AIR CANADA

# 2016 PENSION UPDATE ON AIR CANADA'S CANADIAN PENSION PLANS

## THIS DOCUMENT PROVIDES AN OVERVIEW OF AIR CANADA'S PENSION PROGRAMS FOR EMPLOYEES BASED IN CANADA, BOTH IN TERMS OF DEMOGRAPHIC DATA AND FINANCIAL SITUATION.

AS AT JANUARY 1, 2017...

- For all plans combined:
  - **$ 18.2 BILLION OF PENSION ASSETS**
  - **26,650 ACTIVE MEMBERS** and **31,025 INACTIVE MEMBERS**
  - All defined benefit (DB) plans in a **SURPLUS POSITION**, with a solvency ratio of 111.7 % and a going-concern funded ratio of 131 %
- Given the level of surplus, **NO CONTRIBUTIONS ARE PERMITTED BY AIR CANADA INTO ANY OF ITS DB PLANS FOR THE YEAR 2017**
  - Most employees participate in a DB plan, but the number of employees in other types of plans is growing rapidly

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# RETIREMENT PROGRAMS' STRUCTURE

Air Canada's retirement program structure contains numerous pension plans.
Amongst these plans, there are different types of arrangements, namely:

DB

## DEFINED BENEFIT PLANS

DB plans provide a monthly pension at retirement.
The pension amount at retirement will usually be calculated using a predetermined formula – commonly based on a percentage of salary, multiplied by the number of years of participation in the plan.

DC

## DEFINED CONTRIBUTION PLANS

DC plans provide pension savings at retirement, similarly to registered retirement savings plans (RRSP). The pay-out will be based, amongst other factors, on contributions made to the plan by the employee and the employer during years of participation, as well as potential investment returns on those contributions.

COMBINATION

## COMBINATION PLANS

Some of our DB and DC Plans are combined into a single plan which provide a DB component for some members and a DC component for other members.

HYBRID

## HYBRID PLANS

Hybrid plans are made up of both a DB and a DC component for the same member.

MEPP

## MULTI-EMPLOYER PENSION PLANS

MEPPs combine employees from several employers and provide a pension calculated using a pre-determined formula that can be adjusted, up or down, depending on the financial situation of the plan. These are usually administered by a third party.

Air Canada is the administrator of all pension plans for all its employees, except for the IAM MEPP. Air Canada contributes to the MEPP for IAM represented employees who participate in that plan, but it does not handle its administration.

## WHICH PLAN ARE YOU IN?

The plan you are in is determined by your employee group and date of hire.

Use the below table if you are not sure of your plan's name and type of arrangement.

