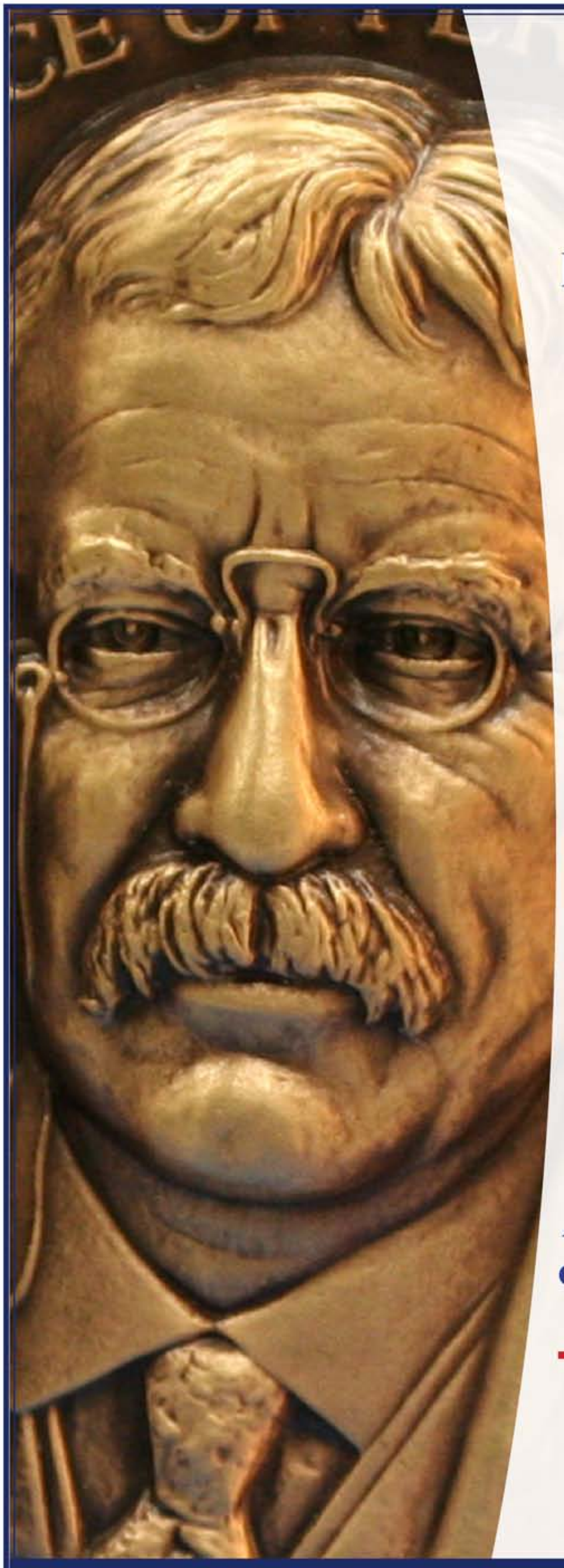

U.S. OFFICE OF
PERSONNEL MANAGEMENT

OFFICE OF THE INSPECTOR GENERAL

A Study of the Risks and Consequences of the USPS OIG's Proposals to Change USPS's Funding of Retiree Benefits

Shifting Costs from USPS Ratepayers to Taxpayers

FEBRUARY 28, 2011

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EXECUTIVE SUMMARY

A Study of the Risks and Consequences of the USPS OIG's Proposals to Change USPS's Funding of Retiree Benefits

Shifting Costs from USPS Ratepayers to Taxpayers

One of the principal responsibilities of the U.S. Office of Personnel Management (OPM) is the administration of the benefits programs for Federal civilian employees and retirees. As part of that duty, it manages and oversees the Civil Service Retirement and Disability (CSRD) Fund, the Postal Service Retiree Health Benefits (PSRHB) Fund, and the Employees Health Benefits (EHB) Fund.

The United States Postal Service (USPS) was established in 1971, replacing the former U.S. Post Office Department (POD). Unlike its predecessor, the USPS is an independent establishment of the Executive Branch rather than a Federal agency. This decision to transform the POD was influenced by the fact that it offered what were essentially commercial services and thus could be expected to produce the revenues to cover its own costs rather than relying upon annual Government appropriations.

In 2009 and 2010, the USPS Office of Inspector General (USPS OIG) issued a series of reports containing proposals that would reduce, modify, or eliminate the legally-mandated payments that the USPS currently makes into the OPM-administered trust funds. These reports make the general argument that the basic goal of each of these proposals is two-fold: (1) to remedy an alleged inequity in the current method by which the USPS funds its retiree obligations (both annuity and retiree health benefits) and (2) to obtain operating capital for the USPS, at least on a temporary basis.

The USPS OIG's Proposal

Proposal 1: Treatment of FERS Surplus. This proposal would change the law regarding an agency's (in this case, the USPS's) contributions to the CSRD Fund made under the Federal Employees Retirement System (FERS) so that when the agency has paid an amount in excess of its current liabilities, it may either receive a rebate or be excused from making contributions until the excess is exhausted.

EXECUTIVE SUMMARY

Proposal 2: Allocation of CSRS Liabilities for POD/USPS Employees. This proposal would change the current allocation of responsibility between the Federal Government and the USPS for funding retirement annuities paid to employees who (1) served in both the POD and the USPS, and (2) participate in the Civil Service Retirement System (CSRS). Under this proposal, the USPS contribution would decrease, thus increasing the Federal Government's share of the liability.

Proposal 3: Reduction in Contribution Levels for Retiree Benefits. This proposal would change the current law requiring the USPS to fully fund both its liabilities under FERS and its obligations for future retiree health benefits, permitting the USPS to meet lower funding levels of 80 percent for FERS liabilities and 30 percent for retiree health benefit obligations.

The OPM OIG's Position

We generally agree with Proposal 1 regarding the disposition of excess FERS contributions. We strongly object to the remaining proposals on several grounds:

- They seek to alter the fundamental policy regarding the relationship between the USPS and the Federal Government. These proposals would cause the Government to assume responsibility for USPS retiree benefit expenses without a corresponding increase in Government oversight of the USPS.
- They do not actually remedy any alleged inequities in the Federal retirement program. Instead, they serve only to provide the USPS with operating capital, which would potentially shift costs from USPS ratepayers to the taxpayers.
- The proposals would create a dangerous precedent whereby the trust funds' assets are used for purposes other than the payment of benefits. If this became common practice, the financial soundness and integrity of the trust funds would be severely compromised.

Of great concern to us is the fact that during the course of our research, we did not find any viable projections indicating that the USPS will be able to restore its operations to profitability. This is problematic because:

- If the USPS were unable to make the employer's contribution under CSRS and FERS, the Federal Government would be liable for any shortfall in the CSRD Fund.
- The integrity of the Federal Employees Health Benefits (FEHB) Program would be seriously compromised, absent emergency appropriations from Congress, if the USPS were to cease contributing the employer's share of premiums.

EXECUTIVE SUMMARY

Recommendations

Based upon the facts and our analysis, we offer the following recommendations:

1. The OPM should consider supporting the proposal to amend the FERS funding mechanism either by permitting amortization of surpluses in the same manner as supplemental liabilities or utilizing the surplus in lieu of annual FERS payments until it is exhausted. In this instance, the proposal maintains the financial integrity of the CSRD Fund. However, the OPM should strongly advocate that the proposal apply to all agencies participating in FERS and not solely to the USPS.

2. The OPM should examine the effects that would result from the creation of a demographic sub-account, which would be utilized in determining the USPS's FERS liability. Such a study should consider the effects upon both the USPS's FERS liabilities and the entire Federal retirement program.

3. As the administrator of the FEHB Program, the OPM should support retaining the requirement that the USPS prefund its retiree health benefits as it does under current law. This requirement protects the FEHB Program against the risk of USPS default.

4. Absent additional Congressional action on the matter, the OPM should refrain from implementing the proposal regarding the modification of its calculation of the USPS's CSRS liability for POD/USPS employees. We believe that it is beyond the OPM's legal authority to adopt this proposal without further legislation. We note that the proposal would shift substantial costs from the USPS to the Federal Government.

5. The OPM should strongly oppose any legislative action that would permit the USPS to fund its FERS responsibilities at 80 percent. This proposal would cause the CSRD Fund to incur substantial unfunded liabilities as well as create a dangerous precedent whereby other agencies would seek to reduce their FERS funding obligations.

6. In its capacity as administrator of the trust funds, the OPM ought to share its technical expertise with Congress and appropriate Executive Branch officials to ensure that they are fully informed of the resulting monetary and programmatic effects of such proposals upon the retirement programs and trust funds.

7. The OPM should protect the retirement programs against being used as a way to address a situation that is entirely unrelated to retirement issues. Using the Federal retirement programs as a vehicle through which to implement other policy objectives would be unwise, inefficient, and harmful to the programs. The debate surrounding the USPS's financial condition should not be focused solely on the funding of retiree benefits.

EXECUTIVE SUMMARY

Conclusion

While we understand that the USPS is having financial difficulties, the OPM's administration of the law has not caused this situation. The OPM has complied with the law as written on all accounts. To say otherwise is both inaccurate and obscures the true causes of USPS's current crisis.

We believe that these proposals would have a lasting negative impact upon the retirement programs and trust funds but have little, if any, positive impact upon the USPS's ultimate long-term profitability. Instead, the result of these proposals would be to shift costs from USPS ratepayers to the American taxpayers.

Patrick E. McFarland
Inspector General

Table of Contents

Index of Charts

Acronyms

1974 Act	Postal Service Payments to Civil Service Retirement Fund Law
2003 Act	Postal Civil Service Retirement System Funding Reform Act of 2003
CBO	Congressional Budget Office
CRS	Congressional Research Service
CSRD	Civil Service Retirement and Disability
CSRS	Civil Service Retirement System
EHB	Employees Health Benefits
FASB	Financial Accounting Standards Board
FEHB	Federal Employees Health Benefits
FERS	Federal Employees Retirement System
GAO	United States Government Accountability Office
OPM	United States Office of Personnel Management
PAEA	Postal Accountability and Enhancement Act of 2006
POD	United States Post Office Department
PPA	Pension Protection Act of 2006
PRC	Postal Regulatory Commission
PSRHB	Postal Service Retiree Health Benefits
S&P 500	Standard and Poor's 500 Index
USPS	United States Postal Service
USPS OIG	United States Postal Service Office of Inspector General

Introduction

During 2009 and 2010, the United States Postal Service's (USPS) Office of Inspector General (USPS OIG) released a series of reports and studies containing proposals meant to alleviate the USPS's current financial difficulties.

Three of these proposals suggest reducing, modifying, or eliminating the statutorily-mandated payments that the USPS currently must make into the Civil Service Retirement and Disability (CSRD) Fund and the Postal Service Retiree Health Benefits (PSRHB) Fund. These two trust funds are administered by the U.S. Office of Personnel Management (OPM) as part of its mission to oversee and protect the Federal retirement and health benefit programs.

OPM's mission is to oversee and protect the Federal retirement and health benefit programs

The proposals are summarized as follows:

Proposal 1: Treatment of FERS Surplus. This proposal would change the law regarding an agency's (in this case, the USPS's) contributions to the CSRD Fund made under the Federal Employees Retirement System (FERS) so that when the agency has paid an amount in excess of its current liabilities, it may either receive a rebate or be excused from making contributions until the excess is exhausted.[1]

Proposal 2: Allocation of CSRS Liabilities for POD/USPS Employees. This proposal would change the current allocation of responsibility between the Federal Government and the USPS for funding retirement annuities paid to employees who (1) served in both the U.S. Post Office Department (POD) and the USPS, and (2) participate in the Civil Service Retirement System (CSRS). Under this proposal, the USPS contribution would decrease, thus increasing the Federal Government's share of the liability.[2]

Proposal 3: Reduction in Contribution Levels for Retiree Benefits. This proposal would change the current law requiring the USPS to fully fund[3] both its liabilities under FERS and its obligations for future retiree health benefits, permitting the USPS to meet lower funding levels of 80 percent for FERS liabilities and 30 percent for retiree health benefit obligations.[4]

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1. USPS OIG, *Federal Employees Retirement System Overfunding*, Report Number FT-MA-10-001 (Aug. 16, 2010) (hereinafter "USPS OIG's FERS Report").
2. USPS OIG, *The Postal Service's Share of CSRS Pension Responsibility*, Report Number RARC-WP-10-001 (Jan. 20, 2010) (hereinafter "USPS OIG's CSRS Report").
3. In this study, the terms "prefund" and "fully fund" are interchangeable. "Prefund" is usually used in the health benefit context while "fully fund" is usually used in the annuity context.
4. USPS OIG, *Substantial Savings Available by Prefunding Pensions and Retirees' Health Care at Benchmarked Levels*, Report Number FT-MA-11-001 (Nov. 23, 2010) (hereinafter "USPS OIG's Funding Levels Report").

At the request of the Director of the OPM, this office initiated a review of the effects that these proposals would have upon the CSRD and PSRHB Funds, as well as the associated retirement and health programs.[5]

Scope and Methodology

Given OPM's jurisdiction, we limited our study to only the three proposals discussed above in the Introduction. We did not evaluate proposals developed by other parties, such as the USPS, the Postal Regulatory Commission (PRC), or Members of Congress.[6]

This study was prepared between November 2010 and February 2011, and is not, nor is it meant to be, a formal audit conducted in accordance with the *Government Auditing Standards* published by the Government Accountability Office (GAO). It is a researched analysis of the financial effects and policy implications of the three identified proposals.

We did not engage an independent actuarial or consulting firm during the development of this study.[7] Instead, we reviewed studies produced by the USPS OIG discussing its proposals as well as reports prepared by the GAO, the Congressional Research Service (CRS), the Congressional Budget Office (CBO), and the PRC. We also examined relevant laws, legislative histories, Congressional testimony, and other public information on this topic. In addition to our independent research, we consulted with the OPM Actuary and staff from other OPM program offices, and met with Congressional committee staff.

