decreases with investment performance relative to an investment hurdle rate. It's important to remember, though, that those increases and decreases in investment performance simply are increases and decreases in unit share values within the retirement. And a decrease in that unit share value simply allows for you to buy more shares in the retirement and potentially to increase your retirement benefit when you actually retire. Then the hurdle rate that I previously mentioned is nothing more than a percentage of investment return that the plan aims to meet or exceed in each plan year. There are some features that can be negotiated into a variable benefit plan to protect the benefit against down markets such as a cap rate, a floor benefit, or a stabilization reserve.

Captain Chris Lee So you mentioned features, what are some of the features that are included in the PSPP?

Captain Pat May Yes, so with the PSPP, we ultimately had a wide range of stabilization features and features to help mirror the similarities with what we have in today's traditional pension plan but there are clearly some differences in that. One of them is the annual benefit accrual amount, which is actually a percentage of the pilot's pensionable earnings. The nice feature there, again, is that that continues to increase as those IRS limits increase. So, you know, the current pension is capped out at $260,000. Well, that cap is removed and would increase as long as the IRS limits were increasing. Second, the annual Company contribution, which is fixed in its percentage relative to the total pilot payroll, that amount actually would be negotiated. But the consistency in that is a benefit that is helpful for the company. So from a planning perspective and an accounting perspective, it's very similar to the defined contribution plan. So as the company, you know, realizes a 9% continual contribution on the DC side they would have a fixed percentage based off of uncapped payroll. So non-IRS limited payroll that gets consistently contributed year after year. So what that does is a two-fold effect, one benefit for the company, it reduces volatility but the benefit for the pilots is that it's a hedge against inflation. And we talked previously about one of the challenges in every pension is that typically they don't have cost of living adjustments anymore. So this has a form of a hedge against inflation and a cost of living adjustment built-in as long as our pay rates are increasing. Now, on the low side, you heard me say that the benefit decreases. Well it decreases to potentially a floor guarantee. So in our plan design, we had also a floor guarantee. And again, that was to mimic and to replicate what we had in the current pension benefit so we could guarantee a minimum return to the pilots on an annual accrual basis. That floor guarantee, again, is something that was part of the plan design. The stabilization reserve ensures that the variable benefit doesn't fall below the floor benefit, but it can also be used in a secondary way and that's for post-retirement stabilization. So if a pilot wanted to maintain a fixed benefit, the fixed benefit, just like today's benefit, would be paid out but it would never change. But there would also be an opportunity to stay in the current investment portfolio, which is a liability driven investment portfolio. So that pilot into their retirement years is trying to hedge against those inflation problems that we discussed earlier. And that stabilization reserve helps protect the low side because, again, you could potentially go below what your fixed benefit would have been if you opted to stay in the investment portfolio as a retiree receiving an actual benefit. The final piece that puts this PSPP or the Pilot Stabilized Pension Plan together for us has to do with the transition. And the transition is always tricky when you're trying to transition an employee benefit from one plan designed to another. And again, we try to minimize some of that turmoil by adding these in but one key ingredient was the transition lookback and the transition lookback is simply this, and it applies to every single pilot on property and it would apply to every pilot on property as of the date of the signing. So the transition lookback simply looks at what you would have accumulated had we never moved you out of the traditional benefit plan. In other words, they'll do a calculation had you never moved out. And let's say, for example, your benefit would have accumulated to, let's say, $120,000. We would take that number and then we would actually look at, under the new plan, what did you accumulate under the PSPP and add that to the frozen benefit. And if that benefit, that total benefit came in less than that $120,000 traditional benefit, well, then the company, FedEx would be responsible for buying you up. Say if the total came in at $100,000. Well, now FedEx would be responsible for buying you up through an annuity or some other vehicle that $20,000 difference per year to get you equal to what your traditional pension would have been.

Captain Chris Lee How would a pilot's retirement benefit accrue under the PSPP?

Captain Ben Douglas So, Chris, as Pat and Rich alluded to, with respect to plan design and some of these features, the pilots would accrue that benefit amount equal to the percentage of the pilot's pensionable earnings up to the IRS compensation limit. So that's the main component or design of this plan. And so those IRS compensation limits are indexed and increase with inflation annually. So as a result, the pilot benefit is self-adjusting as the pilot pay and the IRS compensation limits increase. And the benefit amount is used to buy share units of income in the retirement plan.

