

## **MEC UPDATE 04-02** **RETIREMENT BULLETIN**

March 11, 2004

The Delta MEC office and the Retirement & Insurance Committee have received many calls from pilots who have expressed concerns regarding the security of their pensions in these uncertain times.

While no one can predict the future, there are basic facts regarding defined benefit plans in general, and the Delta Pilots Retirement Plan in particular, of which each pilot should be aware.

### **A PRIMER ON THE DELTA PILOTS RETIREMENT PLAN**

#### **1. Does Delta have access to the assets in our retirement plan?**

No, not as to the assets held for payment of qualified benefits. (The distinction between qualified and nonqualified benefits is discussed in Question 4.) These funds are held in a trust account administered by a third party. Regardless of its financial need, Delta has no access to these funds. The only exception would apply in the very unlikely event that our pension plan were terminated at a time when it is overfunded; in that event, any assets remaining after all obligations to pilots were met would be subject to applicable law. See Questions 11-13 below for information about plan termination.

#### **2. Is there enough money already in the fund to cover benefits for all current active and retired Delta pilots?**

The qualified plan is, and always has been, funded at or above the level required by Federal law with reasonable actuarial assumptions taken into account. However, there are two other considerations. The first has to do with the way a defined benefit pension plan like ours is funded. As required by Federal law, a defined benefit plan is funded based upon reasonable actuarial assumptions such as career length, size of the benefit, growth in salary over a career, expected retirements, life expectancy after retirement, and expected investment returns. The idea behind this arrangement is that the company is required to place enough money into the pension trust so that the assets, with their expected growth, will be there to pay the promised qualified retirement benefit when each pilot retires, and will continue to be there to pay the benefit during the life of the pilot and designated survivor (if any). At any given time, therefore, our plan, like any other defined benefit plan, may not be funded for all of the qualified benefits that all retired pilots have earned and all current pilots are expected to earn over their careers.

The second reason that the pension trust does not hold all of the money needed for our pensions is that our contractual retirement benefits exceed the maximum amount that federal law permits to be protected in a tax-qualified pension fund. Some of our benefits, therefore, are paid out of current Delta revenue rather than from the pension trust. This is discussed in Question 4 below.

3. What happens if the actuarial assumptions or expected investment return prove false?

The fund is valued each year, and any shortfall that exists may be required to be made up via future increased contributions.

4. What is the purpose of the Money Purchase Pension Plan (MPPP)?

The MPPP is a qualified plan designed to shift a portion of a pilot's retirement into an individual account maintained for each pilot. The funds from the MPPP, payable as a lump sum following retirement, will reduce the amount of non-qualified benefits still owed to the pilot. This is a good thing, as it has the effect of reducing the portion of a pilot's annuity that is at risk (paid from Delta's cash flow), and replacing that amount with funds that can be paid as a lump sum, and subsequently rolled over to an IRA, at the time of retirement.

5. Will all of my pension dollars come from the funded trust?

As indicated in Question 2, probably not, depending upon your FAE. Federal law sets a limit upon the level of an employee's annual earnings that may be used to determine how much you may accrue under the qualified plan. This compensation limit increases over time and is \$200,000 for the current plan year (beginning 7-1-2003). Federal law also limits the amount that may be paid to a pilot out of the qualified plan. This benefit limit also increases over time and is currently \$160,000 per year payable at age 60.

The portion of a pilot's pension that is within these limits is known as the "qualified" portion and is funded within the trust fund. The portion of a pilot's pension that is in excess of these limits is known as the "non-qualified" portion, and it will be paid out of Delta's general cash flow each month following a pilot's retirement.