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5. Although it involves the PSRHB Fund, we do not discuss the proposal contained in the report issued by the USPS OIG entitled *Estimates of Postal Service Liability for Retiree Health Care Benefits*, Report Number ESS-MA-0-001(R) (July 22, 2009). The OPM Actuary informed us that prior to the release of the USPS OIG and the Postal Regulatory Commission (PRC) reports on the issue, the OPM had already decided to use actuarial assumptions consistent with those recommended by the PRC.
6. The PRC commissioned a report by the Segal Company that addressed the CSRS liability for employees who worked for both the POD and the USPS. We did not evaluate the Segal Company's methodology or reasoning. We note that the Segal Company found, and the PRC agreed, that the USPS made surplus contributions under the CSRS system for those employees in the amount of \$50-\$55 billion rather than the \$75 billion that the USPS OIG contends. *See*, The Segal Company, *Report to the Postal Regulatory Commission on: Civil Service Retirement System Cost and Benefit Allocation Principles* (June 29, 2010).
7. A January 18, 2011, article published by the *Washington Post* asserted that we had estimated that the USPS has overpaid \$50-\$75 billion into the retirement trust fund. After receiving corrected information, the *Washington Post* then published a correction stating: "Earlier versions of this article incorrectly said that the inspectors general for the U.S. Postal Service and the Office of Personnel Management estimated that the Postal Service has overpaid the Civil Service Retirement System by \$50 billion to \$75 billion. The Postal Regulatory Commission estimated an overpayment of approximately \$50 billion, and the Postal Service inspector general estimated \$75 billion. The OPM inspector general has not yet made an estimate." As stated in the above text, we have not retained an independent actuary and this report will not offer such an estimate. *See*, Ed O'Keefe, "Freshman Leader of Key House Panel Says He'll Focus on Federal Payroll Cuts," *Washington Post*, Jan. 18, 2011; both the article and the correction are available at: http://www.washingtonpost.com/wp-dyn/content/article/2011/01/18/AR2011011805665.html.

Economic and Legal Background

In order to properly evaluate the proposals, one must understand the USPS's relationship with the Federal Government; USPS employee and retiree rights; certain economic considerations; and the operation of Government-administered trust funds. We have provided here a brief overview of each of these topics.

USPS's Relationship with the Federal Government

In 1971, the POD ceased to be an Executive Branch agency and became "an independent establishment of the executive branch."[8] Congress was influenced by the fact that the POD was offering what were essentially commercial services, and thus could be expected to produce the revenues to cover its own costs.[9] A Congressional report issued during the development of the Postal Reorganization Act[10] states:

> The mandate that the Postal Service must be self-supporting is essential if postal affairs are to be conducted with reasonable economy and efficiency. So long as postal management operates with a general awareness that congressional appropriations are always available, within some uncertain limit, to make good any shortfalls of revenue or overruns of costs, there is little real incentive to make the best possible use of resources and efficiency is sure to be more honored in the speech than the observance. Moreover, the "break-even" requirement of [the Postal Reorganization Act] represents a commitment that the Postal Service no longer rely on massive annual infusions of general revenues of the Treasury at the taxpayers' expense.[11]

Budgetary control is a key feature of Congressional and Executive administration of Governmental operations. Therefore, the Government's relinquishing of financial oversight of the USPS, affording it greater management flexibility, was a significant concession.[12] As the CRS points out:

> The budget process is a useful management tool for planning as well as for maintaining accountability. Presidents and central management agencies find the discipline of the budget an essential element in their management arsenal… Government corporations [such as the USPS], on the other hand, are exempt

8. 39 U.S.C. § 201.
9. 39 U.S.C. § 101(d) (Postal rates set to cover costs).
10. Postal Reorganization Act of 1970, Pub. L. No. 91-375, 84 Stat. 719.
11. H.Rep. No. 91-988 (1970), at page 13; *see also*, H.Rep. No. 91-1104 (1970), at page 17.
12. 39 U.S.C. § 410(a) ("no Federal law dealing with public or Federal contracts, property, works, officers, employees, budgets, or funds…shall apply to the exercise of the powers of the Postal Service."); § 101(c) (USPS compensation must be comparable to private sector); § 401 (Postal Service granted power to enter into contracts and "determine the character of, and necessity for, its expenditures"); § 409(h) (court judgment against the Federal Government due to USPS activities must be paid by USPS funds); § 1003(a) (compensation must be comparable to the private sector, although capped at the same salary level as the Vice President of the United States); § 1004(a) (ability to offer higher levels of compensation to management).

> either individually or collectively from many executive branch budgetary regulations. These exemptions are predicated, for the most part, on the idea that with the corporate structure, users, rather than the general taxpayers, are the principal source of revenue…[13]

In other words, Congress granted the USPS fiscal independence in exchange for a promise of fiscal responsibility. This fiscal independence is particularly important because it also entails a release from accountability to the taxpayers because there are no taxpayer dollars being used.[14]

Congress granted the USPS fiscal independence in exchange for a promise of fiscal responsibility

While the USPS does have some statutory constraints regarding use of its funds,[15] it still has far more flexibility than Federal agencies. It has used its unique managerial independence to assume substantial obligations related to employee compensation, including retirement and health care liabilities that are in excess of what Government agencies are permitted to assume.[16]

For example, under the Federal Employees Health Benefits (FEHB) Program, as designed by Congress, the Federal Government pays 72 percent of a weighted average of all FEHB Program plan premiums.[17] In contrast, the USPS's contribution rates for the FEHB Program are "determined through a collective bargaining process with its unions," which has resulted in the USPS paying 79 percent of premiums for most employees for 2010 and 100 percent of premiums for Postal Career Executive Service employees, USPS OIG directors, and Senior Executive Service employees.[18]

In the Postal Reorganization Act, Congress codified the principle that "[o]bligations issued by the Postal Service under this section shall…not be obligations of, nor shall payment of the principal thereof or interest thereon be guaranteed by, the Government of the United States."[19] The only way that such obligations would be backed by the full faith and credit of the United States is if the USPS requests that the Secretary of the Treasury make such a pledge and the Secretary

13. CRS, *Federal Government Corporations: An Overview*, Report RL30365 (Mar. 23, 2006), at pages 8-9.
14. Congress does provide a small annual appropriation to the USPS to pay for the provision of free mail for the blind and overseas voters. 39 U.S.C. § 2401.
15. For example, the USPS's compensation and benefits package must be comparable to that offered in the private sector. 39 U.S.C. §§ 101(c), 1003. USPS employees must participate in CSRS or FERS. 39 U.S.C. § 1005(d). If the USPS wants to change one of its fringe benefit programs, such as health care insurance, the new program may not be "less favorable" than the current program (*i.e.*, the FEHB Program). 39 U.S.C. § 1005(f).
16. 39 U.S.C. § 410(a) ("no Federal law dealing with public or Federal contracts, property, works, officers, employees, budgets, or funds…shall apply to the exercise of the powers of the Postal Service.").
17. 5 U.S.C. § 8906 (note that the Government contribution may not exceed 75 percent of the premium for any individual plan).
18. USPS OIG, *Follow-Up Review of the Postal Service's Employee Benefits Programs*, Report Number HR-MA-01-001 (Sept. 3, 2010), (hereinafter "USPS Follow Up") at page 3. Another example is the USPS's contractual agreement with the former Postmaster General, John E. Potter, a participant in CSRS, whereby he is entitled to a separate pension benefit, called the "USPS Pension Benefit." This benefit was payable for "his attainment of required performance objectives over the six-year period from June 2001-June 2007." *Fiscal Year 2010 Executive Officer Compensation, available at*: http://www.postalreporter.com/pces-salary.htm.
19. 39 U.S.C. § 2005(d)(5).

determines that it is in the public interest to do so.[20] By providing an exception, the law reaffirmed the rule that the USPS is to be solely responsible for its liabilities unless it receives express agreement from the Government.

The USPS, however, has a somewhat different view of the matter, as explained in its 2010 Annual Report:

> The Postal Service's status as a self-supporting entity within the federal government presents unique requirements and restrictions, but also mitigates some of the financial risk that would otherwise be associated with a cash shortfall. Despite falling mail volume, the Postal Service is still widely recognized to provide an essential government service and there are a wide variety of potential legislative remedies that could resolve the short-term liquidity concern. Therefore, it is unlikely that, in the event of a cash shortfall, the federal government would cause or allow the Postal Service to cease operations.[21]

This statement is clearly at odds with the expressed Congressional intent that taxpayer dollars should not be used to pay USPS expenses. The requirement to be self-sustaining was meant to encourage the USPS to be more efficient than its predecessor, the POD, which was a *Federal agency*, unlike the USPS. The POD's Postmaster General answered directly to the President as a member of the Cabinet and the POD received annual appropriations for expenses that exceeded its commercial revenue.

In stark contrast, the USPS is not under the direction of the President and it receives only a very small appropriation from Congress to pay for public services such as mail for the blind – an appropriation that the USPS OIG has recommended foregoing as a means of "cementing the financial independence of the Postal Service in the minds of the public and policy makers."[22]

A key difference between a "Federal agency" and an "independent establishment" is accountability. Federal agencies are permitted to assume financial liabilities on behalf of the Federal Government because the agencies are managed and overseen by elected representatives. The USPS, however, is not subject to the same controls or degree of oversight precisely because it is not supposed to use taxpayer dollars.

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20. 39 U.S.C. § 2006(c).
21. USPS, *2010 Annual Report: Foundation for the Future*, at pages 55 and 70, *available at*: http://www.usps.com/financials/_pdf/annual_report_2010.pdf; *see also*, USPS, Quarterly Annual Report, Form 10-Q (Feb. 9, 2011), at page 10 (identical statement).
22. USPS OIG, *Federal Budget Treatment of the Postal Service*, Report Number ESS-WP-09-001 (Aug. 27, 2009), at page 12.

USPS Employee and Retiree Rights

Pensions

USPS employees are required by law to participate in the Federal retirement program as part of their overall compensation package.[23] This program is a single plan with two benefit systems, CSRS and FERS, each having its own funding method.[24] Under each system, the employer – whether it be a Federal agency or an independent establishment such as the USPS – deposits a statutorily-determined amount based upon each eligible employee's pay into the CSRD Fund for each employee's future annuity.[25] The employee also contributes a statutorily-determined percentage of his or her pay into the CSRD Fund.[26]

USPS employees are required by law to participate in the Federal retirement program

Two technical points must be noted. First, an employee does not have an individual "account" in the CSRD Fund. Second, both CSRS and FERS contributions are made into the CSRD Fund. All amounts deposited into the fund are commingled even though the annuity due to each employee is individually calculated and the transactions of each system are accounted for separately. That is, the assets are used to pay any retirement annuity that is due, regardless of whether the recipient is enrolled in CSRS or FERS.

Even if the USPS were to stop making payments, the USPS retirees would still be entitled to their annuities

A Federal or USPS employee has a legal right to an annuity if he or she meets certain statutory criteria.[27] Neither the right to an annuity nor its amount is conditioned upon the employer's continued contributions to the CSRD Fund. It is the CSRD Fund – *not* the employing entity – that is legally obligated to make the pension payments to annuitants. Thus, even if the USPS were to stop making payments into the CSRD Fund, all USPS retirees would still be legally entitled to their earned annuities and the Government is obligated by statute to pay them. Funds from the U.S. Treasury, direct appropriations to the CSRD Fund from Congress, and the contributions of other Federal employers and employees would have to be redirected or increased to fulfill what is an obligation of the United States Government. As expressed in a recent CRS report, "[t]he ultimate guarantors of Government pensions are the taxpayers."[28]

"The ultimate guarantors of Government pensions are the taxpayers."

- Congressional Research Service

23. 39 U.S.C. § 1005(d)(1).
24. For purposes of this report, we do not discuss the Thrift Savings Plan, which is administered by the Federal Retirement Thrift Investment Board.
25. 5 U.S.C. §§ 8334 (CSRS), 8423 (FERS).
26. 5 U.S.C. §§ 8334 (CSRS), 8422 (FERS).
27. 5. U.S.C. §§ 8333 (CSRS), 8410 (FERS).
28. CRS, *Federal Employees' Retirement System: Benefits and Financing*, Report 98-810 (Sept. 15, 2010) (hereinafter "CRS Report 98-810"), at page 9.

Health Benefits

In addition to the right to an annuity, USPS retirees, like Federal retirees, may choose to continue participating in the FEHB Program, the Federal Government's employee health insurance program, which is administered by the OPM.[29] The OPM negotiates contracts with insurance companies annually to determine premiums, benefits, and other terms. It is these insurance companies, rather than the Federal Government, that actually deliver the health benefits to the employee or retiree.

Under the FEHB Program, a portion of a retiree's health care insurance premium is paid for by the Federal Government (or, in the case of USPS retirees, the USPS) through contributions to the Employees Health Benefits (EHB) Fund.[30] The Federal or USPS retiree contributes the remaining amount of the premium to the fund.

As the USPS OIG's reports have repeatedly pointed out, the Federal Government does not prefund its retiree health obligations.[31] Instead, the employer and employee contributions pay only for the costs of the program for that particular year. Consequently, the EHB Fund maintains only a small amount of reserves and thus does not have significant assets that remain in the fund from year to year.

Eligible employees or retirees choose whether or not they will participate. If they continue to meet the eligibility requirements throughout the year – and continue to pay their share of the premium - they may maintain their insurance coverage.

It is unclear, however, what the effect would be upon USPS employees' or retirees' rights if the USPS ceased making its required payments into the EHB Fund because the fund does not contain sufficient reserves that could be used to "replace" the USPS's contributions. Consequently, the fund's assets would be exhausted very quickly.

The EHB fund does not contain sufficient reserves that could be used to "replace" the USPS's contributions

In such a scenario, the insurance companies would still be legally entitled to the full amount of the premium negotiated under the contract.[32] The OPM would have to take some sort of action because without the USPS's contributions, the fund simply would not have enough money to pay every FEHB Program participant's premium.

29. The retiree must have participated in the FEHB Program prior to retirement in addition to meeting any other eligibility requirements listed in 5 U.S.C. § 8905(b).

30. 5 U.S.C. §§ 8906(b), 8909. Note that this fund is a separate fund from the PSRHB Fund, which is discussed in more detail below, in the section entitled "Structure and Operation of Government Trust Funds."

