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AT A CROSSROADS: THE POSTAL SERVICES'S $100 BILLION IN UNFUNDED LIABILITIES

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL WORKFORCE, US POSTAL SERVICE AND THE CENSUS

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

MARCH 4, 2014

Serial No. 113–100

Printed for the use of the Committee on Oversight and Government Reform

Available via the World Wide Web: http://www.fdsys.gov
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

87–647 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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AT A CROSSROADS: THE POSTAL SERVICE'S $100 BILLION IN UNFUNDED LIABILITIES

Thursday, March 13, 2014,

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND THE CENSUS,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:27 p.m., in Room 2247, Rayburn House Office Building, Hon. Blake Farenthold [chairman of the subcommittee] presiding.

Present: Representatives Farenthold, Walberg, Collins, Clay, and Lynch.

Staff present: Ali Ahmad, Majority Professional Staff Member; Will L. Boyington, Majority Deputy Press Secretary; Sharon Casey, Majority Senior Assistant Clerk; Jeffrey Post, Majority Senior Professional Staff Member; Jaron Bourke, Minority Director of Administration; Kevin Corbin, Minority Professional Staff Member; Adam Koshkin, Minority Research Assistant; Mark Stephenson, Minority Director of Legislation.

Mr. FARENTHOLD. I would like to begin this hearing by stating the Oversight Committee's Mission Statement. We exist to secure two fundamental principles. First, Americans have a right to know that the money that Washington takes from them is well spent. And second, Americans deserve an effective, efficient government that works for them.

Our duty on the Oversight and Government Reform Committee is to protect these rights. Our solemn responsibility is to hold government accountable to taxpayers, because taxpayers have a right to know what they get from their government.

We work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy. This is the mission of the Oversight and Government Reform Committee.

Today we are going to talk about the Post Office. The Postal Service is broke. In the last two years alone, the Postal Service has defaulted on $16.7 billion in payments to the Treasury to pay down accrued retiree health care liability. In recent years, the Postal Service has also temporarily ceased making statutorily required pension funding payments to the government. Then, this year, the Postal Service was forced to resort to an implementation of an unprecedented, exorbitant rate increase as part of a last ditch effort to break even.

The rate increase is at best a temporary fix that will improve revenue a little now. But higher prices will only encourage customers to transition from more expensive paper mail to virtually free electronic communication and commerce.

Over the last several years, a number of reform plans have been put forward to serve the Postal Service and to save the Postal Service, some good, some bad. Last July, the full committee considered our own plan, H.R. 2748, the Postal Reform Act, which I believe stands the best chance to move the Postal Service forward and into financial solvency.

While I ask my friends on the other side of the aisle to work with us on H.R. 2748 and other postal initiatives, such as President Obama's repeated suggestion to move to a modified six-day delivery, we are here today to take a step back from debating specific legislation and to hear from the experts on the current financial position of the Postal Service and the true scope of these unfunded liabilities facing the Postal Service.

As many know, mail volume has declined by more than 25 percent since 2006. Virtually the entire decline has been attributable to the diversion of paper to digital forms of communication. As we proceed, this has accelerated more by our economic times.

Until the last few years, the Postal Service business model has been predicated on the idea that paper mail volume would continue to increase and the Postal Service would always need to grow. For any organization, shifting from expansion to contraction is difficult. But the Postal Service has made great strides to increase efficiency in the last 15 years. They have right-sized the workforce almost exclusively through voluntary means.

However, the Postal Service's legacy, as a much larger institution, will continue to heavily impact its financial future. At the end of fiscal year 2013, the Postal Service had unfunded obligations and liabilities of more than $112 billion, the vast majority of which were directly to postal employees and retirees: $48 billion for retiree health care, $19 billion for pension and $17 billion for workers compensation.

As we will hear today, even if the Postal Service is able to break even in the short term, the agency has no plan under current law to ever address even a small fraction of these liabilities.

I am looking forward to hearing testimony today about the various obligations and liabilities and what will happen in the coming years if the Post Office cannot afford to address them. Additionally, as a strong believer in confronting these financial obligations head-on, I am looking forward to hearing testimony from the Defense Health Agency to hear how the DOD has been taking steps to ensure the proper funding of TriCare costs for Medicare-eligible retirees.

In closing, I would like to thank the witnesses for being here. I apologize for the delay. We are at the mercy of a rather fickle House voting schedule.

I now recognize the distinguished ranking member, the gentleman from Massachusetts, Mr. Lynch, for his opening statement.

Mr. LYNCH. Thank you, Mr. Chairman. Thank you for holding this hearing.

I want to thank the witnesses for their willingness to appear before the committee and help us with our work.

Despite positive developments in the area of revenue growth, the U.S. Postal Service clearly remains in dire financial straits. As evidenced by the most recent quarterly financial report, the agency experienced a net loss of $354 million for the first quarter of fiscal year 2014, marking the 19th out of the last 21 quarters that it has reported a loss.

The Postal Service has also notified Congress that absent the enactment of comprehensive postal reform, it will be forced to default on its annual future retiree health benefit payment, when a $5.7 billion bill becomes overdue on October 1st. This will be the fourth consecutive such default.

Moreover, the Postal Service has reported that it carries a series of unfunded liabilities totaling approximately $100 billion. Among the specific obligations cited by the agency are an estimated $49 billion in retiree health benefit funds, $19 billion in civil service and Federal employee retirement system costs, $17 billion in Department of Labor workers compensation payments and a debt owed to the United States Treasury with an aggregate principal balance of $15 billion. These figures not only evidence the financial condition of the U.S. Postal Service that is still grave, but also reiterates the urgent need for Congress to enact a meaningful postal reform package that is founded on a bipartisan agreement and aims to strengthen the Postal Service by building upon its unparalleled mail network and dedicated workforce.

In the context of today's focus on unfunded postal liabilities, I would note that we could immediately and significantly reduce the Postal Service's net unfunded liability by addressing the billions of dollars in overpayments that the agency has made into the Federal Employee Retirement System. In particular, we could require the Office of Personnel Management to recalculate the amount of Postal Service FERS overpayment, using a more accurate actuarial formula that takes into account the unique position, salary growth and demographic characteristics of postal employees.

As reported by the Office of the Postal Service Inspector General in September last year, the use of so-called postal-specific assumptions in calculating the Federal Employee Retirement System overpayment would result in a $12.5 billion surplus that could be returned to the Postal Service and used by the agency to pay down its debt and other outstanding obligations. I have already introduced legislation to this effect in the 113th Congress. H.R. 961, the U.S. Postal Service Stabilization Act, has received over 160 cosponsors, including ten Republicans. I urge the committee to move this bill forward.

In addition, we need to revisit the onerous mandate that the agency prefund its future retiree health benefits 75 years before it is necessary. It is a requirement that is asked of no other corporation, public or private, and given that the Postal Service has already funded 49 percent of the actuarial liability relating to prefunding, it is a requirement that has drastically reduced the agency's cash supply in recent years.

Now, I understand that the majority has called the Department of Defense to testify this afternoon on DOD's experience in setting

aside funds to pay for future retiree health benefits under the TriCare for Life program, which is only 39 percent funded. While I appreciate the Department's perspective, I would caution my colleagues against comparing apples to oranges. Importantly, Defense Department costs for TriCare for Life are funded through the annual Congressional appropriations process, while the Postal Service is operated as a self-supporting government agency since 1971 and does not receive taxpayer dollars.

In addition, I would note that the health care costs of retired Defense Department personnel are primarily covered by Medicare with only supplemental coverage provided under TriCare for Life. In contrast, the health care costs of postal retirees are primarily covered by plans under the Federal Employee Health Benefit Program, with the Postal Service required to cover the employer's shared costs.

Mr. Chairman, I look forward to discussing these and other issues as we continue to work together to enact comprehensive postal reform. I thank you again, Mr. Chairman, for holding this hearing and I yield back the balance of my time.

Mr. FARENTHOLD. Thank you very much, Mr. Lynch.

Members will have seven days to submit opening statements for the record. We will now recognize our panel.

Mr. Frank Todisco is the Chief Actuary at the U.S. Government Accountability Office. Mr. Jeffrey Williamson is Chief Human Resources Officer and Executive Vice President at the U.S. Postal Service. Mr. Robert Moss is Chief of Budget and Resource Management at the Defense Health Agency. And Mr. Joel Sitrin is the Chief Actuary in the Office of the Actuary at the U.S. Department of Defense. I feel like I need green eyeshades with all these actuaries, but we are excited to have your testimony.

Pursuant to committee rules, all witnesses will be sworn in before they testify. Gentlemen, would you please rise and raise your right hand.

Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth and nothing but the truth?

[Witnesses respond in the affirmative].

Mr. FARENTHOLD. You may be seated. Let the record reflect that all witnesses have answered in the affirmative.

In order to allow time for questions and discussions, we ask that you limit your testimony to five minutes. We have your complete written testimony here in our folders. So if you will summarize, hit the high points and give us a chance to ask you questions, that would be the most efficient use of the time.

In front of you there is a timer that will count down from five minutes. When you are about to run out of time the light will go from green to yellow, which as it does on the streets, means speed up. And then the red light means stop, your time is expired.

So we will start off with Mr. Todisco, your five minutes begins now.

WITNESS STATEMENTS

STATEMENT OF FRANK TODISCO

Mr. TODISCO. Chairman Farenthold, Ranking Member Lynch, members of the subcommittee, thank you for the opportunity to testify today on the Postal Service's unfunded liabilities.

The Postal Service continues to face serious financial challenges with insufficient revenue to cover its expenses and financial obligations, and the continuing decline of first class mail volume. As shown in table 1 of our written testimony, the Postal Service had $100 billion of debt and unfunded benefit liabilities at the end of fiscal year 2013, consisting of $48 billion for retiree health, $20 billion for CSRS pension, $17 billion for workers compensation, the $15 billion debt to Treasury and a small surplus, half a billion dollars for FERS pensions.

As shown in figure 1 of our written testimony, the total of these unfunded liabilities and debt has grown in scale relative to the size of the Postal Service's operations, from 83 percent of postal revenue in 2007 to 148 percent in 2013. The extent of prefunding varies by program. Prefunding of the Postal Service's pension benefits has been required over decades, so that they are over 90 percent funded. Prefunding of retiree health only began in 2007, and the liability is about half funded at present. Workers compensation is pay as you go, so the entire liability is unfunded, the three programs that are prefunded, CSRS, FERS and retiree health, are all subject to different technical rules, regarding such factors as amortization periods, assumptions and use of surplus.

It should be understood that these benefit liabilities are long-term estimates that contain a significant degree of uncertainty. As such, they are moving targets. But they are still important targets, as they represent estimated bills for employee service already rendered.

There are several advantages to having the Postal Service prefund retirement benefits. These include first, protecting the future viability of the Postal Service by not saddling it with bills later on after employees have already retired. Second, protecting the retirement benefits of postal employees, retirees and their beneficiaries. Fully-funded benefits are more secure than unfunded benefits. Third, charging postal ratepayers for the full cost of current services, including retirement accruals. And fourth, protecting any third parties that could potentially become responsible for any unfunded liability.

That said, no prefunding approach will be viable unless the Postal Service can make the required payments. There is a balance between providing short-term breathing room and protecting all stakeholders in the long term.

In our prior reports, we have addressed several specific issues concerning the prefunding of the Postal Service's pension and retiree health benefits. Our points have included first, support for the use of actuarial assumptions that are specific to the postal workforce, subject to third-party recommendation. Second, support for modifying the retiree health prefunding schedule in a fiscally responsible manner. Third, concern about lowering the retiree health prefunding target from 100 percent to 80 percent, which would

mean a permanent unfunded liability. And fourth, fixing the current law treatment of FERS surplus in a fiscally responsible manner. We made specific suggestions in each of these areas that I would be happy to discuss.

Ultimately, the viability of funding promised benefits depends on the financial viability of the Postal Service's underlying business model. We continue to recommend that Congress adopt a comprehensive package of actions that will facilitate the Postal Service's ability to align costs and revenues and to cover all of its financial obligations.

This concludes my prepared statement. I would be pleased to answer your questions.

[Prepared statement of Mr. Todisco follows:]

United States Government Accountability Office

Testimony

Before the Subcommittee on Federal Workforce, U.S. Postal Service and the Census, Committee on Oversight and Government Reform, House of Representatives

For Release on Delivery
Expected at 1:30 p.m. EDT
Thursday, March 13, 2014

U.S. POSTAL SERVICE

Action Needed to Address Unfunded Benefit Liabilities

Statement of Frank Todisco, Chief Actuary
Applied Research and Methods

GAO-14-398T

GAO Highlights

Highlights of GAO-14-398T, a testimony before the Subcommittee on Federal Workforce, U.S. Postal Service and the Census, Committee on Oversight and Government Reform, House of Representatives

Why GAO Did This Study

USPS continues to be in a serious financial crisis, with insufficient revenue to cover its expenses and financial obligations as the volume of USPS's most profitable product, First-Class Mail, continues to decline. At the end of fiscal year 2013, USPS had about $100 billion in unfunded liabilities: $85 billion in unfunded liabilities for benefits, including retiree-health, pension, and workers' compensation liabilities, and $15 billion in outstanding debt to the U.S. Treasury—the statutory limit. These unfunded liabilities are a large and growing financial burden, increasing from 83 percent of USPS revenues in fiscal year 2007 to 148 percent of revenues in fiscal year 2013. Unfunded benefit liabilities represent estimated future benefit payments to current and retired employees for which USPS has not set aside sufficient money to pay. This testimony discusses (1) the extent to which USPS's benefit liabilities are unfunded and (2) the potential impacts of USPS's unfunded benefit liabilities absent action by Congress to address them and key policy issues for consideration. This testimony is based primarily on GAO's work over the past 4 years and updated USPS financial information for fiscal year 2013.

GAO has previously reported that a comprehensive package of legislative actions is needed so that USPS can achieve financial viability and assure adequate benefits funding for more than 1 million postal employees and retirees. GAO has also previously identified various approaches Congress could consider to restructure the funding of USPS retiree health benefits and pensions.

View GAO-14-398T. For more information, contact Frank Todisco at (202) 512-2834 or todiscof@gao.gov.

March 13, 2014

U.S. POSTAL SERVICE

Action Needed to Address Unfunded Benefit Liabilities

What GAO Found

The extent to which the U.S. Postal Service (USPS) has funded its liabilities varies due to different statutory funding requirements specific to each benefit program and USPS's financial means to make payments. For example, USPS has been required to prefund its pension benefit liability over decades, and as shown in the table below, its pension liability is 94 percent funded. Prefunding USPS's retiree health benefits began in 2007, and the liability is about half funded. In contrast, USPS funds its workers' compensation benefits on a pay-as-you-go basis, and the entire liability is unfunded. The largest unfunded liabilities, in order of decreasing size, are $48 billion for retiree health, $19 billion for pensions, and $17 billion for workers' compensation. The rules for calculating the amount that USPS must fund each year differ among the pension and retiree health programs, including variations in amortization periods, recognition of any surpluses, use of actuarially determined versus fixed payments, and actuarial assumptions.

Funding Levels for Liabilities in Selected USPS Benefit Programs at the End of Fiscal Year 2013

(Dollars in Billions)

	Pension	Retiree health	Workers' compensation
Liability	$306.2	$95.6	$17.2
Fund balance	286.9	47.3	0
Percentage funded	94	49	0
Unfunded liability	19.3	48.3	17.2

Source. USPS.

GAO has previously reported that without congressional action to address USPS's benefit funding issues and better align its costs and revenues, USPS faces continuing low liquidity levels, insufficient revenues to make annual prefunding payments, and increasing liabilities. Deferring funding could increase costs for future postal ratepayers and increase the possibility that USPS may not be able to pay for these costs. GAO has previously identified the following key considerations related to USPS's funding of its benefits liabilities:

- Reasons for prefunding include fairly allocating costs between current and future ratepayers, protecting USPS's future viability, providing greater benefit security to employees and retirees, and protecting potential third parties.
- Prefunding decisions involve trade-offs between USPS's current financial condition and its long-term prospects.
- Congress needs to modify USPS's retiree health prefunding payments in a fiscally responsible manner, and USPS should prefund any unfunded retiree-health benefits liability to the maximum extent that its finances permit.
- Lowering the retiree health funding target from 100 to 80 percent would have the effect of carrying a permanent unfunded liability.
- USPS liabilities are estimated using assumptions for the federal workforce as a whole, rather than USPS-specific assumptions. GAO supports the use of the most accurate actuarial assumptions available, and if USPS-specific assumptions are used, that they be recommended by an independent body.