Example: Normal Retirement in plan year 2003:

- \* Age 60
- \* 25 years of Credited Service
- \* Pilot chooses 50% Lump Sum option
- \* MPPP balance = \$76,000

FAE \$260,000 IRS Qualified Compensation Limit \$200,000 IRS Age 60 Benefit

Limit \$160,000

Contractual Benefit (60% FAE) \$156,000 Qualified Benefit (60% Qualified Funds)  
\$120,000\*

Calculation of Annual Benefit:

50% X \$156,000 = \$78,000 = Basis for Lump Sum paid entirely from the qualified plan

50% X \$156,000 = \$78,000 = Basis for Fixed Annuity, broken down as:

\* Qualified annual amount \$42,000

\* Non-qualified annual amount \$29,839

\* Theoretical MPPP (Money Purchase Pension Plan) annuity \$ 6,161

OK, what does all this mean to my bank account and my peace of mind?

Calculation of Payment:

Lump Sum Payment (dependent upon GATT rate) (in your hand) MPPP Lump Sum \$76,000 lump sum (in your hand) Annual Qualified Benefit \$42,000/year (from trust fund) Annual Non-Qualified Benefit \$29,839/year (from Delta cash flow)

\* The IRS requires the benefit amount that is determined by applying the Compensation Limit to be compared to the Age 60 Benefit Limit. Whichever is lower is the amount of qualified benefits paid from the trust. Applying the Compensation Limit of \$200,000, the maximum qualified benefit is \$120,000 (60% x \$200,000). This amount is less than the Age 60 Benefit Limit of \$160,000, so the maximum qualified benefit is \$120,000.

6. How much notice does our plan require for early retirement?

There is no language in our plan requiring that a pilot give any minimum notice for an early retirement. Past practice has established that a pilot may retire by notifying the Delta Employee Service Center, in writing, prior to the first day of the bid period which will include the effective date of the pilot's retirement (which is always the first day of the bid period). Example: Pilot wishes to retire effective November 1. He must present his written notice to Delta no later than October 31.

7. Can benefits under the Delta Pilots Retirement Plan be reduced through negotiation?

The starting point for this issue is the distinction between qualified and nonqualified benefits as discussed in Question 4. With a minor and unlikely exception, the company and union cannot negotiate to reduce qualified benefits that have already been accrued, because they are protected by Federal law.

For each month a pilot is on the seniority list, he accrues 0.20% of FAE toward the retirement benefit (2.4% per year). As of any date, therefore, a pilot's accrued benefit is determined by multiplying the pilot's years and partial years of service times his FAE times 2.4%. (Note: your FAE for this purpose is what you have already earned, subject to the IRS limitations, not what you expect to earn in later years of employment.) If a pilot retires early, this accrued benefit is reduced by 0.25% for each month prior to age 60. ALPA and Delta, in general, cannot negotiate to reduce this accrued benefit as it applies to qualified funds (Question 4). Certain protections also apply to nonqualified funds, and all nonqualified benefits are protected by the PWA as long as the PWA and successor agreements remain in force without change to those benefits.

If, through negotiation, the retirement calculation were changed, e.g., to change the accrual rate to something less than 0.20% per month, the plan would require an amendment. The amendment could apply only to future accruals of qualified benefits. The qualified benefits accrued up to the effective date of such amendment, including the ability to take a 50% lump sum on such benefits accrued prior to the amendment, would not change.

### **OK. What, If Any, Are the Threats to My Pension?**

8. Would our pension fund be threatened by a sudden surge of early retirements?

An analysis has been done on this very question, and the conclusion is that such a surge, even one numbering in the hundreds, would not put our plan in immediate jeopardy. To understand why, one must consider that for every lump sum taken out of the plan assets, there is a corresponding reduction in future liabilities for the plan. Although the dollar balance is not one for one, the overall effect is such that our plan would not be in immediate jeopardy as the result of such a surge. The annual valuation of the plan (Question 3) would recognize any actuarial losses generated by unexpected early retirements and would call for increased funding in the future. Depending on the number of early retirements, that could result in future requirements for a "deficit reduction contribution," which is a legal requirement for additional funding into the plan when the plan assets fall below a certain funded level.