31. *See, e.g.*, USPS OIG, *Civil Service Retirement System Overpayment by the Postal Service*, Report Number CI-MA-10-001 (June 18, 2010) (hereinafter "USPS OIG CSRS Overpayment Report"), at pages 10-11; USPS OIG, *Summary of Substantial Overfunding in Postal Service Pension and Retiree Health Care Funds*, Report Number FT-MA-10-002 (Sept. 30, 2010) (hereinafter "USPS OIG Summary"), at page 10.

32. *Health Insurance Plan of Greater New York, Inc. v. United States*, 62 Fed. Cl. 33 (2004).

Absent an emergency appropriation from Congress, it is possible that the OPM would have to exercise its regulatory authority to disenroll USPS employees and retirees as a class in order to continue providing health care coverage to all other FEHB Program participants.[33]

If the OPM did not take such drastic measures, the EHB Fund would very quickly run out of assets and plans would stop receiving premium payments because OPM simply would not have the money to pay them. In that scenario, some insurance companies may unilaterally decide that the Government is in default of the plan contract and withdraw from the program.

If enough insurance companies withdrew, it would threaten the existence of the FEHB Program

If enough insurance companies withdrew, it would threaten the existence of the FEHB Program. Even if some insurance companies continued to offer coverage for the remainder of the year, they may decide not to participate in the FEHB Program the following year. If they did decide to stay in the program, they may be forced to increase premiums dramatically in order to make up the premium shortfall, which would affect other non-USPS participants.

Economic Considerations

In the public debate surrounding USPS contributions to the trust funds, there has been much confusion between the creation of a debt and the payment of a debt.[34] Pension and retiree health benefit liabilities are current liabilities – not future ones, even if they are not payable until a future date. As the Financial Accounting Standards Board (FASB)[35] explains:

> In exchange for the current services provided by the employee, the employer promises to provide, in addition to current wages and other benefits, [pension] and health and other welfare benefits after the employee retires…. The employer's obligation for that compensation is incurred as the employees render the services necessary to earn their postretirement benefits.[36]

Therefore, just as an organization must budget to ensure that it can meet its current payroll obligations, so too must it plan for these future payments.

An organization must budget and plan for future payments

33. 5 U.S.C. § 8913.
34. *See, e.g.*, Statement of Inspector General David C. Williams, USPS, *U.S. Postal Service in Crisis*, Subcommittee on Federal Financial Management, Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate (April 6, 2009), at page 2.
35. FASB is the designated organization in the private sector that establishes the standards of financial accounting that govern the preparation of financial reports by nongovernmental entities. *See*, www.fasb.org.
36. FASB Statement No. 106; *see also*, FASB Statement No. 87.

Deferral of Liabilities

The USPS has amassed a significant amount of general debt to the U.S. Treasury[37] in addition to accumulating considerable unfunded liabilities with regard to pensions and retiree health benefits.[38] While unfunded liabilities are a type of debt, for purposes of this study, we distinguish them from the USPS's general debt held by the U.S. Treasury. As used here, unfunded liabilities specifically refer to the "promises" that the USPS has made to its employees and retirees for which it has not set aside money to pay.[39]

Two of the proposals suggest amending the law to postpone or decrease payments that the USPS is currently statutorily-mandated to make to the CSRD and the PSRHB Funds.

It is likely that deferral of these payments would provide temporary financial relief to the USPS. The proposals advocating for deferral assume that eventually the USPS will resume such payments; in the meantime, the USPS would continue to incur new future financial obligations.

This is financially risky for three reasons. First, future USPS customers (ratepayers) will have to pay for expenses that the USPS is incurring today. This will likely hurt the USPS's ability to compete in the future and affect its ability to improve its financial situation. Second, the USPS will lose the benefit of the interest that its deposits into the trust funds would have otherwise earned. This interest would have reduced its future retiree liabilities. Consequently, implementation of these proposals would require the USPS to make larger contributions in the future. Third, if the USPS becomes insolvent, the Federal Government, through the trust funds, will still have to pay these pension liabilities and possibly assume responsibility for USPS retiree health benefit obligations as well.

USPS's Financial Outlook

While various parties have worked diligently to develop business and operational initiatives geared towards improving the USPS's business model and financial condition, we have yet to see a report that contains viable projections that it will improve its financial situation.[40] The

37. As of the end of fiscal year 2009, this amount was $12 billion. USPS, Form 10-Q (Feb. 9, 2011), at page 10.
38. According to the OPM Actuary, as of the end of fiscal year 2009, the USPS had unfunded pension liabilities of $16.7 billion and unfunded retiree health benefit liabilities of $85.9 billion.
39. For example, if the USPS pledges to pay an employee $20,000 annually upon retirement, current law requires that the USPS deposit into the CSRD Fund during the employee's working lifetime the entire amount that it would take to fulfill that pledge when the employee retires. Thus, the fund would be able to make the full $20,000 payment each year without additional contributions from the USPS. An unfunded liability would exist if the USPS deposited only enough to pay the retiree $15,000 a year, with the expectation that when the time comes to make the $20,000 payment, the USPS will pay the remaining $5,000 out of its current revenues.
40. *See, e.g.*, Statement of Phillip Herr, Director, Physical Infrastructure Issues, GAO, *U.S. Postal Service: Financial Challenges Continue, with Relatively Limited Results from Recent Revenue-Generation Efforts*, Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, U.S. House of Representatives, GAO-10-191T (Nov. 5, 2009), at Introduction; CRS, *The U.S. Postal Service's Financial Condition: Overview and Issues for Congress*, Report R41024 (Oct. 5, 2010) (hereinafter "CRS Report R41024"); USPS, *2010 Annual Report: Foundation for the Future*, at page 70, *available at*: http://www.usps.com/financials/_pdf/annual_report_2010.pdf.

CBO's "projections indicate that USPS's costs are on a trend to rise somewhat faster than general inflation – if only because health care costs are expected to grow in real terms." [41] Furthermore, both the GAO and the PRC have noted:

> Current pressures from declining revenue and volume do not appear to be abating, but rather seem to be increasing. During the economic downturn, there has been an accelerated diversion of business and individual mail, and some mailers have left the market entirely. An economic recovery may not bring a corresponding recovery in mail volume due to continuing social and technological trends that have changed the way that people communicate and use the mail.[42]

The USPS itself has similarly bleak projections:

> Industry experts confirm that the marketplace trends challenging the Postal Service in recent years are expected to accelerate. The organization will continue to face declining volume, stagnant revenue, large fixed costs, and rising workforce costs. Without additional action to address these trends, the Postal Service would face annual losses as great as $33 billion by 2020.[43]

"The organization will continue to face declining volume, stagnant revenue, large fixed costs, and rising workforce costs."

-USPS

The USPS continually cites the annual payments required by the Postal Accountability and Enhancement Act of 2006 (PAEA)[44] as a "significant" contributor to its inability to meet its expenses.[45] However, the CRS noted that "even before PAEA's enactment in early FY2007, the rate of growth of the USPS's operating expenses exceeded that of its operating revenue."[46]

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41. Letter from Douglas Holtz-Eakin, Director, CBO, to the Honorable Judd Gregg, Chairman, Committee on the Budget, U.S. Senate (Sept. 1, 2005), at page 8.
42. Statement of Phillip Herr, Director, Physical Infrastructure Issues, GAO, *U.S. Postal Service: Deteriorating Postal Finances Require Aggressive Actions to Reduce Costs*, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate, GAO-09-332T (Jan. 28, 2009), at 5 (referring to PRC, *Report on Universal Service and the Postal Monopoly* (Dec. 19, 2008)).
43. USPS, Ensuring a Viable Postal Service for America: An Action Plan for the Future, at page 6, *available at*: http://www.usps.com/strategicplanning/_pdf/ActionPlanfortheFuture_March2010.pdf#search='.
44. Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, 120 Stat. 3198.
45. *See, e.g.*, Statement of Patrick R. Donahoe, Postmaster General/CEO-Designate, *Finding Solutions to the Challenges Facing the U.S. Postal Service*, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate (Dec. 2, 2010) at pages 4-5 ("In 2007 and 2008, the Postal Service made the required pre-funding payments and consequently sustained losses of $5.1 billion and $2.8 billion, respectively. Had it not been for these payments, in 2007 the Postal Service would have seen profits of $3.3 billion and in 2008 profits would have been $2.8 billion."); USPS, *2010 Annual Report: Foundation for the Future*, at 9, *available at*: http://www.usps.com/financials/_pdf/annual_report_2010.pdf ("The prefunding requirement, as it currently stands, contributes significantly to postal losses.").
46. CRS, *The U.S. Postal Service's Finances and Financial Condition*, Report R40768 (Sept. 17, 2009), at page 5.

The increase in costs due to health care and the problems generating revenue in a changing marketplace are obviously not a result of the way the USPS is required to fund its retiree obligations. To alter the funding structure of the Federal retirement program would not only fail to address these pressing problems, but cause new ones by requiring the trust funds to take on unnecessary risk through an increase in their unfunded liabilities.

The Protection Afforded By Prefunding and Full Funding

The CBO and GAO have repeatedly raised the point that the Federal Government will be liable for USPS retiree benefits if the USPS is unable to pay those costs itself.[47] This concern has underlined the GAO's continuing emphasis regarding the importance of ensuring that the USPS prefund its substantial unfunded retiree health benefits to the maximum extent possible.[48] Specifically, the GAO has noted:

> The Postal Service is required to pay the retiree health premiums regardless of whether it prefunds some or all of these costs, and the annual costs are expected to increase over the next 20 years. If prefunding health benefits for new employees proves to be more costly than estimated, or if the premiums for current retirees continue to grow rapidly, the Service could find itself facing a significant obligation at a time when revenues are shrinking. It seems prudent to set aside funds now, while they are available to address escalating future costs rather than waiting until costs are higher and adequate revenue may not be forthcoming.[49]

While it recognizes that the USPS does need financial relief, the GAO points out the tradeoffs in providing the relief through modification of how the USPS funds its retiree health benefits obligations:

> Deferring some prefunding of these benefits would serve as short-term fiscal relief. However, deferrals also increase the risk that USPS will not be able to

47. *See, e.g.*, Letter from Barry B. Anderson, Acting Director, CBO, to the Honorable Jim Nussle, Chairman, Committee on the Budget, U.S. House of Representatives (Jan. 27, 2003), at pages 11-12 ("If that uncertain [competitive] environment substantially hindered the Postal Service's ability to produce income, the federal government could be left with the long-term burden of paying for the retiree health benefits of postal workers."); GAO, *U.S. Postal Service: Strategies and Operation to Facilitate Process toward Financial Viability*, GAO-10-455 (April 12, 2010), at pages 26 ("Because its retirees are eligible to receive the same health benefits as other federal retirees, if USPS cannot make its required payments, the U.S. Treasury, and hence the taxpayer, would still have to meet the federal government's obligations.") and 58 ("If no action is taken, the risk of USPS's insolvency and the need for a bailout by taxpayers and the U.S. Treasury increases.").

48. *See, e.g.*, Statement of Phillip Herr, Director, Physical Infrastructure, GAO, *U.S. Postal Service: Legislation needed to Address Key Challenges*, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate, GAO-11-244T (Dec. 2, 2010) at page 9; GAO, *U.S. Postal Service: Strategies and Operation to Facilitate Process toward Financial Viability*, GAO-10-455 (April 12, 2010), at pages 22 and 53; GAO*, Postal Pension Funding Reform: Issues Related to the Postal Service's Proposed Use of Pension Savings*, GAO-04-238 (Nov. 26, 2003) at 5 and 11.

49. GAO, *Postal Pension Funding Reform: Issues Related to the Postal Service's Proposed Use of Pension Savings*, GAO-04-238 (Nov. 26, 2003), at pages 20-21.

> make future payments as its core business declines. Therefore, it is important that USPS fund its retiree health benefit obligations – including prefunding these obligations – to the maximum extent that its finances permit. In addition to considering what is affordable and a fair balance of payments between current and future ratepayers, Congress would also have to address the impact of these proposals on the federal budget. Further, the Congressional Budget Office has raised concerns about how aggressive USPS's cost cutting measures would be if prefunding payments for retiree health care were reduced.[50]

Despite the GAO's warnings, the series of USPS OIG reports analyzed in our study foster a contrary perception that deferring the payment of obligations for retirees, particularly for retiree health benefits, is a solution that can alleviate the USPS's current financial difficulties without any adverse effects.

However, modification of the USPS's payments to the retirement trust funds in the past has not resolved the USPS's continuing financial difficulties. For example, a similar stopgap measure in 2009 failed to produce any lasting results. In that year, Congress permitted the USPS to defer $4 billion of its $5.4 billion payment to the PSRHB Fund, as required by the PAEA.[51]

As current Postmaster General Patrick R. Donahoe recently testified, "While the Postal Service appreciated that [2009] effort, it was a short-term fix. Further, even with the deferral, Postal Service's losses for 2009 totaled $3.8 billion."[52] Moreover, the USPS stated in its 2010 Annual Report that "[e]ven if such legislation is enacted to address shorter-term liquidity matters such as the [PSRHB Fund] pre-funding payment schedule, the Postal Service still faces longer-term financial stability concerns."[53] These statements strengthen our belief that deferring the USPS's payment of its retiree benefits is not the appropriate remedy for this situation.

50. Statement of Phillip Herr, *supra* note 48, at page 9 (citing CBO, *H.R. 22: United States Postal Service Financial Relief Act of 2009* (July 20, 2009); CBO, *S.1507: Postal Service Retiree Health Benefits Funding Reform Act of 2009* (Sept. 14, 2009)).

51. Legislative Branch Appropriations Act of 2010, Pub. L. No. 111-68, 123 Stat. 2023.

52. Statement of Patrick R. Donahoe, Postmaster General/CEO-Designate, USPS, *Finding Solutions to the Challenges Facing the U.S. Postal Service*, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate (Dec. 2, 2010), at page 5.

53. USPS, *2010 Annual Report: Foundation for the Future*, at page 70, *available at*: http://www.usps.com/financials/_pdf/annual_report_2010.pdf.