Chairman Farenthold, Ranking Member Lynch, and Members of the Subcommittee:

We appreciate the opportunity to discuss the U.S. Postal Service's (USPS) unfunded liabilities. USPS continues to be in a serious financial crisis, with insufficient revenue to cover its expenses and financial obligations, a continuing decline in profitable First-Class Mail volume, increasing unfunded benefit liabilities, and borrowing limitations due to having reached its $15 billion statutory debt limit. Attention to USPS's unfunded benefit liabilities is important, as they represent scheduled future benefit payments to current and retired employees for which USPS has not set aside sufficient money to pay. This testimony focuses on 1) the extent to which USPS's current benefit liabilities are unfunded, and 2) the potential impacts of USPS's unfunded benefit liabilities absent action by Congress to address them as well as key policy issues for consideration.

This testimony is based primarily on reports and testimonies we issued in the past 4 years that examined USPS's financial condition, including its liabilities.[1] The reports and testimonies cited in this statement contain detailed information on the methods used to conduct our work. For this testimony, we also updated USPS financial information with results from fiscal year 2013, which ended September 30, 2013. The work upon which this testimony is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]GAO, *U.S. Postal Service: Health and Pension Benefits Proposals Involve Trade-offs*, GAO-13-872T (Washington, D.C.: Sept. 26, 2013); *U.S. Postal Service: Proposed Health Plan Could Improve Financial Condition, but Impact on Medicare and Other Issues Should be Weighed before Approval*, GAO-13-658 (Washington, D.C.: July 18, 2013); *U.S. Postal Service: Status, Financial Outlook, and Alternative Approaches to Fund Retiree Health Benefits*, GAO-13-112 (Washington, D.C.: Dec. 4, 2012); *Federal Employees' Compensation Act: Analysis of Proposed Program Changes*, GAO-13-108 (Washington, D.C.: Oct. 26, 2012). *U.S. Postal Service: Allocation of Responsibility for Pension Benefits between the Postal Service and the Federal Government*, GAO-12-146 (Washington, D.C.: Oct. 13, 2011); *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010).

Background

As table 1 shows, at the end of fiscal year 2013, USPS had about $100 billion in unfunded liabilities for pension, retiree health, and workers' compensation benefits as well as outstanding debt. These unfunded liabilities have increased by 62 percent since fiscal year 2007.

Table 1: Selected USPS Liabilities and Unfunded Retiree Health and Pension Benefit Liabilities, Fiscal Year End 2007 through 2013

(Dollars in billions)

	Liabilities		Unfunded retiree health and pension liabilities (surplus)			
Fiscal Year	Outstanding debt	Workers' compensation	Retiree health	CSRS[a]	FERS[a]	Total
2007	$4.2	$7.7	$55.0	$3.1	$(8.4)	**$61.6**
2008	7.2	8.0	53.5	3.3	(8.8)	**63.2**
2009	10.2	10.1	52.0	9.6	(6.8)	**75.1**
2010	12.0	12.6	48.6	7.3	(6.9)	**73.6**
2011	13.0	15.1	46.2	(1.7)	(11.4)	**61.2**
2012	15.0	17.6	47.8	18.7	(3.0)	**96.1**
2013	15.0	17.2	48.3	19.8	(0.5)	**99.8**

Source: USPS

[a]The Civil Service Retirement System (CSRS) is the federal pension plan that covers most employees hired before 1984, and the Federal Employees Retirement System (FERS) covers most employees hired in 1984 or later.

Note: For financial reporting purposes, USPS's debt and its workers' compensation liabilities are reported as liabilities on USPS's balance sheet. USPS's unfunded liabilities for pension and retiree health benefit are "off-balance-sheet liabilities"; these amounts are disclosed in USPS's financial statements but are not reported as liabilities on USPS's balance sheet. USPS does report a liability on its balance sheet for the statutorily required prefunding payments into the Postal Service Retiree Health Benefits Fund that it did not make; this liability is equal to $16.7 billion for the missed payments due during the fiscal years 2011-2013.

Since fiscal year 2007, USPS has experienced significant financial challenges. USPS's gap between expenses and revenues has grown significantly. In fiscal year 2009, we returned USPS to our high-risk list due, in part, to a projected loss of $7 billion—and an actual loss of over $8.5 billion—in fiscal year 2010.[2] Also, USPS did not make retiree health benefit prefunding payments totaling $16.7 billion due during fiscal years

[2]GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009).

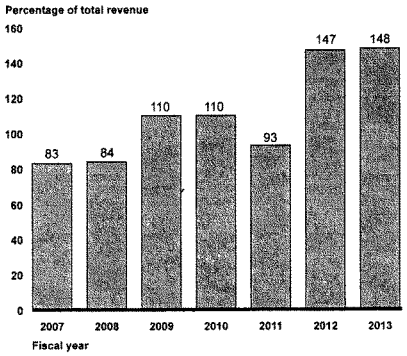
2011 through 2013.[3] In addition, USPS's outstanding debt to the U.S. Treasury increased from $2.1 billion at fiscal year-end 2006 to its current statutory borrowing limit of $15 billion.[4] As shown in figure 1, USPS's debt and unfunded liabilities have become a large and growing burden—increasing from 83 percent of USPS's revenues in fiscal year 2007 to 148 percent of revenues in fiscal year 2013.

USPS's dire financial condition makes paying for these liabilities highly challenging. In the short term, USPS lacks liquidity to fund needed capital investments and cannot increase its liquidity through borrowing since USPS has hit its $15 billion statutory debt limit. At the end of fiscal year 2013, USPS held unrestricted cash of $2.3 billion, which it states represents approximately 9 days of average daily expenses. This level of liquidity could be insufficient to support operations in the event of another significant downturn in mail volume. In the long term, USPS will be challenged to pay for its unfunded liabilities on a smaller base of First-Class Mail, its most profitable product. First-Class Mail volume has declined 37 percent since it peaked in fiscal year 2001. In addition, USPS's five-year business plan projects this volume will continue declining by about 5 to 6 percent annually.

[3] Originally due at the end of fiscal year 2011, USPS's $5.5 billion retiree health benefits payment was delayed until August 1, 2012. Pub. L. No. 112-74, § 632 (Dec. 23, 2011). USPS missed that payment, as well as the $5.6 billion that was due by September 30, 2012 and the $5.6 billion that was due by September 30, 2013.

[4] 39 U.S.C. § 2005(a)(2).

Figure 1: Selected USPS Liabilities and Unfunded Pension and Health Benefit Liabilities as a Percentage of USPS Revenues



Source: USPS

USPS's Funding of Its Benefit Liabilities Varies by Program

The extent to which USPS has funded its benefit liabilities varies as a result of different statutory funding requirements specific to each benefit program as well as USPS's financial means to make funding payments. For example, prefunding of USPS's pension benefits has been required over decades, and as a result, USPS's pension liability is over 90 percent funded. Prefunding USPS's retiree health benefits began in 2007, and at a fairly aggressive pace, and the liability is about half funded at present. In contrast, under the Federal Employees Compensation Act (FECA),[5] USPS funds its workers' compensation benefits on a pay-as-you-go basis, pursuant to statutory requirements, so the entire FECA liability is unfunded. Also, as discussed further below, the ongoing prefunding requirements—i.e., the rules for calculating the amount that USPS must pay each year—differ among the pension, retiree health, and workers' compensation programs.

[5]FECA, as amended, provides federal employees injured in the performance of duty with workers' compensation benefits. 5 U.S.C. § 8101, et. seq.

For each of the four post-employment benefit programs—Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS), retiree health, and workers' compensation—table 2 illustrates, as of the end of fiscal year 2013, USPS's liability, the value of the assets that have been set aside, the funded percentage, and the unfunded liability. The funded percentages are 91 percent for CSRS, 101 percent (i.e., a slight surplus) for FERS, 49 percent for retiree health, and 0 percent for workers' compensation. The unfunded liabilities, in order of decreasing size, are $48 billion for retiree health, $19 billion for pensions, and $17 billion for workers' compensation. These total to about $85 billion, which, together with USPS's debt to the Treasury of $15 billion, adds to the $100 billion of total debt and unfunded liabilities cited earlier.

Table 2: Selected USPS Benefit Liabilities at the End of Fiscal Year 2013 (Dollars in Billions)

	Pension				
	CSRS	FERS	Pension total	Retiree health	Workers' compensation
Liability	$208.8	$97.4	$306.2	$95.6	$17.2
Assets	189.0	97.9	286.9	47.3	0.0
Percentage funded	91	101	94	49	0
Unfunded liability (Surplus)	19.8	(0.5)	19.3	48.3	17.2

Source USPS

What USPS's Liabilities Represent

USPS's benefit liabilities are actuarial estimates of the present value of a portion of the future benefits projected to be paid under each program based on formulas in current law. Specifically, for both the pension and retiree health programs, the liability includes two pieces: (1) the present value of all projected future benefits for current retirees and their beneficiaries, plus (2) the present value of a portion of the projected future benefits for current employees and their beneficiaries, based on employees' service to date (with each additional year of service adding to the liability, such that approximately the full liability is accrued when

employees reach retirement).[6] Contrary to statements made by some employee groups and other stakeholders, these liabilities do not include any amounts for future USPS employees not yet hired or born. The workers' compensation liability represents the present value of all projected future benefits for former employees who have sustained an injury and are eligible for benefits; it does not include a provision for projected future injuries to current employees.

These liability measurements depend on a combination of economic and demographic assumptions regarding such factors as future investment returns, interest rates, inflation, salary increases, medical costs, and longevity. These liability measurements inherently contain significant degrees of uncertainty, and can change from year to year, both because of actual experience differing from the assumptions and because of changes to the assumptions themselves, which can occur in response to emerging experience and changing conditions. As an example of the sensitivity of these liabilities to changes in assumptions, USPS has estimated that its $48 billion unfunded liability for retiree health benefits could have ranged from $35 billion to $64 billion, solely by varying the inflation rate by 1 percent in either direction.

USPS's pension and retiree health liabilities are estimated using demographic and pay-increase assumptions developed for the federal workforce as a whole, rather than assumptions developed for the USPS workforce in particular. Some have suggested that USPS's benefit liabilities may be overstated in that the use of USPS-specific assumptions would result in a lower liability measurement.[7] In 2013, we testified that we support using the most accurate numbers possible. We suggested that if USPS-specific assumptions are used, the assumptions should

[6]For the pension programs, the liability also includes the present value of projected future benefits for former employees who met the plan's vesting requirements but who have not yet retired and started receiving benefits. For the retiree health program, benefit payments take the form of USPS's payment of its share of retiree health premiums.

[7] USPS's Office of Inspector General (OIG) has estimated, based on an analysis of the liabilities as of the end of fiscal year 2012, that the use of USPS-specific assumptions would have reduced its FERS liability by $9.5 billion, reduced its CSRS liability by $1.3 billion, and increased its retiree health liability by $2.3 billion, for an overall net total liability reduction of $8.5 billion. We have not analyzed USPS OIG's assumption selection or estimates. Also, we have not researched USPS's workers' compensation liability to assess whether there is a similar question with regard to the assumptions underlying that estimate.

continue to be recommended by an independent body (such as OPM's Board of Actuaries).[8]

Different Funding Rules Apply to Different Programs

USPS's ongoing prefunding contributions are governed by separate rules applying to the funding of its CSRS, FERS, retiree health benefit, and workers' compensation liabilities. These separate rules include variations in amortization periods, recognition of any surpluses, use of actuarially determined versus fixed payments, and actuarial assumptions.

CSRS

The Postal Accountability and Enhancement Act (PAEA)[9] eliminated USPS's agency contributions for CSRS, as the USPS had a CSRS surplus at that time. The surplus of $17 billion was transferred to the new Postal Service Health Benefits Fund (PSHRBF) to begin prefunding USPS's retiree health liability.[10] Under current law, USPS is not required to make any prefunding contributions for CSRS prior to fiscal year 2017. If USPS were to have an unfunded CSRS liability in 2017 (for example, if the current unfunded CSRS liability of $20 billion persists), USPS would have to begin making prefunding payments to eliminate the unfunded liability by September 30, 2043, i.e., over a 27-year amortization period from fiscal years 2017 to 2043. If USPS were to have a CSRS surplus as of the close of any of the fiscal years ending in 2015, 2025, 2035, and 2039, the CSRS surplus would be transferred to the PSHRBF.

FERS

For FERS, USPS is annually required to contribute its share of the "normal cost" plus an amortization payment toward any existing unfunded liability. The normal cost is the annual expected growth in the liability attributable to an additional year of employees' service. The amortization

[8]We have also reported on a difference in the assumptions used in calculating the pension and retiree health liabilities. The assumptions for determining USPS's funding requirements for CSRS and FERS represent OPM's estimate of future, long-term experience, informed by advice from its independent Board of Actuaries. In contrast, key economic assumptions for determining USPS's liability for retiree health benefits are based on 10-year historical averages rather than a current long-term economic outlook. This divergence developed because of changes to federal accounting standards promulgated subsequent to the enactment of the Postal Accountability and Enhancement Act. GAO-13-872T.

[9]Pub. L. No. 109-435,§ 102 (Dec. 20, 2006).

[10]An additional $3 billion of savings, accrued due to changes in the estimates of USPS's funding obligations for CSRS, had been placed in escrow and was also transferred to the PSRHBF.

payment toward any unfunded liability is determined using a 30-year amortization period. Since USPS has had a FERS surplus for a number of years, it has not had to make any amortization payments, only its normal cost payments.[11] Current law does not provide any provision for utilization of any FERS surplus, as discussed further in the next section. USPS made FERS normal cost payments of $3.5 billion in fiscal year 2013.

Retiree Health

Unlike its pension liability, prior to 2007 USPS had been funding its retiree health liability on a pay-as-you-go basis—an approach in which USPS paid its share of premiums for existing retirees, with no prefunding for any future premiums expected to be paid on behalf of current retirees and employees. We have drawn attention to USPS's retiree health benefit liability over the past decade. In May 2003, the Comptroller General testified that USPS's accounting treatment—which reflected the pay-as-you-go nature of its funding—did not reflect the economic reality of its legal liability to pay for its retiree health benefits, and that current ratepayers were not paying for the full costs of the services they were receiving. Consequently, the pension benefits being earned by USPS employees—which were being prefunded—were being recovered through current postal rates, but the retiree health benefits of those same employees were not being recognized in rates until after they retired. The Comptroller General testified that without a change, a sharp escalation in postal rates in future years would be necessary to fund the cost of retiree health benefits on a pay-as-you-go basis.[12]

In 2006, PAEA established requirements for USPS to begin prefunding its retiree health benefits. USPS stated in its 2007 Annual Report that such prefunding was a "farsighted and responsible action that placed the Postal Service in the vanguard of both the public and private sectors in providing future security for its employees, and augured well for our long-

[11]Near the end of fiscal year 2011, USPS temporarily halted its regular FERS contributions that are supposed to cover the cost of benefits being earned by current employees in order to maintain its liquidity. However, USPS has since made up those missed FERS payments.

[12]GAO, *U.S. Postal Service: Key Postal Transformational Issues*, GAO-03-812T (Washington, D.C.: May 29, 2003).

term financial stability," but also acknowledged that the required payments would be a considerable financial challenge in the near term.[13]

PAEA required USPS to make "fixed" prefunding payments to the PSRHBF, ranging from $5.4 billion to $5.8 billion per year, due each fiscal year from 2007 through 2016.[14] However, USPS has not made the last three required annual payments.[15] We have referred to these 10 years of required payments as "fixed" because the amounts are specified in statute rather than calculated based on an actuarial measurement of the liability. In addition to these prefunding requirements, USPS is also required to continue paying its share of health benefit premiums for current retirees and their beneficiaries, payments USPS has been making. USPS paid $2.9 billion for its share of retiree health benefit premiums in fiscal year 2013.

Beginning in fiscal year 2017, USPS's retiree health prefunding requirement switches to an actuarial approach. Each year USPS will be required to make an actuarially determined prefunding payment to the PSRHBF, and USPS's share of premiums for then-current retirees and beneficiaries will be paid out of the PSRHBF rather than directly by USPS. The required prefunding payment will be equal to the normal cost, plus an amount to amortize any unfunded liability (or minus an amount to amortize any surplus). The amortization period is to fiscal year 2056 or, if later, 15 years from the then current fiscal year. As a result, the retiree health benefit prefunding required under PAEA occurs over a period of 50 years or more, from fiscal years 2007 through 2056 and later—not over a

[13]USPS, *United States Postal Service Annual Report 2007*, (Washington, D.C.: Nov. 15, 2007).

[14]USPS's $5.4 billion retiree health benefit prefunding payment due at the end of fiscal year 2009 was reduced to $1.4 billion. Pub. L. No. 111-68, § 164 (Oct. 1, 2009). We reported on USPS's retiree health prefunding requirements in GAO-13-112.