9. Would a bankruptcy by Delta automatically threaten my pension?

A bankruptcy filing has no automatic effect on a defined benefit plan such as ours. Benefits under both the qualified and non-qualified plans are covered by the PWA. Therefore, no changes may be made to either without ALPA consent, except through a Section 1113 proceeding as described in Questions 10 and 13, and through satisfying ERISA standards in the case of a plan termination.

10. Can the Company change my retirement plan in bankruptcy?

Benefits that are subject to an agreement between ALPA and the company cannot be changed unilaterally. If the company wants to make a change to our PWA while in bankruptcy it must undertake a negotiation process described in Section 1113 of the Bankruptcy Code. If no agreement is reached, the company may file a motion with the bankruptcy court, requesting that the PWA be "rejected" in order to permit Delta to impose new terms and conditions. This proposal could include proposed changes to the retirement benefits. If the company and ALPA reach agreement on the proposal, including changes to retirement benefits, those changes would go into effect. If they do not reach agreement, the court would hold a hearing on the rejection motion.

Section 1113 sets out the procedures and the legal standards for rejection of a collective bargaining agreement such as the PWA, as follows:

1. Delta must first make a proposal to ALPA with only those changes as it can demonstrate are necessary for a successful reorganization and that are fair and equitable to all parties in the case;
2. Delta must negotiate in good faith with ALPA;
3. If no agreement is reached, the bankruptcy court will hold a hearing and Delta must establish that:
  - a. the changes proposed by Delta are necessary to the reorganization of the airline;
  - b. the proposal is fair and equitable to all parties;
  - c. certain other procedural requirements have been met, such as the obligation to make available all relevant information;
  - d. ALPA lacked good cause for rejecting the proposal;
  - e. The balance of the equities clearly favors rejection.

If the court approves the rejection, Delta would be able to impose its final offer, including proposed changes to the retirement benefits. (See Question 7 regarding the status of retirement benefits accrued prior to this point.)

## 11. Does a bankruptcy automatically lead to a plan termination?

No. A retirement plan remains in existence until it is terminated in accordance with applicable non-bankruptcy law. US Airways, for example, was in bankruptcy for 8 months prior to the termination of the pilots' pension plan, and that termination was approved by the US Airways MEC and the bankruptcy court in order to make it possible for the company to receive the financing it needed as a condition of avoiding liquidation. At the same time, the defined benefit plans of all non-pilot employees at US Airways were left intact. United has been in bankruptcy for over a year, and that company's qualified and nonqualified defined benefit plans remain in place and are paying all negotiated benefits. The following questions discuss how a bankruptcy court may be asked to make certain findings in connection with a proposed termination of our retirement plan.

## 12. What are the rules for termination of our pension plan in bankruptcy?

Qualified pension plan terminations are governed by Federal law, including ERISA and the rules of the Pension Benefit Guaranty Corporation (PBGC). Nonqualified pension plan terminations are not governed by the same rules, but our nonqualified plans are governed by the PWA.

The procedure for the termination of an under-funded defined benefit retirement plan is a distress termination. Oddly, this is considered to be a "voluntary" termination since it is initiated by the plan's sponsor, the company, rather than by the PBGC. Under ERISA, Delta can proceed with a distress termination only if it meets the statutory criteria. One of the criteria is that the company is seeking either reorganization or liquidation under the Bankruptcy Code.

In the most likely scenario, a company in Chapter 11 applies to the PBGC to approve a distress termination of the qualified plan. The PBGC will not proceed with a distress termination if the termination would violate the terms of an existing collective bargaining agreement (our PWA). In addition, in order to satisfy the distress termination criteria under the Chapter 11 standard, the bankruptcy court would have to rule that, unless the plan is terminated, the company would be unable to pay its debts under a reorganization plan and will be unable to continue in business outside of Chapter 11. The PBGC would then make the other necessary determinations as to whether a distress termination would be approved.

