MEMORANDUM

TO: Stakeholders
FROM: Puget Sound Pilots
RE: Funded Pension Plan Options
DATE: April 20, 2022

I. Introduction.

Following up the stakeholder session on April 13, 2022 in Seattle, PSP agreed to share analysis provided by its pension attorney setting out the types of defined benefit pension plans and defined contribution pension plans available to employers or plan sponsors in the US. This memorandum briefly summarizes the funded defined benefit plan that would replicate the existing PSP retirement plan benefits in its currently unfunded pay-as-you-go or farebox pension system. This type of plan was the subject of the 50-year cost projections presented by PSP's actuary in the first stakeholder session on March 2, 2022. This memorandum also summarizes the types of defined contribution pension plans available in the US and the maximum annual contributions that can be made to those plans.

II. Defined Benefit Pension Plans.

A defined benefit pension plan is a type of pension plan in which the employer or plan sponsor promises a specified pension benefit paid over a period of years (e.g., a life annuity) on retirement that is determined by a formula based upon the participant's compensation and years of service. This type of retirement plan often utilizes a unit benefit formula to calculate the pension benefit payable under the defined benefit plan. This is the type of benefit defined in the PSP pension plan where each pilot accrues a 1.5% unit benefit per year of service and the ultimate retirement benefit is based upon total years of service and a pilot's average compensation over the last three years of service as a pilot.

A pension law expert retained by PSP has concluded that PSP could establish a multiple employer plan (“MEP”) that provides the same benefits to retirees as those set out in the current PSP retirement plan. To participate in an MEP, which is a type of fully funded defined benefit pension plan, each PSP pilot would be required to participate through an entity such as a LLC or subchapter S corporation. At present, all but two of PSP's current pilots participate in the Puget Sound Pilots Association through an entity. PSP's pension lawyer is of the opinion that an MEP including all PSP pilot entities could satisfy the tax-qualification requirements applicable to an MEP under section 401(a) of the Internal Revenue Code of 1986.
III. Defined Contribution Pension Plans.

A defined contribution plan is a type of retirement plan in which the employer, employee, or both make contributions on a regular basis. An individual account is established for each participating employee for the contributions, and the benefit payable to each participant at the time of the participant's retirement or separation from service is determined based upon the total amount of the contributions made to the participant's account (adjusted for earnings or losses). A profit-sharing plan with a 401(k) feature is a common type of defined contribution plan. The types of defined contribution plans available in the United States and the maximum annual contributions are summarized below.

A. Traditional 401(k) Plans.

Traditional 401(k) plans allow considerable flexibility for the sponsoring employer with respect to eligibility to participate (e.g., the sponsor can choose age and hours of service not to exceed 21 and 1,000 hours of service), contributions (e.g., the level of matching contributions and whether to make discretionary employer contributions) and the vesting schedule for the contributions (e.g., three-year cliff vesting or a graded vesting schedule with 100% vesting after six years). The tax code imposes limitations on the contributions that may be made to the accounts of plan participants. The annual employee contributions are limited to $20,500 for 2022, with additional contributions for employees age 50 and over of $6,500 for 2022. The maximum annual contribution is limited to $61,000 for 2022, and $67,500 including catch-up contributions by employees age 50 and over.

B. Simplified Employee Pension ("SEP").

A SEP requires contributions made by an employer and does not permit employee elective deferral contributions. A SEP can be established by any type of business, including a sole proprietor, partnership, LLC, or corporation to provide retirement plan coverage to employees. The employer usually makes a contribution to each eligible employee's IRA (referred to as a "SEP-IRA") that is equal to the same percentage of compensation for each employee. The annual per-participant contribution cannot exceed the lesser of 25% of compensation or $61,000 in 2022.

C. Savings Incentive Match Plan for Employees ("SIMPLE IRA").

A SIMPLE IRA plan allows businesses with fewer than 100 employees to establish an IRA for each employee. In 2022, employees may make salary deferral contributions up to the lesser of 100% of compensation or $14,000. Employees who are age 50 or older may also make catch-up contributions of up to $3,000 annually. The employer must also generally make a matching contribution dollar-for-dollar for employee contributions up to 3% of compensation to contributing employees or a nonelective contribution of up to 2% of compensation to all eligible employees up to no more than $305,000 of compensation in 2022, which limits that contribution to $6,100 in 2022.
D. Payroll Deduction IRA.

A payroll deduction IRA allows an employer to establish a payroll deduction IRA program with a bank, insurance company or other financial institution. Then, each employee may choose whether to participate and, if so, the amount of payroll deduction for contribution to the IRA. Employee contributions are limited to $6,000 for 2022. Additional catch-up contributions of $1,000 per year are permitted for employees who are age 50 or older.

IV. PSP Position.

As stated by PSP representatives at both the March 2 and April 13 stakeholder sessions, PSP is committed to seeking full funding in the pilotage tariff for the Puget Sound pilotage district for the pension benefits promised to retirees and to all working pilots at the time of initial licensure. PSP believes that it has both a legal and moral obligation to honor these pension commitments. Further, considering that PSP's pension accrual rate of 1.5% per year of service is in the lower third of similar pension plans for major pilot groups in the US (which range from 1% to 2.2% per year), we strongly favor maintaining the current pension plan for new licensees in order to remain competitive with other major US pilot groups in the recruitment of top-flight applicants.

With respect to the other pension plan options summarized above, all of which are defined contribution pension plans, PSP's actuary has advised that the annual contribution limits on these plans make it impossible for a pilot to build up sufficient funds in his or her pension plan to come close to replicating the benefits earned in the average 20-year career of a PSP pilot. As noted in the April 13 stakeholder session, one of the reasons for the relatively generous accrual rates in US pilot group pension plans is the need to make up for the pension-related losses that occur when a mariner makes a mid-career move to become a maritime pilot.