[15]Originally due at the end of fiscal year 2011, USPS's $5.5 billion retiree health payment was delayed until August 1, 2012. Pub. L. No. 112-74, § 632 (Dec. 23, 2011). USPS missed that payment, as well as the $5.6 billion that was due by September 30, 2012, and the $5.6 billion that was due by September 30, 2013.

period of just 10 years, as has sometimes been stated.[16] However, we have reported that the required payments are significantly "frontloaded," in that the total payments required in the first 10 years (fiscal years 2007–2016) were significantly in excess of estimates of what actuarially determined amounts would be.[17]

Workers' Compensation

The Federal Employees' Compensation Act (FECA) is the workers' compensation program for federal employees, including USPS. FECA is managed by the Department of Labor (DOL) and provides benefits paid out of the Employees' Compensation Fund to federal employees who sustained injuries or illnesses while performing federal duties. USPS funds its workers' compensation under a pay-as-you go system by annually reimbursing the DOL for all workers' compensation benefits paid to or on behalf of postal employees in the previous year. USPS reimbursed DOL $1.4 billion for fiscal year 2013.

Impact of Unfunded Benefit Liabilities Absent Actions by Congress to Address Them and Key Considerations

Without congressional action to address USPS's benefit funding issues and better align its costs and revenues, USPS faces continuing low liquidity levels, insufficient revenues to make annual prefunding payments, and increasing benefit liabilities. Deferring funding could increase costs for future ratepayers and increase the possibility that USPS may not be able to pay for these costs. USPS stated that in the short term, should circumstances leave the agency with insufficient cash, it would be required to implement contingency plans to ensure that mail delivery continues. These measures could require that USPS prioritize payments to employees and suppliers ahead of some payments to the federal government. For example, as discussed previously, near the end

[16]We have reported that, contrary to statements made by some employee groups and other stakeholders, PAEA did not require USPS to prefund 75 years of retiree health benefits over a 10-year period. The references to "75 years of benefit payments" may represent a shorthand description of the benefits being prefunded. As noted earlier in this testimony where we described the composition of USPS's retiree health liability, the prefunding target actually covers (1) all projected future benefits for current retirees and their beneficiaries, plus (2) a portion of projected future benefits for current employees and their beneficiaries, such portion accruing over the employees' careers. This prefunding target would include some benefits projected to be paid beyond 75 years—because, for example, some current employees can be expected to live beyond 75 more years—but it would also exclude some benefits projected to be paid within the next 75 years—because it only includes a portion of the benefits that are expected to ultimately be paid for current employees.

[17]GAO-13-112.

of fiscal year 2011, in order to maintain its liquidity USPS temporarily halted its regular FERS contribution. However, USPS has since made up those missed FERS payments. According to USPS, current projections indicate that it will be unable to make the required $5.7 billion retiree health benefit prefunding payment due in September 2014. USPS has stated that its cash position will worsen in October 2014 when it is required to make an estimated payment of $1.4 billion to DOL for its annual workers' compensation reimbursement. USPS's statements about its liquidity raise the issue of whether USPS will need additional financial help to remain operational while it restructures and, more fundamentally, whether it can remain financially self-sustainable in the long term.

We have previously reported that Congress and USPS need to reach agreement on a comprehensive package of actions to improve USPS's financial viability.[18] In previous reports, we have discussed a range of strategies and options, to both reduce costs and enhance revenues, that Congress could consider to better align USPS costs with revenues and address constraints and legal restrictions that limit USPS's ability to reduce costs and improve efficiency.[19] We have also reported that it is important for USPS to align its expenses and revenues to avoid even greater financial losses, repay its outstanding debt, and increase capital for investments needed to sustain its national network.[20] In addition, we have reported that Congress needs to modify USPS's retiree health prefunding payment in a fiscally responsible manner, and that USPS should prefund any unfunded retiree health liability to the maximum extent that its finances permit.[21] Implementing strategies and options to better align costs with revenues would better enable USPS to be in a financial position to fund and pay for its debt and unfunded benefit liabilities.

Key Funding Considerations

With any unfunded liability comes the risk of being unable to pay for it in the future. This risk can be heightened when future revenues are declining or highly uncertain, as is the case for USPS. We have reported

[18]GAO-10-455.

[19]GAO-10-455.

[20]GAO-13-347T.

[21]GAO-13-112.

on several rationales for prefunding pension and retiree health benefits.[22] Some of the same reasoning could be applied to workers' compensation benefits as well. The benefits of prefunding include the following:

- **Achieving an equitable allocation of cost over time by paying for retirement benefits during employees' working years, when such benefits are earned.** For USPS, this is about equity between current and future postal ratepayers. This is in line with helping USPS align costs with revenues. An additional consideration here is the "legacy" unfunded liability that was not paid by ratepayers in prior years.
- **Protecting the future viability of the enterprise by not saddling it with bills later after employees have retired.**
- **Providing greater benefit security to employees, retirees, and their beneficiaries.** Prefunded benefits are more secure against the future risks of benefit cuts or inability to pay.
- **Providing security to any third party that might become responsible in the event of the enterprise's inability to pay for some or all of the unfunded liability.**

Prefunding decisions also involve trade-offs between USPS's current financial condition and its long-term prospects. While reducing unfunded liabilities protects the future viability of the organization, no prefunding approach will be viable unless USPS can make the required payments, but attempting to do so in the short term could further strain its finances. USPS currently lacks liquidity and postal costs would need to decrease or postal revenues to increase, or both, to make required prefunding payments. To the extent prefunding payments are postponed, larger payments will be required later, when they likely would be supported by less First-Class Mail volume and revenue.

In 2012, we developed projections of USPS's future levels of liability and unfunded liability for its retiree health benefits. These projections showed that current law would result in a significant reduction of USPS's future

[22]GAO-13-112.

unfunded liability if USPS resumed making the required payments.[23] However, USPS has indicated that it does not expect to make any of the remaining fixed prefunding payments, through fiscal year 2016, an intention that means its unfunded liability would increase and its future payments would be greater.

From the perspective of all USPS's post-employment benefit programs, any relaxation of funding requirements in the short term—for example, by suspending retiree health prefunding for a period of years—will result in a higher overall unfunded liability for these programs in total. Nonetheless, Congress has to consider the balance between (1) providing USPS with liquidity that provides breathing room in the short term in order to restructure its operations for long-term success, and (2) protecting USPS, its employees and retirees, and other stakeholders in the long term by funding its liabilities for benefits that have already been earned or accrued.

It is also important to note that unfunded liabilities can be reduced in either of two ways. An unfunded liability is the difference between the liability and its supporting assets. As such, an unfunded liability can be reduced by increasing the amount of assets (i.e., through prefunding), but it can also be reduced by decreasing the size of the liability, such as by decreasing benefit levels or USPS's share of such benefit costs, where such a reduction is deemed to be feasible, fair, and appropriate. We have reported on proposals to increase the integration of USPS's retiree health benefits with Medicare, which would have the effect of reducing USPS's liability but would also involve other policy considerations.[24]

In our prior reports, we have identified funding issues related to USPS's unfunded liabilities that remain unresolved and have identified potential methods for addressing these issues:

- *Actuarial assumptions:* We support making the most accurate measurements possible of USPS's benefit liabilities, and support the development and use of assumptions specific to USPS's population of

[23]More specifically, we modeled a modified version of current law that assumed that USPS's missed prefunding payments for fiscal years 2011 and 2012 would be waived and that USPS would resume making required payments in fiscal year 2013. USPS subsequently failed to make its $5.6 billion payment due by September 30, 2013.

[24]GAO-13-658.

plan participants.[25] We have suggested that if USPS-specific assumptions are used, that the assumptions should continue to be recommended by an independent body, such as OPM's Board of Actuaries.

- *Fixed versus actuarially determined payments:* We have reported that the retiree health prefunding schedule established under PAEA was significantly frontloaded, with total payment requirements through fiscal year 2016 that were significantly in excess of what actuarially determined amounts would be.[26] We added that Congress needs to modify these payments in a fiscally responsible manner. We support proposals to replace the fixed payments with actuarially determined amounts.

- *Funding targets:* We have expressed concern about proposals to reduce the ultimate funding target for USPS's retiree health liability from the current target of 100 percent down to 80 percent. Such a reduction would have the effect of carrying a permanent unfunded liability equal to roughly 20 percent of USPS's liability, which could be a significant amount.[27] If an 80 percent funding target were implemented because of concerns about USPS's ability to achieve a 100 percent target level within a particular time frame, an additional policy option to consider could include a schedule to achieve 100 percent funding in a subsequent time period after the 80 percent level is achieved.

- *FERS surplus:* Under current law, USPS's payments to FERS increase, appropriately, when USPS has an unfunded FERS liability, but USPS realizes no financial benefit when it has a FERS surplus. We have reported that we would support a remedy to this asymmetric treatment, but we have reported on important trade-offs to consider

[25]GAO-13-872T.

[26]GAO-13-112.

[27]For example, USPS's retiree health benefit liability at the end of fiscal year 2013 was $95.6 billion. Twenty percent of that is $19.1 billion.

for different types of remedies.[28] While the most recent estimate shows a relatively small FERS surplus for USPS—an estimated $0.5 billion—USPS has stated that it believes its FERS surplus would have been substantially larger if its FERS liability had been estimated using postal-specific demographic and pay increase assumptions.[29] A conservative approach to permit USPS to access any FERS surplus would be to use it to reduce USPS's annual FERS contribution by amortizing the surplus over 30 years (which would mirror the legally required treatment of an unfunded FERS liability). Another approach would be to reduce USPS's annual FERS contribution by offsetting it against the full amount of surplus each year until the surplus is used up; this would be comparable to what occurs for private-sector pension plans. We have previously suggested that any return of the entire surplus all at once should be done with care, given the inherent uncertainty of the estimated liability and the existence of USPS's other unfunded liabilities.[30] A one-time-only return of the entire surplus should be considered as a one-time exigent action and only as part of a larger package of postal reforms and restructurings. Any provision that would return a surplus whenever one developed would likely eventually result in an unfunded liability.

In conclusion, we again emphasize that deferring funding liabilities in benefit programs could increase costs for future ratepayers and increase the possibility that USPS may not be able to pay for its benefit costs, and that USPS should work to reduce its unfunded liabilities to the maximum extent that its finances permit. Ultimately, however, the viability of funding promised benefits depends on the financial viability of USPS's underlying business model. We continue to recommend that Congress adopt a comprehensive package of actions that will facilitate USPS's ability to align costs with revenues based on changes in the workload and the use of mail.

[28]GAO, *Responses to Questions for the Record; Committee on Homeland Security and Governmental Affairs, February 13, 2013, Hearing on "Solutions to the Crisis Facing the U.S. Postal Service"* (Washington, D.C.: Apr. 5, 2013). GAO, *Responses to Questions for the Record; Committee on Homeland Security and Governmental Affairs, September 26, 2013, Hearing on "Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"* (Washington, D.C.: Nov. 21, 2013).

[29]United States Postal Service, *2013 Report on Form 10-K* (Washington, D.C.: Nov. 15, 2013) 32.

[30]GAO-13-872T.

Chairman Farenthold, Ranking Member Lynch, and Members of the Subcommittee, this concludes my prepared statement. I would be pleased to answer any questions that you may have at this time.

GAO Contact and Key Acknowledgments

For further information about this statement, please contact Frank Todisco, Chief Actuary, FSA, MAAA, EA, Applied Research and Methods, at (202) 512-2834 or todiscof@gao.gov. Mr. Todisco meets the qualification standards of the American Academy of Actuaries to render the actuarial opinions contained in this testimony. Contact points for our Congressional Relations and Public Affairs offices may be found on the last page of this statement. In addition to the contact named above, Lorelei St. James, Director, Physical Infrastructure Issues; Teresa Anderson; Samer Abbas; Lauren Fassler; Thanh Lu; and Crystal Wesco made important contributions to this statement.

Mr. FARENTHOLD. Thank you very much. We will finish with the testimony before we get to questions.

We will now go to Mr. Williamson.

STATEMENT OF JEFFREY WILLIAMSON

Mr. WILLIAMSON. Good afternoon, Chairman Farenthold, Ranking Member Lynch and members of the subcommittee. My name is Jeffrey Williamson, and I am the Chief Human Resources Officer and Executive Vice President at the U.S. Postal Service. Thank you, Mr. Chairman, for calling this important hearing today to discuss the Postal Service's unfunded liabilities.

As we have stressed over the past several years, the Postal Service urgently needs comprehensive reform legislation. We greatly appreciate the efforts of both the House and the Senate oversight committees to date, and we strongly urge Congress to pass comprehensive reform legislation this year.

The Postal Service continues to do its part within the bounds of existing law to place the organization in a sound financial footing. We are positively pleased with our results.

We reduced our costs by a billion dollars in 2013, and in total by $15 billion since the passage of the Postal Accountability and Enhancement Act in 2006. In addition, we have grown revenue by almost a billion dollars in 2013, which is the first revenue growth we have seen since 2008. We are especially proud of our employees, who are determined to do their part to ensure the long-term viability of the Postal Service through continued revenue growth and cost cutting, without sacrificing their commitment to high degrees of service, both from customers and the delivery standpoint.

Despite our efforts and our hard work, we cannot return the organization to profitability or secure our long-term financial outlook without the passage of comprehensive reform legislation. The lingering effects of the great recession and the related impact of digital diversion continue to negatively impact financial results. And the pressure of significant unfunded liabilities continues to leave the Postal Service in a dire financial situation.

We ended fiscal year 2013 with a net loss of $5 billion and liabilities of $61 billion. As we ended first quarter of 2014, we experienced a net loss of $354 million and saw liabilities grow to $63 billion, which exceeded our assets by approximately $40 billion.

It is important, however, to consider items not included on our GAPP financial statement. The major factors contributing to our unfunded liabilities include retiree health benefits, pension obligations, workers compensation and debt to the treasury. OPM has calculated a total unfunded retiree health benefit liability of $48.3 billion, which is greater than the $18.1 billion which is shown on our GAPP accounting statement, which represents only the statutorily prefunded obligations we have defaulted on.

We have proposed a solution to this retiree health benefit which requires FEHB programs to set aside health care plans that will fully integrate with Medicare for current and future postal retirees, which would virtually eliminate this future unfunded liability. From a pension standpoint, OPM has estimated a FERS surplus of half a billion dollars, rather than the $6 billion surplus that would

exist if postal-specific salary growth and demographic assumptions were used.

While addressing the current surplus, and returning it to the Postal Service is critical, a long-term solution does exist, which would be to create a defined contribution system similar to the TSP system that is currently within the FERS program.

Employee safety and injury prevention is also a top priority. Unfortunately, given the size and the nature of our workforce, some employees do get injured. The Postal Service has an unfunded liability of $15.9 billion at the end of quarter one on workers compensation. And while we continue to work with our employees to bring them back to productive work, we ask for a FECA reform that would allow us to further reduce this liability.

Due to constraints that can only be lifted through legislation, the organization has been forced to borrow to its $15 billion statutory obligation. Without legislative change, the Postal Service is almost certain to default on its upcoming $5.7 billion retiree prefunding payment.

We also will continue to struggle with low levels of liquidity, which on December 31st of 2013 represented only 14 days of average operating expense. A private sector company of comparable size could have as much as five times that amount.

The bottom line is the Postal Service's total obligations exceed our assets by approximately $90 billion. While these imbalances are substantial, it is important to note the Postal Service has substantially funded many of these liabilities. And with comprehensive reform legislation, we will be able to fulfill our obligations to the American people and our employees.

The problems we face are significant, but they are solvable. With help from Congress, we are confident that the future of the Postal Service can be very bright.

Mr. Chairman, we look forward to continuing the work with you and the subcommittee to accomplish meaningful postal reform and I am pleased to answer any questions you may have.

[Prepared statement of Mr. Williamson follows:]

UNITED STATES POSTAL SERVICE

STATEMENT OF
CHIEF HUMAN RESOURCES OFFICER AND EXECUTIVE VICE PRESIDENT
JEFFREY C. WILLIAMSON
BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE,
U.S. POSTAL SERVICE AND THE CENSUS
UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 13, 2014

Good afternoon, Chairman Farenthold, Ranking Member Lynch, and members of the Subcommittee. My name is Jeffrey Williamson and I serve as Chief Human Resources Officer and executive vice president of the U.S. Postal Service. In this role, I oversee all aspects of Human Resources for the entire postal workforce, including the Labor Relations and Employee Resource Management functions.

Thank you, Mr. Chairman, for calling this important hearing on the Postal Service's substantial unfunded liabilities. I am pleased to be here to discuss this important matter. As we have stressed over the past several years, the Postal Service urgently needs comprehensive reform legislation. As you are aware, last summer the House Oversight and Governmental Reform Committee passed H.R. 2748, the *Postal Reform Act of 2013*. In addition, last month, the Senate Homeland Security and Governmental Affairs Committee passed its version of postal reform legislation, S. 1486, the *Postal Reform Act of 2014*. We greatly appreciate the efforts of both the House and Senate oversight committees, and we strongly urge Congress to pass comprehensive reform legislation this year.

