Mr. Amon G. Carter

AMERICAN AIRLINES, INC.

New York

August 6, 1951

Members of the Finance Committee
American Airlines, Inc.

Attached is a summary of the present retirement pension plan of American Airlines together with the methods presently employed in funding this plan and suggested revisions in the funding of the plan which has been prepared by Geoffrey N. Calvert, a consulting actuary whom we have retained for the presentation of this study.

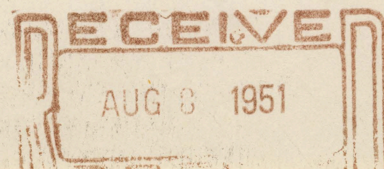
Should there be any questions which you would like to have answered, please do not hesitate to call upon me for I can get for you as much additional information as you may think will be helpful in studying out the pros and cons of the suggested plan of funding.

It is my understanding Mr. C. R. Smith wishes to have this subject reviewed at the meeting of the Finance Committee to be called for the morning of September 19th prior to the Directors Meeting.

Bill

Wm. J. Hogan

Encl.



AMERICAN AIRLINES, INC.

REVISION OF PENSION FUNDING ARRANGEMENTS

The Retirement Benefit Plan of American Airlines provides for benefits and employee contributions as follows:

	Pilots and Co-pilots	Other Males	Females
Retirement age	60	65	60
Employee Contributions:			
Based on First $600 of annual pay	Nil	Nil	Nil
Based on Next $1800 of annual pay	6%	3%	3%
Based on Excess over $2400	6%	4%	4%
Future Service Benefit: For each year of service since entry into Plan:			
* Based on First $600 of annual pay	1.2%	1%	1%
Based on Next $1800 of annual pay	1.2%	1%	1%
Based on Excess over $2400	1.2%	1%	1%
Past Service Benefit: For each year of service prior to entry into Plan, and based on pay as of Dec. 31, 1941:-			
If under $10,000	2/3%	3/4%	3/4%
If over $10,000	2/3%	1/2%	1/2%

(Maximum Annuity: $10,000 annually)

* Note: Benefits based on the first $600 of Annual Pay, and on past service, were not definitely committed under the Plan at the outset. Since then, the funding of past service benefits has been almost completed, but not that related to the first $600 of pay.

The Plan has so far been funded on a rigid group annuity basis, under which the amount of each year's deposit is determined by the insurance company (the John Hancock). Under this system, no latitude exists as to the choice of calculation method. The "entry age normal and supplemental" method of calculation (which is of maximum tax advantage) cannot be used. Turnover rates cannot

be introduced. No recognition can be given for future salary increases.

It is important to notice that these funding arrangements can be changed, without departing from the basic idea of an insured plan, to what is known as a "deposit administration" plan, under which the employer determines each year how much to place in the fund.

The present improved earnings of American Airlines, and increased tax rates, indicate that such a change would be particularly advantageous.

No suggestion is being made at this time for any increase or change in the above benefits. However, an increase in the amount paid toward the cost of the present benefits would be advantageous since:

(a) An increase in deposits, while profits are favorable, will create a cushion which will provide the basis for relief, if it is desired temporarily to make smaller deposits at some time in the future.

(b) An increase in deposits at a time when taxes are abnormally high will reduce the overall cost of the Plan, since tax credit is obtainable on deposits toward the Plan.

As pointed out above, the existing arrangement is not only rigid as to annual payments, but does not provide for the funding of all of the accruing benefits.

In the year 1947, the net cost of the Plan to American Airlines was some $468,000. Subsequent (and projected) annual costs are as follows:

Year	Cost
1948	$556,000
1949	591,000
1950	665,000
1951	708,000 *
1952	751,000 *
1955	891,000 *
1958	1,013,000 *

*Estimated

As compared with the figure of $708,000 shown above for the year 1951, we have made an actuarial cost calculation (on the basis of 1950 statistics) which shows that the maximum annual deposit for which tax credit can be secured at the present time is approximately $1,380,000, if all parts of the accruing benefits were funded.

One of the major determinants of the long-run cost of the Retirement Plan is the interest yield earned on the Fund. The fund of the John Hancock is currently earning approximately 3.07% annually. Premiums are calculated on a 2-1/2% interest basis, the surplus earnings over this rate going into a surplus account to the credit of American Airlines.

It can be shown that an increase of 1/2% in the interest earnings of a pension Fund will cut down the long-run costs of the Plan by as much as 12%. For this reason many pension funds are employing equities as a part of the total portfolio. The use of an insurance policy prevents advantage being taken of this method of investment. Further, there are better prospects of offsetting a contimued inflationary trend if a portion of the Fund is invested in equities.

On the other hand, there are strong arguments both for maintaining the existing John Hancock certificates in the hands of employees, so as not to risk arousing employee reactions as to any possible change in funding arrangements. Further, there is an advantage in having retired employees carried for the remainder of their lives by a substantial insurance company which is completely independent of American Airlines.

With these considerations in mind, we have made an analysis of seven alternative methods of overhauling the present funding arrangements. As a result of this examination, it would appear that the following will provide the maximum of advantage:

(a) Establish a Trust Fund liable for all obligations of the Plan, <u>except</u> insofar as funded by an insurance policy or policies.

(b) Convert the existing group annuity policy to a "deposit administration" policy, retaining the John Hancock as the carrier for this purpose.

All pensions would continue to be paid by the present insurance carrier. Deposits made with the trustee would be for the purpose of investment only. When the Trust Fund has grown to the required size in relation to the insurance fund, all interest earnings would flow to the insurance carrier in reduction of deposits otherwise necessary to maintain benefits.

Records of individual members would be maintained by American Airlines, thus avoiding the present duplication as between American Airlines and the John Hancock. There would be no penalties connected either with termination of the old group annuity plan or for individual terminations of employment, as would otherwise be the case.

This arrangement will enable the maximum deposit allowable by Treasury under any system to be made in the current fiscal year. It will permit the maximum possible range of flexibility, in case of necessity. It will enable all benefits now being funded with the John Hancock to continue to be funded with the Hancock, and hence will involve a minimum of disturbance to the understanding which employees now have of the funding arrangements.

It will permit the certificates in the hands of employees to be retained by them, although an innocuous rider to these certificates will be issued by the John Hancock. Newly entering employees will receive a certificate very similar to the dertificates now held. Pensions to retiring employees will remain an obligation of the John Hancock.

With regard to the trusteed portion of the total funds, it can be arranged that 35% (or some similar proportion) of the total funds will be held by the Trustee, the major portion of which would be carefully invested in equities, thus raising the yield of the over-all funds by a substantial margin, and reducing the ultimate costs of the Plan.

All of the foregoing arrangements have been discussed with the John Hancock. They have also been discussed in principle with the actuary attached to the Bureau of Internal Revenue in Washington. These discussions have indicated that the whole of the deposits contemplated under these arrangements would be deductible for tax purposes.

In agreeing to leave the certificates in the hands of employees and issue fresh certificates to new entrants, the John Hancock have made a definite concession, in consideration of which it is understood that the funding would be maintained at at least as high a level as if the present group annuity plan had continued in force.

In selecting the Bank to handle the trusteed funds, we would suggest that great care be taken in selecting a Bank that has had a successful record particularly in the utilization of equities, as there are only a few which have an outstanding record.

ALEXANDER & ALEXANDER, INC.

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Consulting Actuary.