

**DELTA**

# MEC UPDATE



## *Retirement Bulletin*

05-09

**November 4, 2005**

Your Delta MEC Retirement & Insurance Committee has been hard at work evaluating our situation, and interacting with our professional staff, outside consultants and other airlines in preparing to deal with the challenges we might face in the upcoming months. This bulletin will update you on our retirement fund's financial status, explain how we got here and answer the most common questions that arise. We'll also provide you a comparison with other airlines' retirement plan benefits and review the history at some airlines. We hope this information arms you to provide input to your LEC representatives as they prepare to give us direction on retirement issues.

First, here's a brief update on our current defined benefit plan:

Plan assets as of September 30, 2005:	\$1.89 Billion
Change in assets from July 01, 2004:	(\$0.78 Billion)
# of pilots retiring last twelve months	1090
Lump sums paid last twelve months	\$907 million
Monthly annuity benefits paid last twelve months:	\$240 million
Current Liability Funding Percentage:	54.31 percent (as of July 01, 2005)

**Q1. Just how under funded are the Delta plans?**

**A1.** According to Delta, the plans are \$5.3B under funded, but the PBGC says \$10.6B. Keep in mind that these numbers reflect ALL Delta pension plans, not just the pilot plan.

**Q2. Why is there such a large difference between Delta's and the PBGC estimates? Who's right?**

**A2.** The short answer is they both are. ERISA funding calculations for a continuing pension plan differ drastically from the PBGC calculations of a terminated plan. The major difference is that Delta's Pilot Plan actuaries use an assumed 8.5 percent rate of return for plan assets going forward. The PBGC, on the other hand, assumes the plan terminates, and calculates what it would cost as if they were to purchase annuities at current interest rates (presently approximately 3.5 percent) to fund all current plan liabilities.

**Q3. What is a "Current Liability Funding Percentage (54.31 percent)?"**

**A3.** This is the value of plan assets divided by the plan's "current liability." For this calculation, the value of assets used is the "actuarial value of assets" which is different from actual plan assets in that it is a smoothed number intended to remove short term volatility from the plan assets amount. The

“current liability” is calculated using a mandated interest rate (maximum allowable is 5.9 percent for the current plan year beginning July 1, 2005).

**Q4. How did it drop from 75 percent last year to 54.31 percent now?**

**A4.** Several factors contributed to this drop. First is basic mathematics. Using round numbers, hypothetically, if the plan had assets of \$3B and liabilities of \$4B last year, the funding percentage would be 75 percent. Paying \$1B in lump sums reduces the assets to \$2B and the liabilities to \$3B. As a result, the funding level would reduce to 67 percent even though the fund is the same \$1B short of full funding. Second, due to plan assumptions and our contractual formula for calculating lump sums, the actual result is that for every \$1 removed from the asset side, an estimated \$0.85 was removed from the liability side. This is because our lump sums must be paid at a mandated interest rate (GATT rate) that is lower than the mandated rate used to value plan liabilities. Finally, a decrease in the IRS mandated interest rate used to calculate plan liabilities resulted in an increase in those liabilities.

**Q5. Why did the lump sums stop?**

**A5.** The decrease in plan assets, caused primarily by the payment of lump sums, resulted in a liquidity shortfall of \$160 million. Under ERISA funding law, Delta was required to contribute this amount to the plan by October 14, but failed to do so claiming protection by bankruptcy law. ERISA regulations prohibit the payment of lump sums when the employer fails to make the required liquidity shortfall contribution. Delta management has indicated it has no current intention to fund the plan and thus, effective for pilots retiring after September 30, 2005, the payment of lump sums ceased (see Q7 below).

**Q6. What is a liquidity shortfall, and specifically how did that occur?**

**A6.** The liquidity shortfall is a snapshot calculation performed at the end of each quarter. It compares the total plan liquid assets with the disbursements from the fund over the previous four quarters. As can be seen by the formula detailed below, the current liability funding percentage is used in this calculation and our 54.31 percent funding level exacerbated the problem.