The Postal Service continues to do its part within the bounds of existing law to place the organization in a favorable financial position, and we are proud of the achievements we have made to reduce costs while significantly growing our package business. We are especially proud of our employees, who are determined to do their part to ensure the long-term viability of the Postal Service by growing revenue and cutting costs without sacrificing their commitment to high levels of delivery and customer service.

Despite all of our efforts and the hard work of our employees, we cannot return the Postal Service to profitability, nor can we secure our long-term financial outlook without the passage of comprehensive reform legislation. Our current business plan (available for viewing on usps.com) clearly demonstrates that management actions combined with comprehensive legislative reform is the only option for restoring the financial viability of the Postal Service.

USPS FINANCIAL CONDITION

Last year's financial results—and the results of the first quarter this year—illustrate the dire financial condition in which the Postal Service finds itself.

We ended Fiscal Year (FY) 2013 (Oct. 1, 2012 – Sept. 30, 2013) with a net loss of $5 billion and liabilities of $61 billion, which exceeded assets by approximately $40 billion. As we ended the first quarter of fiscal year 2014, we experienced a net loss of $354 million and saw our liabilities grow to $63 billion. The Postal Service has incurred a net loss in 19 of the last 21 quarters, highlighting the need to continue to capitalize on growth opportunities and cost reduction initiatives. The only two quarters during which the Postal Service did not incur a loss were the quarters in which Congress modified its retiree health benefits prefunding requirements. (*Figure 1*) This trend underscores the critical need for comprehensive reform legislation that provides a long-term solution to our financial challenges.

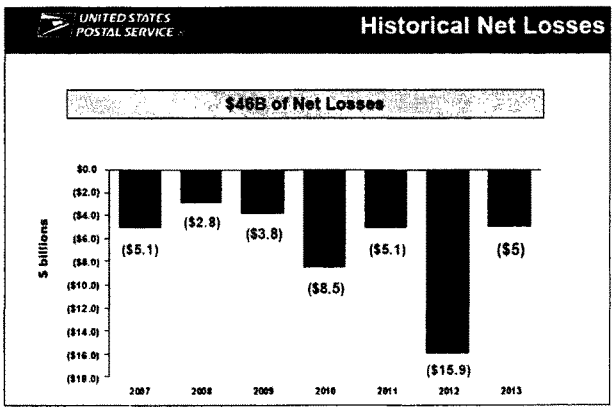


Figure 1

In FY 2013, the Postal Service achieved its first revenue growth since 2008. This growth was driven by an 8 percent, or $923 million increase in our package business, and a 3 percent, or $487 million increase in Standard Mail. Growth in our package business was fueled by our Priority Mail simplification and enhancement efforts. Marketed to customers as the Priority You campaign, we improved our package tracking system, added free insurance, and introduced day specific delivery dates. We also formed a strategic partnership with Amazon to test Sunday package delivery in select markets, and we are exploring similar partnerships with other companies.

Standard Mail revenue increases resulted from new innovative product offerings and a strong election mail season. In response to the changing needs of our customers we developed new products such as Every Door Direct Mail (EDDM) and EDDM Retail. EDDM is a saturation Standard Mail product with simplified addressing and acceptance requirements that allows local retailers and businesses to reach current and potential customers effectively and affordably. To capitalize on the advertising industry's increasing adoption of integrated campaigns, we launched seven promotions last year to encourage digital and mail integration.

While last year's operating revenue—excluding a $1.3 billion non-cash accounting adjustment—was $66 billion compared to $65.2 billion in 2012, the continued effects of the Great Recession on consumer and business behavior and the impact of digital diversion continues to negatively impact financial results. This is especially true for First-Class Mail, our most profitable product. In FY 2013, First-Class Mail revenue dropped $704 million or 2.4 percent on a 4.1 percent decrease in volume. In the first quarter of fiscal year 2014, First-Class Mail revenue decreased $209 million or 2.8 percent. The decline in correspondence and bill payment volumes was the largest contributor to these losses. In fact, total mail volume in 2013 declined by another 1.4 billion to 158.4 billion—as compared to 159.8 billion in 2012—and has declined 25 percent from 2007 to 2013. (*Figure 2*)

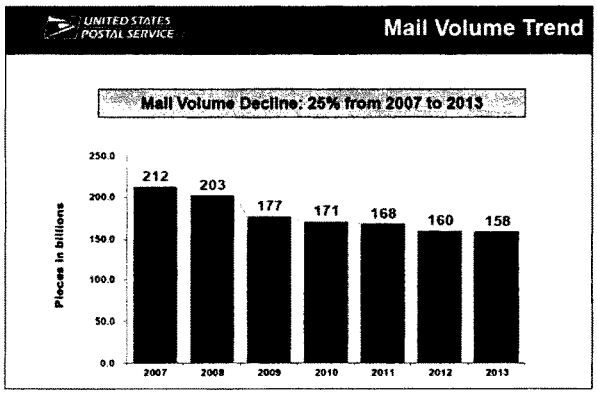


Figure 2

As the Postal Service simplified and enhanced products to minimize volume declines and to grow revenue, reducing expenses remained a priority. Total operating expenses were $72.1 billion in 2013, compared to $81.0 billion in 2012. Much of the operating expense decrease occurred because the 2013 retiree health benefits (RHB) prefunding expense was $5.6 billion, compared to $11.1 billion in 2012. In both 2012 and 2013, the Postal Service was unable to pay the RHB prefunding expenses. Expenses in

2013 were also favorably impacted by rising interest rates, which reduced the net present value of our workers' compensation liability by $1.7 billion. In total, workers' compensation expenses declined by $2.7 billion. Setting aside the workers' compensation expense decline and separation costs of $351 million that we incurred to incentivize employees to retire or resign, operating expenses declined by $900 million from $67.4 billion in 2012 to $66.5 billion in 2013.

In 2013, the Postal Service consolidated 143 mail processing facilities, modified retail hours to two, four, or six hours at nearly 8,000 Post Offices to better align operating hours with customer demand, consolidated 510 delivery units, and utilized all workforce flexibility available under the terms of our union contracts. These efforts resulted in a decrease of 12 million work hours, or 1.1 percent, despite an increase of approximately 774,000 delivery points last year. These combined efforts allowed us to capture approximately $1 billion of savings in 2013. Amidst these efforts to rightsize the Postal Service, our productivity did not suffer. In fact, total factor productivity improved by 1.9 percent last year, and as I mentioned earlier, our employees continued to deliver high levels of service performance.

As noted above, 2013 expenses included a required $5.6 billion contribution to RHB that the Postal Service was unable to make. Absent legislation, the Postal Service will almost certainly be forced to continue to default on these payments, the next of which is a $5.7 billion payment scheduled for September 30, 2014.

LEGISLATIVE REQUIREMENTS

Despite the Postal Service implementing a number of strategies that resulted in approximately $15 billion in annual expense reductions since the *Postal Accountability and Enhancement Act* (PAEA) was passed in 2006 and recent revenue growth, the combination of onerous mandates in existing law and continued First-Class Mail volume declines threatens the organization's financial viability. Initiatives undertaken by postal management will not, by themselves, be sufficient to ensure both immediate and long-term financial stability. Congressional action is necessary.

The legislative requirements put forward by the Postal Service, as outlined in our 2013 *Five-Year Business Plan*, include:

- Require within the Federal Employees Health Benefit (FEHB) Program, a set of specific health care plans that would fully integrate with Medicare and virtually eliminate the retiree health benefits (RHB) unfunded liability.
- Refund FERS overpayment and adjust future FERS payment amount using postal-specific demographic and salary growth assumptions.
- Adjust delivery frequency (six-day packages/five-day mail).

- Streamline governance model and eliminate duplicative oversight.
- Provide authority to expand products and services.
- Require defined contribution retirement system for future postal employees.
- Require arbitrators to consider the financial condition of the Postal Service.
- Reform Workers' Compensation.
- Allow the Postal Service the right to appeal EEOC class action decisions to Federal Court.

Many of these legislative requirements are directly related to the Postal Service's ability to address the unfunded liabilities that I will outline today.

UNFUNDED LIABILITIES

The Postal Service's financial crisis is even more severe than what the ongoing pattern of annual net losses on our income statement indicates. As shown on our balance sheet, there is a critical imbalance between our assets and liabilities, with liabilities totaling nearly three times our available assets. As of December 2013, the Postal Service had $23 billion in assets and $63 billion in liabilities on its balance sheet that is prepared in accordance with *Generally Accepted Accounting Principles* (GAAP). *(Figure 3)*

UNITED STATES POSTAL SERVICE

A Deep Financial Hole - December 2013
US Postal Service Balance Sheet

- **Liabilities exceed assets by approx. $40 billion**
- **The USPS has only 36 cents of assets to cover each dollar of its liabilities**

ASSETS		LIABILITIES	
Unrestricted Cash	$ 3.8B	Retiree Health Benefits	$18.1B
Buildings & Equipment, net of depreciation	$17.2B	Workers' Compensation	$15.9B
		Debt	$15.0B
Other Assets	$ 1.8B	Accrued Compensation, benefits, and leave	$ 4.9B
		Deferred Revenue	$ 3.8B
		Other	$ 5.3B
Total Assets	**$22.8B**	**Total Liabilities**	**$63.0B**

- Under multi-employer accounting rules, there are approximately $50B in obligations not shown on the balance sheet
  - > Significant profits over multiple years and legislation are needed to recover

Figure 3

This imbalance can only be addressed through legislative reform. Without legislative change the Postal Service will almost certainly default on another required $5.7 billion retiree health benefits prefunding

payment due by September 30, 2014, and the Postal Service will continue to struggle with a very low level of liquidity. Our most recent calculations reveal that, as of September 30, 2013, we had available liquidity of $3.8 billion, representing only 14 days of average daily operating expenses. A healthy private sector firm of comparable size would have more than five times the available liquidity.

Even with the (temporary) exigent price increase implemented on January 26, 2014, we project that our liquidity will remain dangerously low for the foreseeable future. In the event of insufficient cash, the Postal Service would be required to implement contingency plans to ensure that all mail deliveries continue. These measures could require the Postal Service to prioritize payments to employees and suppliers ahead of some payments to the federal government.

In order to more fully understand the dire financial situation, however, it is important to consider items not included on our GAAP balance sheet. *(Figure 4)*

UNITED STATES POSTAL SERVICE

A Deep Financial Hole - December 2013
USPS + Assets & Liabilities of Retirement Funds

- **Total Liabilities, Including Retirement Obligations exceed assets by ~ $90 billion**
- **Retirement Fund assets cover 83 cents of each dollar of retirement obligations.**
- **Total assets cover 80 cents of each dollar of liabilities.**

ASSETS (Including Assets Held by US Treasury)		LIABILITIES & RETIREMENT OBLIGATIONS	
CSRS Fund Balance	$189.0B	CSRS Actuarial Liability	$208.8B
FERS Fund Balance	$97.9B	FERS Actuarial Liability	$97.4B
RHB Fund Balance	$47.3B	Retiree Health Benefits Obligation	$95.6B
Total Retirement-Fund Assets	$334.2B	Total Retirement-Related Liabilities	$401.8B
		Workers' Compensation	$15.9B
		Debt	$15.0B
Unrestricted Cash	$ 3.8B	Accrued Comp. benefits, and leave	$ 4.9B
Land, Buildings & Equipment, net	$17.2B	Deferred Revenue	$ 3.8B
Other Assets	$ 1.8B	Other	$ 5.3B
Total Assets	**$357.0B**	**Total Liabilities**	**$446.7B**

> This slide includes all assets and liabilities of pension and postretirement health benefits obligations.
> Items highlighted in yellow are not shown on our balance sheet under GAAP and are valued as of September 30, 2013
> Significant profits over multiple years and legislation are needed to recover.

Figure 4

This chart shows our total unfunded retiree health benefits liability of $48.3 billion ($95.6 billion in liabilities versus $47.3 billion in assets) as of September 30, 2013, as calculated by the Office of Personnel Management (OPM), rather than the $18.1 billion reflected on our GAAP balance sheet, which represents only the statutorily required retiree health benefit fund payments that the Postal Service has been forced to miss. The chart also includes OPM's estimate of our CSRS unfunded liability of $19.8 billion ($208.8 billion in liabilities versus $189.0 billion in assets), which is also not reflected on our balance sheet. Further, it reflects OPM's estimate of our FERS surplus, of $0.5 billion ($97.4 billion of

liabilities versus $97.9 billion in assets), rather than the estimated $6.0 billion that would exist if postal-specific salary growth and demographic assumptions were used in the calculation. This chart also demonstrates that total obligations exceed assets by approximately $90 billion. While the imbalances are substantial, it is important to note that the Postal Service has significantly funded these liabilities, and with legislative reform we will have essentially fully funded these liabilities. As information, the "other" category includes such items as accounts payable, customer deposits, contingent liabilities, outstanding money orders, deferred gains on the sale of property, and long-term capital lease obligations.

The following sections describe the Postal Service's largest liabilities and initiatives we have proposed to provide long-term solutions to our financial challenges.

A. Retiree Health Benefits (RHB)

Currently, approximately 20 cents of every revenue dollar the Postal Service takes in goes toward health care expenses. This major component of our total operating cost is second only to wages, and is largely outside of our control. Total health care cost for 2013 was $13.4 billion, which includes $4.9 billion for current employees, $2.9 billion for retirees, and $5.6 billion for RHB prefunding. As illustrated in *Figure 4*, the Postal Service has a very large unfunded liability for RHB benefits. By 2014, we project the total liability to be $95.9 billion, with an unfunded liability of $46.8 billion. *(Figure 5)*

Savings from Current USPS Healthcare Proposal with Full Integration of Medicare Part A, B and D
(in Billions)

	PAEA (Today)	Medicare Integration Inside FEHB (Proposed)
Estimated 2014 Liability for current plan using OPM funding assumptions	$95.9 B	$95.9 B
Non-Medicare Annuitants and Survivors assumed to enroll in Medicare A & B with no penalty		($20 7 B)
Additional savings from EGWP (Medicare Part D) plan for Post-65 enrollees		($23 1 B)
Total Savings		$43.8 B
Estimated 2014 Liability	**$95.9 B**	**$51.1 B**
Estimated 2013 RHB Fund Assets	$48.8 B	$48.1 B
Estimated 2014 Unfunded Liability	**$46.8 B**	**$3.0 B**

This chart above demonstrates the differences of how the integration of health care with Medicare reduces USPS' remaining unfunded retiree health benefits from $46.8 B to approximately $3 B.

Figure 5

In order to address the Postal Service's long-term financial stability, it is absolutely essential to deal with the root cause of the problem—the size of the RHB liability, which is dictated by the costs the Federal Employees Health Benefits (FEHB) Program incurs in providing health care benefits to our annuitants. Moving to a system in which our annual prefunding payments are actuarially-based, and allowing the existing assets in the RHB fund to be used to pay annuitant premiums more quickly than is contemplated under current law, are important aspects of comprehensive reform legislation. However, these reforms are insufficient by themselves, because they do nothing to reduce the size of the RHB liability. Even if the prefunding payments are changed to an actuarial basis with a longer amortization schedule, they will still be unaffordable without changes to address the Postal Service's unnecessarily high health care costs.

By addressing the costs of providing RHB directly, we can almost completely eliminate the unfunded liability associated with those benefits. The way to do this is by properly integrating retiree health care benefits with Medicare, so that Medicare becomes the primary payer of health care claims for eligible annuitants and covered family members, with FEHBP being the secondary payer. Under FEHBP, Medicare-eligible individuals are not required to enroll in Medicare. Ten percent of Postal Service retirees are not enrolled in Part A, and 24 percent are not enrolled in Part B. This failure to integrate fully with Medicare is despite the fact that the Postal Service and its employees are the second-largest payer into Medicare, contributing $27 billion since 1983, and has resulted in significantly higher retiree health care costs and liabilities. Failing to properly integrate our retiree health benefits with Medicare increases the Postal Service's FEHBP costs, and is contrary to the virtually universal practice among private sector employers and state and local governments that provide health care benefits for their retirees.

The Postal Service has worked extensively with all stakeholders to develop a proposal that would ensure proper integration with Medicare Parts A, B, and D within the structure of FEHBP. Under this proposal, Postal Service employees and annuitants would remain in FEHBP, and their health care benefits would still be administered by OPM. FEHBP carriers that have more than 5,000 postal participants (active and retired) in their plans would be segregated from the rest of FEHBP. These carriers would establish rates for Postal Service employees and annuitants based on a separate, postal-only claims pool. Postal Service Medicare-eligible annuitants (and covered family members) covered by those carriers would be required to enroll in Medicare Parts A and B, and the carriers would provide prescription drug benefits to Medicare-eligible individuals through Medicare Part D Employer Group Waiver Plans (EGWPs). These requirements, in combination with the separate claims pool, would lead to lower FEHBP premiums for Postal Service employees and annuitants.