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Structure and Operation of CSRD and PSRHB Trust Funds

CSRD Fund

Contributions into the CSRD Fund are required by law to be invested in "interest-bearing securities of the United States" or other investments that meet statutory specifications.[54] The Treasury Department takes the cash payments and converts them to a type of bond, which is deposited in the applicable trust fund. When an annuity payment must be made, the Treasury Department redeems the needed value of bonds held by the trust fund, and then the Department makes the payment out of its general cash account.[55]

When Congress created the CSRD Fund, it mandated that the employer and employee retirement contributions made to the fund be used to pay pension obligations and any associated administrative costs.[56]

Chart 1 illustrates the flow of funds into and out of the CSRD Fund. The Federal employee, USPS employee, and USPS contributions to the CSRD Fund, in green [····] boxes at the top of the chart, are considered to be incoming revenue to the U.S. Treasury.[57] In contrast, the contributions by Federal agencies into the CSRD Fund are not new revenue but rather intergovernmental transfers of funds previously appropriated to agencies. Likewise, the mandatory appropriation that Congress provides to pay for the unfunded CSRS liabilities and FERS supplemental liabilities is also an intergovernmental transfer.[58] These assets are invested in Treasury holdings, as described above, and are represented in **Chart 1** by the blue [══] boxes.[59] Collectively, these contributions are used to pay annuities, which are debts of the Federal Government and represented in the red [– –] box on the right side of the chart.

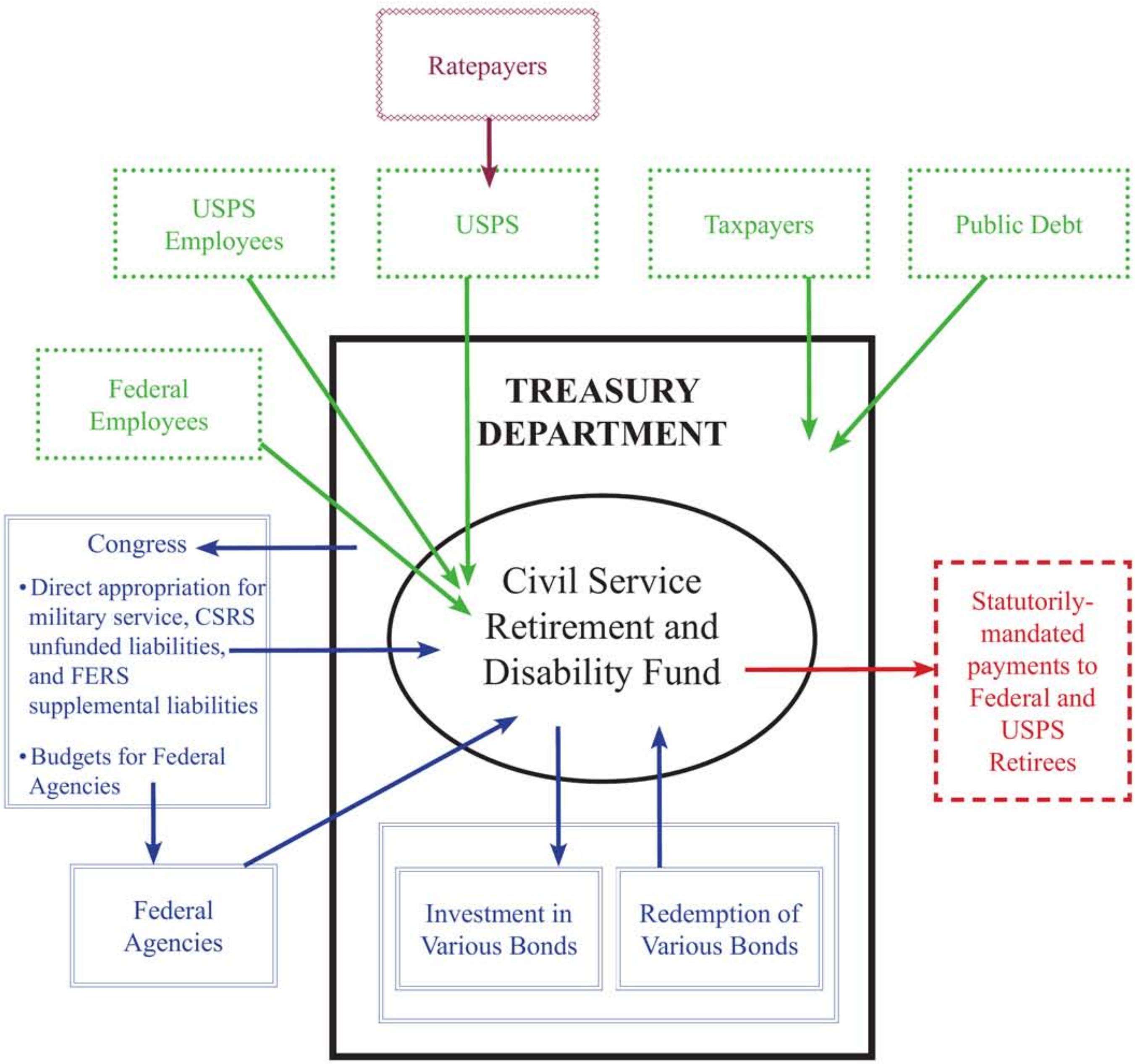
PSRHB Fund

The PSRHB Fund is quite different from the CSRD Fund. It is a separate USPS-specific trust fund. Congress established it in 2006 in the PAEA to ensure "that the Postal Service reduces its growing unfunded liability for retiree health benefits."[60] These assets are invested in Treasury holdings in a similar manner as the CSRD Fund.

The PSRHB Fund is not used to pay for current benefits to current retirees. Instead, the USPS makes an annual contribution to the EHB Fund to pay premiums for current retirees.

54. 5 U.S.C. § 8348(c)-(e). *See also*, The Secretary of the Treasury's Authority with Respect to the Civil Service Retirement and Disability Fund, 19 Op. Off. Legal Counsel 286 (1995).
55. *See*, The Secretary of the Treasury's Authority with Respect to the Civil Service Retirement and Disability Fund, 19 Op. Off. Legal Counsel 286 (1995).
56. 5 U.S.C. § 8348(a). *See also*, GAO, *Federal Trust and Other Earmarked Funds: Answers to Frequently Asked Questions*, GAO-01-199SP (Jan. 2001), at page 15.
57. 39 U.S.C. § 2009a.
58. 5 U.S.C. § 8348(a).
59. The boxes are blue because the investment of trust fund assets are intergovernmental transfers because the Treasury is investing trust fund assets in Government securities.
60. H.Rep. No. 109-66 Part I (2005), at page 69.

Chart 1. Structure and Operation of the Civil Service Retirement and Disability Fund

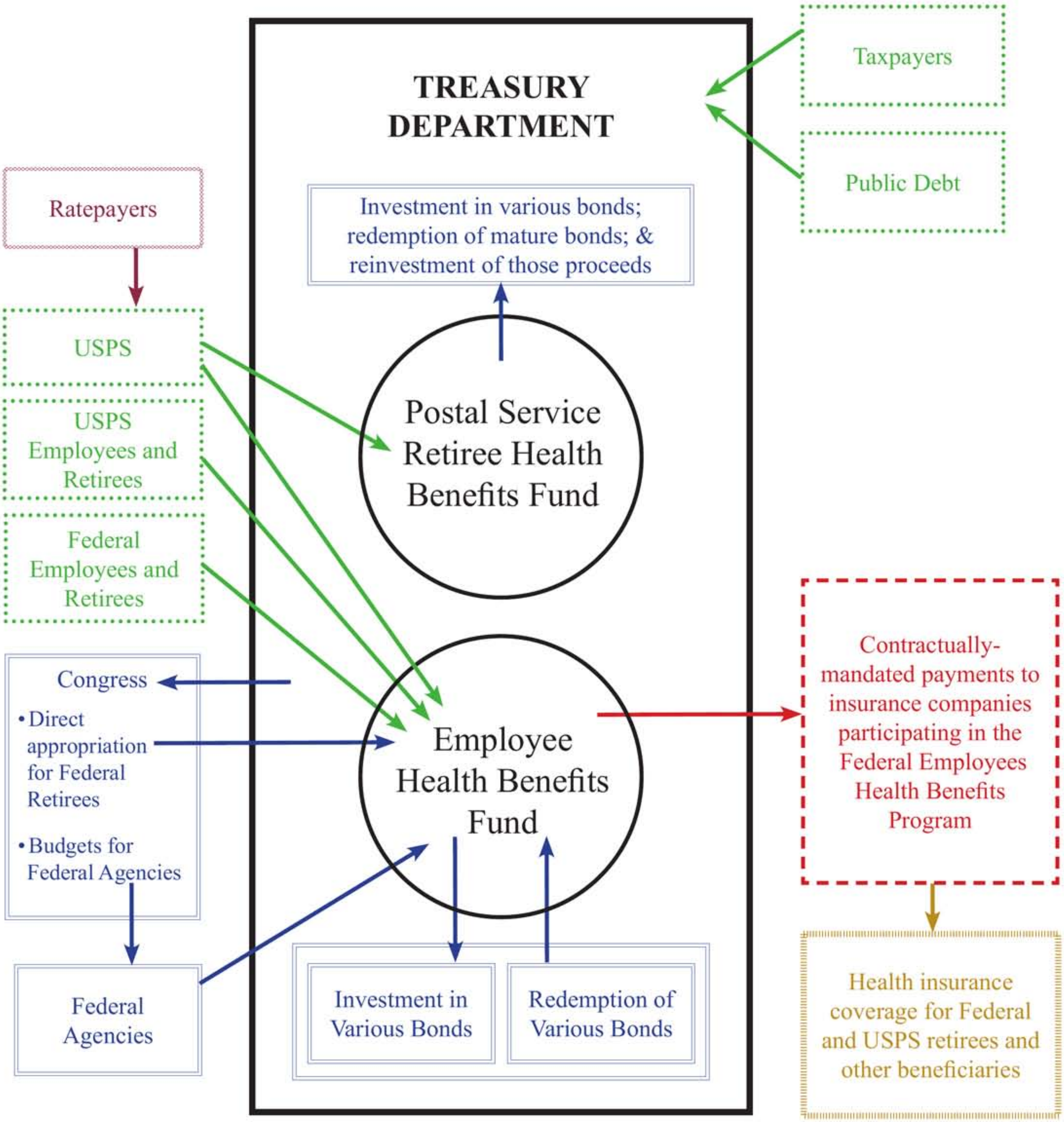


In addition to this annual contribution to the EHB Fund, the USPS also makes an annual payment into the PSRHB Fund according to a specific statutory schedule. No other entity pays into the fund. The USPS and OPM may not utilize the assets until 2017, at which point the OPM will use those assets to pay the current retiree health benefit costs for Postal retirees. Therefore, the PSRHB Fund is currently collecting contributions (and earning interest), but not making any payments.

Chart 2A describes how health benefits for retirees are *currently* funded through the operation of both the EHB Fund and the PSRHB Fund. (Neither **Chart 2A** nor **Chart 2B** address the funding of benefits for current employees.) Once again, the green [⋯⋯] boxes representing the Federal employees and retirees, USPS employees and retirees, and USPS contributions to the EHB Fund are considered to be incoming revenue to the U.S. Treasury. The contributions by Federal agencies and direct appropriation by Congress to the EHB Fund are intergovernmental transfers and again are represented by blue [═] boxes. These commingled amounts are used to make premium payments to the insurance companies, which in turn provide health insurance coverage to retirees and their eligible family members.

Chart 2A. Structure and Operation of the Postal Service Retiree Health Benefits Fund Pre-2017

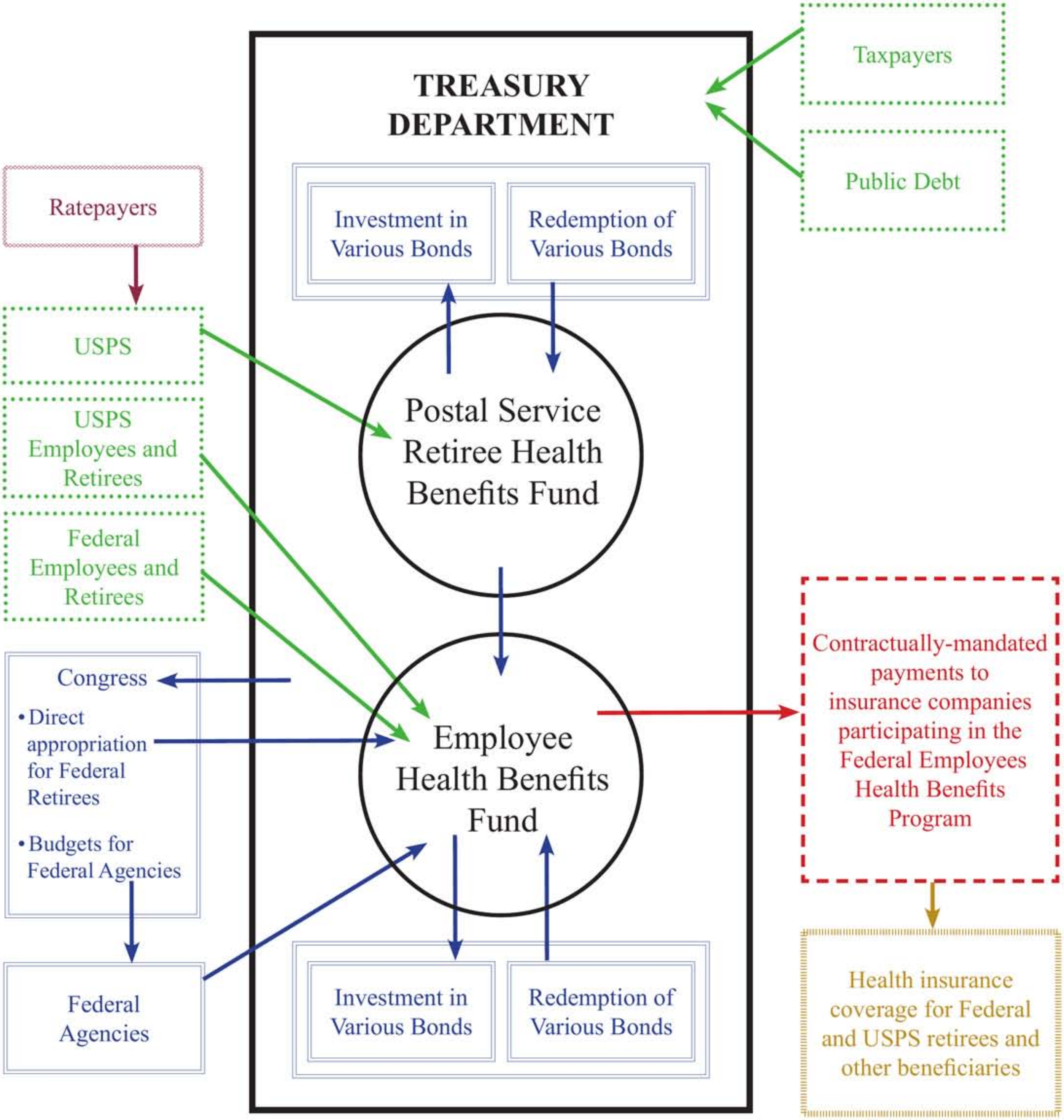
(NOTE: This chart describes the funding of health benefits for USPS retirees only. It does not address the funding of health benefits for current USPS employees.)