Captain Rich Brown So as we're talking about these share values, as we buy these shares, it's similar to dollar-cost averaging into a mutual fund where if the share value were to go up a little bit because investment returns were good, you'd buy a few less shares. If investment performance is not quite what we hope, then you buy a few more shares so that you are accumulating shares until the end of your career so that the ups and downs during your working career don't necessarily affect the benefit that you will get after you retire. Except in terms of how many shares that you accumulate along the way.

Captain Chris Lee Is there any scenario where a pilot would receive less than they would have in the current pension plan?

Captain Rich Brown No, Chris, there's not. You would receive the higher of whatever the computation would have been for the Pilot Stabilized Pension Plan or the current traditional plan. And that money is funded by FedEx and backstopped by FedEx so that if there's not enough money in the PSPP or the floor value is below the minimum guarantee, FedEx is responsible for adding extra money to ensure that you get that guaranteed benefit.

Captain Chris Lee OK. How would the PSPP be funded?

Captain Rich Brown The company is fully responsible for funding the plan. The Pilot Stabilized Pension Plan would be funded by a negotiated annual Company contribution based on a percentage of uncapped payroll.

Captain Chris Lee So how does the PSPP improve our retirement?

Captain Pat May The PSPP, Chris, would remove the service cap and final average earnings cap, which limits the benefit accrued under the current pension plan. You know that since 1999 our traditional pension plan has been in place and there's only been temporary modifications through contract negotiations in '99 and '06 where we've put years of service multiplier to a targeted group of pilots. This would be a permanent change to our pension plan and we would essentially put a pension plan in place that was on autopilot. It would also account for the increased regulatory age change, where we went from age 60 to 65. We haven't capitalized on that increased age ability for pilots to continue work. So we have a number of pilots, the vast majority of our pilots now are staying to 65 years old before they retire. So if over 50 percent of the pilots wait until they're 65, the other 50 percent typically come from age 61 to 64 bracket. Single digit numbers are retiring early. So we need to be able to capitalize on those extra years of potential increase in benefit earned. This plan does that. So whether you're here for 20 years, 25, 30, 35 years, there's a benefit accrual for each and every year. The second aspect of that which I mentioned was the final average earnings cap, which simply tracks along with the increasing IRS limit. When we first started looking into this plan design, it was $260.000. Now it's up to

$285,000, exactly what Cheiron had predicted in their modeling and it continues to be supported by IRS improvements. So as our pilots continue to increase their pay, which typically tracks along at about a 3% year over year increase, we're seeing those same IRS limits increase. So one other benefit here, Chris, has to do with the bankruptcy protection. FedEx announced in its recent quarterly earnings report that they are not going to fund the pension this upcoming fiscal year. They wouldn't have that option in the current plan design. In fact, they have to fund this plan design year over year based off of the pilots' earnings. So what that does is if FedEx started getting into trouble financially and we were approaching, say, a termination or distressed termination in the current plan, FedEx can turn off their contributions there, whereas this plan continues to be funded. And because it's constantly matching its assets and liabilities, you're going into a bankruptcy potentially with a fully funded or nearly fully funded PSPP, unlike the current pension plan, which could be vastly underfunded at that point. So the level of benefit produced going into that scenario where PBGC is measuring both your current benefit that you accrued, what's capable of being paid out of the trust versus what they're backing up, your outcome is much improved with the PSPP.

Captain Chris Lee Does the PSPP eliminate the need to address retirement in future negotiations?

Captain Pat May Well, that's one of the inherent benefits of this plan design is that the continued leverage that we've had to exercise in negotiations when we sought retirement improvements has been significant. And it will continue to be significant in future negotiations if we don't get a permanent change, such as a PSPP. So there are inherent benefits with putting this plan in place. You don't have to go back and continue to try and renegotiate cap increases. So let's say if we only went in and tried to capture a cap increase, again which we've been unsuccessful at so far. But if we were successful in a cap increase this time around well, that's great for everybody here through this contract cycle. But it's highly probable that the following contract negotiations, another group of pilots will be forced to go in and exercise that capital in negotiations again to try and increase that cap. And we've seen that we've been unsuccessful doing it. We've offset some of that with our defined contribution improvements that we've made. We've been successful there, but it hasn't completely eliminated the need to see improvements here. So, yes, it basically puts this particular plan on autopilot when it comes to the benefit plan design, as it's designed today.

Captain Chris Lee Pat, Rich, Ben, thanks again for coming. If you have any questions for the R&I Committee or the Negotiating Committee, please go to fdx.alpa.org and use the PDR link. Thanks for listening and as always, be safe out there and we'll see you next time.