This proposal would almost completely eliminate the current unfunded RHB liability, and would make future amortization payments manageable (*Figure 5*). Properly integrating our health care with Medicare, consistent with the universal practice of private sector employers, is the only way to reduce our liability

and make retiree health benefits an affordable proposition for the Postal Service moving forward. This, in turn, will ensure that we can continue to fulfill our commitment to employees and retirees to provide those benefits.

B. Pension Obligations

Based on their starting date of employment, career Postal Service employees primarily participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The obligations of the Postal Service under either of these pension systems are set by statute or implementing regulations, and are outside the control of the Postal Service under current law. In that regard, while the Postal Service has overfunded its obligations for FERS, and has funded 91 percent of its CSRS obligations, there is a problem looming on the horizon, which is described later in my testimony. That problem will further exacerbate the precarious financial condition of the Postal Service unless Congress enacts comprehensive postal legislation that addresses our long term costs.

Civil Service Retirement System (CSRS)

CSRS is a defined benefit plan, which is closed to new participants, and covers most federal employees who first entered a covered position prior to January 1, 1984. CSRS provides a basic annuity toward which the Postal Service and the employee contribute at rates prescribed by law. Effective October 2006, the PAEA suspended the Postal Service's obligation to make employer contributions to the Civil Service Retirement and Disability Fund (CSRDF) until 2017. At that time, OPM will perform an actuarial valuation to determine whether additional payments are necessary.

The Postal Service's CSRS liability is 91 percent funded. This is a higher funding percentage than the remainder of the Federal Government and a mechanism to fully fund the Postal Service's liability exists under current law. As of December 2013, the Postal Service's unfunded liability for CSRS, as estimated by OPM's actuarial calculations, is $19.8 billion. *(Figure 6)*

Present Value Analysis of Retirement Programs as calculated by OPM
(9/30/13 latest actual data available)
(Dollars in billions)

CSRS	Projected 2013	Actual 2012	Actual 2011
Actuarial Liability 9/30	$ 208.8	$ 209.5	$ 210.8
Current Fund Balance	189.0	190.7	193.0
Unfunded	$ (19.8)	$ (18.8)	$ (17.8)

Figure 6

In accordance with the provisions of the PAEA, OPM will, in 2017, perform an actuarial valuation of the CSRS liability and establish an amortization schedule to be paid through 2043. It is currently estimated that the required amortization payment will be approximately $1.6 billion per year. This amortization payment, in combination with the ongoing retiree health benefits obligation will simply be unaffordable. If the Postal Service is ever going to be in a position to assume yet another substantial payment, enactment of comprehensive reform legislation that addresses the Postal Service's other liabilities is essential.

Federal Employees Retirement System (FERS) Overpayment

Effective January 1, 1987, career Postal Service employees hired after December 31, 1983, are covered by the *Federal Employees Retirement System Act of 1986*, except for those covered by Dual CSRS. Also included are employees formerly covered by CSRS who elected in either 1987, 1988, or 1998 to participate in FERS.

FERS consists of Social Security, a basic annuity plan (defined benefit plan), and Thrift Savings Plan (TSP) (defined contribution plan). The Postal Service and the employee contribute to Social Security and the basic annuity plan at the rates prescribed by law. The Postal Service is required to contribute to TSP a minimum of 1 percent per year of the basic pay of employees covered by this system. It also matches a voluntary employee contribution up to 3 percent of the employee's basic pay, and 50% of an employee's contribution of between 3 percent and 5 percent of basic pay.

OPM has determined that the Postal Service has overfunded our obligation to FERS by $0.5 billion, as of September 30, 2013. This analysis applied government-wide salary increase and demographic assumptions to the Postal Service. *(Figure 7)*

Present Value Analysis of Retirement Programs as calculated by OPM
(9/30/13 latest actual data available)
(Dollars in billions)

FERS	Projected 2013	Actual 2012	Actual 2011
Actuarial Liability 9/30	$ 97.4	$ 90.8	$ 84.0
Current Fund Balance	97.9	91.7	86.6
Surplus	$ 0.5	$ 0.9	$ 2.6

Figure 7

In December 2012, the Postal Service Office of the Inspector General (OIG) issued an update to a previously released white paper on the causes of the FERS surplus. The OIG reported that demographic and salary growth differences between postal employees versus other federal employees impacted the

calculation of the FERS liability estimate, resulting in a higher liability being attributed to the Postal Service than was warranted. The OIG specified that Postal Service employees have distinguishing characteristics (termination, retirement, disability, death, life expectancy, and health care plan elections) and salary growth expectations that are significantly different from the rest of the federal employee population and that OPM does not take these factors into consideration when applying actuarial assumptions. The Postal Service agrees with the major conclusions in the OIG's report.

We believe that OPM should take the following actions: first, OPM should use postal-specific demographic information and salary growth assumptions to calculate the FERS liability, second, in order to prevent excessive surpluses from accumulating in the future, OPM should adjust the Postal Service's future FERS contribution rate to take into account postal-specific demographic information and salary growth assumptions, and third, once calculated, the current surplus should be refunded to the Postal Service. The Postal Service, using postal-specific demographic information and salary growth assumptions, estimates the FERS overfunding amount to be approximately $6 billion.

Directing OPM to utilize postal-specific demographic information and salary growth assumptions in calculating the FERS surplus and returning the full amount of that surplus to the Postal Service is important. The Administration agrees with this approach, as reflected in its 2015 budget proposal, which requires OPM to calculate FERS costs using actuarial assumptions and demographics specific to the Postal Service workforce.

Retirement System for Future Employees

Addressing the FERS overfunding issue today is critical. However, just as important is developing a solution to address pension liabilities for future employees. The Postal Service is changing, and so are our employees and their career expectations. Employees joining the Postal Service today will likely have different career paths than our current employees. We need to provide a retirement system that better matches benefits with long-term employee needs, while ensuring that the system is financially viable. The defined benefit portion of FERS leaves the Postal Service with little ability to control future costs and leaves employees with limited investment and portability options. We should provide a defined contribution retirement system that benefits both the employee of the future and the Postal Service. The TSP portion of FERS does this very thing.

The Postal Service is proposing a new defined contribution retirement system, for future employees only, for the following reasons:

- The ability to meet obligations under the *Postal Reorganization Act* (PRA).
  The Postal Service is required to provide wages and benefits comparable to those provided in the entire private sector. The FERS system is not comparable to pension programs in the entire private

sector and is more costly. Permitting this move would allow the Postal Service, like the private sector, to adjust to market conditions by modifying plan design, portability, provider services, employee engagement and other factors.

- The Postal Service's employee base is changing.
  Our emerging workforce is younger and less likely to stay with one employer for their entire career, as most of our established employees have done. This type of portable and flexible retirement program holds a greater appeal for the younger demographic.

- Permits a reduction in labor costs.
  The Postal Service is a labor intensive organization, with labor costs making up the majority of our total costs. Benefit costs constitute approximately half of total labor costs when RHB prefunding is included. We cannot resolve our fiscal problems without addressing this issue.

A defined contribution retirement system for future employees would help ensure that the Postal Service remains financially viable, and can therefore fulfill its obligations not only to future employees, but to retirees and current employees as well. It should be noted that this change would not impact the existing retirement systems for current employees. The new system would be implemented for newly hired employees in the future.

C. Workers' Compensation

A top priority for the Postal Service is employee safety and injury prevention. We have a safety philosophy that all accidents are preventable. We believe it is our responsibility to provide safe working conditions in all of our facilities and to train and develop a safe workforce. We work closely with our unions to support safe working conditions through national, regional and local safety committees. Unfortunately—with the size of our workforce and the occasional hazards encountered while meeting our universal service obligation, such as walking, driving and loading equipment in snow, ice and rain conditions—some employees do get injured.

Postal employees injured on the job are covered by the *Federal Employees, Compensation Act* (FECA), administered by the Department of Labor (DOL) Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. The Postal Service annually reimburses the DOL for all workers' compensation benefits paid to or on behalf of postal employees, and pays an administrative fee to DOL. In October 2013, the Postal Service paid OWCP $1.4 billion, including an administrative fee of $68 million.

As of June 30, 2013, the Postal Service had 16,380 employees on Workers' Compensation Periodic Rolls and an additional 7,628 employees on the Workers' Compensation Daily Rolls. A liability is recorded for the net present value of estimated future payments to postal employees, or their qualified survivors. The estimate is based on the total cost of claims, segregated by the date of injury, based on the pattern of historical payments, frequency (number of claims per hours worked) or severity (average cost per claim) of the claim-related injuries, and the expected trend in future costs.

As of September 30, 2013, the net present value of the liability for future workers' compensation payments was $17.2 billion, compared to $17.6 billion at September 30, 2012, a decrease of 1.9 percent. Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases, and the progression of existing cases.

The existing FECA benefit structure is, in most cases, superior to benefits available under normal federal retirement, and, as a result, these more lucrative payments often continue for the rest of the lives of the claimants. The Postal Service has been actively working with our employees to move them off the workers' compensation rolls and return them to work. At the same time we have taken steps to ensure that our workplace remains safe in order to prevent accidents from happening, whenever possible. However, legislation that would require recipients who reach retirement age to transition from workers' compensation to a retirement program would be cost effective, and create a more equitable system that would also reduce the Postal Service's unfunded liability. In addition, legislation that would allow the Postal Service to settle workers' compensation claims would be beneficial for both the Postal Service and those employees who are unable to return to postal employment.

D. Debt to US Treasury

As an independent establishment of the Executive Branch of the Federal Government of the United States, the Postal Service receives no tax dollars for ongoing operations and has not received an appropriation for operational costs since 1982. We fund operations chiefly through cash generated from our products and services, and by borrowing from the Federal Financing Bank (FFB). The annual increase in debt is limited by statute to $3 billion and we have a statutory debt ceiling of $15 billion.

Due to operational and financial limitations that can only be lifted through legislation, the Postal Service has been forced to borrow up to its statutory limit. In 2012, we reached our $15 billion debt ceiling. Our interest expense in 2013 was $191 million. The RHB prefunding, lack of control of pension and workers compensation costs, and inflexible business model have forced the Postal Service to reach its debt ceiling. Comprehensive legislative reform can provide the Postal Service with the ability to reduce its

long-term liabilities, better control costs and grow revenue, pay down its debt, and enable the Postal Service to make investments to further modernize.

CONCLUSION

The enactment of comprehensive postal reform legislation cannot wait. The Postal Service has exhausted its borrowing authority, faces unnecessary and artificial costs that it cannot afford, and is constrained by law from correcting the problem.

The Postal Service has implemented a series of innovative revenue generating initiatives including Sunday delivery, Every Door Direct Mail, and Priority Mail simplification and enhancement efforts, resulting in revenue growth in 2013 for the first time since 2008. In addition, the Postal Service has implemented a number of strategies that resulted in approximately $15 billion in annual expense reductions since the Postal Accountability and Enhancement Act (PAEA) was passed in 2006. However, much more needs to be done to return the Postal Service to long-term sustainability.

We cannot get there by our actions alone. There exists no scenario where the Postal Service returns to financial stability without enactment of postal reform legislation. Now is the time for bold and sweeping action, which will allow us to move forward with solutions that will last for years to come, instead of piecemeal efforts that will only bring the Postal Service back here again, pursuing legislative reform in a few years.

Our proposals and legislative requirements address our key liabilities.

- Retiree health benefits – full Medicare integration would reduce the unfunded liability by almost $44 billion, almost to zero.

- FERS overfunding– utilizing Postal Service specific demographic and salary growth assumptions would result in approximately $6 billion in overfunding which should be returned to the Postal Service. This would minimize the likelihood that FERS would become overfunded in the future.

- Long-term pension liabilities – creating a defined contribution plan for future employees would provide a retirement system that better matches benefits with long-term employees' needs, while ensuring the system's financial viability.

- Worker's compensation reform that would require recipients who reach retirement age to transition from workers' compensation to a retirement program would be cost effective, and create a more

equitable system that would also reduce the Postal Service's unfunded liability. In addition, legislation that would allow the Postal Service to settle workers' compensation claims would be beneficial for both the Postal Service and those employees who are unable to return to postal employment.

We need to act now to implement strategies designed not only for the Postal Service of today, but for the Postal Service of ten, and even twenty years into the future. The problems we face are significant, but they are very solvable. With help from Congress, we are confident that the future of the Postal Service can be very bright.

Mr. Chairman, we look forward to continuing to work with you and the rest of the Subcommittee to accomplish meaningful postal reform legislation.

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U.S. Postal Service Testimony - March 13, 2014
Replacement Chart for Figure 5

Savings from Current USPS Healthcare Proposal with Full Integration of Medicare Part A, B and D (in Billions)		
	PAEA (Today)	Medicare Integration Inside FEHB (Proposed)
Estimated 2014 Liability for current plan using OPM funding assumptions	$95.9 B	$95.9 B
Non-Medicare Annuitants and Survivors assumed to enroll in Medicare A & B with no penalty		($20.7 B)
Additional savings from EGWP (Medicare Part D) plan for Post-65 enrollees		($23.1 B)
Total Savings		$43.8 B
Estimated 2014 Liability	**$95.9 B**	**$52.1 B**
Estimated 2014 RHB Fund Assets	$49.1 B	$49.1 B
Estimated 2014 Unfunded Liability	**$46.8 B**	**$3.0 B**

This chart above demonstrates the differences of how the integration of health care with Medicare reduces USPS' remaining unfunded retiree health benefits from $46.8 B to approximately $3 B.

Note: This is an update to figure 5 on page 7. This will also update the last sentence on page 7.
Should read:
By 2014, we project the total liability to be $95.9 billion, with an unfunded liability of $49.1 billion. (Figure 5)

Mr. FARENTHOLD. You hit that at exactly five minutes.

Mr. WILLIAMSON. I practiced.

[Laughter.]

Mr. FARENTHOLD. This may be the best timed testimony I have seen in my three years in Congress. Congratulations.

Mr. WILLIAMSON. Thank you.

Mr. FARENTHOLD. It is my understanding our two folks from the DOD actually are going to do only one set of prepared testimony. Mr. Moss, I believe we are going to go to you for that.

STATEMENT OF ROBERT MOSS

Mr. MOSS. Good afternoon, Chairman Farenthold and Ranking Member Lynch and other members of the committee.

The Department of Defense thanks you for the opportunity to be here today to discuss the operation of our health care liability trust fund.

Public Law 106–398, also known as the Floyd D. Spence National Defense Authorization Act for fiscal year 2001 authorized the establishment of two TriCare benefits for uniformed service retirees, their dependents and survivors who are Medicare eligible. Section 711 addressed implementation of the TriCare senior pharmacy benefit and Section 712 established eligibility conditions for CHAMPUS and TriCare upon the attainment of Medicare eligibility.

To provide mandatory funding for these two new health care entitlements, the fiscal year 2001 NDAA also established on the books of the Treasury the Department of Defense Medicare Eligible Retiree Health Care Fund, also referred to as The Fund, codified in Title 10, Subtitle A, Part 2, Chapter 56 of the United States Code. The Fund is used for the accumulation of funds in order to finance on an actuarially sound basis liabilities of the Department of Defense under uniformed service retiree health care programs for Medicare eligible beneficiaries. The Fund covers certain Medicare eligible DOD, U.S. Coast Guard, Public Health Service and NOAA retirees, retiree family members and survivors, not simply over 65s and not active duty dependents who are Medicare eligible. It pays directly for medical treatment facility care, serves as a secondary payer to Medicare for purchased care and pays for pharmacy benefits provided in either setting to Medicare eligible uniformed service beneficiaries.

Using an actuarially funding mechanism for the new benefits was consistent with the Congressional belief that decision makers should be confronted with the full cost of future benefits incurred by current personnel decisions and that Federal agencies should recognize the cost of all compensation and benefits offered to Federal employees at the time costs are incurred. The Fund's revenues are derived from three sources. The first source is Treasury funded unfunded actuarial liability payments, so determined by the Fund's board of actuaries. The original unfunded liability represents service performed prior to the Fund's establishment date of October 1st, 2002. This liability is currently being amortized over 45 years, starting in fiscal year 2003.

The second source is annual uniformed services actual normal cost contributions, also determined by the Fund's board of actu-

aries. These contributions fund the health care liability attributable to service performed in the current year by uniformed service members and are paid annually by Treasury on behalf of the uniformed services.

The third revenue source is investment earnings from investment in Treasury securities. The Fund invests in these securities to the extent annual fund contributions exceed annual health care expenditures. The Secretary of Defense annually transfers from the Fund to applicable appropriations of the Department of Defense amounts necessary to cover the costs chargeable to those appropriations for uniformed service retiree health care programs for beneficiaries who are Medicare eligible.

Amounts so transferred are merged with and available for the same purposes, for the same time period, as the appropriation to which transferred. Upon a determination that all or part of the funds transferred from the Fund are not necessary for the purposes for which transferred, such amounts may be transferred back to the Fund no later than the end of the second fiscal year after the fiscal year for which the appropriation is available for obligation.

