The Three-Legged Stool Begins to Wobble . . .

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In the past, retirement savings have always been considered as a three-legged stool with the legs being (1) personal retirement savings, (2) Social Security, and (3) any company-sponsored pensions. With all that has transpired recently with the pilots’ pension plan, more weight than ever has been placed on the first and second legs because several inches have been chopped off the third leg.

First, let’s clarify some terms. A defined benefit plan, often referred to in geek-speak (benefits specialist language) as a DB plan, is a formula-based retirement. An employee is granted a percentage or dollar amount for each year of service. The funds are held in a master trust fund, but the individual’s name is not attached to a specific account. A defined contribution or DC account, on the other hand, can be your 401(k), which is an account in your name bearing your own contributions, or an account into which the Company places contributions on your behalf (sometimes referred to as a match or a profit-sharing account). The account is in your name, can be withdrawn as a lump sum upon retirement or termination with tax consequences, and has survivorship passage as a lump sum to your spouse or heirs in the event of your death.

The takeover of the pilots’ pension plan by the PBGC drastically reduced or decimated what each and every pilot expected as a retirement benefit. Those who were younger than age 53 when the plan terminated will receive the maximum monthly guarantee from the PBGC of $2,382.10 when they reach age 60. In many cases, that represents a 50 to 75 percent reduction or more in what they would have earned had the plan survived.

Social Security is only a small addition to this benefit at approximately $1,741 per month at age 65. Since pilots are forced by law to retire at 60, this further reduces their benefits if they chose to collect Social Security at the earliest possible age of 62. The benefit at 62 is reduced to 80 percent of the $1,741, or $1,392.80.

The other leg of the stool is your 401(k) and any IRAs or other savings accounts one may have. With the stock market in one of the longest declines since the Depression, many employees have watched the balances in their retirement savings accounts dwindle. Many others saw their hard-earned contributions decimated by the failures of the Company stock they purchased in their 401(k)s.

Even the most focused investor who deferred the maximum 22 percent of salary to the 401(k) in 2003 could still only set aside $12,000, plus another $2,000 for the over-50 makeup contributions. In order to take advantage of the additional makeup contributions (which becomes available in the third quarter of 2003), you MUST first defer up to the maximum allowable annual limit ($12,000 in 2003). For those with a shorter horizon to retirement, it’s just not enough time to get where you need to be and to compensate for the loss of a majority of the decimated company pension.

Deferring after-tax contributions can help build that nest egg. However, there are limits of $40,000 per year, which includes any money put into the 401(k) through regular deferrals (the $2,000 makeup contribution DOES NOT count toward this limit). Having negotiated a follow-on defined contribution (DC) plan, while certainly a welcome benefit, only exacerbates this situation. Why? Because any money deposited into the DC plan is counted toward the $40,000 annual limit. This makes salary deferrals into your 401(k) a personal risk decision.
So, you need to learn everything you can about how to invest your money, pitfalls to avoid and practices to keep your investments safe and keep you sane.

because once the $40,000 cap is reached, any overflow must go into the “notional” account. That doesn’t mean you should immediately stop funding your 401(k). On the contrary, if you are over 50, you may NEED to continue to fund it to take advantage of the makeup contributions. How else will you make up for the fact that you have a shorter horizon in which to recover?

For example, Joe Pilot is 52 when the plan was terminated, which means he will only receive the PBGC Priority Category 4 maximum of $2,382 per month by deferring the maximum to his 401(k) for the next eight years. (This assumes the limit doesn’t increase. We know it will, but this is the safer assumption, since we don’t know how much the increases will be.) This allows the pilot to defer another $96,000 plus makeup contributions of $2,000 in 2003, $3,000 in 2004, $4,000 in 2005 and $5,000 in 2006, for a total of $110,000 over the next eight years. During this time, contributions are still being made by the Company into the DC account up to the maximum qualified limit, and an amount is building in the notional account and will be compounded at the set rate of return of 8 percent when it is paid to you at retirement. While the money from that notional account is taxed when received, it still will have gained, based on the interest rate assumptions inherent in the plan.

Herein lies the critical question:

Q: Should I maximize my own contribution to the 401(k), which will cause some of what the Company contributes on my behalf to go into the nonqualified “notional” account, or should I stop my 401(k) contributions so that the Company has to put the maximum amount into the DC plan?

A: That depends. There are two ways of looking at this.

1) If you maximize your deductions from your paycheck and defer the full $12,000 and the makeup contribution of $2,000 ($14,000) in 2003 into your 401(k), the money that the Company has to put into the “notional” account gets to earn a guaranteed fixed rate of return of 8 percent as specified in the Agreement. The risks to that money are that it is subject to the survival of US Airways and that it is taxed as ordinary income when it is received. You also avoid taxation on the $14,000 ($12,000 plus $2,000 makeup) in your paycheck, probably a higher tax bracket than you would be in retirement. That’s because 401(k) deferrals are subtracted pre-tax (before taxes are applied to your gross wages).

2) If you opt out of 401(k) payroll deductions, the Company puts the maximum amount into your qualified DC plan. Less money rolls over into the “notional” account and should US Airways liquidate, everything in the DC account is yours to keep. You are at risk in the DC account for earning the assumed eight percent rate of return. If you fail to meet that rate of return, you will not meet the retirement amount targeted for you. The “notional” account will be gone in liquidation (actually, you are an unsecured creditor with a return of maybe one cent on the dollar). If you withdraw the money from the DC plan upon liquidation, you will be taxed at your current tax bracket rate, plus you may have potential penalties depending on your age.

Both of these issues are personal decisions and should be made only after getting proper advice from your own tax professional and considering your own personal circumstances. We’re just trying to point out some facts and educate you on the intricacies.

What does this all mean? It means that it’s now time to become the most educated pension consumer that you can be because you are going to need to be. According to Jane White, President of Retirement Solutions Foundation:

The rule of thumb is that you need a nest egg that is approximately 10 times your salary right before you retire—a sum that takes into account Social Security and a company-paid pension, if you’re lucky enough to collect one. Assuming that your pre-retirement pay is about 10 times your starting pay, a 25-year-old earning $25,000 a year today will need to amass a $1 million nest egg 40 years from now when he or she is ready to retire. So a million-dollar nest egg for somebody making less than the median wage of $42,000 isn’t a windfall. It’s the goal.

So, you need to learn everything you can about how to invest your money, pitfalls to avoid and practices to keep your investments safe and keep you sane. Your MEC R&I Committee and ALPA International’s R&I staff will do everything they can to help you amass the knowledge you need to reach your goals, whatever they are! Stay tuned as information on the design of the plan progresses over the next several months. Also, keep listening to the code-a-phone and watching the usairwayspilots.org website for further directions from your MEC on what you need to do to assist in the battle to restore your defined benefit plan.

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