

## **Pension Meeting Summary – October 21, 2003**

### **Renaissance Hotel – Atlanta**

This meeting was jointly hosted by DALRC and DP3. Approximately 325 people attended, representing most departments and including active and retired employees and survivors of deceased employees.

Cathy Cone, Chairperson of DALRC representing non-pilot active, retired, and surviving spouses, opened the meeting. She and Bill Houseman, Chairman of DP3 representing retired pilots, introduced their respective committee members.

#### Guest Speakers

Mr. Norman P. Stein is Professor of Law – University of Alabama and holder of the Douglas Arant Professorship of Law. Professor Stein teaches in the areas of federal taxation, labor law, and employee benefits and has spoken before congressional committees. He participates in the Pension Counseling Program at the University of Alabama, which is supported by a grant from the Council on Aging.

#### **Professor Stein made the following observations:**

Retirees don't want change.

Currently retired, non-pilots' pensions are pretty secure because of the PBGC.

Pilots' qualified plan is pretty secure, but bridge and supplemental annuities are not funded.

Medical benefits are not so secure. Delta claims the right to change the benefit program in the future, even though they have said they won't do so right now.

Qualified plans have certain tax benefits to the company and are funded from the Master Trust Fund.

Non-qualified plans are paid from general operating revenues. Those that are funded are subject to significant tax implications.

Non-qualified plans cannot generally become qualified plans; however, secular trusts guarantee money even with substantial tax consequences.

The real answer to benefit security is for Delta to do well. Improvement in the depressed business market and an increase in interest rates can improve the current under funding of the qualified plans.

The 1974 ERISA Act created the PBGC, which currently pays benefits this year to a maximum of \$44,000 at age 65. The maximum is indexed to the rate of inflation so is subject to increases annually. No increase occurred this year.

Good news is there is an order to determining how the funds will be appropriated and the money first goes to those currently retired and for the full benefit without regard to the \$44,000 limit. Younger are more affected.

Cash Balance conversion is a defined contribution plan similar to a 401K, but it is a defined benefit and guaranteed by the PBGC

Until the 1980's most worker's pensions were defined benefit annuities, joint and survivor annuities. Cash Balance Plans came in as a way to legally break promise of a defined benefit). Delta's contribution to the new cash balance plan is 6% of salary and interest credit is based on 30-year treasury notes (about 5%). It's not really a defined contribution plan because there are no individual accounts. . The benefit promise then becomes the same as the promise to a 21-year old employee. Most of the increase of a traditional defined benefit plan for older employees comes in the last third of their career. Delta has a 7-year transition. At the end of the 7 years the employee's final average earnings are determined for pension purposes. No additional credit can then be earned under the old plan. If you are much over 40+ and don't retire within the 7 years, you may be hurt by the cash balance transition. However if you already have 30 years of service before the end of the 7-year transition, you could fair better. On the positive side, cash balance has a lump sum payout provision, which allows you to get around the \$44,000 PBGC limit.

In the well-known IBM case (4-5 years ago), the court decision was that all cash balance plans are illegal). If that decision is upheld, cash balance plans will go away. Right now Treasury Department regulations say they are okay. Three years ago the IRS said issues re: cash balance plans need to be studied, but still approved cash balance.

Discussion in Washington is that no regulation will be adopted until decision on IBM is resolved (appellate court decision). There is some discussion that Congress will adopt certain regulations to allow cash balance plans under the amendment.

Delta's 7 year conversion plan is more generous than most. The overall plan is not the best nor the worst I have seen. Delta's plan would be in the top half. In the qualified plan the 3% per year reduction for early retirement and the survivor benefit are very generous. In shifting pension monies from excess benefits to defined (insured) benefits, the Bridge Plan for pilots picks up excess of IRS maximum. As the index to inflation allows the IRS limit to increase, excess benefits can be shifted into the defined benefit plan.