The fiscal year 2001 NDAA also directed the establishment of a Medicare eligible retiree health care board of actuaries. The board consists of three members who are appointed by the Secretary of Defense from among qualified professional actuaries who are members of the Society of Actuaries. The members of the board serve for a term of 15 years. The board reports to the Secretary of Defense annually on the actuarial status of the Fund and furnishes its advice and opinion on matters referred to by the Secretary. It also reports not less than once every four years to the President and Congress on the status of the Fund.

One of its primary responsibilities is the actuarial based computation of the Treasury's amortized payment against the unfunded liability and the uniformed services normal cost contribution.

That concludes my statement, and I am happy to answer any questions you may have. Thank you.

[Prepared statement of Mr. Moss follows:]

STATEMENT BY

ROBERT MOSS

CHIEF, BUDGET AND RESOURCE MANAGEMENT

BUSINESS SUPPORT DIRECTORATE

DEFENSE HEALTH AGENCY

March 13, 2014

ESTABLISHMENT AND PURPOSE OF THE FUND

Public Law 106-398, also known as the Floyd D. Spence National Defense Authorization Act (NDAA) of Fiscal Year 2001 authorized the establishment of two new TRICARE benefits for Uniformed Services (Army, Navy, Air Force, Marine Corps, U.S. Coast Guard ((USCG)), U.S. Public Health Service ((PHS)), and National Oceanic and Atmospheric Administration ((NOAA)) retirees, their dependents, and survivor beneficiaries who are Medicare-eligible. Section 711 addressed implementation of the TRICARE Senior Pharmacy Program benefit, and Section 712 established eligibility conditions for CHAMPUS and TRICARE upon the attainment of Medicare eligibility. To provide mandatory funding for these two new health care entitlements, the FY 2001 NDAA also established on the books of the Treasury the Department of Defense Medicare-Eligible Retiree Health Care Fund (MERHCF), also referred to as the Fund, codified in (***Title 10, Subtitle A, Part II, Chapter 56, United States Code***).

- The Fund is used for the accumulation of funds in order to finance, on an actuarially sound basis, liabilities of the Department of Defense (DoD) under uniformed services retiree health care programs for Medicare-eligible beneficiaries.
- The Fund covers certain Medicare-eligible DoD, USCG, PHS, and NOAA – **retirees**, **retiree** family members and **survivors** – not simply "over 65s" and not active duty/dependents who are Medicare eligible.
- It pays directly for Military Treatment Facility (MTF) care, serves as secondary payer to Medicare for purchased care, and pays for pharmacy benefits provided in either setting to Medicare-eligible uniformed services beneficiaries.
- The Fund recognizes the uniformed services' accrued and future liabilities for the cost of retiree/survivor health care for uniformed service members, their family members and survivors who are Medicare-eligible.

RATIONALE FOR FUND

Using an accrual funding mechanism for the new benefits was consistent with a Congressional belief that decision-makers should be confronted with the full cost of future benefits incurred by current personnel decisions, and that federal agencies should recognize the costs of all compensation and benefits offered to federal employees at the time the costs are incurred.

ASSETS OF THE FUND

Funding of the MERHCF is derived from three sources.

▪ The first source is Treasury unfunded actuarial liability payments. These payments comprise two components.

- The original unfunded liability for service performed prior to the Fund's establishment date of October 1, 2002. This liability is currently being amortized over 45 years starting in FY 2003.
- Deviations from expectations (or actuarial "gains" and losses") and changes to benefit provisions. These liabilities are currently amortized over a weighted-average period that uses 30 years for each year's new gain or loss.

▪ The second MERHCF funding source is annual uniformed services actuarial "normal cost" contributions. These fund the health care liability attributable to service performed in the current year by uniformed service members, and are paid annually by Treasury on behalf of the uniformed services.

▪ The third funding source is investment earnings from investments in Treasury securities. The Fund invests in Treasuries to the extent annual Fund contributions exceed annual health care expenditures.

PAYMENTS FROM THE FUND

The Fund pays for the costs of all uniformed service retiree health care programs for the benefit of members or former members of a participating uniformed service who are entitled to retired or retainer pay and Medicare-eligible, and eligible dependents who are Medicare eligible. The Secretary of Defense annually transfers from the Fund to applicable appropriations of the Department of Defense such amounts as the Secretary determines necessary to cover the costs chargeable to those appropriations for uniformed service retiree health care programs for beneficiaries under those programs who are Medicare-eligible. Such transfers may include amounts necessary for the administration of such programs. Amounts so transferred are merged with and available for the same purposes and for the same time period as the appropriation to which transferred. Upon a determination that all or part of the funds transferred from the Fund

are not necessary for the purposes for which transferred, such amounts may be transferred back to the Fund. This transfer authority is in addition to any other transfer authority that may be available to the Secretary. A transfer from the Fund may not be made to an appropriation after the end of the second fiscal year after the fiscal year that the appropriation is available for obligation. A transfer back to the Fund may not be made after the end of the second fiscal year after the fiscal year for which the appropriation to which the funds were originally transferred is available for obligation. The Secretary of Defense, by regulation, establishes the method for calculating amounts to be transferred.

Payments from the Fund support both civilian sector purchased care and care provided in the DoD MTFs.

- MERHCF purchased care support transactions are expensed, tracked, and reconciled against the Fund on a daily basis for appropriate charges from the Defense Health Agency (DHA) Contract Resource Management Office (CRM) in Aurora, CO. through the Defense Finance and Accounting Office (DFAS) in Indianapolis, IN to the Department of Treasury. MERHCF purchased care support consists of:
  - TRICARE For Life (TFL) – Medicare is the primary payer with TRICARE as a supplemental last payer (beneficiary must be enrolled in Medicare Part B).
  - Managed Care Support Contracts – network-at-risk costs reimbursed from the Fund (under 65 retired Medicare-eligible beneficiaries – must be enrolled in Medicare Part B)
  - TRICARE Senior Pharmacy – includes both retail pharmacy network and mail order pharmacy costs (beneficiary must be enrolled in Medicare Part B)
  - U.S. Family Health Plans (USFHP) also known as Designated Providers (DPs) – MERHCF covers over 45,000 retired Medicare-eligible beneficiaries enrolled in one of the six remaining plans. The MERHCF pays an agreed upon annual capitation rate premium per enrollee. All care provided to beneficiaries enrolled must be obtained through the USFHP.
- MERHCF MTF (direct care) support consists of:
  - Operations & Maintenance (O&M) funds are transferred from the MERHCF to the Services' MTFs on a quarterly basis at the beginning of each fiscal quarter.

The amounts transferred are based on projected eligible beneficiary weighted workload for each MTF. Projected workload is multiplied by the appropriate O&M inflation rates per workload unit.

· Military Personnel (MILPERS) funds are transferred from the Fund to the Services' MILPERS accounts on a quarterly basis at the beginning of each fiscal quarter. The amount transferred is based on projected eligible beneficiary weighted workload for each MTF multiplied by the appropriate inflated MILPERS cost per weighted workload unit.

· Projected workload and costs are developed in a distribution plan and approved by the Office of Management and Budget (OMB) prior to the start of each fiscal year. The approved plan becomes the basis for funds distribution in the new fiscal year with no further overall apportionment changes/modifications allowed in the budget execution year.

· After the close of the fiscal year, a reconciliation is completed on the MERHCF workload accomplished at each MTF. The resulting analysis discloses the level and cost of health care actually provided to uniformed services Medicare-eligible beneficiaries in DoD MTFs compared to projected workload and costs used to formulate the budgeted program. The analysis forms the basis for the subsequent year's distribution. Additionally, excess funding is recouped back into the Fund through the transfer of prior year unobligated appropriations.

BOARD OF ACTUARIES

The FY 2001 NDAA directed the establishment of a Medicare-Eligible Retiree Health Care Board of Actuaries. The Board consists of three members who shall be appointed by the Secretary of Defense from among qualified professional actuaries who are members of the Society of Actuaries. The members of the Board serve for a term of 15 years (with the exception of staggered initial appointments of 5, 10 and 15 years). The Board reports to the Secretary of Defense annually on the actuarial status of the Fund and furnishes its advice and opinion on matters referred to it by the Secretary. The Board reviews the Department's actuarial valuations of the Fund and the Department must receive Board approval for its methods and assumptions.

The Board also reports, not less than once every four years, to the President and Congress on the status of the Fund. The Board includes in these reports recommendations for such changes as in the Board's judgment are necessary to protect the public interest and maintain the Fund on a sound actuarial basis.

DETERMINATION OF CONTRIBUTIONS TO THE FUND

The Board determines the amount that is the present value (as of October 1, 2002) of future benefits payable from the Fund that are attributable to service in the participating uniformed services performed before October 1, 2002. That amount is the original unfunded liability of the Fund. The Board has chosen a 45-year period for the liquidation of this liability, with payments that increase at the assumed rate of military payroll increases. By law these payments are made by the Department of Treasury.

The Secretary of Defense determines, before the beginning of each fiscal year, the total amount of the Department of Defense contribution to be made to the Fund for that fiscal year. This contribution is based on two actuarially determined annual per capita rates, one rate for active duty personnel and one rate for guard and reserve personnel. The rates are multiplied by the expected average force strength for each of the uniformed services to compute the "normal cost" contribution for each of the uniformed services. The annual per capita rates are calculated by the Department based on actuarial methods and assumptions approved by the Board.

The Secretary of Defense also conducts valuations to determine if there have been actuarial "gains" or "losses" to the Fund – and if so, determines an amortization methodology for the liquidation of such gains/losses. Payments to amortize these gains/losses become part of the overall Treasury unfunded liability payment (covering the original unfunded liability as well as new unfunded liabilities arising from gains/losses), and must be determined using Board approved methods and assumptions.

PAYMENTS INTO THE FUND

At the beginning of each fiscal year, the Secretary of the Treasury promptly pays into the Fund from the General Fund of the Treasury—

- The amount certified to the Secretary by the Secretary of Defense, which includes the "normal cost" contribution on behalf of uniformed members of the Department of Defense as well as the amortized payment on the unfunded actuarial liability.
- On behalf of the non-DoD uniformed services, the amount determined by each administering Secretary as the annual "normal cost" contribution to the Fund on behalf of members of the uniformed services under the jurisdiction of that Secretary. That is, the Secretaries of Homeland Security (Coast Guard), Health and Human Services (Public Health Service), and Commerce (NOAA), determine the contribution on behalf of uniformed members under their jurisdiction in a manner comparable to the Secretary of Defense's determination for uniformed DoD members – based on Board-approved per capita rates multiplied by each service's expected average force strength.

INVESTMENT OF THE ASSETS OF THE FUND

The Secretary of the Treasury invests such portion of the Fund as is not in the judgment of the Secretary of Defense required to meet current withdrawals. Such investments are made in public debt securities with maturities suitable to the needs of the Fund, as determined by the Secretary of Defense, and bearing interest at rates determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States of comparable maturities. The income on such investments shall be credited to and form a part of the Fund.

Mr. FARENTHOLD. Thank you very much. And you were less than two seconds over. We have a great panel here. Thank you all very much for being more considerate of our time than we were with your with the unscheduled votes.

I will now recognize myself for some questions, then we will go to Mr. Lynch and the other members of the committee.

Mr. Todisco, there was an editorial in the Wall Street Journal last week, Senator Bernie Sanders of Vermont said Congress in 2006 passed legislation that required the Postal Service to prefund over a 10-year period 75 years worth of future retirement benefits. Is that accurate?

Mr. TODISCO. No, Mr. Chairman, that is not quite accurate. There has been some misunderstanding about that, which we addressed in our 2012 report on this topic.

There is no set number of years that that is prefunded for. What is actually prefunded, the funding target consists of all the estimated future payments for those who are already retired. And for those who are still working, current postal employees, a more or less pro rata portion of their future benefit payments based on their term of service so far. That means some of those payments will go beyond 75 years, because some of the current workers will live beyond 75 years from today. But it also does not include some payments that will be made in less than 75 years. So it is an approximation.

The other point about that is it is not being funded in the 10-year period. The funding schedule in the 2006 law was over 50 years or more, although somewhat frontloaded in the first 10 years.

Mr. FARENTHOLD. I just wanted to make sure we had gotten that clear.

Mr. Williamson, you have some great employees at the Postal Service. I am friends with my letter carrier, I don't see him nearly as much now that I am here in Washington. The only time I get frustrated is when there is a long line at the post office, and that is not your fault, it is people refuse to mail early at Christmas, just like I do.

But as someone who wants to look, I assume you want to look out for and take care of your employees, just like I would want to look after and take care of my employees, do you think it is a good idea that we actually have these benefits prefunded so we are sure there is money there and we are not at the whim of a Congressional appropriation to allocate money in the future?

Mr. WILLIAMSON. Mr. Chairman, we absolutely agree. In fact, as I said in my opening statement, it is extremely important to us to be able to fund our requirements and maintain the commitment that were made to our employees out into the future.

Mr. FARENTHOLD. So if we were to follow what some folks have asked and actually, and I will ask Mr. Todisco, if we actually go to more of a pay as you go type system and don't prefund, what are the downsides to doing that, besides the whim of Congressional appropriations? Which is a pretty big one.

Mr. TODISCO. Given that the Postal Service is intended to be a self-sustaining agency, to the extent there are unfunded liabilities, there is always a concern about whether those will be able to be funded in the future.

Mr. FARENTHOLD. So mail volume is going down, right? So it is not like there is going to be, unless there is some sort of major paradigm change, there is not going to be more money coming into the Postal Service in the foreseeable future. Would that be an accurate forecast?

Mr. TODISCO. What is happening and what has happened over the last number of years is that these obligations have grown in size relative to the size of the organization supporting it.

Mr. FARENTHOLD. And Mr. Williamson, you would agree, you don't really see a turnaround in mail volume, though we may have some revenue enhancement opportunities elsewhere?

Mr. WILLIAMSON. I think there are a couple of areas within mail volume. With first class single piece letters, it is unlikely for first class single piece letters, for the continued decline to rise. However, with standard mail, advertising mail, some of the innovative things we are doing there, it is likely that we can maintain that volume in the system. And then the package growth in the organization.

Mr. FARENTHOLD. You don't think that would be enough if we were to go on a pay as you go basis without massive rate increases to pay the retiree benefits?

Mr. WILLIAMSON. I think the important element here is, as Mr. Todisco mentioned earlier, we are 91 percent funded on our CSRS obligation, we are overfunded on our FERS obligation. And we do have a plan that would allow us to virtually fully fund our retirement health care obligation. So from a Postal Service standpoint, we view that we have solutions and plans that would allow us to fully fund those obligations.

Mr. FARENTHOLD. So you would like to see some of the postal reform we are talking about here come to be?

Mr. WILLIAMSON. Yes.

Mr. FARENTHOLD. All right. I will now go to Mr. Lynch and allow him his chance to do some questions.

Mr. LYNCH. Thank you, Mr. Chairman. Let me just follow up on the pay as you go sort of scenario. From 1970 to 2006, we were on a pay as you go. When I say pay as you go, what I mean is, I sat on the pension fund for the Iron Workers, we had to make sure that our obligations were met as they arose. So that is what I mean by a pay as you go system, in case there is some question about that term.

So if we look at the, let's look at the obligations of the FERS situation first. The Office of Personnel Management's most recent calculation estimated that the Postal Service had overpaid its FERS pension account by approximately $500 million. This surplus has significantly decreased since 2011 when it was reported that the surplus was $11.4 billion. The key here is, however, that we would like to use demographics specific to postal employees, because there are a lot of ups and downs in private industry. I know, I was in the construction industry, work was very choppy.

But for most of our postal employees, they go in there, they go to work, they have a set number of hours they work each week, there are no ups and downs in the economy basically that disrupts that Postal Service. Got to get the mail out every single week.

And the Hay Group reported that the total using postal specific demographics, that the surplus could be as high as $12.5 billion. Mr. Todisco, are you familiar with that?

Mr. TODISCO. Yes, I am.

Mr. LYNCH. Are you in agreement with sort of the calculation there, or is that off base here?

Mr. TODISCO. Well, we haven't analyzed their calculation. It is plausible that it could turn out that way, and we do support the use of postal specific assumptions.

Mr. LYNCH. Okay, that would result in a more accurate number?

Mr. TODISCO. Yes, that is right.

Mr. LYNCH. Mr. Williamson, why would that be important? Could you elaborate on why it is important to use the postal specific characteristics in determining what the FERS overpayment or the unfunded liability might be?

Mr. WILLIAMSON. Absolutely. From our perspective, using assumptions that match our workforce and our demographics, given we are self-sustaining and self-funding, makes sense when you think about what that true long-term liability and obligation is. So we support using the salary growth and demographic assumptions to calculate the FERS payment.

Mr. LYNCH. Great. Mr. Williamson, would you support returning the surplus to the United States Postal Service?

Mr. WILLIAMSON. Yes.