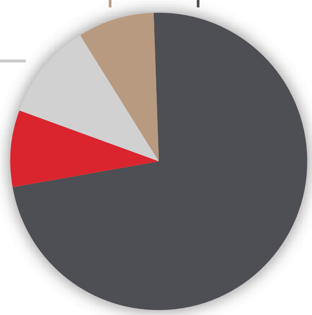
| PILOTS | |
|---|---|
| Hired before August 1, 2012 | Hired since August 1, 2012 |
| **DB** • Air Canada Pension Plan – Pilots | **DC** • Air Canada Defined Contribution Pension Plan for Pilots |
| **DISPATCHERS** | |
| Hired before February 21, 2012 | Hired since February 21, 2012 |
| **DB** • Air Canada Pension Plan – Dispatchers | **DC** • Air Canada Pension Plan – Dispatchers |
| **FLIGHT ATTENDANTS** | |
| Hired before November 7, 2011 | Hired since November 7, 2011 |
| **DB** • Air Canada CUPE Represented Employees Pension Plan | **HYBRID** • Air Canada CUPE Represented Employees Pension Plan |
| **CREW SCHEDULERS & CUSTOMER SERVICE AGENTS** | |
| Customer Service Agents hired before June 27, 2011 | Customer Service Agents hired since June 27, 2011 |
| Crew Schedulers (Flight Operations) hired before February 17, 2012 | Crew Schedulers (Flight Operations) hired since February 17, 2012 |
| Crew Schedulers (In Flight) hired before February 15, 2012 | (Crew Schedulers – In Flight) hired since February 15, 2012 |
| **DB** • Air Canada Pension Plan – Crew Schedulers and CSS Agents | **HYBRID** • Air Canada Pension Plan – Crew Schedulers and CSS Agents |
| **TMOS, FINANCE AND CLERICAL EMPLOYEES** | |
| TMOS hired before June 17, 2012 | TMOS hired since June 17, 2012 |
| Finance employees hired before October 11, 2012 | Finance employees hired since October 11, 2012 |
| Clerical employees hired before October 19, 2012 | Clerical employees hired since October 19, 2012 |
| **DB** • Air Canada Pension Plan – TMOS, Clerical and Finance Employees | **MEPP** • IAM Multi-Employer Pension Plan |
| **MANAGEMENT & ATS** | |
| Hired before January 1, 2005 | Hired since January 1, 2005 |
| **DB** • Air Canada Pension Plan – Management & ATS employees | **DC** • Air Canada Pension Plan – Management & ATS employees |
| **EXECUTIVES** | |
| Hired before October 1, 2012 | Hired since October 1, 2012 |
| **DB** • Air Canada Executive Pension Plan | **DC** • Air Canada Executive Pension Plan |

Employees covered by a DB, DC and/or hybrid arrangement may participate in the same pension plan (i.e. Combination Plan). This is why the name of the plan for some employee groups is the same for different types of arrangement (i.e. the plan has two components).

# RETIREMENT PROGRAMS' MEMBERSHIP at a glance

As at January 1, 2017, there were **26,650 active members** in Air Canada's pension plans. The chart below provides a breakdown of members per type of arrangement.

## MEMBERSHIP PER TYPE OF ARRANGEMENT (active members)




+ 28,006 pensioners & survivors in receipt of a monthly pension

+ 3,019 members entitled to a deferred pension

= 50,396 members

## MEMBERS' "AVERAGE" PROFILE per type of pension arrangement

### DB PLAN

**ACTIVE MEMBERS**

18.2 years of service

AGE 49.4

**PENSIONERS AND SURVIVORS**

AGE 72.2

Average yearly pension paid in 2017 **$25,600**

**DID YOU KNOW?** In 2016, the total amount paid in pensions was $716,943,000

### DC PLAN

3.9 years of service

AGE 40.2

### HYBRID PLAN

2 years of service

AGE 31.8

### MEPP PLAN

1.8 years of service

AGE 34.5

# RETIREMENT PROGRAMS' FINANCIAL SITUATION at a glance

| MARKET VALUE OF ASSETS PER TYPE OF PLANS AS AT DECEMBER 31, 2016 | |
|---|---|
| **DB PLANS** (including DB component of Combination Plans or Hybrid Plans) | **$ 18.1 BILLION** |
| **DC PLANS** (including DC component of Combination Plans or Hybrid Plans) | **$ 75 MILLION** |

## OVERVIEW OF PLANS' HEALTH as at January 1, 2017

### DB PLANS (including DB components of Combination or Hybrid Plans)

**ACTUARIAL VALUATION**

All pension plans are in a surplus position on January 1, 2017, both on a solvency and going-concern basis.