Should we be concerned about health of PBGC? Even if they took in no more money, the PBGC would not run out of money for 15 years. Given interest rate and market improvements, PBGC is not in as big a stew as they tell Congress. The government doesn't guarantee the PBGC funding. However, if they were to go bankrupt (highly

unlikely), the government would likely bail them out as they did in the Savings & Loan crisis.

The PBGC is now hiring outside help for administering benefits. PBGC can take over if a company requests because of pension plan under funding, or if a plan is in such bad shape the PBGC wants to cut its losses. They are now more aggressive in this latter area. Funding rule issues that could make the PBGC act would include a finding that the plan is so under funded it cannot make a comeback or the balance between under funding and cash flow which could cause bankruptcy when it would not have otherwise occurred.

Social Security offset in the Delta plan is not restored under PBGC.

Regarding medical benefits, there are a number of lawsuits re: whether a company can change retiree benefits. The legal trend is to allow these changes. If benefits are part of a contract or if a company promised benefits forever if you would retire, it could be more difficult for them to change them. Regardless, if Delta goes bankrupt, these benefits will likely disappear.

A lot is going on in the legislative area. In the funding debate, there are special proposals dealing with the airline industry, such as changes in interest rate projections, which would allow for lower contributions.

I don't think this is good, but I am not aligned with many of these changes, including labor unions. The PBGC wants changes as well. As mentioned earlier, cash balance legislation is pending.

Three questions pending answers from Professor Stein:

1. Under the PBGC, what happens to a person who hasn't retired, but wants to retire prior to 55?
2. For Pilots who took lump sum, can PBGC deny the qualified benefit?
3. How are benefits allocated by PBGC (phase in issue)?

Answers will be provided in future mailings. Professor Stein did provide his phone number to the group – 205-348-1136.

**Mr. Tom Roeck – Retired Chief Financial Officer of Delta.**

Mr. Roeck provided a slide presentation and narrative to help us understand where the pension plan is today and where it is likely headed. These are his comments and observations:

I am a finance guy, not a pension specialist, so this is a view from 40,000 feet. I have followed this situation with great interest; the more I learned, the less I realized I knew.

A staff at Delta manages The Family Care Retirement Plan and the Delta Pilot Plan, reporting to Delta's Chief Investment Officer, Jim Taylor. My experience has been that

Jim managed one of the best run plans in the country. Mercer Consulting and Tower Perrin do the actuarial work. During my tenure we established an incentive compensation plan for the investment group which operates independent of Delta's profitability and corporate goals, which I understand is still in place. This incentive plan is based on beating benchmarks in the investment arena.

To understand where we are now and what the future holds, we need to start with the question: How did the Delta Pension Plans get in the shape they were in at the end of last year?

Terms:

Measurement Date – September 30 of every year for financial statement purposes. This is the cutoff for what is reported each fiscal year ending December 31.

Projected Benefit Obligation – As of the measurement date, what is the company's total dollar liability to pay out all defined benefit plans' retirement benefits (both vested and unvested and including the retired officers non-funded plan) at that point in time and including an estimate for future salary increases? (Termination liability is smaller as it excludes future salary increases) The PBO is still an estimate. It has to make assumptions about what today's value is of all future payouts, how much the pension funds will earn over time, what is the market value of plan assets (for investments like real estate, fair market values are estimated).

September 30, 2000 to September 30, 2002  
(in billions of dollars)

	<u>2000</u>	<u>2002</u>
Projected Benefit Obligation	9.3	11.7
Fair Value of Plan Assets	10.4	6.8
Surplus (Shortfall)	1.1	(4.9)

\$6.0 Billion change in two years

2002 is most current info available. 2003 will be reported at end of Fiscal Year 2003.

## What happened to the \$6.0 billion?

Investment Losses	\$2.2 billion
Lower Interest Rate Assumption (rate assumed at 1 ½%- ½% change in 2002 = \$730,000, so 3 times \$730K is \$2.2)	2.2
Benefits Paid	1.5
All Other (net)	<u>.1</u>
Total	\$6.0 billion

If interest rates went up, much of shortfall would go away.