Mr. LYNCH. And Mr. Todisco, is it correct that Congress has not yet instructed OPM how to deal with any surpluses generated within the FERS pension account?

Mr. TODISCO. That is correct, Congressman. Under current law, the Postal Service cannot realize any financial benefit from that surplus.

Mr. LYNCH. Okay. Thank you.

Would GAO support a one-time transfer of the surplus to go to paying down some of the liabilities? I have a bill out there, not to ring my own bell, but under one of the bills I have, H.R. 961, it would actually cause the transfer of the surplus to pay down some of these liabilities. Is that something you would support?

Mr. TODISCO. To transfer the surplus to take care of the unfunded liabilities?

Mr. LYNCH. The obligations, yes. Not to use it for operational, but for paying down some of the debt that is outstanding?

Mr. TODISCO. Yes, that makes complete sense from a holistic standpoint, yes.

Mr. LYNCH. Has the GAO provided any legislative suggestions on how to deal with this?

Mr. TODISCO. We haven't drafted any language but we have offered a number of suggestions for how to deal with the surplus.

Mr. LYNCH. Okay.

I hate to drag the DOD in here, but we have already brought you in. Let me just ask, Mr. Moss, in your testimony you stated that under the DOD system, most payments derive from three sources, is that correct?

Mr. MOSS. Yes, sir.

Mr. LYNCH. Are any of those sources funded by Congressional appropriations?

Mr. MOSS. The payment that the Department of Defense pays in to fund the normal cost contribution, that is part of their appropriated top line that comes to them each year.

Mr. LYNCH. Okay, so Congress appropriates money for you to meet your prefunding requirement?

Mr. MOSS. That is correct.

Mr. LYNCH. Okay. That is quite different than what the Postal Service is dealing with.

Mr. Williamson, does any of the Postal Service receive appropriations from Congress to meet its prefunding liability?

Mr. WILLIAMSON. No, we do not.

Mr. LYNCH. So apples and oranges here. I see I have 12 seconds left, so why don't I stop right there. Thank you.

Mr. FARENTHOLD. Thank you very much.

We will now go to our Vice Chair, Mr. Walberg, for questions.

Mr. WALBERG. Thank you, Mr. Chairman.

Mr. Todisco, your testimony stated that GAO supports legislation that would shift USPS remaining retiree health care fixed payments to actuarially determined payments, which is a provision of both the House version and the Senate version, as I understand it, of the Postal Reform Act in the President's fiscal year 2015 budget proposal. But GAO has expressed concern about proposals that would lower the funding target for the retiree health care liability from 100 percent to 80 percent, something currently in the Senate version of the Postal Reform Act and in the President's fiscal year 2015 budget.

If the funding targets are lowered, what happens if USPS doesn't have the funds set aside to pay the benefits?

Mr. TODISCO. OPM has indicated that they are not sure legally what exactly would happen if those benefits can't be paid at some point. There is uncertainty about that.

Mr. WALBERG. So that just sits out there?

Mr. TODISCO. That sits out there.

Mr. WALBERG. Without the ability to plan?

Mr. TODISCO. Hypothetically, people could lose benefits. Taxpayers could be burdened. But we don't know exactly what will happen.

Mr. WALBERG. I guess that went to my follow-up question, how might taxpayers be affected by the decision to lower funding targets. And you are saying we don't know. They could be brought in?

Mr. TODISCO. That is right. OPM has told us they don't know.

Mr. WALBERG. Okay. USPS, Mr. Todisco, currently has an unfunded liability for retiree health care of $48 billion. How sensitive is this projection to the assumptions for medical inflation? And secondly, if for instance, medical inflation increases by 1 percent, what happens to the size of the unfunded liability?

Mr. TODISCO. The most recent, it is a highly sensitive number to those assumptions, Congressman. The most recent estimates are that if medical inflation were, say, 1 percent higher, the unfunded liability would be somewhere on the order of $15 billion more than it is today.

Mr. WALBERG. Fifteen billion. You are testifying that an increase of 1 percent in medical inflation would result in over a 30 percent

increase. Does this sensitivity to medical inflation factor in GAO's recommendation that USPS fully fund the benefit?

Mr. TODISCO. No, it doesn't. Our recommendation is really for other reasons outside of that issue.

Mr. WALBERG. According to your testimony, USPS's debt and unfunded liabilities have become a large and growing burden, increasing from 83 percent of USPS's revenues in fiscal year 2007 to 148 percent of revenues in fiscal year 2013. Your testimony also notes that USPS holds unrestricted cash of $2.3 billion, which would cover only nine days of average daily expenses.

What effect does USPS debt and unfunded liability have on the agency's ability to make capital improvements?

Mr. TODISCO. Well, it is a severe constraint, certainly.

Mr. WALBERG. So I guess again we are looking here at a setting that everything is affected, the viability, the planning, the uncertainty. All goes to the bottom line of more than just the problem, but ultimately a taxpayer problem as well?

Mr. TODISCO. That is potentially, but again legally how it would play out, we don't know.

Mr. WALBERG. Okay. Mr. Chairman, I yield back.

Mr. FARENTHOLD. Thank you very much.

We will now recognize Mr. Clay for five minutes.

Mr. CLAY. Thank you, Mr. Chairman. Congress does not provide any funds to the Postal Service to meet its prefunding requirement. And that is a pretty big difference. In fact, comparing the DOD to Postal Service is a little bit like comparing apples to oranges. And you know, today's hearing is meant to look at the Postal Service's unfunded liabilities. Since the Majority invited DOD to testify, I wondered what DOD's unfunded liability is for their retiree health care program. And committee staff found that at the end of fiscal year 2013, DOD's Medicare eligible fund had assets of approximately $187 billion, while containing a liability of $502.4 billion.

Mr. Chairman, let me caution my colleagues about where we are going on this path. And I hope it is not to dismantle the Postal Service. I know my constituents rely heavily on the U.S. Postal Service, and just like you do, Mr. Chairman, at Christmas time. It is perplexing to hold this agency to one standard and not other agencies. We are talking about $100 billion in liabilities, but yet nobody has talked about dismantling the Federal Government when we have $17 trillion in national debt. It is just perplexing to me.

And then I see that the President has come out in his budget advocating five-day service. I know the Majority couldn't be for anything the President has offered up.

[Laughter.]

Mr. CLAY. Let me ask a question. Since there is $502.4 billion in liability from DOD's Medicare eligible fund, is that correct, Mr. Moss?

Mr. MOSS. That is the total liability, sir. The unfunded portion of that liability, I would defer to Mr. Sitrin, is far less than that.

Mr. CLAY. Would it be the difference between $187 billion and $502 billion, is that right? Mr. Sitrin? Okay. You are a mathematician. What is that, about $300 billion?

Mr. SITRIN. Yes, sir.

Mr. CLAY. About $315 billion, right?

Mr. SITRIN. Yes.

Mr. CLAY. At the end of fiscal year 2013, the Postal Service had assets of approximately $47.3 billion, and liability of approximately $95.6 billion, is that correct, Mr. Williamson?

Mr. WILLIAMSON. That is correct.

Mr. CLAY. Based on these numbers, the Postal Service is 49 percent funded, while the DOD is just 39 percent funded. In other words, DOD's unfunded liability is much larger than the Postal Service's. So, Mr. Moss, should we be concerned that DOD will not be able to meet its unfunded liability, given that they are so much larger?

Mr. MOSS. No, sir, I don't think that given the current circumstances and the way the fund is funded each year by DOD and by Treasury as that continues then I don't think there is a problem with the Department of Defense meeting its unfunded liability at the end of that 45 year period.

Mr. CLAY. What if Congress decides not to appropriate any more funds for that?

Mr. MOSS. Then there would obviously be a problem.

Mr. CLAY. Let me ask Mr. Todisco, what would be the increased rate to consumers of the U.S. Postal Service in order to eliminate the unfunded liability and to fix the issue?

Mr. TODISCO. I don't know that figure, Congressman, as to how it would translate into a postage rate.

Mr. CLAY. Okay. It seems to me that Congress is a large part of the reason to blame for this problem and this hearing is intended to focus on that. DOD's requirement to prefund its health care liability isn't the same as the Postal Service's. Mr. Todisco, would you agree that the Postal Service is being required to prefund in more aggressive pace than DOD?

Mr. TODISCO. They are both using a 100 percent funding target. The Postal Service is farther ahead. And yes, as we have reported, the schedule that the Postal Service has had to follow has been an ambitious schedule in that while it is a 50-year schedule, approximately, payments are frontloaded in the first 10 years.

Mr. CLAY. Mr. Chairman, I see my time is expired. I yield back.

Mr. FARENTHOLD. Thank you very much.

I would like to follow up. I know my colleagues on the other side of the aisle have made a distinction that we may be comparing apples to oranges here based on funding sources. I wanted to examine that and talk a little bit about the rationale for what we are doing.

The Department of Defense is funded almost exclusively through appropriations, is that not correct, Mr. Moss?

Mr. MOSS. Yes, sir.

Mr. FARENTHOLD. And Mr. Williamson, the Postal Service basically gets no appropriations and funds itself through the rates it charges its customers, is that correct?

Mr. WILLIAMSON. That is correct.

Mr. FARENTHOLD. So even though we are talking about, they say apples and oranges, because the Defense Department gets appropriations, well, they are using part of the money that they get from whatever source to prefund their retirement and the Postal Service, I think we are asking that they do the same.

Let me ask you, Mr. Moss. You touch a little bit in your testimony on the rationale for why DOD should have to, or is required to do this prefunding. Could you elaborate on that a little bit?

Mr. MOSS. Yes, sir. Prior to the establishment of the fund, whenever there was discussion about the funding of the old CHAMPUS program or TriCare, it was primarily focused with the medics and looking at what were the additional benefits or the expansion of benefits that would be afforded to our beneficiaries. With the establishment of the trust fund and the Department having to pay into the fund each year, and I would add that when the Department pays into the fund, as the fund stood up, the DOD top line was not increased by the amount of the payment into the trust fund.

So DOD was told, you still have your essential basic funding level, and from that you will fund, you will start to prefund the trust fund. When that happens, now you have much more involvement and much more scrutiny from senior management within the Department, looking at what are the various benefits and what is the impact of expanding or in some way changing those benefits, as related to the payment into the fund. So there is much more involvement and much more interest on the part of senior management other than just the medics about the health care benefit that we are affording our beneficiaries.

Mr. FARENTHOLD. And then at the risk of sounding like Captain Obvious, I had some folks from the Post Office in my office this week talking to me. And one of their talking point was that they are the only agency within the U.S. Government that is required to prefund.

Mr. Moss, is the Defense Department an agency of the United States government?

Mr. MOSS. It is.

Mr. FARENTHOLD. And you are required to prefund?

Mr. MOSS. That is correct.

Mr. FARENTHOLD. I just want to have them scratch that talking point off so we could talk about some other things next time that we are up.

Let me see, I think I have one more question here, if you can give me one second to find it. It actually already got asked by one of my colleagues, so Mr. Lynch, we will let you have another round of questioning.

Mr. LYNCH. Thank you, sir. I appreciate that, Mr. Chairman.

I think the point we are trying to make is, and the Postal Service is trying to make is, they are the only U.S. agency government department that is required to prefund and pay it for themselves. I think the distinction is that you receive money from Congress in an appropriation every year to prefund your benefits. That is the distinction that we are trying to make there.

According to Mr. Williamson's testimony earlier, about 20 cents of every dollar of revenue that the Postal Service brings in, and their revenue is they sell stamps, that is basically it, that is how the Postal Service funds its operations. People can't believe that, they don't get tax money, they just sell stamps. That is why stamps cost what they do.

So 20 percent of every dollar goes for paying the health care expenses. And in 2013, total health care costs for the Postal Service was approximately $13.4 billion.

Now, Mr. Williamson, how much of those costs were for current employees versus retirees? Can you tell me that?

Mr. WILLIAMSON. Yes. Only $4.7 billion of that $13.4 billion was for active employee premiums. The bulk of it.

Mr. LYNCH. So the huge part is all retirees? That makes sense, they are older, they are using more medical services. That makes sense. So if eligible, are Postal employees mandated to enroll in Medicare, since most of these people are all retired, are they required to enroll in Medicare?

Mr. WILLIAMSON. No, they are not required to enroll in Medicare. Only 90 percent of our current retirees are in Medicare Part A, and 76 percent in Medicare Part B.

Mr. LYNCH. So there is a huge chunk of them that are not?

Mr. WILLIAMSON. Correct.

Mr. LYNCH. Mr. Moss, can I ask you, are military service members required to enroll in Medicare if they are eligible?

Mr. MOSS. Yes, sir.

Mr. LYNCH. Okay, well, that might be a huge difference.

Mr. Williamson, in your testimony you mentioned the Postal Service proposal to integrate current health care benefits with Medicare to create a Medicare wraparound plan for employees. Could you explain why this is important for the Postal Service?

Mr. WILLIAMSON. Absolutely. Currently, our unfunded liability is based on a FEHB plan that does not integrate nor coordinate benefits with Medicare, which means the cost of that plan is much higher. So when you calculate, and Mr. Todisco and some of the other actuaries can get into the details, but when you calculate the actuarial estimate of what that cost is on a higher per capita cost plan, your liability grows.

What we are proposing is, we have already paid us and our employees $27 billion in contributions to Medicare, and we would like to require our employees to take on Medicare once they become eligible and create wraparound type plans that would coordinate their benefits and fully integrate with Medicare, therefore Medicare being the primary payer and the FEHB plans, the Postal Health care plans, to be the secondary.

Mr. LYNCH. I have to say, Mr. Moss, that sounds a lot like TriCare. That sounds a lot like how you handle DOD benefits through TriCare.

Mr. MOSS. Yes, sir. We share with CMS our manpower documents as far as our retirees. And when a beneficiary obtains care from a civilian provider and the bill is sent to CMS and they pay their share, then they see that that beneficiary is dual eligible, they electronically transfer that claim over to our fiscal intermediary and then we wind up paying the rest of that health care bill.

Mr. LYNCH. Now, this might be obvious, but does having Medicare as the primary insurer, does that reduce DOD's health care expenses?

Mr. MOSS. It does reduce health care expenses as they are today. But prior to the establishment of the TriCare for Life program in

2001, DOD was not paying anything toward the care of those beneficiaries once they became Medicare eligible.

Mr. LYNCH. Okay, so now you are picking up some.

Mr. MOSS. Now we are picking up some, but it is still far less than it would be if we had to fund the entire benefit.

Mr. LYNCH. Which is what Mr. Williamson's situation is.

Mr. MOSS. Yes, sir.

Mr. LYNCH. Mr. Williamson, has the Postal Service estimated the cost savings derived from this integration proposal where you have a wraparound Medicare situation?

Mr. WILLIAMSON. Yes, sir, we have. We, based on our actuarial estimates, full Medicare integration would reduce our unfunded liability from the $48.3 billion to $3 billion.

Mr. LYNCH. Say that again?

Mr. WILLIAMSON. It would virtually eliminate our unfunded liability and maintain the same level of benefits for our retirees.

Mr. LYNCH. Wow.

Mr. WILLIAMSON. Yes. It would reduce from the $48.3 billion to $3 billion.

Mr. LYNCH. Now, would the Postal Service need authorization from Congress to initiate that integration plan?

Mr. WILLIAMSON. Yes. We would need OPM to be required to set aside specific plans within FEHB that would be required to integrate with Medicare and coordinate the benefits.

Mr. LYNCH. Okay, and I am a former union president, so I want to ask you, is this integration plan, is this subject to collective bargaining with the postal unions?

Mr. WILLIAMSON. We have already, over a year ago we proposed a plan that would actually take postal retirees outside of the FEHB plan and create our own plan. Subsequent to that, we have worked very closely with our stakeholders, the unions' management associations, to come up with a proposal that we can all agree on that would maintain these components but do it within the umbrella of FEHB. So we are not proposing that it would be something we would collectively bargain in terms of the design. What we are requiring is that OPM, for retirees, require Medicare and require the integration within those plans.

Mr. LYNCH. Right. Well, I think design is probably a management function. But I would encourage you to continue your talks with those unions, because they have been very, very cooperative and progressive in terms of meeting the Postal Service's challenges.

Mr. Chairman, I yield back.

Mr. FARENTHOLD. Thank you very much, and we will now go to Mr. Walberg for a second round of questions.

Mr. WALBERG. Thank you, Mr. Chairman. Just basically one question, Mr. Todisco. As I understand it, the CRS account of USPS has a projected deficit of $19.8 billion, while the FERS account has a projected surplus of just $500 million. While using the USPS specific demographic assumptions may slightly change these numbers, I think for the purposes of today they would be illustrative.

As an actuary, do you think it makes sense to treat these and other employee benefit liabilities in a holistic manner?

Mr. TODISCO. Yes, I do, Congressman. I would actually expand that to include the debt to Treasury. Over the last 10 years, the debt has increased in part to make retiree health prefunding payments that were made. So you have money going from one section to another.