Our PWA does not permit the company to terminate the retirement plan on its own. Termination of the plan can take place under the PWA only by agreement between ALPA and the company, or, if there is no agreement, the company would have to undergo the process under Section 1113 of the Bankruptcy Code to obtain court approval of a rejection of the PWA. (Question 10).

This was the procedure that led to the termination of the US Airways pilots' pension plan. That company made the case to the bankruptcy court that the requirement to contribute almost \$800 million to the pilots' plan would prevent it from obtaining the financing it needed to reorganize. The court held that the

distress termination met the ERISA standards, but there was no Section 1113 motion. Instead, given the reality as analyzed by the bankruptcy court, the pilots negotiated the termination of their plan in return for a replacement, defined contribution plan. The PBGC then approved the plan termination and the terms of the new defined contribution plan. (The US Airways pilots' nonqualified plan was also terminated because the PBGC would not allow continuation of any defined benefit plan for the pilots after termination of their qualified defined benefit plan.)

Another procedure available to the PBGC for plan termination is an involuntary termination imposed by the PBGC in order to protect itself against future unreasonable risk of increased liability. Unlike a distress termination, this procedure can go forward despite the PWA. In addition, unless the company and the PBGC agree upon the terms of an involuntary termination, the PBGC would have to go to federal district court for approval of an involuntary termination.

13. Would our plan be a likely candidate for a distress termination in the event of a Delta bankruptcy?

Not under present trends. Without ALPA's consent, a termination of our plan would require, among other things, that the bankruptcy court, under Section 1113 of the Bankruptcy Code, approve the rejection of our collective bargaining agreement. Further, the court would have to find that termination of the Delta Pilots Retirement Plan met the requirements for a distress termination (see Question 12). To prove this latter point, Delta would have to show that, unless our plan were terminated, Delta would be unable to continue in business outside of Chapter 11 and unable to pay its debts under a reorganization plan. There are other criteria that the company can attempt to satisfy as well, in lieu of the bankruptcy criteria, and the PBGC would have to determine whether these other criteria are met. For example, the company could attempt to prove to the PBGC that, without the termination, the company will not be able to pay its debts or that the cost of providing pension coverage has become unreasonably burdensome. The funding obligations of our plan, as now understood, are not expected to rise to a level that would support any of those findings.

14. Can my lump sum under the qualified plan be negotiated away?

Not, in general, for that part of your qualified benefit that you accrued before the plan is amended. Yes, for that part of your qualified benefit that you expect to accrue after the plan is amended. Lump sums are not payable with respect to nonqualified benefits. See Question 7.

15. OK, what happens if the qualified plan is terminated in a distress termination?

First, the company must issue a "Notice of Intent to Terminate" the plan to each participant, ALPA and the PBGC, at least 60 days and not more than 90 days before the proposed termination date. To do so, the company must be able to state that it expects that a distress termination of the plan will occur on the proposed termination date (Questions 12 & 13). Effective upon issuance of the Notice, there would be no further lump sum distributions paid from the plan, until

and unless it is later determined that the company did not meet the requirements for a distress termination. For example, it might be determined that the company's intended termination of the plan would violate the PWA, or that termination of the plan is not necessary for the company to reorganize and emerge from bankruptcy. In either of these situations, the Notice of Intent to Terminate would be void retroactively, and the payment of lump sum distributions would resume, including those whose payments had been suspended. Assuming a distress termination is approved, all pilots' qualified benefits will be divided among Priority Categories under the rules of the PBGC. There are six Categories in all, but it is probable that in the event of a distress termination, only two would concern our plan:

1. PRIORITY CATEGORY 3 (PC-3) - covers qualified benefits for:

- a. each pilot who had retired at least three years prior to the plan termination date, and
- b. each pilot who could have retired at least three years prior to the plan termination date (i.e. each pilot who has reached age 53 and had met service requirements for retirement prior to the plan termination date).
- c. Pilots' benefits described in (a) or (b) have equal priority.