The following table compares the financial position, on a **solvency basis**, of each plan as at January 1, 2017 with its financial position as at January 1, 2016. Between the two valuation dates, the surplus increased in all plans, which were all funded at 105% or more with a combined solvency surplus of $1.9 billion.

| | AT JANUARY 1, 2017 | | AT JANUARY 1, 2016 | |
|---|---|---|---|---|
| DB PLANS | **Solvency Ratio** | Solvency Surplus (in $ million) | **Solvency Ratio** | Solvency Surplus (in $ million) |
| Crew Schedulers and CSS Agents | 111% | 211 | 108% | 155 |
| TMOS, Clerical and Finance | 112% | 591 | 109% | 447 |
| CUPE Represented Employees | 112% | 314 | 108% | 213 |
| Dispatchers | 106% | 5 | 104% | 3 |
| Management & ATS | 113% | 250 | 109% | 172 |
| Executives | 114% | 8 | 110% | 5 |
| Pilots* | 111% | 513 | 108% | 350 |
| **TOTAL** | **111.7%** | **1,892** | **108.5%** | **1,345** |

**Reflects the merger of the two pilots plans as at January 1, 2016*

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Actuarial valuation

Every year, actuaries determine if there are sufficient assets in the plan in order to pay promised pensions (actuarial valuation methods include "going-concern basis" and "solvency basis"). Based on the actuarial valuation results, a DB plan will be in a surplus or a deficit position.

Solvency basis

Valuation method which shows if the plan would have sufficient assets to pay promised pensions, assuming the plan would be terminated on the valuation date.

Solvency ratio

A ratio of 100% or more means that plan assets would be sufficient to cover the full value of the pensions promised to plan members on a solvency basis.

The following table compares the financial position, on a **going-concern basis**, of each plan as at January 1, 2017 with its financial position as at January 1, 2016. The surplus increased in all plans between the two valuation dates and all plans are funded at 125% or more with a combined going-concern surplus of $4 billion.

| | AT JANUARY 1, 2017 | | AT JANUARY 1, 2016 | |
|---|---|---|---|---|
| DB PLANS | **Funded Ratio** | Going-concern Surplus (in $ million) | **Funded Ratio** | Going-concern Surplus (in $ million) |
| Crew Schedulers and CSS Agents | 132% | 483 | 125% | 366 |
| TMOS, Clerical and Finance | 133% | 1,266 | 124% | 937 |
| CUPE Represented Employees | 131% | 661 | 126% | 520 |
| Dispatchers | 126% | 17 | 116% | 10 |
| Management & ATS | 128% | 455 | 120% | 324 |
| Executives | 136% | 15 | 128% | 12 |
| Pilots* | 130% | 1,138 | 124% | 860 |
| **TOTAL** | **131%** | **4,035** | **124%** | **3,029** |

**Reflects the merger of the two pilots plans as at January 1, 2016*

Going-concern basis

Valuation method which shows if the plan would have sufficient assets to pay promised pensions, assuming Air Canada continues to operate and the plan would be maintained indefinitely.

Funded ratio

A ratio of 100% or more means that plan assets would be sufficient to cover the full value of the pensions promised to plan members on a going-concern basis.

**THE IMPROVEMENT IN THE FINANCIAL POSITION OF THE DB PLANS IN 2016, ON BOTH A SOLVENCY AND GOING-CONCERN BASES, IS MAINLY THE RESULT OF A GOOD INVESTMENT RETURN.**

## DC PLANS (including DC components of Combination or Hybrid Plans)

Employees who participate in a DC plan (or DC component of a Combination Plan or Hybrid Plan) have an individual DC account in which the employee's and the employer's contributions are deposited. The amount of an employee's DC account depends on the rate of contributions selected by the employee and the potential return on invested contributions. The potential investment return depends on the funds selected by the employee. Thus, the return (or loss) for each individual account is different.

### CONTRIBUTIONS TO MATCH

Member contributions generate an employer matching contribution, up to a certain level. The employer match % and maximum contribution vary by plan. For all DC plans and DC components combined, in 2016, 38% of members contributed enough to maximize the employer match.

## EMPLOYER CONTRIBUTIONS

### DB PLANS (including DB components of Combination or Hybrid Plans)

Air Canada's required contributions depend on the results of the actuarial valuation, and are subject to applicable legislation.

