AIR CANADA

April 2016

Air Canada Pension Update

We are providing you with an update on the financial position, as at January 1, 2016, of the following defined benefit pension plans sponsored by Air Canada for its Canadian-based unionized, management, administrative and technical support and executive employees:

- Air Canada Pension Plan – Crew Schedulers and CSS Agents
- Air Canada Pension Plan – TMOS, Clerical and Finance Employees
- Air Canada CUPE Represented Employees Pension Plan
- Air Canada Pension Plan – Dispatchers
- Air Canada Pension Plan - Management & ATS Employees
- Air Canada Executive Pension Plan
- Air Canada Pension Plan – Pilots
- Pension Plan for Air Canada Pilots Formerly Employed by Canadian Airlines International Ltd.

What's new?

In a few words………

All pension plans in a surplus position as at January 1, 2016 on both solvency and going-concern basis

Total solvency surplus of $1,345 million - Solvency ratio of 108%

Total going-concern surplus of $3,029 million - Funded ratio of 124%

Return of 8.7% on pension assets in 2015

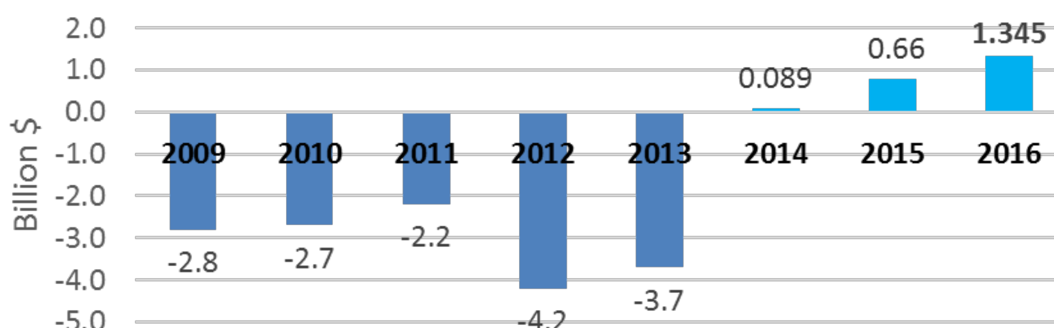
Air Canada contributions of $217 million to the plans in 2015

In more detail………

FINANCIAL POSITION OF THE PLANS

Solvency Position – All Plans Combined

As announced, the consolidated financial position of Air Canada's defined benefit pension plans has significantly improved again in 2015, from a solvency surplus of $660 million as at January 1, 2015 to a surplus of $1,345 million as at January 1, 2016. The following graph shows the evolution of the financial position of the plans on a solvency basis since 2009.



Solvency Position by Plan

The following table compares the financial position, on a solvency basis, of each plan as at January 1, 2016 with its financial position as at January 1, 2015. The surplus increased in all plans between the two valuation dates.

(in $ millions**)**

	At January 1, 2016		At January 1, 2015	
Plan	**Solvency Ratio**	**Solvency Surplus**	**Solvency Ratio**	**Solvency Surplus**
Crew Schedulers and CSS Agents	108%	155	105%	85
TMOS, Clerical and Finance	109%	447	104%	203
CUPE Represented Employees	108%	213	106%	151
Dispatchers	104%	3	102%	1
Management & ATS	109%	172	104%	75
Executives	110%	5	103%	2
AC Pilots	107%	216	104%	106
CAIL Pilots	109%	134	102%	37
Total	**108%**	**1,345**	**104%**	**660**

A solvency ratio of less than 100% means that if a plan were terminated, the assets would not be sufficient to cover the full value of the pension promised to plan members whereas a ratio at or above 100% means the assets would be sufficient.

Factors that contributed to improve the solvency position in 2015

The increase in the surplus from $660 million to $1,345 million results mainly from the 8.7% return on pension assets (net of fees), which contributed to an increase in assets of $848 million more than expected on a solvency basis. The balance of the variation in the solvency surplus results from the net effect of all other factors including a gain due to the $96 million solvency contribution made by Air Canada in 2015 and some decreases resulting from the change in actuarial assumptions used for the solvency valuation and other factors such as demographics.

The improvement in solvency ratio between January 1, 2015 and January 1, 2016 varies by plan depending on plan specific factors such as the demographic characteristics of each group and the different level of required contributions made to the plans in 2015.

Going-Concern Position by Plan

As indicated above, as at January 1, 2016, the plans had sufficient assets to cover the full value of the pension promised to plan members had the plans been terminated on that date. A "going-concern" valuation provides the financial position of the plans on the basis of Air Canada continuing to operate and maintaining its pension plans indefinitely.