As previously stated, the PSRHB Fund's assets are not yet being used to pay for any USPS retiree health benefits. Only in 2017 can the fund's assets begin to be used to pay the premiums for *all* USPS retirees. Starting in that year, as **Chart 2B** illustrates, the USPS will make payments for retiree health benefits only into the PSRHB Fund. The PSRHB Fund, in turn, will make the payments to the EHB Fund necessary to cover the total cost of USPS retiree health benefits.

Chart 2B. Structure and Operation of the Postal Service Retiree Health Benefits Fund Beginning in 2017

(NOTE: This chart describes the funding of health benefits for USPS retirees only. It does not address the funding of health benefits for current USPS employees.)



Financial Effects of the Proposals

As the preceding charts illustrate, the trust funds are not a "store of wealth."[61] They are Government assets that are expressly pledged to pay specific liabilities. If those pledged assets are not sufficient to cover the liabilities, the Government must use general revenues to pay the difference.

The red [– –] boxes representing pension liabilities and payments to health insurers in **Charts 1** and **2A-B**, respectively, do not change size, regardless of any changes in the other transactions illustrated in the charts. In **Chart 1**, the legally-required outlays to annuitants will be decreased only if Congress amends the law to change either the annuity benefits or the qualifications required to obtain them. Likewise, the payments to insurers, seen in **Charts 2A** and **2B**, would remain the same absent contract termination or amendment.

In **Chart 1**, if the green [·····] box representing the USPS payments into the CSRD Fund is eliminated (or if assets are transferred out of the CSRD Fund to the USPS), there is less money specifically identified to be used to pay the unchanged annuity obligations. Consequently, the CSRD Fund will need to redeem more bonds in order to generate enough revenue to make the pension payments.[62]

As of September 30, 2009, the CSRD Fund had approximately $759 billion in assets available to pay CSRS and FERS annuity payments.[63] The current unfunded liabilities of the fund total $673.1 billion, as of the end of fiscal year 2009.[64] The CSRD Fund is on schedule to be fully funded by 2085.[65] This is because CSRS annuity obligations will continue to decrease as the population of CSRS participants diminishes, eventually leaving only FERS participants, whose annuities are essentially fully funded. If the unfunded liability of the CSRD Fund were increased by $75 billion to about $750 billion, that figure - $750 billion - would still have to be paid in full by about 2085, according to the OPM Actuary. Under current law, the immediate effect would be to increase the annual mandatory appropriation made by Congress to pay interest on the unfunded liability, thereby ultimately shifting the cost for these liabilities to the American taxpayer.

The PSRHB Fund operates in a slightly different manner. The creation of the PSRHB Fund was spurred by the fact that the USPS was incurring substantial unfunded liabilities related to future retiree health benefits. Therefore, Congress decided to ensure that the USPS fund those future liabilities in addition to paying the current year's retiree health premiums. This would allow the USPS to spread its future retiree health benefit costs evenly over a period of time. A halt to payments to the PSRHB Fund would defeat the very purpose for which the fund was created.

61. CRS Report 98-810, at page 13.

62. If the CSRD Fund does not contain any more bonds, then the mandatory Congressional appropriation to the trust fund must increase because, as discussed in the section entitled "Postal Employee and Retiree Rights," the trust fund, and therefore the Federal Government, is the entity that is legally responsible for the payments.

63. *Annual Report of the Board of Actuaries, Civil Service Retirement and Disability Fund, Fiscal Year Ended September 30, 2009*, at page 1.

64. *Id.*, at page 15.

65. *Id.*, at page 28.

This prefunding arrangement requires the USPS to efficiently and effectively manage its resources so that taxpayer dollars do not end up paying for USPS expenses.

If the USPS fails to make the required retiree benefit contributions the Federal Government will have to pay the USPS share

As of September 30, 2009, the PSRHB Fund had approximately $42.5 billion in assets available to pay approximately $85.9 billion of USPS retiree health benefit liabilities.[66] Thus, if the USPS stopped making contributions, the remainder of the retiree health benefits liabilities, approximately $43.4 billion, would continue to be unfunded by the USPS.

Therefore, as the charts demonstrate, the effect of the proposals if the USPS fails to make the required retiree health benefit contributions is that the Federal Government may have to pay the USPS share.

66. These figures were provided by the OPM Actuary.

Analysis of the Proposals

As mentioned earlier, the USPS OIG presented three proposals related to the USPS's funding of its retiree benefits. All of the proposals, although different, have some things in common. First, the basic goal of each of these proposals is two-fold: (1) to remedy alleged inequities in the current method by which the USPS funds its retiree obligations (both annuity and retiree health benefits)[67] and (2) to obtain operating capital for the USPS, at least on a temporary basis.[68] Additionally, the practical effect of each would be a shifting of costs from ratepayers to taxpayers.

It should be noted that there have been statements made on the USPS OIG website as well as in a report summarizing its proposals that foster the perception that as much as $142.4 billion may be saved by following its proposals.[69] This number is arrived at by adding the purported savings resulting from implementation of these proposals.[70] Even if we agreed with the amount of the purported savings from each proposal, these numbers cannot simply be aggregated because some of these proposals overlap.

In the following pages, we describe the funding mechanisms under current law. We then describe the proposal and discuss the supporting arguments offered in the respective reports. Finally, we offer our own analysis and conclusions as to the validity of the proposals.

67. USPS OIG's CSRS Report, at pages 3-4; USPS OIG's FERS Report, at page 1; USPS OIG Summary, at pages 2-3; USPS OIG's Funding Levels Report, at page 2.
68. USPS OIG's CSRS Report, at page 4; USPS OIG's FERS Report, at page 6; USPS OIG Summary, at pages 4-5; USPS OIG's Funding Levels Report, at page 3.
69. "Overfunded Programs May Offer Postal Service Opportunities to Rebound", *available at*: http://www.uspsoig.gov/overfunded.pdf ; USPS OIG Summary, at page 4.
70. The savings come from the three proposals examined in our study as well as a fourth found in the report entitled *Estimates of Postal Service Liability for Retiree Health Care Benefits* (Report Number ESS-MA-0-001(R) (July 22, 2009)).

Proposal 1: Treatment of FERS Surplus

Current Law

FERS is designed to be fully funded by employee and agency contributions. Each year, as required by law, the OPM calculates the Federal Government's and the USPS's liabilities under FERS to see if there is a surplus or a supplemental liability.[71] If there is a supplemental liability, the OPM establishes an amortization schedule so that the liability is paid off completely in 30 years.[72] The statute does not contemplate what would happen should a surplus exist.

USPS OIG's Proposed Action

According to the OPM Actuary, the USPS currently has a surplus under the FERS program. A report issued by the USPS OIG estimated that the amount of the surplus is approximately $5.5 billion as of the end of fiscal year 2009, based upon projections provided to it by the OPM and additional analysis performed by the Hay Group, an independent consulting firm engaged by the USPS OIG.[73]

The report makes several recommendations with respect to the disposition of the funding surplus: (1) Congress should amend the law to address the treatment of surpluses so they are amortized in the same manner as shortfalls, or the surpluses may be used to make future payments until they are exhausted; (2) the law should be amended to permit use of funding corridors in the calculation of FERS liabilities; (3) the USPS should work with the OPM "to identify causes of actual payout differences between the Postal Service and the rest of the Federal Government and use that information to reduce the risk of future surpluses;" and, (4) the OPM or Congress should create a "sub-account" for the USPS in the CSRD Fund.[74]

The Hay Group made two suggestions regarding how the law might be changed so that surpluses are distributed over a period of time. The first (Hay Group Option A) would be to amend the law so that surpluses are treated the same way as supplemental liabilities (*i.e.*, they would be amortized over 30 years).[75]

The second suggestion (Hay Group Option B) would amend the law to essentially expand the definition of "fully funded."[76] This involves the creation of a funding "corridor." The example given by the Hay Group proposes that instead of using 100 percent of projected liabilities as the benchmark for full funding of the pension plan, the range of 90 percent to 110 percent would be considered fully funded. As long as the assets are within 90 percent to 110 percent of the estimated liabilities, then the USPS would not have to amortize a supplemental liability or surplus.

71. 5 U.S.C. § 8423(b)(1).
72. 5 U.S.C. § 8423(b)(2).
73. USPS OIG's FERS Report, at page 6.
74. *Id*.
75. *Id*., at page 21.
76. *Id*., at pages 21-22.

However, if the plan is funded at lower than 90 percent, then the USPS would have a supplemental liability. Conversely, if the funding of the plan were over 110 percent, then the USPS would receive a "negative amortization payment" (*i.e.*, the CSRD Fund would pay the USPS the excess amount so that the funding level was brought down to 110 percent).

The final part of the proposal suggests creating a sub-account that would allow the USPS's FERS liability to be based upon the USPS's actual demographics rather than Government-wide demographics.

USPS OIG's Justification for the Proposal

The USPS OIG's report points out that because there is a surplus, there needs to be a way to it.

According to the report, the creation of a "sub-account" would provide the USPS with more accurate information to include on its financial reports and would permit OPM to more accurately assess the USPS's FERS liabilities. When calculating the USPS's – or any Federal agency's – annual FERS payments, OPM relies upon demographic assumptions that are based upon the FERS population as a whole. Because the demographic characteristics of the USPS workforce may be different from the overall FERS population, this actuarial approach may have the effect of generating a higher contribution rate for the USPS than would be obtained if only USPS employees were considered.[77]

Furthermore, the report asserts that a USPS sub-account would prevent the USPS's FERS surplus from "effectively subsidiz[ing] appropriated tax dollars."[78]

Discussion

First, we must emphasize that the USPS's FERS surplus is not "subsidizing appropriated tax dollars."[79] The surplus is held in the CSRD Fund and any interest earned on that surplus reduces the USPS's FERS liability. The USPS, rather than the Federal Government, earns the benefit from the surplus.

The USPS's FERS surplus is not "subsidizing appropriated tax dollars"

The Hay Group Option A would amend the law to allow for surpluses to be treated in the same manner as supplemental liabilities. While it is unclear whether the Hay Group intended Option A to apply to all Federal agencies, it is a logical and fair solution so long as it is not limited to the USPS.

77. *Id.*, at page 3.
78. *Id.*, at page 5.
79. *Id.*

However, we are concerned with the Hay Group Option B, whereby funding corridors would be created.[80] Congress expressly intended that FERS be fully funded, meaning funded at *100 percent*. Indeed, that is why there is a statutory directive as to how shortfalls must be addressed. In the section entitled "Reduction in Contribution Levels for Retiree Benefits," we discuss the drastic nature of such a change to FERS in more detail.

With regard to the USPS OIG's first recommendation, there is precedent in the private sector to support the proposal to permit the USPS to use the surplus to make future payments until the surplus is exhausted. The CRS reports that in the private sector "[u]nder current law, plans that are [overfunded]…may apply previous years' credit balances to offset the current year's required funding."[81] The drawback of this proposal is that it assumes that the USPS will be able to generate enough revenues in the future to make its usual annual FERS payments, which, as we have noted in earlier sections of this study, is questionable.

We support the USPS OIG's recommendation that the OPM and the USPS collaborate to collect information regarding causes of the USPS's FERS surplus. Their work would likely be very useful to policymakers given the critical nature of this issue. However, it should be emphasized that such collaboration could produce only recommendations, as OPM does not have the authority to alter the statutory formula used to calculate FERS payments.

If that collaborative effort determines that the USPS population's demographics is linked to the creation of its FERS surplus, the OPM should examine the feasibility of establishing the creation of a "sub-account" for the USPS. In doing so, it should consider the effects that such a sub-account would have upon both the USPS's FERS liabilities and the Federal retirement program as a whole. We note that such fragmentation of demographics would create a potentially dangerous precedent. All agencies – or perhaps even individual offices within agencies or departments – may also request sub-accounts. Such a situation would create an administrative burden as well as introduce an element of uncertainty in Federal agencies' budgeting.

Conclusion

We agree with the Hay Group Option A insofar as it is not limited to the USPS. It aims to match contributions with outlays, as is appropriate. Trust fund assets would not be used for a purpose other than the payment of benefits nor would they be transferred out of the CSRD Fund while simultaneously increasing Federal liabilities.

80. We assume that, given the language of the Hay Group's report, the corridor would be used by all agencies to determine supplemental liabilities or surpluses and not only to the USPS. As discussed in the next section entitled "Reducing Contribution Levels for Retiree Benefits," we strongly believe that any proposal treating the USPS differently from other agencies under FERS would be unwise and contrary to Congressional intent.

81. CRS, *Pension Guaranty Corporation (PBGC): A Fact Sheet*, Report 98-118 (June 28, 2010) (hereinafter "CRS Report 98-118"), at pages 4-5.