The use of "3 years prior" and "age 53" language is often confusing to pilots. Since our plan requires that a pilot be at least age 50 in order to retire, then a pilot must be at least age 53 on the plan termination date (and, thus, at least age 50, 3 years prior to the plan termination date) due to the fact that the PBGC procedure looks back 3 years from the plan termination date.

2. PRIORITY CATEGORY 4 (PC-4) - generally covers qualified benefits for pilots who do not qualify for Priority Category 3. Under our plan, that includes each pilot who had neither retired nor reached age 50 at least three years prior to the plan termination date.

Finally, benefits are calculated for both PC-3 and PC-4 pilots:

3. PRIORITY CATEGORY 3: Qualified benefits for each pilot in PC-3 are equal to:

- a. in the case of a pilot who was retired 3 years prior to the plan termination date, the benefit that was being paid 3 years prior to the plan termination date, or
- b. in the case of a pilot who was not retired 3 years prior to the plan termination date, the benefit that would have been payable had the pilot retired 3 years prior to the plan termination date.

In either case, benefits are calculated pursuant to the plan provisions in effect 5 years prior to the plan termination date. The calculated benefits are then paid to PC-3 pilots up to the limit of the funds available in the plan. If there are insufficient funds to pay the calculated benefit to each PC-3 pilot, then each will receive an identical percentage of their calculated benefit. If there are excess funds after each PC-3 pilot is paid his calculated benefit, then the funds are applied toward benefits in PC-4. It is believed that the funding in our plan would cover most, if not all, of the PC-3 benefits.

4. PRIORITY CATEGORY 4: Qualified benefits for each pilot in PC-4 are equal to the pilot's accrued benefit under the plan (that is not covered by PC-3), up to the maximum amount guaranteed by the PBGC, according to a schedule published each year. The PBGC pays 100% of this guaranteed benefit, whether or not any plan assets remain for allocation to PC-4. The PBGC schedule in effect during the calendar year when a pension plan actually terminates is the schedule that will be used to determine the PBGC guarantee that will apply to the participants of a terminated plan. For plans terminating in 2004, the PBGC maximum annual guarantee for a pilot is as follows, based upon the pilot's age on the later of the date he commences to receive his benefit or the date of plan termination:

- a. age 65 - \$44,386;
- b. age 60 - \$28,851;
- c. age 55 - \$19,974;
- d. age 50 - \$15,535.

16. If I retire prior to plan termination, do I gain a higher priority for claims?

No. A pilot's level of priority is not affected by whether he retires before or after the plan termination date. If the DPRP is terminated in a "distress termination," the plan's assets will be allocated, in order, among the Priority Categories discussed above. Under these Priority Categories, a retired pilot has no higher claim on the assets than does an active pilot. Furthermore, for purposes of PC-3, where the bulk of our plan's funds would be allocated, a pilot's level of priority is determined based on whether the pilot is eligible to retire as of a certain date, not whether the pilot has actually retired.

17. Will my benefit be identical if I retire before, or after, a plan termination?

Although a pilot gains no higher claim on funds by retiring before a distress termination, there may be a difference in the form in which benefits are paid. If a pilot is already retired and receiving benefits on the plan termination date, the form in which the benefits are being paid will be continued by the PBGC after the plan termination date. If a pilot has not begun to receive benefits as of the plan termination date, the PBGC makes distributions available in the form of a single life annuity, a joint and 50% survivor annuity, a 5-, 10-, or 15-year certain-and-continuous annuity, a joint and 75% or 100% survivor annuity, or a joint and 50% survivor "pop-up" annuity (where the pilot's benefit "pops up" to the unreduced level if the beneficiary dies first). As mentioned above, lump sums are not available in the case of a distress termination (after the Notice of Intent to Terminate is provided as described in Question 15).