- When a plan is in a surplus position on both solvency and going-concern bases, **past service contributions** are not permitted.
- **Current service contributions** are not required for plans funded at 105% or more on a solvency basis and 100% or more on a going-concern basis. In addition, current service contributions are not permitted for plans funded at 105% or more on a solvency basis and funded at 125% or more on a going-concern basis.
- Combination Plans include both a DB and a DC component. As permitted by legislation and applicable plan rules, the surplus in the DB component of such plan is used to cover the employer contributions to the DC component of the plan.

Based on the above, for 2016, Air Canada contributed to the *Air Canada Pension Plan – Dispatchers* (in the amount of $1M). Indeed, this plan was the only one funded at less than 105% on a solvency basis. For other plans, Air Canada used $155M of the surplus in the DB plans to fund the current service cost in the DB plans ($151M) and to contribute to the DC component of certain plans ($4M).

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Past service contributions

Employer contributions that are required to repay any deficit in the plan.

Current service contributions

Employer contributions that cover the cost of granting one additional year of service in the plan.

Note that, despite the fact that Air Canada only contributed to the Dispatchers' plan for 2016, all plans remain in a surplus position as at January 1, 2017. Indeed, all plans are funded at 105% or more on a solvency basis and at 125% or more on a going-concern basis. Based on these results, Air Canada is not permitted to make any contribution to any DB plan (or DB component of a Combination Plan or Hybrid Plan) for 2017. This represents an amount of approximately $158 million for the year 2017.

### DC PLANS (including DC components of Combination or Hybrid Plans)

Air Canada's required contributions are determined based on a fixed percentage of each member's contributions, which varies by plan.

In 2016, Air Canada contributed $9.3M to these plans, of which $4.9M was paid from general revenues and $4.4M was paid using the surpluses available in the DB components of applicable plans.

The Air Canada contributions required in 2017 are estimated at $11M, of which approximately $3M will be paid from general revenues and approximately $8M using DB plans' surpluses.

### MEPP

Air Canada's required contributions are determined based on a fixed percentage of each member's salary. In 2016, Air Canada contributed $3.6M to that Plan and the estimated amount for 2017 is $4.7M.