The consolidated financial position of the plans on a going-concern basis evolved from a surplus of $2,039 million (116% funded ratio) as at January 1, 2015 to a surplus of $3,029 million (124% funded ratio) one year later. In other words, on the basis of Air Canada continuing to operate and maintaining its pension plans indefinitely, the plan assets at January 1, 2016 exceed by $3 billion the amount that will be required to pay all the pension entitlements accrued by all current members. The results by plan are as follows:

(in $ millions**)**

	At January 1, 2016	
Plan	**Funded Ratio**	**Going-concern Surplus**
Crew Schedulers and CSS Agents	124%	366
TMOS, Clerical and Finance	124%	937
CUPE Represented Employees	126%	520
Dispatchers	116%	10
Management & ATS	120%	324
Executives	128%	12
AC Pilots	122%	529
CAIL Pilots	127%	331
Total	**124%**	**3,029**

The improvement in the going-concern financial position is again mainly due to favorable investment returns.

CONTRIBUTIONS

2015 Contributions

In 2015, Air Canada contributed $96 million for past service and $121 million for current service for a total contribution of $217 million to all plans combined. Employees contributed a total of $78 million to the plans.

2016 Contributions

Employees will contribute approximately $76 million to the plans in 2016. Employee contributions are determined by a fixed formula and do not depend on the financial situation of the plans. Whether the plans are in a surplus or deficit position, employees contribute the same percentage of their salary.

Air Canada contributions depend on the financial situation of each plan in accordance with the *Pension Benefits Standards Act, 1985* and the *Income Tax Act*. Since all pension plans are in a surplus position as at January 1, 2016, both on a solvency and going-concern basis, no employer contributions are required or permitted for past service for 2016. For current service, based on restrictions in the Income Tax Act, contributions are either required, optional or not permitted depending on the solvency ratio and funded ratio as follows:

Rule to determine employer current service contributions – Categories	**Plans in that category as at January 1, 2016**
Contributions are required for pension plans with a solvency ratio of less than 105%	• Dispatchers
Contributions are optional for pension plans with a solvency ratio of 105% or more and a funded ratio between 100% and 125%	• Crew Schedulers and CSS Agents • TMOS, Clerical and Finance • Management & ATS • AC Pilots
Contributions are not permitted for pension plans with a solvency ratio of 105% or more and a funded ratio of 125% or more	• CUPE • Executives • CAIL Pilots

As a result, employer contributions for current service are only required to be made in 2016 to the Air Canada Pension Plan – Dispatchers in the amount of approximately $1 million. For other plans, employer contributions are either optional or not permitted. In order to treat all plans funded over 105% the same, Air Canada has elected not to make any contributions for 2016 to the plans for which contributions are not required. It represents a savings of approximately $144 million for the year 2016.

Future Company contributions will be dependent on future actuarial valuations.

INVESTMENT STRATEGY

No significant changes were made to the pension investment strategy in 2015. The portion of plan liabilities immunized against the interest rate risk remains at 75%. This means that 75% of the assets will increase (or decrease) in value in direct proportion to increases (or decreases) in the plan liabilities when long-term interest rates change. Long-term interest rates are the risk factor that has the most negatively impacted the pension plans in the past.

Air Canada's objective is to continue to increase the level of immunization to reduce the risk further, subject to favourable market conditions. However, Air Canada plans to retain assets invested in equities and alternative investments in order to maintain its total pension cost at an acceptable level.

With the new investment strategy implemented after 2009, Air Canada reduced its pension risk by approximately 50% compared to the investment strategy in place before 2009. The table below illustrates the sensitivity of solvency surplus to returns on plan assets and decreases in long-term interest rates under the new investment strategy compared to a more traditional asset portfolio (similar to the one in place prior to 2009, which consisted in 60% equities and 40% bonds):

Factor	Scenario	Impact on Solvency Surplus	
		New Pension Investment Strategy	Previous Pension Investment Strategy
Return on equities and alternative investments	Return of 10% less than the interest rate used to determine the liabilities	Decline of $690 million	Decline of $1,030 million
Interest rate used to determine the liabilities	Interest rate drops by 1%	Decline of $460 million	Decline of $1,590 million
Impact of the combined scenario		Decline of $1,150 million	Decline of $2,620 million

As illustrated above, if interest (currently at historically low) rates were to drop by 1% and return on equities and alternative investments were 10% lower than the rate used to determine the liabilities, the surplus would decrease by approximately $1,150 million (= $690 million + $460 million), which still would have left the plans with a modest surplus based on the latest valuations. Under the former investment strategy, this same unfavorable scenario would have resulted in a $2,620 million decline in the aggregate solvency surplus. It should be noted that the opposite scenario also holds true; that is, a 1% increase in interest rates and a return on equities and alternative investments 10% higher than expected, would increase the solvency surplus by a similar amount.

CONCLUSION

We are very proud of the financial situation of our defined benefit pension plans. It is a result of employees' and the Company's efforts to realign the plans in the right direction. Of course, we continue to closely monitor the financial position of our pension plans.

The Company's decision to not make a current service payment for 2016 is consistent with its plans and strategy which is bearing fruit. With the plans in good financial health, the Company is able to further invest in Air Canada's future. For example, a savings of current service costs of $144 million is equivalent to adding another Dreamliner to the fleet to expand Air Canada's international network or to adding several narrow-body aircraft to provide feed to Air Canada's major hubs. This, along with other key strategic initiatives, is allowing the Company to execute on its business strategy which is aimed at achieving sustained profitability which, in turn, benefits all Air Canada stakeholders in the long term.