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DB Plan Weighs Heavily on American Airlines

By Matt Gunn December 7, 2011

If history is any indication, the future of American Airlines' defined benefit pension plan could be in jeopardy as a result of parent company AMR Corp.'s Nov. 29 Chapter 11 reorganization filing, experts say. If so, it could mean big changes for asset managers as well.

But while the airline might try to terminate its pension as part of a larger reorganization, it might run into pressure from stakeholders and the **Pension Benefit Guaranty Corp.**, the government agency that oversees the distribution of benefits of defined benefit plans terminated under distress.

American is the last of the so-called legacy carriers – airlines founded prior to deregulation – to file for bankruptcy. But unlike those other legacy carriers, such as United Continental, US Airways and Delta Air Lines, which terminated pensions as part of reorganization, American still has four active DB plans.

Historically, the legacy airlines that have previously entered bankruptcy have ultimately emerged without an active DB plan.

"Pensions have been one of the major causes that have put the legacy airlines into bankruptcy," says **Stephen Selbst**, a bankruptcy attorney at Herrick, Feinstein. "All of the airlines that had a DB plan have had the same fate."

American's combined \$8.3 billion in DB assets – which is to cover about \$18.5 billion in benefits – comprises the largest portion of the airline's debt.

"They've got a big pension relative to the rest of their finances," says **Jon Waite**, director of investment management advice for SEI's institutional investors group. "In addition, their main competition does not have big pensions or any pensions relative to the rest of their operations. From a competitive perspective, it puts them, I would guess, in a more difficult position."

From that standpoint, Waite says, it may not be enough for American to simply freeze its DB plans, as the airline would still be responsible for those benefit obligations. Bearing that in mind, the airline would negotiate the termination of its plans, ultimately handing off the assets and liabilities to PBCG. Such a handoff would also have implications for the managers overseeing American's DB plan, such as **American Beacon Advisors**.

"All those managers, say American Beacon or whoever is managing the assets will at some point lose those assets under management," Waite says. "PBCG does use external managers, but ultimately make the asset allocation decisions

internally and effectively have their own resources.”

American Airlines declined to say exactly what role the pensions play in its bankruptcy, though it has stressed the fact that its personnel costs are higher than those of the legacy airlines it considers to be its direct competitors.

“The company’s Chapter 11 reorganization doesn’t mean that the pension would be terminated, even though that’s a possible outcome,” says an airline spokesman. “As you probably know, the company spends more on them than our competitors do on their plans.”

Under Chapter 11, American has 18 months to establish a new business plan. During that time, it will be business as usual for the airline, though anything out of the ordinary, such as selling off assets, has to be approved by the courts, Selbst says, adding that the general trend is to establish a plan and move forward on a resolution as quickly as possible.

“The trend in bankruptcy these days – both in pre-negotiated and non-traditional – is to try and do them faster,” he says. “It’s hard to say how quickly American will move, but it will know that the clock is ticking.”

While it’s unclear exactly how things will shake out for American’s pensions, it might not be as simple as the airline passing the liabilities off to PBCG, SEI’s Waite says.

“The PBCG is taking a more aggressive stance toward pushing back and forcing the bankruptcy court to take into consideration whether the corporation can take all or some of the responsibility of those plans,” he says. “Don’t expect that the PBCG will willingly take these over at the first go.”

The PBCG already has said that the burden of taking on American Airlines’ DB liabilities would put a strain on the agency.

“If American Airlines were to end their plans, the agency would be responsible for paying about \$17 billion in benefits; about \$1 billion in benefits would be lost,” PBCG director **Josh Gotbaum** said in a statement soon after AMR announced its bankruptcy. “A termination would also weaken the financial condition of PBGC, which has a record \$26 billion deficit as a result of failed plans the agency has already assumed.”

American Airlines’ bankruptcy could have an impact on the industry in any event.

“From the industry perspective, it’s not a good thing because there’s one less potential client out there,” Waite says. “So I hate to see that. But my initial thought when I saw the AMR bankruptcy was how much the pension has contributed to this, because it was big.”

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