For the reasons discussed previously, the Hay Group Option B, suggesting the implementation of funding corridors, should not be adopted.

We agree that the OPM and the USPS should analyze the causes of the USPS's FERS surplus. However, before the OPM establishes a sub-account for the USPS, the OPM should carefully examine the effects that such a sub-account would have upon both the USPS's FERS liabilities and the entire Federal retirement program.

Proposal 2: Allocation of CSRS Liabilities for POD/USPS Retirees

Current Law

Annuity Calculations

There are two main components in the computation of an annuity, whether under CSRS or FERS: (1) years of service and (2) salary. The "years of service" piece includes qualifying military service.[82] The salary figure is calculated using an employee's "high-3 salary," which is an average of the three highest salaries received in a continuous three-year period. This is frequently the last three years of the employee's career.[83]

The calculation of the present value of annuities (*i.e.*, the future liability to pay benefits) is performed using actuarial assumptions regarding interest rates, inflation, mortality rates, etc. Naturally, these assumptions must be revisited and modified regularly to reflect actual experience. The OPM recalculates all liabilities incurred (by both the Federal Government and the USPS) under CSRS and FERS on an annual basis (Annual Review).[84] The Annual Review determines if the prior year's assumptions differed from actual experience to the extent that there was either an overpayment to the CSRD Fund (surplus) or an underpayment (supplemental liability).

Title 5 of the United States Code contains special instructions with regard to the Annual Review of the USPS's liabilities. The PAEA relieved the USPS of all "regular" future CSRS payments (*i.e.*, the payments it would otherwise make on an annual basis using the statutory formula in Title 5) because when the PAEA was passed in 2006, the USPS had theoretically paid a sufficient amount into the CSRD Fund to meet its entire CSRS liability.

Under current law, as enacted by the PAEA, any USPS CSRS surplus calculated in an Annual Review prior to 2015 remains in the CSRD Fund.[85] In 2015, if there is a surplus, that amount will be transferred from the CSRD Fund to the PSRHB Fund.[86] If, however, an Annual Review indicates that the USPS has a supplemental liability, as it had at the end of fiscal year 2009,[87] the USPS does not pay anything towards that supplemental liability until 2017. At that point, the OPM will establish a schedule (an "amortization schedule") by which the USPS will pay off that amount through annual payments so that the debt is completely paid off by September 30, 2043.[88]

82. 5 U.S.C. §§ 8332(c) (CSRS), 8411 (FERS).
83. For example, perhaps an employee earned $48,000 in year 1, $49,000 in year 2, and $50,000 in year 3, making that the most he or she has ever earned. The "high-3" is the average of those figures ($49,000) and that is what is used in the formula to determine his or her annuity. [Note that $49,000 is NOT the amount of the annuity.]
84. 5 U.S.C. §§ 8348(g)-(h) (CSRS), 8423 (FERS).
85. 5. U.S.C. § 8348(h)(2)(B).
86. 5 U.S.C. § 8348(h)(2)(C).
87. According to the OPM Actuary, the USPS's CSRS unfunded liability as of the end of fiscal year 2009 was $7.3 billion.
88. 5 U.S.C. § 8348(h)(2)(B).

After 2017, the OPM will continue to conduct an Annual Review and revise any amortization schedules accordingly.[89]

Actuarial Methodology at Issue

There are some USPS employees who participate in CSRS and who worked for both the POD and the USPS (POD/USPS employees). Their years of service at both entities are included in their annuity calculations. Therefore, the Federal Government and the USPS each pay part of that annuity (POD/USPS annuity). One of the formulae used to calculate these annuities is the subject of the proposal discussed in this section.

Just as it does for other annuity liabilities, the OPM must perform an Annual Review in order to determine whether there is a surplus or supplemental liability related to the POD/USPS annuities. However, because the financial responsibility for the cost of these annuities is split between the Federal Government and the USPS, the OPM must perform other computations before it performs the normal Annual Review.

The OPM first determines the total cost of the annuity owed to the employee using the standard CSRS formula. For CSRS participants other than USPS or POD/USPS employees, this is the total cost of the annuity and no other calculations are needed.

For USPS (including POD/USPS) employees, the OPM must then calculate the baseline for the allocation of the annuity costs between the Federal Government and the USPS (Baseline Allocation).

The first step in the Baseline Allocation is the determination of whether any portion of the annuity cost is attributable to military service. The Federal Government is responsible for this cost for any USPS retiree, regardless of whether he or she worked for the POD.

For USPS employees other than POD/USPS employees, this completes the Baseline Allocation. For POD/USPS employees, however, an additional step is needed.

The last step in the Baseline Allocation for POD/USPS employees is the determination of the annuity cost that the Federal Government would have paid if the POD/USPS employee had retired on June 30, 1971, the last day that the POD was in existence. That is, the OPM calculates the annuity costs using the years of service at the POD and the salary paid during those years. This cost remains the same no matter how long the POD/USPS employee works at the USPS. Neither the years of service at the USPS nor the salary during those years is taken into consideration. Therefore, because this cost will never increase, it is sometimes referred to as a "frozen benefit."

89. 5 U.S.C. § 8348(h).

This figure plus the cost of the annuity due to military service comprises the Federal Government's share (Federal Share). The USPS pays the cost of the annuity that is in excess of the Federal Share.

One consequence of this Baseline Allocation method is that because one component of the Federal Share is the frozen benefit, the USPS must pay for the increase in pension benefits attributable to USPS salary increases while employed by the USPS, even on the years of service attributable to POD service.

USPS OIG's Proposed Action

This proposal recommends that the OPM calculate the Baseline Allocation differently. It advocates a "years of service" method, which would divide the POD/USPS annuity contributions proportionately between the USPS and the Federal Government using the number of years that the employee worked for each entity. For example, if an employee worked for the POD for 15 years and the USPS for 15 years, then the USPS and the Federal Government would each pay half of that annuity payment. However, the Federal Government would still pay the full cost attributable to creditable military service.

The USPS OIG has determined that if the OPM had used this revised Baseline Allocation, then over the years the USPS has paid $75 billion more in CSRS payments than would be required. These funds could be used to first pay off the USPS's general debt to the U.S. Treasury (unrelated to the CSRD Fund) and the USPS's CSRS supplemental liability. The remainder could then be transferred to the PSRHB Fund, fully funding it. This would allow the USPS to (1) cease the statutory PAEA payments since the PSRHB Fund would be fully funded and (2) immediately start using the PSRHB Fund, rather than its current operating capital, to pay the health care premiums for current retirees.[90]

USPS OIG's Justification for the Proposal

This proposal was developed because the USPS OIG's report asserts that it is unreasonable and inequitable to use "[a]n allocation method that assumes [that] employees will receive no pay increases – not even to offset inflation."[91] The formula by which CSRS pensions are calculated uses the high-3 figure and the employee's years of service. Under CSRS, not all years of service are equal in value. Later years are "worth more" than earlier years because the CSRS formula weighs the later years of an employee's service more heavily in computing annuities. Consequently, as the report argues, the Federal Government's share not only reflects lower, pre-1971 salaries, but it also has the benefit of using the earlier, less valuable years of service. The report notes that one potential consequence is that the USPS "could be responsible for 70 percent of the pension of an employee who worked only 50 percent of his or her career for the Postal Service."[92]

90. USPS OIG's CSRS Report, Introduction, at page 3.
91. *Id.*, at page 2.
92. *Id.*

Furthermore, the report contends that the fact that the OPM uses a years of service calculation for allocating the costs of health benefits for these POD/USPS CSRS retirees suggests that the current Baseline Allocation is incorrect because the costs for each benefit should be assigned using the same method.[93]

Another argument advanced by the USPS OIG is that the Postal Civil Service Retirement System Funding Reform Act of 2003 (2003 Act)[94] repealed the provision in Title 5 of the United States Code that explicitly stated that USPS would be responsible for all CSRS costs associated with USPS pay increases. [95] The 2003 Act required that USPS's CSRS liabilities be calculated using the FERS funding formula, which unlike CSRS, accounts for inflation. The contention is that the adoption of a specific formula repealed the general requirement that the USPS be responsible for the portion of the POD/USPS annuity attributable to USPS wage increases.[96]

Discussion

Before reviewing the arguments put forth in support of this proposal, we note that the USPS OIG does not precisely explain how it calculated the $75 billion figure that it uses. The Hay Group estimated that, if the Baseline Allocation was calculated by using a years of service method, the U.S. Treasury would owe the USPS $58.7 billion as of September 30, 2006.[97] The USPS OIG's report states, in a footnote, that it obtained the $75 billion figure by "extend[ing] the Hay Group's analysis to 2009."[98] Nowhere is this "extension" computation explained. Reports from various other sources that we reviewed on this issue appear to have accepted the $75 billion as an accurate figure when examining the proposed allocation methodology despite the fact that an explanation regarding how that number was calculated has not been provided. In this context we caution against reliance upon this unsupported figure.

Congress intended that POD/USPS annuity responsibilities be divided in the manner used in the OPM's current Baseline Allocation

<u>Allocation of Pay Increases and Equity Issues</u>

There is extensive legislative history that Congress intended that POD/USPS annuity responsibilities be divided in the manner used in the OPM's current Baseline Allocation. For example, a House Report discussing Public Law 93-349, passed in 1974 (1974 Act), [99] states:

93. *Id.*, at pages 2-3.
94. Postal Civil Service Retirement System Funding Reform Act of 2003, Pub. L. No. 108-18, 117 Stat. 624.
95. USPS OIG CSRS Overpayment Report, at page 2; *see also*, Letter from Inspector General David C. Williams, USPS, to John Berry et al., Director, OPM (Mar. 4, 2010).
96. Letter from Inspector General David C. Williams, USPS, to John Berry et al., Director, OPM (Mar. 4, 2010), at pages 2-3.
97. USPS OIG's CSRS Report, at page 19.
98. *Id.*, at footnote 5.
99. An Act to provide for payments by the Postal Service to the Civil Service Retirement Fund for increases in the unfunded liability of the Fund due to increases in benefits for Postal Service employees, and for other purposes, Pub. L. No. 93-349, 88 Stat. 354.

> The Congress now has no control – no oversight whatsoever – with respect to the pay machinery in the Postal Service. Since each future pay raise, negotiated or otherwise granted to employees in the Postal Service, will result in a specific unfunded liability and a new drain on the Retirement Fund, the cost of this liability should properly and equitably be borne by the Postal Service.[100]

Indeed, as the OPM has pointed out, the USPS itself also recognized and explicitly accepted this policy as an inherent condition of its independent status. The Postmaster General sent a letter to the Senate Committee dated March 27, 1973, stating:

> This legislation has been proposed on the ground that the Postal Service should operate on a financially self-sufficient basis, meeting its operating costs out of its revenues and not out of hidden subsidies. After careful consideration – and in full awareness of the financial burdens enactment of the bill will impose – the Postal Service has concluded that it is proper, as a matter of principle, for these costs to be imposed on postal ratepayers rather than taxpayers.[101]

It should also be noted that the OPM has consistently utilized this method for 40 years. Indeed, at a joint hearing held by the House Oversight and Government Reform Committee and the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, John O'Brien, then the OPM Director of Planning and Policy Analysis, testified:

> OPM's methodology…was considered by the GAO in Report Number GAO-03-448R, dated January 31, 2003, which…evaluated the reasonableness of OPM's methodologies for allocating estimated benefit payments and other expenses between service rendered before and after July 1, 1971…and suggested no changes to the allocation methodology used for Postal Retirement funding.[102]

Mr. O'Brien also testified that the OPM did not find any record that Congress was concerned with the OPM's allocation method as it drafted and passed the 2003 Act or the PAEA.[103] We were likewise unable to locate any such records.

Retiree Health Benefit Costs Versus Annuity Costs

Pensions and retiree health benefits are two very different entitlements and thus it is appropriate to use different methods to allocate the respective contribution responsibilities to them. Pension rights are earned over time and the value of a pension is dependent upon both years of service and salary. The USPS and not the Federal Government sets the salary level for USPS employees.

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100. H.Rep. No. 93-120 (1973).
101. S.Rep. No. 93-947 (1974), cited by statement of John O'Brien, Director of Planning and Policy Analysis, OPM, *Who Owes Who What? An Examination of the United States Postal Service's Civil Service Retirement System Pension Contributions*, Joint Hearing before the Committee on Oversight and Government Reform and Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, U.S. House of Representatives (2010), at page 3.
102. Statement of John O'Brien, *supra* note 101, at page 4.
103. *Id.*, at page 5.

Therefore, the USPS and not the Federal Government controls the value of the pension. This is why it is proper to allocate the value of salary increases to the USPS rather than on a pro rata basis.

Retiree health care insurance, on the other hand, is a benefit that is not earned over time nor dependent upon the USPS salary. It is merely conditioned upon the person's status as a retiree who is eligible for the benefit. Therefore, because the USPS does not control the amount of the benefit, it is appropriate to use a years of service method to allocate these health care costs between the USPS and the Federal Government.

Impact of the 2003 Act

The USPS OIG contends that the 2003 Act repealed the USPS's liability for the increases in CSRS pension costs attributable to USPS pay increases.[104] The language repealed by the 2003 Act was originally added to Title 5 by the 1974 Act. The original provision stated:

> Notwithstanding any other statute, the United States Postal Service shall be liable for that portion of any estimated increases in the unfunded liability of the Fund which is attributed to any benefits payable from the Fund to active and retired Postal Service officers and employees, and to their survivors, when the increase results from an employee-management agreement under title 39, or any administrative action by the Postal Service taken pursuant to law, which authorizes increases in pay on which benefits are computed.[105]

This language directs the OPM how to calculate the Baseline Allocation (*i.e.*, the division of financial liability for the POD/USPS annuities between the USPS and the Federal Government). It clearly supports the current Baseline Allocation used by the OPM.

The 2003 Act replaced this section with language that provides the formula that the OPM should use in the USPS's Annual Review. As discussed in the section "USPS OIG's Justification for the Proposal," the 2003 Act replaced the 1974 language with a specific formula requiring that when calculating the USPS's CSRS liability in its Annual Review, the OPM use the FERS funding formula, which accounts for inflation. This formula is used for *all* USPS employees, not simply POD/USPS employees. The 2003 statutory language does not address the calculation of the Baseline Allocation, only the Annual Review.