### Investment Losses (How did Jim Taylor's group do?)

	<u>Jim's group*</u>	<u>S&amp;P 500</u>
Year ended 9/30/01	(15%)	(28%)
Year ended 9/30/02	(9%)	(22%)

- \*Estimated by taking annual loss divided by opening balance

### How might things look on 9/30/03? (very crude assumptions)

Interest rate assumption – 2002: 6.75%, down from 2001's 7.75%

Long-term interest rates appear to have risen slightly and continued since 9/30, so assume a ¼% increase on 9/30/03

S&P 500 rose 22% year over year 9/30/03, so assume a 20% increase over 9/30/02 fair value plan assets

## Crude Assumptions

Projected Benefit Obligation	
Balance 9/30/02	\$11.7 billion
Assume additional Service Cost is offset by small benefit of interest rate increase and everything else washes	<u>0.0</u>
	\$11.7
Fair Value of Plan Assets	
Balance 9/30/02	\$ 6.8
Assume gain on assets of 20% over 9/30/02 balance	1.4
Assume a billion in benefits are paid (\$ .9 billion was paid in 2002)	(1.0)
Company Contributions	<u>.1</u>
	\$ 7.3 billion

## What These Crude Assumptions Yield Rough 9/30/03 Projection

Projected Benefit Obligation	\$11.7 billion
Fair Value of Plan Assets	<u>7.3</u>
Rough Estimate of Shortfall	(\$ 4.4) billion

9/30/02 Shortfall: (\$4.9) billion

Could see some improvement 9/30/03, but expect a continuing good size shortfall

## What Does This Mean For Me?

If the plan had been terminated on 9/30/02, the Projected Benefit Obligation of \$11.7 billion at that time would be subject to decreased obligations. Future salary increases and the non-funded officers' obligations would be removed.

September 30, 2002

Projected Benefit Obligation	\$11.7 billion
Take out future salary increases	(1.6)
Take out officers non-funded plan (assume '01 numbers)	<u>(.3)</u>
Revised Benefit Obligation	\$ 9.8 billion

The \$6.8 billion in plan assets covers 69% of the \$9.8 billion obligation

If the plans were terminated and taken over by the PBGC, under ERISA, “Priority Categories” come ahead of everyone else. The US Airways pilot website is an excellent source for understanding individual exposure – [www.usairwayspilots.org](http://www.usairwayspilots.org)

Go back to the plans as they existed 5 years prior to termination to calculate Priority Category 3. Priorities 1 & 2 apply to plans in which the individual contribute, therefore they do not apply to Delta.

If you have been retired 3 years or been eligible to be retired for 3 years, you fall under Priority Category 3 (to the extent you benefits fell under the plans of 5 years ago)

Everyone else comes after Priority Category 3:

- Retirees to the extent not in Priority Category 3
- Other vested active employees – 5 years service
- Other non-vested active employees

If you are in Priority Category 3, and the plan is terminated, are you at risk?

#### Benefits Paid

Year ended 3/30/00	\$491 million
Year ended 9/30/02	\$888 million

Benefits paid increased 55% in 2 ½ years

One could argue that the \$491 million paid out in 99-00 was largely to Category 3 eligible recipients

One could also argue that the present value of a person's payout in Category 3 coverage is smaller than a person not covered by category 3 because of the Category 3 recipients are generally older

Given the 69% funding, the improvement assumed for 9/30/03, and the probability that much of the 55% increase in payouts between 3/31/00 and 9/30/02 did not go to Category 3 eligible recipients, one could argue that the Category 3 retirees are in a reasonably secure position.

Mr. Roeck's information was extrapolated from public financial information. He pointed out that other assumptions could be made:

- All plans are lumped together in the footnotes of the annual report
- Don't know if pattern of lump sum payouts changed between 2000 and 2002
- Don't know the Category 3 component of the 55% increase in benefits paid

His personal example:

- I assume if Delta bankrupts, my senior officer excess benefits will end
- I assume my Category 3 benefits will continue

If Delta gets into serious financial trouble, will they terminate the plans?