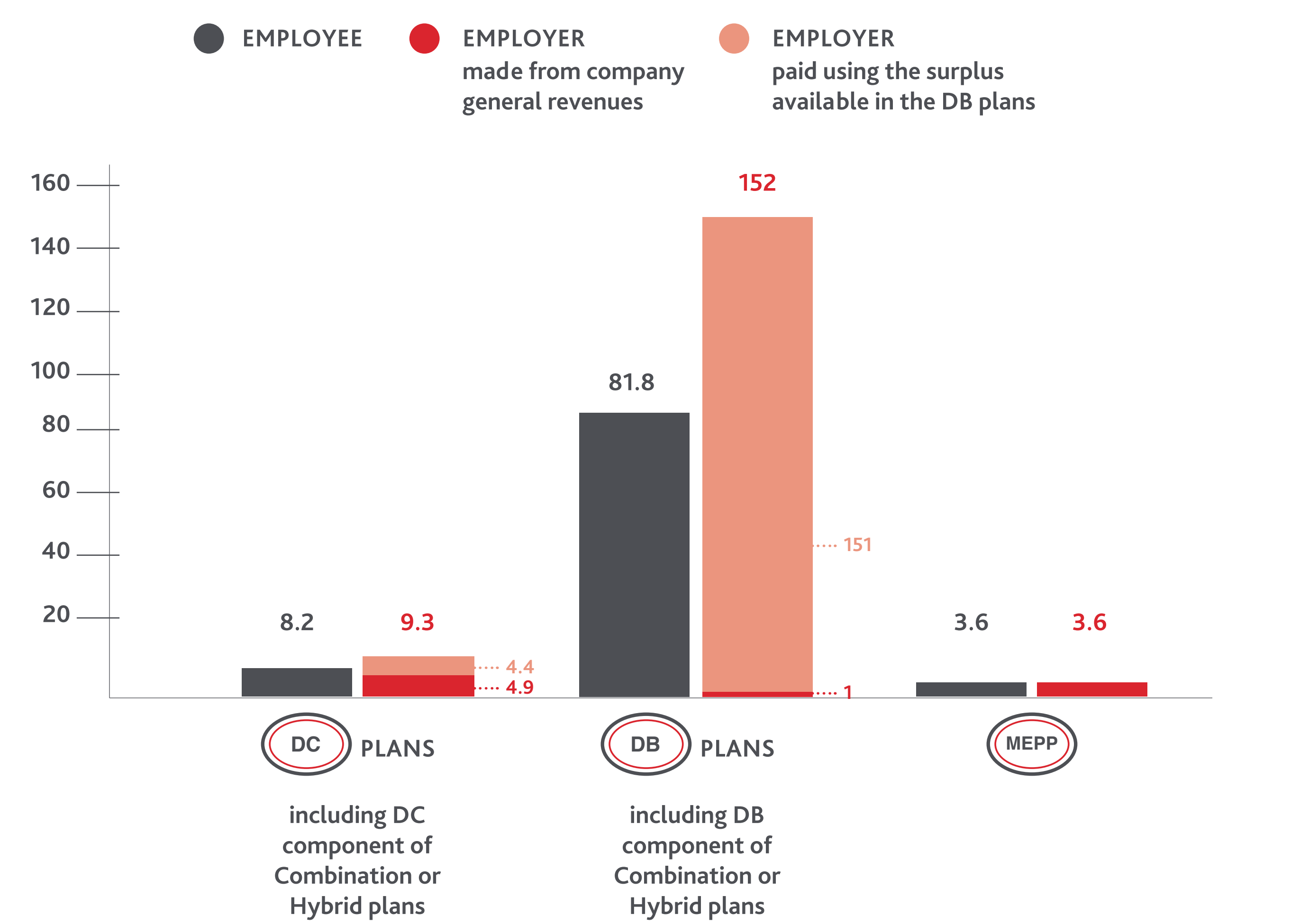
## EMPLOYEE CONTRIBUTIONS

ALL TYPES OF ARRANGEMENT

DB DC COMBINATION HYBRID MEPP

- Employee required contributions are determined based on a fixed percentage of each member's salary, which varies by plan.
- In 2016, employees contributed a total of $94M to all plans combined.
- Refer to the graphic below for the breakdown between employee and employer contributions by type of pension arrangement.

### 2016 CONTRIBUTIONS (in M$) PER TYPE OF ARRANGEMENT



# RETIREMENT PROGRAMS' INVESTMENTS

A team of 40 professionals working at Air Canada in the pension investment division (ACPI) is responsible for the investment of pension plan assets. Based on the investment strategy and policies approved by the Pension Committee of the Board of Air Canada, ACPI selects the investments for the DB plans. ACPI also selects and oversees the periodic monitoring of the funds offered in the DC plans. While most of the assets in the DB plans are managed internally, ACPI relies on some external managers and experts to help them fulfilling their mandate. They also ensure that the assets are invested in accordance with applicable legislation.

## DB PLANS (including DB components of Combination or Hybrid Plans)

In the DB plans, the investment decisions are made by Air Canada, based on the Investment Policy in place. In 2016, the return on DB plan assets was **9.4%** (net of fees).

## INVESTMENT POLICY

In 2009, Air Canada implemented a new investment strategy to help reduce the risk it is facing with its pension plans. By improving the alignment between assets and **liabilities**, Air Canada reduced its pension risk by approximately 50% compared to the investment strategy in place before 2009.

The current investment strategy, to which no significant changes were made in 2016, can be split in two components as illustrated below:

- the 'Liability Hedging Portfolio', which is made up of bonds
  - **objective** is to mimic the behaviour of the pension liabilities which are very sensitive to movements in long-term Canadian interest rates, and therefore generate a return that is tied to liabilities
- the 'Return Seeking Portfolio', which is made up of equities and alternative investments (such as Real Estate, Private Debt and Infrastructure)
  - **objective** is to generate extra return to keep pension costs at an acceptable level.