It is highly unlikely that such an amendment, which applies to the entire USPS CSRS population, was meant to repeal a fundamental policy decision made in 1974 related solely to POD/USPS employees. Indeed, the Senate Committee report accompanying the 2003 Act rejects such an idea, noting that the 2003 Act "continues the Postal Service's liability for the retirement costs

104. USPS OIG CSRS Overpayment Report, at page 2; *see also*, Letter from Inspector General David C. Williams, USPS, to John Berry et al., Director, OPM (Mar. 4, 2010).
105. Pub. L. No. 93-349 (adding a new subsection (h) to section 8348 of Title 5, United States Code; the quoted passage is paragraph (1) of this new subsection (h)).

attributable to its employees covered by the CSRS, which was imposed when the Post Office Department became the self-supporting United States Postal Service in July 1971."[106]

The USPS Inspector General David C. Williams, in a March 4, 2010, letter to OPM Director John Berry, points out that current law states that when performing the Annual Review, the OPM may include in its calculations "any other appropriate amount, as determined by [the OPM] in accordance with generally accepted actuarial practices and principles."[107] The letter asserts that this provision would permit the OPM to make an adjustment to the Baseline Allocation without a need for new legislation.

We disagree with this assertion. The suggestions offered by the USPS OIG and the PRC involve a radical revision to the Baseline Allocation. The statutory clause cited above is an example of a "catch-all" provision that is often included in laws to provide an agency with some regulatory flexibility. Making the type of adjustment suggested in the Inspector General Williams's letter entails increasing the financial liabilities of the Federal Government by $50 to $75 billion. It would be *highly* inappropriate for the OPM to unilaterally make such a decision without clear statutory direction from Congress.

Impact Upon Taxpayers

Adoption of this proposal would entail a transfer of significant retirement liabilities to the Federal Government. As the CRS points out:

> Changing the allocation of CSRS pension expenses between the Postal Service and general fund of the U.S. Treasury is a zero-sum game. A reduction in the amount of CSRS pension expenses allocated to the USPS would result in an equal increase in CSRS pension expenses borne by the U.S. Treasury.[108]

"A reduction in the amount of CSRS pension expenses allocated to the USPS would result in an equal increase in CSRS pension expenses borne by the U.S. Treasury."

- CRS

Adopting the USPS OIG's revised Baseline Allocation (or that of the PRC)[109] would mean that the Government is agreeing to pay a larger share of the pensions of POD/USPS employees. Under the proposal, a certain amount of assets - $50 to $75 billion, depending upon which revised Baseline Allocation is adopted – would be transferred from the CSRD Fund to the PSRHB Fund. The CSRD Fund's obligations remain unchanged. Furthermore, the USPS would be relieved of making any future payments into the PSRHB Fund because the assets received

106. S.Rep. No. 108-35 (2003), at page 3.
107. 5 U.S.C. § 8348(h)(1)(B)(iii). *See*, Letter from Inspector General David C. Williams, *supra* note 104, at pages 2-3.
108. CRS Report R41024, at page 11.
109. The PRC's consultant, the Segal Company, suggested an allocation formula that would set USPS's CSRS surplus at $50 to $55 billion. The Segal Company, *Report to the Postal Regulatory Commission on: Civil Service Retirement System Cost and Benefit Allocation Principles* (June 29, 2010).

from the CSRD Fund would satisfy all of the USPS's unfunded liabilities related to retiree health benefits (*i.e.*, the PSRHB Fund would be fully funded). This would allow the USPS to use the PSRHB Fund to pay all retiree health benefit premiums.

Consequently, if this proposal were enacted, the Federal Government could lose a stream of income (the annual PAEA payments made by the USPS into the PSRHB Fund), while acquiring new pension liabilities and maintaining its current level of retiree health benefit liabilities.

Conclusion

The OPM is complying with the law

We conclude that the OPM is complying with current laws relating to the allocation of CSRS liabilities for POD/USPS retirees. Furthermore, the OPM does not have the authority to implement the proposed changes to the Baseline Allocation formula without new legislation.

Under this proposal, the Federal Government would be assuming new liabilities without obtaining a corresponding increase in Government oversight of the USPS. As discussed in the subsection entitled "USPS's Financial Outlook," there are many causes of the USPS's financial difficulties. By focusing only on the retirement liability issue, the overarching policy considerations regarding the relationship between the USPS and Federal Government would not be addressed.

Clearly a transparent and more efficient approach to the USPS's funding shortfall would be a direct appropriation to the PSRHB Fund or the USPS itself. Such an appropriation would allow Congress to set conditions or require other oversight reporting to ensure that the Federal funds being used by the USPS are used efficiently.

Proposal 3: Reduction in Contribution Levels for Retiree Benefits

Current Law

Congress created FERS to be a fully funded pension plan, unlike CSRS. There are several reasons why Congress chose to prefund its obligations:

> First, by providing a continuous source of budget authority, the [CSRD Fund] allows benefits to be paid on time, regardless of any delays that Congress may experience in passing its annual appropriations bills. Secondly, the balance in the trust fund acts as a barometer of the Government's future pension obligations… Finally, prefunding pension obligations forces Federal agencies to recognize their full personnel costs when requesting annual appropriations from Congress. Otherwise, these costs would be recognized only in the central administrative accounts of [OPM], and not by the agencies where the costs are incurred.[110]

The USPS's pension liabilities under FERS are calculated in the same way as those of Federal agencies.

With regard to retiree health benefits, the USPS currently makes two separate payments to meet its liabilities. One is an annual payment for the actual costs associated with the health benefits provided to current USPS retirees. The second payment is the PAEA-mandated payment into the PSRHB Fund to prefund its obligations to future retirees.

Beginning in 2017, the assets of the PSRHB Fund will be used to pay the actual annual health care costs of current retirees. This means that beginning in 2017, the USPS will make only a single annual payment into the PSRHB Fund. This payment will be based upon annual calculations by the OPM regarding the projection of USPS's future responsibilities, and the USPS's payment schedule will be adjusted accordingly each year.

USPS OIG's Proposed Action

This proposal would amend the law so that the USPS would be permitted to (1) cease fully funding its FERS obligations and (2) cease making the PAEA scheduled payments into the PSRHB Fund, which would have over time fully funded its retiree health benefits obligations. Instead, the USPS would prefund only 80 percent of its FERS liabilities and 30 percent of its retiree health benefit liabilities.

If this proposal were enacted, the USPS would already have a "surplus" for both its FERS and retiree health benefits funding. The proposal envisions that the "federal government could retain [these surplus amounts] in the current funds…eliminat[ing] the need for the Postal Service to make payments to the pension and retiree health care funds until the lowered funding threshold is reached."[111]

110. CRS Report 98-810, at page 10.

111. USPS OIG's Funding Levels Report, at page 3.

USPS OIG's Justification for the Proposal

The USPS OIG's report claims that its "[b]enchmarking results indicate the Postal Service has prefunded its pension and retiree health benefits plans at substantially higher levels than other entities."[112] The entities used for the "benchmarking" of pension funding are the companies in the Standard & Poor's 500 index (S&P 500) as well as State and Federal Governments. To establish a benchmark for the funding of retiree health benefits, the report indicated that it reviewed the practices of Fortune 1000 companies, State Governments, and the Federal Government.

With regard to pension funding, the report found that the pension prefunding levels among the S&P 500 during the period of 2001 to 2009 ranged from 73 percent to 112 percent, with a median of 79 percent.[113] The report also notes, but without further explanation, that "[t]he aggregate prefunding for States' pensions in 2008 was also 79 percent."[114] In addition, the USPS OIG has pointed out repeatedly in the past that the Federal Government funds its civilian pension responsibilities at 41 percent and its military pension responsibilities at 24 percent.[115]

Futhermore, the report found that many Fortune 1000 companies do not prefund retiree health benefits at all and of those that do, the average level is 28 percent. The report also determined that State Governments prefund these benefits at 30 percent.[116] It notes that the military prefunds its liabilities at 29 percent and the Federal Government does not prefund retiree health benefits for civilians at all.

Discussion

The radical nature of the proposed reduced funding levels cannot be overstated. We strongly oppose the entire proposal and believe that the financial soundness and integrity of the CSRD Fund would be seriously compromised if it were enacted.

Benchmarks

Before looking at specific arguments and pieces of the proposal, we would like to note that the report fails to support its "benchmarks." The calculation of these benchmarks is not explained in that report or any other report that we have reviewed. Therefore, we are unable to evaluate the propriety of using these benchmarks in comparing funding practices across the various sectors.

The use of these benchmarks as justification for a radical change to the retirement funding structure is an example of what concerns us about the tenor of the debate on these matters. The

112. *Id.*, at page 2.
113. *Id.*, at footnote 3.
114. *Id.*, at page 2.
115. *See, e.g.*, USPS OIG CSRS Overpayment Report, at page 10; USPS OIG Summary, at page 10.
116. USPS OIG Summary, at page 10.

report contains several declaratory statements that are presented as fact and yet offer no factual support.[117] Such statements serve only to confuse matters and create misleading impressions.

Comparison to Private Sector

There is some support for the report's concepts as applied to the private sector. Bills were introduced in the 111th Congress that would provide funding relief similar to what the report is proposing.[118] These proposals would reduce payment obligations, permitting corporations to redirect the money to more immediate needs. These bills were introduced in response to the fact that requirements imposed by the Pension Protection Act of 2006 (PPA)[119] upon private corporations, combined with various economic factors, have increased the funding obligations of pension plan sponsors.[120] However, that is where the similarities between the private sector and the USPS end.

While the USPS and private companies may face the same problems, they are very different types of entities. A private company can terminate its pension plan at any time. Furthermore, bankruptcy proceedings offer private companies the potential of financial relief with regard to both pension and retiree health benefits. The former Assistant Secretary of the Treasury for Financial Markets, Timothy S. Bitsberger, testified at a hearing before the Senate Committee on Homeland Security and Governmental Affairs that "the private sector has the ability to eliminate [its retirement health liabilities] and other obligations either voluntarily or through a bankruptcy proceeding. These changes generally take the form of reduced or eliminated benefits."[121]

It is not only reasonable but prudent to require the USPS to fully fund its liabilities since the U.S. taxpayer acts as the USPS's insurer

If a company does go bankrupt and its pension plan is not fully funded, its employees and retirees have a degree of protection because the Pension Benefit Guaranty Corporation steps in and, assuming certain criteria are met, fulfills the company's pension obligations up to a specified maximum benefit level.[122] The USPS, on the other hand, has no such backstop except for the U.S. Treasury. As discussed in the subsection entitled "Postal Employee and Retiree Rights," the Federal Government is the entity that is legally bound to satisfy annuity obligations to USPS retirees. Therefore, it is not only reasonable but prudent to require the USPS to fully fund its liabilities since the U.S. taxpayer acts as the USPS's insurer.

117. See our discussion in the subsections entitled "Comparison to Private Sector" and "Comparison to States."
118. H.R. 3936 (Preserve Benefits and Jobs Act of 2009); H.R. 2989 (401(k) Fair Disclosure and Pension Security Act of 2009); H.R. 4213 (Tax Extenders Act of 2009, later the American Jobs and Closing Tax Loops Act of 2010, which included provisions from H.R. 2989); Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, Pub. L. No. 111-192, 124 Stat. 1280. *See*, CRS Report 98-118, at pages 3-4.
119. Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780.
120. *See*, CRS Report 98-118, at page 3.
121. Statement of Timothy S. Bitsberger, Assistant Secretary for Financial Markets, U.S. Department of the Treasury, *Reform of the United States Postal Service*, Committee on Homeland Security and Governmental Affairs, U.S. Senate (April 14, 2005), at page 4.
122. 29 U.S.C. § 1322.

The description of the legal standards governing the funding levels of private pension funds contained in the USPS OIG's report is confusing at best. It states that the PPA "considers pensions prefunded at less than 70 percent as being 'at risk' and attempts to protect such plans by commencing restrictions on corporate pension funds only when prefunding is below 80 percent."[123] The report concludes that "80 percent prefunding for pensions…represents a reasonable level in addressing retirees' needs, yet also provides the Postal Service with a means of halting its current financial slide."[124]

A 2006 CRS report[125] explains that the PPA established new rules for pension plans and set the funding target for single-employer plans at 100 percent, although this is phased in over five years, reaching 100 percent only in 2011.[126] Pension funds that do not meet certain funding tests will be determined to be at risk of defaulting on their liabilities (called "at-risk plans") and plan sponsors will be required to use actuarial assumptions that result in larger annual payments to the plan.[127]

Therefore, the law does not *promote* 80 percent as a funding level, as the USPS OIG's report implies. That is simply the lowest funding level a plan can have to avoid being penalized; it is the *floor* set by the law, not the *target*. Considering the USPS's own unfavorable financial projections and its approximately $12 billion debt to the U.S. Treasury, the PPA offers no support for the proposal to change from fully funding a plan to using the minimum funding percentage permitted without penalty.

The USPS OIG's report offers only a single sentence regarding the prefunding of retiree health benefits in the private sector.[128] It states that "the average level that Fortune 1000 companies prefund retiree health care (many do not prefund) is 28 percent."[129] However, former Assistant Secretary Bitsberger stated at a Congressional hearing:

> [T]he private sector generally has not fully pre-funded these liabilities, but… in recent years, many firms that offer post-retirement health benefits have in fact established dedicated trusts to fund these liabilities as the seriousness of these obligations became apparent.[130]

123. USPS OIG's Funding Levels Report, at page 2.
124. *Id.*, at page 3.
125. CRS, *Summary of the Pension Protection Act of 2006*, Report RL33703 (Oct. 23, 2006), at pages 4-5.
126. *Id.* For 2009, the target was 94 percent and for 2010, it was 96 percent.
127. There are two tests to determine if a plan is at-risk. First, if the plan is funded below 70 percent under "worst-case scenario" assumptions that (1) the employer is not permitted to use credit balances to reduce its cash contribution and (2) employees will retire at the earliest possible date and will choose to take the most expensive form of benefit, then it is at risk unless it meets the second test. Under the second test if, under standard actuarial assumptions, the plan is considered to be funded above 65 percent, then it would not be considered at-risk. The standard under the second test changed to 70 percent in 2009, 75 percent in 2010, and 80 percent in 2011 and thereafter. *Id.*, at page 4.
128. USPS OIG's Funding Levels Report, at page 2.
129. *Id.*
130. Statement of Timothy S. Bitsberger, *supra* note 121, at page 4.