Liquidity Shortfall Calculation as of 09/30/05  
*Based on Bankruptcy Stipulation of Facts dated 10/12/05*

1. Annuity Payments (10/01/04-9/30/05)	\$240M
2. Lump Sum Payments (10/01/04-9/30/05)	\$907M
3. Current Liability Funding percent (7/1/05)	54.31 percent
4. Includable Lump Sums (Item 2 x [100 percent - Item 3])	\$414M
5. Est. Admin Expenses (10/01/04-9/30/05)	\$29.3M
6. 3 times disbursements (Item 1+Item 4+Item 5)x3	\$2.050B
7. Market Value of Plan Assets (9/30/05)	\$1.890B
8. Liquidity Shortfall (Item 7-Item 6)	(\$160M)

**Q7. Does this mean lump sums will NEVER be paid again?**

**A7.** No. Lump sums are a vested benefit that cannot be negotiated away. The liquidity shortfall calculation will be performed at the end of each quarter, and once the calculation shows that no supplemental contributions are required, the payment of lump sums may resume. Even if Delta fails to make the required contributions to the Qualified Pilot Plan, management estimates the plan will no longer have a liquidity shortfall as of the end of the 1<sup>st</sup> quarter of 2006 and, if so, lump sum payments would then resume. The plan would first pay pilots who retired on or after October 1<sup>st</sup>, 2005 and make lump sum payments in the order of retirement to all pilots who requested but did not receive their lump sum upon retirement.

**Q8. Is there anything else that could affect the payment of lump sums?**

**A8.** Yes. Current proposed pension legislation may restrict the payment of lump sums; this will likely be based on the funding status of the plan. The legislation is still being debated and it is likely to change several times before being enacted into law. Your R&I Committee and the ALPA Legislative Affairs Committee are watching this closely; we will keep you updated as the legislative process continues. Also, if the pension plan were terminated, lump sum payments would not be available.

**Q9. So, how does this affect me?**

**A9.** As a result of current funding levels and the present ERISA requirements, absent Congressional relief, Delta is required to make very large contributions going forward. Delta estimates their funding obligations are approximately, \$179 million in 2006, \$430 million in 2007, and \$750 million in 2008. These funding estimates are for the pilot plan only. In addition to the pilot plan, Delta must also fund the non-contract employees' pension plan.

**Q10. Will our plan be terminated?**

**A10.** This is the big unknown. Although Delta has not sought to terminate the non-contract or pilot pension plans thus far in bankruptcy, they also have essentially stopped funding them. Delta missed the \$160 million required liquidity shortfall payment due October 17. Since Delta is now failing to meet its minimum funding requirements, the PBGC could seek an involuntary termination. The PBGC can seek court approval to involuntarily terminate a plan even if the termination is contrary to terms of the collective bargaining agreement.

**Q11. So, what would it take for the Pilot Pension Plan to survive?**

**A11.** Good question. In reality, there are five "stars" that must come into alignment if our plan is to survive the current pressure.

1. Delta must begin funding the plan.
2. The PBGC must not seek to involuntarily terminate it.
3. Congressional legislation must pass and be timely, adequate and of sufficient duration to meet the company's funding needs.
4. Interest rates and/or plan asset values must increase to take pressure off the funding level.
5. The parties that provide exit financing to Delta must not require the plan be terminated as a condition of their funding.

**Q12. If changes are made to the defined benefit plan, what will happen to our defined contribution plan?**

**A12.** We are analyzing a number of options for the MEC to consider under a variety of circumstances.

***Looking Ahead***

The path through airline bankruptcy has been well traveled in recent years and we know there are lessons to be learned from those who have been through this before us. As part of our ongoing process to prepare for any contingency, we have been analyzing the changes made at other airlines during recent years. We have also been in contact with their R&I committees to learn from their experience and gained a great deal of insight that will better prepare us for whatever lies ahead.

***The Road They've Traveled***

United Airlines and USAirways recently underwent major changes to their retirement plans; these changes took place while in bankruptcy. On the other hand, Continental made the changes during the course of normal negotiations. Northwest Airlines is negotiating in Chapter 11 and we'll be monitoring their situation over the next few months. The benefits for UAL, AAA and CAL represent significant changes from their old plans. Furthermore, the bankrupt carriers didn't get where they are in a one-step process, they transformed over time. Let's take a look at their experience.