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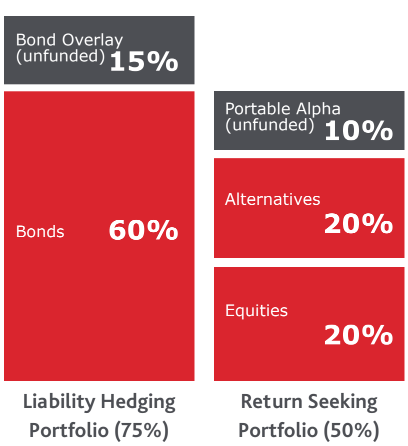
Liabilities

Represent the value of pension benefits promised to plan members




The asset mix adds up to more than 100%, since it includes the following unfunded programs:

- Bond Overlay program (strategy that increases the exposure to bonds)
- Portable Alpha program (strategy that invests in areas that have little to no correlation with the market)

The unfunded nature of these programs mean that the exposure is obtained with derivative instruments, and that the return obtained on these programs is added to (or subtracted from) the return of the funded assets.

## DC PLANS (including DC components of Combination or Hybrid Plans)

In the DC plans, investment decisions are made by plan members from the funds selected by Air Canada. Members have the choice to invest in **target-date funds** (TDF), or to build their own portfolio. In the absence of a Member's investment choice, contributions are allocated by default to the moderate TDF.

Air Canada offers three sets of target date funds, according to the investor's style: **CONSERVATIVE, MODERATE OR DYNAMIC.**

**AS AT JANUARY 1, 2017:**

- **72%** of DC assets were invested in target date funds (TDFs)
  Note: 44% of assets are invested by default in Moderate TDFs (no choice made by members)
- **28%** of DC assets were invested in speciality funds, meaning members elected the "Build your own portfolio" approach.

Target-date fund (TDF)

It is a fund made up of some funds offered in the "Build your own portfolio" option and based on the expected participant's date of retirement. As the participant gets closer to retirement, the asset mix of his TDF becomes more conservative, without any action required from the participant.

**INVESTMENT RETURNS PER FUND AS AT DECEMBER 31, 2016**

| Fund | 1-year return | 5-year return | Fees |
|---|---|---|---|
| **SAMPLE OF TARGET DATE FUNDS** | | | |
| 30 years to retirement - Conservative Portfolio (1) | 8.9% | n/a | 0.579% |
| 30 years to retirement - Moderate Portfolio (1) | 8.9% | n/a | 0.579% |
| 30 years to retirement - Dynamic Portfolio (1) | 9.3% | n/a | 0.601% |
| **FUNDS OFFERED IN THE "BUILD YOUR OWN PORTFOLIO" OPTION** | | | |
| Manulife 5 Year Guaranteed Interest Account | 1.8% | n/a | 0.00% |
| Manulife Canadian Money Market Fund | 0.9% | 1.2% | 0.1% |
| Manulife Asset Management Canadian Bond Index Fund | 1.7% | 3.2% | 0.1% |
| Manulife BlackRock Long Bond Index Fund | 2.4% | 3.9% | 0.2% |
| Manulife SSGA WindWise Canadian Fundamental Equity Fund II | 21.8% | 9.2% | 0.615% |
| Manulife FGP Small Cap Canadian Equity Fund | 22.6% | 11.4% | 0.345% |
| Manulife BlackRock U.S. Equity Index Fund | 8.1% | 21.1% | 0.2% |
| Manulife BlackRock International Equity Index Fund | -2.3% | 12.8% | 0.27% |
| Manulife JP Morgan Emerging Markets Fund | 11.7% | 8.3% | 1.14% |
| Manulife Global Enhanced Equity Fund (AQR) | 2.2% | n/a | 0.61% |

(1) *It represents the return and fees for 2016 of a TDF for a 35 year old participant who is expecting to retire at age 65.*

AIR CANADA