While the USPS OIG's report does not provide the source of its data regarding the treatment of retiree health benefits in the private sector, the CBO has stated that "[a]ccording to one analysis, just 35 percent of Fortune 1000 companies have set aside assets to cover those liabilities. Moreover, those assets are only large enough to cover about one-third of the expected costs, on average."[131] The paper goes on to point out that fewer and fewer companies are now offering these benefits and if they do, they are cutting benefits. Again, however, the key difference is that the private sector can avoid these obligations through plan termination and/or the application of the bankruptcy laws.

Comparison to States

The USPS OIG's report indicates that "[t]he aggregate prefunding for States' pensions in 2008 was 79 percent of liabilities."[132] However, again, the method used to calculate that figure is not explained. While it cites a 2008 GAO report for the proposition that "many experts consider at least 80 percent prefunding to be sound for government pensions,"[133] it fails to mention other key points in the GAO report.

The GAO explains that the method it used to determine the funding status of a plan was to look at three different measures: (1) the yearly contributions made by the Government-employer; (2) the funded ratio (*i.e.*, liabilities covered by assets); and (3) the unfunded liabilities.[134] In its analysis, the GAO found that because State and local governments use different actuarial cost methods, assumptions, and amortization periods to estimate the second and third factors, "[t]he funded status measures of different plans cannot be compared to one another easily."[135]

The USPS OIG's report states that it used the S&P 500 to develop the private sector benchmark but fails to offer any indication of what data it used for the State Government benchmarks. It cannot be relying upon the GAO research because the USPS OIG's report speaks only of State Governments while the GAO report uses data from both State *and* local governments.[136] Moreover, the USPS OIG indicates that it is *not* using "computer-generated data to support the opinions and conclusions presented in this report."[137] Consequently, we are unable to rely upon the assertion that State Governments are funding their pension plans at 79 percent.[138]

131. CBO, Letter from Barry B. Anderson, Acting Director, CBO, to the Honorable Jim Nussle, Chairman, Committee on the Budget, U.S. House of Representatives (Jan. 27, 2003), at page 15 (citing Watson Wyatt, *Retiree Health Benefits: Time to Resuscitate?* Research Report (Washington, D.C.: 2002)).
132. USPS OIG's Funding Levels Report, at page 2.
133. *Id.* (citing GAO, *State and Local Government Retiree Benefits: Current Funded Status of Pension and Health Benefits*, GAO-08-223 (Jan. 29, 2008) (hereinafter "GAO-08-223")).
134. GAO-08-223, at page 2.
135. *Id.*, at pages 8 and 11.
136. Moreover, GAO's own data set is by no means exhaustive: its two sources contain "self-reported data on state and local government pension plans in years 1994, 1996, and 2000 to 2006. Each year, between 62 and 72 plans were represented in [the] dataset." GAO-08-223, at footnote 15.
137. USPS OIG's Funding Levels Report, at page 5.
138. *Id.*, at page 2.

The USPS OIG's report also contains only a single sentence regarding the prefunding of retiree health benefits by State Governments.[139] Therefore, we cannot comment on the report's comparison of the USPS to State Governments except to note its lack of factual support.

Comparison to the Federal Government

In several of its reports discussing the USPS's funding of its retirement obligations, as well as in testimony before Congress, the USPS OIG has emphatically repeated that (1) Federal Government civilian annuities are funded at 41 percent, (2) military pensions are funded at 24 percent, (3) Federal civilian retiree health plans are not funded at all, and (4) military plans are funded at 29 percent. These facts are used to argue that the USPS should be treated in a similar manner.

It is misleading to use the 41 percent figure in describing the status of the Federal retirement programs in their entirety because this figure *combines* CSRS and FERS.[140] It has never been in dispute that CSRS is not fully funded. FERS, on the other hand, is designed to be fully funded. Granted, supplemental FERS liabilities exist, but they are a very small fraction of the Government's total unfunded CSRD Fund liabilities. For example, at the end of fiscal year 2008, the CSRD Fund had approximately $674 billion in unfunded liabilities and according to the Congressional Research Service, "[a]ll but $1 billion of this unfunded liability is attributable to CSRS."[141]

The former Acting Director of the OPM, Dan G. Blair (later the first chairman of the PRC), testified at a Senate hearing that "[t]he Postal Service has been treated differently than other Federal entities for more than three decades when it comes to retirement payments."[142] There is a very good reason for this: it is not a Federal agency and its obligations are not – absent express consent – backed by the full faith and credit of the Federal Government.[143] Instead, it is an independent establishment of the Executive Branch[144] that is empowered to issue debt in its own name.[145] Former Acting Director Blair went on to state:

> The law requires the Postal Service to manage its finances to ensure that its revenues cover its costs, unlike virtually all other Federal agencies. The parallels between departments such as Defense, Education, Housing and Urban Development, Health and Human Services, Treasury, Homeland Security, Justice, et al., and the Postal Service simply do not exist.[146]

139. *Id.* ("In addition, we determined that state governments that prefund retiree health care averaged 30 percent.").
140. USPS OIG's Funding Levels Report, at page 2.
141. CRS Report 98-810, at page 12.
142. Statement of Dan G. Blair, Acting Director, OPM, *Reform of the United States Postal Service*, Committee on Homeland Security and Governmental Affairs, U.S. Senate (April 14, 2005), at page 1.
143. 39 U.S.C. § 2005 (USPS debts shall "not be obligations of, nor payment of the principal thereof or interest thereon by guaranteed by, the Government of the United States except as provided in section 2006(c)"); § 2006(c) (USPS obligations will be backed by the full faith and credit of the U.S. Government only if the Secretary of the Treasury "determines that it would be in the public interest to do so.").
144. 39 U.S.C. § 201.
145. 39 U.S.C. § 2005.
146. Statement of Dan G. Blair, *supra* note 142, at page 3.

As discussed above in the subsection entitled "USPS's Relationship with the Federal Government," neither Congress nor the President has budgetary authority over the USPS. In contrast, Federal agencies are subject to such authority because they are funded by appropriated taxpayer dollars. If there is an unfunded liability in a trust fund attributable to a Federal agency, then regardless of whether it is "charged to the General Fund of the Treasury or charged to agency budgets," that cost is still borne by the taxpayer.[147]

Conclusion

The unintended consequences of this proposal are particularly far-reaching and would threaten the viability of the trust funds.

The unintended consequences of this proposal are particularly far-reaching and would threaten the viability of the trust funds

Congress intended for FERS to be fully funded because it sought to create a cost-efficient pension program that could compete effectively with the private sector. A report issued by the Senate Committee on Governmental Affairs discussing the design of this new retirement program stated:

> [F]or an enterprise to survive it must keep its costs under control. Compensation is a major cost for any organization, such as the Government, and retirement can account for 15-25 percent of payroll. Related to cost is how a retirement plan is funded. Retirement costs, unlike other costs, do not necessarily surface until many years after the establishment of a plan. Federal law, however, requires private employers to prefund their plans to a certain extent to ensure the availability of assets to pay for benefits when they come due. The committee finds that the costs of the Federal Government plan should be on par with corporate plans. Additionally, the committee believes that the Government should prefund its plan to avoid the revelation of startling costs at a later period.[148]

Congress intended for FERS to be fully funded

While the Federal Government does not prefund its CSRS pension or retiree health benefits obligations at 100 percent, it *does* prefund its FERS liabilities at 100 percent. This in no small part has contributed to the continued viability of the CSRD Fund:

> One reason that the [CSRD Fund] will not exhaust its resources is that all Federal employees hired since 1984 are enrolled in FERS. By law, the benefits that employees earn under FERS must be fully funded by the sum of the employer and employee contributions and interest earnings.[149]

147. *Id.*
148. S.Rep. No. 99-166 (1985), at page 5.
149. CRS Report 98-110, at page 12.

Another major flaw with this proposal is that it carves out a unique advantage for a single Governmental entity without any justification for such special treatment. In 2004, former Secretary of the Treasury, John W. Snow, raised the same objection that we do today:

> This issue is best considered in the wider context of the Federal Government's retirement funding system. Choosing to treat the Postal Service in a manner that is inconsistent with the FERS funding paradigm has implications to the wider Government retirement structure. By so doing, the door is open to tinker with FERS across agencies, as it will be difficult to conclude that the Postal Service is the only exception to an otherwise consistent retirement system. The costs are likely to be enormous in their entirety.[150]

As former Secretary Snow warned, permitting the USPS to deviate from the established FERS formula creates the dangerous – and expensive – risk that agency by agency exceptions to the CSRD Fund's operations will be enacted into law. If this proposal were adopted, it is readily foreseeable that virtually all other Federal agencies, Government corporations, and any other Governmental entities that participate in the Federal retirement program will argue that they too should be able to reduce their personnel costs by funding their FERS obligations at 80 percent.

As former OPM Acting Director Blair pointed out, the Federal Government is liable for any unfunded obligations it creates, regardless of the account from which the money is actually taken.[151] This is logical given that elected officials are charged with acting responsibly to protect public funds and are held accountable by the voters. The USPS lacks equivalent accountability.

The USPS fully prefunding retirement liabilities provides important protection for taxpayers

The requirement for the USPS to fully prefund its retiree liabilities provides important protection for taxpayers by guaranteeing that the USPS will continue to pay its own expenses. We have already explained our concerns regarding potential the USPS insolvency and the Federal Government's subsequent assumption of those debts. Those concerns apply equally here.

We question whether permitting anything less than 100 percent prefunding of either pension or retiree health benefits would be a wise use of public funds. The USPS may need the operating capital right now, but as discussed throughout our study, it has encountered financial crises in the past, received some level of monetary relief, and yet is still in a critical financial situation.

If the USPS needs Federal assistance, it should not be debated within the context of funding retirement obligations

We suggest that if the USPS needs Federal assistance, then that assistance should be examined and debated independently and not within the context of funding retirement obligations.

150. Statement of John W. Snow, Secretary, Department of the Treasury, *Reform of the Postal Service*, Joint Hearing before the Committee on Government Reform, U.S. House of Representatives, and the Committee on Governmental Affairs, U.S. Senate (Mar. 23, 2004) (discussing the issue of military service credit).
151. Statement of Dan G. Blair, *supra* note 142, at page 3.

Recommendations

Based upon our research and analysis, we make the following recommendations:

1. The OPM should consider supporting the proposal to amend the FERS funding mechanism either by permitting amortization of surpluses in the same manner as supplemental liabilities or utilizing the surplus in lieu of annual FERS payments until it is exhausted. In this instance, the proposal maintains the financial integrity of the CSRD Fund. However, the OPM should strongly advocate that the proposal apply to all agencies participating in FERS and not solely to the USPS.

2. The OPM should examine the effects that would result from the creation of a demographic sub-account, which would be utilized in determining the USPS's FERS liability. Such a study should consider the effects upon both the USPS's FERS liabilities and the entire Federal retirement program.

3. As the administrator and fiduciary of the FEHB Program, the OPM should support retaining the requirement that the USPS prefund its retiree health benefits as it does under current law. This requirement protects the FEHB Program against the risk of the USPS default.

4. We recommend that the OPM not implement the proposal regarding the modification of the Baseline Allocation used to calculate the USPS's CSRS liability for POD/USPS employees. It is beyond the OPM's legal authority to adopt either the USPS OIG's or the PRC's revised Baseline Allocation. Absent Congressional action on the matter, the OPM should refrain from making the USPS OIG's (or PRC's) suggested amendments to its Baseline Allocation formula. We note that a change in the Baseline Allocation would shift substantial costs from the USPS to the Federal Government.

5. We recommend that the OPM strongly oppose any legislative action that would permit the USPS to fund its FERS responsibilities at 80 percent. This proposal would cause the CSRD Fund to incur substantial unfunded liabilities as well as create a dangerous precedent whereby other agencies would seek to reduce their FERS funding obligations. Permitting the USPS to fund its FERS liabilities below 100 percent would strip the taxpayer of protection against USPS default. Furthermore, if other agencies were to adopt the same model, (a) agencies would avoid being accountable for their full personnel costs, leaving the Federal Government to pay retiree costs out of the U.S. Treasury's general fund rather than through the agencies' annual appropriations, (b) the continued use of trust fund assets for purposes other than the payment of retiree benefit would compromise the integrity of the trust funds by increasing its unfunded liabilities, and (c) this directly contradicts the Congressional intent that FERS be a fully funded program.

6. The OPM, as the administrator of the trust funds, should ensure that Congress and appropriate Executive Branch officials are informed regarding the monetary and programmatic effects of the proposals upon retirement programs and trust funds. Because the Federal Government will be responsible for the payment of retiree benefits should the USPS default, the OPM should consult with the above policymakers so that any new policies are adopted with the full knowledge of the impact upon the retirement and health care programs as well as the U.S. Treasury and ultimately, the American taxpayers.

7. The OPM should protect the retirement programs against being used as a way to address a situation that is entirely unrelated to retirement issues. Using the Federal retirement program as a vehicle through which to implement other policy objectives would be unwise, inefficient, and harmful to the program itself. The debate surrounding the USPS's financial condition should not be focused solely upon the funding of retiree benefits.

Conclusion

While we understand that the USPS is having financial difficulties, the OPM's administration of the law has not caused this situation. The OPM has complied with the law as written on all accounts. To say otherwise is both inaccurate and obscures the true causes of USPS's current crisis.

We believe that these proposals would have a lasting negative impact upon the retirement programs and trust funds but have little, if any, positive impact upon the USPS's ultimate long-term profitability. Instead, the result of these proposals would be to shift costs from USPS ratepayers to the American taxpayers.

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