The United Airlines pilots' previous program consisted of a defined benefit of 1.5 percent x years of service (no limit), a 9 percent defined contribution plan, a pilot-funded 401k and ESOP. They initially reduced their defined benefit multiplier and imposed other limits in an effort to prevent termination of their plan. Later, they agreed to consensual termination of their DB plan by way of an agreement with management not to oppose termination of the defined benefit plan. In exchange, the pilots would receive an additional 6 percent defined contribution benefit if the plan was terminated. In December, 2004 the PBGC moved to terminate the United pilots' plan and the pilots will receive the 6 percent DC increase. United's current benefit is a flat-rate DC plan totaling 15 percent and a pilot-funded 401k. They will also receive \$550M in notes upon exiting from Chapter 11; the distribution method of this money is up to the pilots and has not yet been finalized.

USAirways pilots' old plan was a defined benefit that yielded 65 percent at age 60 with 30 years of service. Here too, they reduced their multiplier in an attempt to save the plan, but the defined benefit plan was ultimately terminated during USAir's first run through bankruptcy. The judge ruled that the plan qualified for distress termination but also ruled the plan was covered by the collective bargaining agreement. In 2003, ALPA agreed to consensually terminate the DB plan; in exchange they received a follow-on defined contribution plan. This plan was a targeted benefit plan with contribution rates from 0-100 percent. One year later, USAirways re-entered bankruptcy and the pilots re-negotiated a 10 percent flat-rate defined contribution plan. The pilots also have a self-funded 401k.

The Continental pilots also restructured their retirement, but they did this outside of bankruptcy. The CAL pilots were originally covered by the same defined benefit plan as all other employees. The pilots split from that plan and formed a pilot-only fund with a hard freeze. Their new plan is a flat-rate defined contribution plan with a contribution rate of 6.75 percent this year, 10 percent next year and 12.75 percent the following year. They also have a 401k and the company matches 6 percent of contributions, diminishing to 2 percent in 2008.

Northwest Airlines has retirement benefits very similar to our old plan. They are currently in bankruptcy and Northwest management has filed an 1113 motion. The R&I committee will be closely monitoring the situation at Northwest.

## ***Retirement Benefit Comparison***

Below is a brief look at the retirement benefits in place at other carriers.

<b>Airline</b>	<b>Defined Benefit Plan</b>	<b>De fined Contribution Plan</b>
Delta	Soft freeze	Targeted plan from 0-19.2 percent (averaging 9 percent), 401k with 2 percent company contribution
United	Terminated in 2004; PC-3 funded 75-80 percent (estimate); PC-4 formula benefit up to PBGC maximum of \$28,851 at age 60	15 percent flat rate plan, 401k-pilot funded
American	1.25 percent per year of service	11 percent flat rate plan, 401k-pilot funded
Continental	Hard freeze	Flat rate plan increasing over the next 3 years as follows: 6.75 percent/10 percent/12.75percent. 401k, variable company profit-sharing contribution of up to 6 percent decreasing to up to 2 percent on 9/1/08
Northwest	2.4 percent per year of service; 60 percent at age 60 with 25 years	401k with a 3 percent company contribution  Note: NWA is rene gotiating their contract under Section 1113 of the US Bankruptcy Code
USAirways	Terminated in 2003; PC-3 funded 98 percent (estimate); PC-4 formula benefit up to PBGC maximum of \$28,585 at age 60	10 percent flat rate plan, 401k-pilot funded
Southwest	None	401k, 7.3 percent company match plus profit sharing deposit (average 8 percent) into a qualified DC plan
America West	None	401k, 7 percent company contribution plus matching contribution of 50 percent of first 6 percent
Airtran	None	401k-pilot funded, Money Purchase Plan with 10.5 percent company contribution

## ***In Closing***

Bankruptcy is a difficult process and our retirement and insurance benefits are under attack. Management has ceased funding our defined benefit plan at the required levels, they have stopped paying non-qualified benefits to retirees and are attacking many of the retirement and insurance benefits in the ongoing negotiations. We pledge to do everything possible to keep you informed and present the MEC the information needed to make the best decisions on retirement, insurance, disability and survivorship issues as we proceed through these tough times.