- United didn't
- US Airways terminated only the pilot plan
- The Wall Street Journal on 5/06/03 said, based on 12/31/02 information, that UAL and US Airways were more under funded than Delta

Will Delta get into serious financial trouble?

- The airline industry is recovering
- Delta management is taking steps
  - Cutting costs
  - Delta's long-term labor situation is more promising than UAL or American. Quality of ALPA leadership + more constructive environment
  - The ATL hub is an asset
  - Delta is better positioned than UAL and American both cash wise and in development of strategy
- In the near term, absent another incident like 9/11, not likely

What about pension funding relief currently being discussed in Washington?

- Last April Delta said it planned on funding \$350-\$450 million in 2004

Absent continued stock market turnaround and rising interest rates, funding requirements could increase. It depends on your view of the industry and Delta in particular:

Pessimistic – Don't reduce funding levels because the more money we can get in the fund before termination, the better.

Optimistic – National ALPA view – This is a short term problem and if we keep the industry (Delta) solvent, Delta is positioned to do well in the future. We don't want to force the industry (Delta) to the wall and keep them from seeing the promised land.

Delta management and dialogue with ALPA are key. We don't want to be the Steel industry or the U.S. Auto industry. GM employment fell from 240K to 120K over the last 8 years.

Should we be concerned about long-term debt?

Yields are better; short term looks better, but DL must sort out long-term strategy. DL is strongest legacy carrier.

When was the last time AAL/UAL stock was higher than DL?

Late 80's

How will the non-priority category 3 people fair in a plan termination?

Not in very good shape

What is the likelihood of Chapter 11 as a strategy?

There are so many issues in a bankruptcy, that it would not be wise

If DL doesn't turnaround and legislative relief does not come through, what is the point at which DL could go bankrupt?

That's probably several years away. The economy and interest rates continue to improve. Management has to figure out the answer to low cost carriers.

Is Song a good plan?

I don't know the plan around Song. The continued purchase of CRJ aircraft and leveraging the Connection carriers is sound. I'm not certain that there's a strong plan around the larger airplanes.

What are the minimum/maximum funding requirements?

The margin is pretty narrow between the two. In some cases we use to fund more in a downturn because we could make more money there.

In the letter about the 150% medical cap, they gave a \$562 per month medical cost. I'm single. That number doesn't fit me.

The \$562 is an average cost per covered individual. It includes the employee and his/her dependents.

In Board decisions, who introduces the proposed change?  
Generally management

Both the DALRC and DP3 discussed the funding requirements for ongoing activities of the two committees. Money is needed for such things as incorporation as a non-profit organization, websites, and meetings such as this one. In addition, both groups believe it is important to begin a legal fund in the event of bankruptcy and plan termination. DALRC is requesting a minimum \$10 per year donation (more would be good) and DP3 is requesting \$50. DALRC donations can be mailed to:

DALRC

214 Wood Creek Rd.

Williamson, GA 30292

Pilots, please contact the DP3 for more information regarding your Committee (Bill Houseman, Chairman) [bhouseman@adelphia.net](mailto:bhouseman@adelphia.net).

In the event all of the money collected is not needed for the purposes described, the website and mailing list will be used to solicit recommendations for redistribution of funds (charities, etc. ?).

Rochelle Oms, advisory member of DALRC, briefed the group on what to expect for a website in January. She advised that the master e-mail mailing list will be contained in a site called Coollist and they would receive an e-mail inviting them to sign up. This will allow us to have one master list for communication. This process will eliminate the need for Cathy Cone and others to send out updates to their mailing list since information will be posted on the website when it becomes available. The sign up will request their birth date, which she suggested they not provide accurately.

On behalf of the DALRC, we want to take this opportunity to “Thank” everyone making the effort to attend these very informative meetings. Of course, they would not have been possible without the participation of our retired CFO, Tom Roeck and Professor Norman Stein both of whom provided great information.

DALRC

Cathy Cone   Jenny Poole   John Hoover   Barry Braender

Bill Hutcheson   Thom Stone   Mike Podett   Joe Turner   Grant Weier