Economically, the CSRS falls from retiree health and debt to Treasury. In one sense, there is unfunded obligations and debt, they are all debt, they are all payments that have to be made.

Mr. WALBERG. Thank you. Thank you, Mr. Chairman.

Mr. FARENTHOLD. Thank you very much. Did you have any more questions, Mr. Lynch?

I will say we appreciate your testimony. It will help us as we move forward with various iterations of postal reform. I should have caught Mr. Clay before he left, but we actually don't agree with the President on five-day delivery. We want modified six-day delivery. So it not a complete agreement there, but we are moving on our side in the same direction.

Mr. LYNCH. I was getting nervous there.

[Laughter.]

Mr. FARENTHOLD. We appreciate our witnesses' testimony and the members. Thank you very much, and we are adjourned.

[Whereupon, at 3:25 p.m., the committee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

HOUSE SUBCOMMITTEE ON FEDERAL WORKFORCE,
U.S. POSTAL SERVICE AND THE CENSUS
"At a Crossroads: The Postal Service's $100 Billion in Unfunded Liabilities"
March 13, 2014

Post-Hearing Questions for the Record
Submitted to Jeffrey Williamson, Chief Human Resources Officer and Executive VP

From Chairman Blake Farenthold:

1. **Current law requires that, in 2017, the Office of Personnel Management review the unfunded liability in the Civil Service Retirement System (CSRS) and establish an amortization schedule to pay for that unfunded liability by 2043.**

a. **What is the approximate size of the new annual amortization payment if the CSRS deficit stays the same?**

Answer:

The Office of Personnel Management (OPM) annually provides the Postal Service with a report detailing the funding status of Postal Service obligations to both the CSRS and Federal Employees Retirement System (FERS), based on OPM's most recent actuarial estimate. This report also includes estimates of future payments that the Postal Service and its employees will make into the CSRS Fund. In the report received October 29, 2013, OPM estimated that the Postal Service's annual amortization payment for CSRS will be $1.6 billion, beginning in 2017 and continuing through 2043.

b. **Assuming there are no statutory changes enacted, do you think USPS will make this payment?**

Answer:

The Postal Service is currently in the process of updating its financial forecasts in light of the PRC decision of December 24, 2013, permitting a temporary exigent price increase. There are always challenges in developing long-term financial forecasts, including the decline in volumes of First-Class Mail, growth in package shipping, and uncertainty over the overall growth rate of the U.S. economy. While we are continuing to develop our forecast, certain facts make clear that 2017 will represent a continuation of the Postal Service's significant liquidity challenges.

The Postal Service projects that it will not have sufficient liquidity to be able to afford the $5.7 billion retiree health benefits (RHB) prefunding payments due in 2014 and 2015, nor the $5.8 billion payment due in 2016. Beginning in 2017, the Postal Service will be required to pay the "normal cost" of its current employees' expected retirement health benefits costs, plus an amount intended to amortize the unfunded RHB liability by 2056. It is estimated that the 2017 RHB funding requirement will be approximately $5.5 billion, whereas the actual RHB premiums paid in fiscal year (FY) 2013 was only $3.0 billion. This a $2.5 billion increase in RHB. Combined with the $1.6 billion CSRS amortization payment discussed above, this is a $4.1 billion increase in cash requirements, compared to FY 2013.

The Postal Service also has an urgent need to invest in vehicle and package infrastructure, which will further strain our cash resources.

In combination, these factors will continue to place the Postal Service at risk of defaulting on its financial obligations to the federal government. This underscores the need for comprehensive reform legislation that will permit the Postal Service to take the actions necessary to regain financial stability.

For example, the amortization portion of the 2017 RHB payment is estimated to be approximately $3.1 billion. Substantially all of that $3.1 billion could be eliminated if retiree health benefits costs within FEHBP were fully integrated with Medicare—as are the costs of TRICARE, the Defense Department's plan—reducing the Postal Service's estimated cash outlay to a much more manageable $2.4 billion. This would make it more likely that the Postal Service would have sufficient liquidity to fund the CSRS amortization payment in 2017 and beyond.

c. **In light of this and the fact that USPS stands in default to the federal government for $16.8 billion, why has USPS consistently backed away from major cost-cutting efforts over the past four years?**

Answer:

The Postal Service has not backed away from implementing cost-cutting efforts that are within our ability to adopt. We have taken a number of actions that resulted in $15 billion in annual expense reductions over the last seven years. The Postal Service has been able to maintain sufficient liquidity to continue providing prompt and reliable service to the American people, despite significant volume declines and onerous statutory mandates, precisely because of its extensive efforts to reduce costs and grow revenues.

Since 2006, these actions have included reducing our career employee complement by over 200,000, without resorting to layoffs, and consolidating nearly 24,000 delivery routes, despite adding nearly seven million new delivery points. Since announcing our Network Rationalization initiative in 2011, we have consolidated 350 mail processing plants—reducing our processing footprint by one-third. In addition, since 2012, we have consolidated more than 2,400 delivery units, and are adjusting the hours and staffing of 13,000 Post Offices to two, four, or six hours per day—with more than 8,700 Post Offices completed in 2012, and the remaining adjustments scheduled for completion by October 2014. Even while making these significant network changes, we have maintained high levels of efficiency and customer service.

The impact of the Great Recession, as well as digital diversion, resulted in a 26 percent mail volume decline over the last seven years. The Postal Service's net losses during this same period, exclusive of the RHB prefunding obligations, total nearly $9 billion. Given these facts, we recognized that implementing prudent cost savings initiatives alone would not return the Postal Service to financial solvency. Therefore, we also focused our efforts on developing new products and enhancing existing product offerings to meet the needs of a changing marketplace. As a result, our overall package business grew by nearly 22 percent over the last three years. Moreover, when excluding market-dominant package products, we experienced a 44 percent growth increase during this same period.

In 2011, we introduced Every Door Direct Mail (EDDM), a saturation Standard Mail product with simplified addressing and acceptance requirements that allows local retailers and businesses to reach current and potential customers effectively and affordably. Since its inception, EDDM has generated almost $1 billion in revenue.

In 2012, the Postal Service began a market test for Metro Post, an innovative premium delivery service product designed to improve the e-commerce experience for customers shopping online by offering same-day delivery service for certain purchases. We also formed a strategic partnership with Amazon last year to test Sunday package delivery in select markets. The Postal Service implemented this premium service just in time for the holiday mailing and shipping season and, due to overwhelming interest, we are currently exploring similar partnerships with other companies.

In addition, the Postal Service implemented an "exigent" price increase in January 2014 concurrent with implementation of the annual CPI-based price increase for Market Dominant products. These combined price change implementations are expected to contribute approximately $2 billion in additional annualized revenue. The exigent price increase is to be repealed, as directed by the PRC, after it has generated $3.2 billion in revenue. We are currently appealing the PRC's decision to limit the duration of the exigent price increase.

Despite all these measures, the Postal Service projects that it will continue to have a low level of liquidity for the foreseeable future if comprehensive postal reform legislation is not enacted. Should circumstances leave the Postal Service with insufficient cash to meet of its obligations, we could be forced to prioritize payments to employees and suppliers ahead of some payments to the federal government, in order to ensure that mail delivery continues.

i. Particularly, why have additional plant consolidations been postponed?

Answer:

As indicated above, since 2011, the Postal Service has consolidated 350 mail processing plants. As a result of these consolidations, and as a part of our continuous improvement process, we are making significant improvements to the efficiency of our existing mail processing network. One such example is the recent implementation of our load leveling initiative, which will help achieve a more balanced distribution of mail volume across all of our delivery days. These improvements should result in additional cost savings to the Postal Service. We are also determining whether additional excess capacity exists in our plants and if further consolidation is appropriate. A part of this determination hinges on the prospects for comprehensive postal reform legislation.

ii. Why has USPS not shifted to a 2-3 day service standard for First-Class Mail? Such a service standard change was proposed publicly as early as December of 2011.

Answer:

In January 2014, the Postal Service temporarily postponed the adoption of revised service standards for First Class Mail that would shift the mail (with the exception of certain presort First-Class Mail) to a 2-3 day service standard. Service standards directly correspond with the Postal Service's efforts to rationalize its network through processing plants consolidations. As mentioned in the previous response, the next phase of consolidations has been temporarily placed on hold.

iii. Why has USPS not developed a coherent program to encourage or mandate residential customers to shift to curbside and centralized delivery?

Answer:

The Postal Service has an initiative in place requesting business and residential customers to convert from door delivery, which is our most costly form of delivery, to either curbside or centralized. At the present time, we are notifying property managers and discussing the advantages of centralized deliveries to encourage such conversions. We have successfully converted 35,000 deliveries this fiscal year (through Feb 28), and we have additional signed agreements that will convert another 42,000 later this year. Furthermore, our current policy of directing all new growth to centralized or curbside delivery is driving a migration towards a more efficient mode of delivery for new addresses. Over the past three years 60 percent of all new deliveries were centralized.

We have not determined it prudent to adopt a policy compelling existing addresses to convert from door delivery for a variety of reasons. Among other things, converting all or most door delivery points to centralized or curbside delivery would result in a significant investment and maintenance expense and could lead to significant customer and political opposition. The impact on mail volume would also have to be carefully studied before an estimate of the actual savings from such conversions can be determined.

d. Is the Postal Service content to "run out the clock" with its current Medicare proposal and simply ask for a taxpayer bailout? Has USPS developed a contingency plan should postal reform not be enacted this Congress? If so, please provide the details of that plan. If not, why not?

Answer:

The Postal Service has worked extensively to maintain sufficient liquidity to continue providing prompt and reliable service to the American people in spite of significant volume declines and onerous statutory mandates. Our efforts to reduce costs and grow revenue belie the notion that we are content to await a taxpayer bailout.

Unfortunately, the situation is such that the only way the Postal Service can restore financial solvency is through the enactment of postal reform legislation. For instance, considering its current and projected volumes, the Postal Service simply cannot afford to make retiree health benefits payments at the level required by law, and the only way to ensure that such benefits can be provided over the long-term is through statutory changes that address the size of the retiree health benefits liability.

The Postal Service has worked extensively with all stakeholders to develop a health care proposal that would ensure proper integration with Medicare and reduce our current RHB unfunded liability by $43 billion. Implementing this plan— which would almost completely eliminate the RHB liability and make future amortization payments manageable—requires legislative change. If such legislation is not enacted, and the Postal Service remains subject to unaffordable benefits payments, our primary plan to remain solvent is to continue to make responsible efforts to reduce costs and generate new revenues to ensure sufficient liquidity to continue delivering the mail. We have taken a number of actions that resulted in $15 billion in annual expense reductions over the last seven years.

Since 2006, these actions have included reducing our career employee complement by over 200,000, without resorting to layoffs, and consolidating nearly 24,000 delivery routes, despite adding nearly seven million new delivery points. Since announcing our Network Rationalization initiative in 2011, we have consolidated 350 mail processing plants—reducing our processing footprint by one-third. In addition, since 2012, we have

consolidated more than 2,400 delivery units, and are adjusting the hours and staffing of 13,000 Post Offices to two, four, or six hours per day—with more than 8,700 Post Offices completed in 2012, and the remaining adjustments scheduled for completion by October 2014. Even while making these significant network changes, we have maintained high levels of efficiency and customer service.

The impact of the Great Recession, as well as digital diversion, resulted in a 26 percent mail volume decline over the last seven years. The Postal Service's net losses during this same period, exclusive of the RHB prefunding obligations, total nearly $9 billion. Given these facts, we recognized that implementing prudent cost savings initiatives alone would not return the Postal Service to financial solvency. Therefore, we also focused our efforts on developing new products and enhancing existing product offerings to meet the needs of a changing marketplace. As a result, our overall package business grew by nearly 22 percent over the last three years. Moreover, when excluding market-dominant package products, we experienced a 44 percent growth increase during this same period.

In 2011, we also introduced Every Door Direct Mail (EDDM), a saturation Standard Mail product with simplified addressing and acceptance requirements that allows local retailers and businesses to reach current and potential customers effectively and affordably. Since its inception, EDDM has generated almost $1 billion in revenue.

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In addition, the Postal Service implemented an "exigent" price increase in January 2014 concurrent with implementation of the annual CPI-based price increase for Market Dominant products. These combined price change implementations are expected to contribute approximately $2 billion in additional annualized revenue. The exigent price increase is to be repealed, as directed by the PRC, after it has generated $3.2 billion in revenue. We are currently appealing the PRC's decision to limit the duration of the exigent price increase.

Despite all these measures, the Postal Service projects that it will continue to have a low level of liquidity for the foreseeable future if comprehensive postal reform legislation is not enacted. Should circumstances leave the Postal Service with insufficient cash to meet of its obligations, we could be forced to prioritize payments to employees and suppliers ahead of some payments to the federal government, in order to ensure that mail delivery continues.

2. **Your testimony states that USPS would like to transition to a defined contribution retirement plan for future employees. Could you elaborate on how that will help you resolve your current unfunded liability issues?**

Answer:

The Postal Service proposal to transition to a defined contribution retirement plan for future employees addresses future pension liabilities. It does not resolve our current unfunded liabilities. We have funded 91 percent of our CSRS liability and overfunded our FERS liability. Current law sets forth a mechanism by which the Postal Service will fund our remaining CSRS liability, although, as noted in my testimony, we may not be able to make

this payment without comprehensive postal reform legislation. Furthermore, to prevent the Postal Service from continuing to overfund FERS, we have proposed that OPM be required to calculate our pension liabilities using postal-specific demographic and salary growth assumptions. This would result in more actuarially appropriate assumptions, as opposed to the Federal Government-wide assumptions that OPM currently uses.

The Postal Service also is proposing a new defined contribution retirement system, for future employees only, as the current FERS retirement program is not comparable to pension programs in the private sector at large. It is not only more expensive, but it is less appealing to an emerging younger workforce who prefer a more portable and flexible retirement program. Our retirement proposal addresses the cost issues and provides portability and flexibility.

A defined contribution retirement system for future employees would help ensure that the Postal Service remains financially viable, and can therefore fulfill our obligations not only to future employees, but to retirees and current employees as well.

3. **Your testimony states that "in October 2013, the Postal Service paid the Office of Worker's Compensation Programs $1.4 billion, including an administrative fee of $68 million."**

    a. **What percentage of employees who are currently on the workers' compensation rolls would be eligible for immediate retirement benefits?**

    Answer:

    Currently 28.6 percent of our employees on the workers' compensation rolls are immediately eligible for retirement benefits.

4. **Your testimony states that the Postal Service's most recent calculations show that as of September 30, 2013, the agency has available only $3.8 billion in liquidity, and that this represents only 14 days of average daily operating expenses. You state "A healthy private sector firm of comparable size would have more than five times the available liquidity."**

    a. **Can you describe the Postal Service's contingency plan to ensure that all mail deliveries continue?**

    Answer:

    The Postal Service has worked extensively to maintain sufficient liquidity to continue providing prompt and reliable service to the American people in spite of significant volume declines and onerous statutory mandates. Our actions to reduce costs and grow revenue belie the notion that we are content to await a taxpayer bailout.

    Unfortunately, the situation is such that the only way the Postal Service can restore financial solvency is through the enactment of postal reform legislation. For instance, considering its current and projected volumes, the Postal Service simply cannot afford to make retiree health benefits payments at the level required by law, and the only way to ensure that such benefits can be provided over the long-term is through statutory changes that address the size of the retiree health benefits liability.

The Postal Service has worked extensively with all stakeholders to develop a health care proposal that would ensure proper integration with Medicare and reduce our current RHB unfunded liability by $43 billion. Implementing this plan— which would almost completely eliminate the RHB liability and make future amortization payments manageable—requires legislative change. If such legislation is not enacted, and the Postal Service remains subject to unaffordable benefits payments, our primary plan to remain solvent is to continue to make responsible efforts to reduce costs and generate new revenues to ensure sufficient liquidity to continue delivering the mail. We have taken a number of actions that resulted in $15 billion in annual expense reductions over the last seven years.

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limit the duration of the exigent price increase.

Despite all these measures, the Postal Service projects that it will continue to have a low level of liquidity for the foreseeable future if comprehensive postal reform legislation is not enacted. Should circumstances leave the Postal Service with insufficient cash to meet of its obligations, we could be forced to prioritize payments to employees and suppliers ahead of some payments to the federal government, in order to ensure that mail delivery continues.

From Representative Doug Collins:

Opening Statement: During the hearing, we discussed the Postal Service's unfunded liabilities that could exceed $100 Billion if left unaddressed. On several occasions, including during the March 13 hearing, the Postal Service has asked Congress for relief from some of these liabilities, including employee healthcare and pensions obligations, based on differing rationales.

However, I am uncomfortable taking a position on providing financial relief to the Postal Service without first having a better understanding of how the Postal Service is spending its money. Several events have recently been brought to my attention that I would like to have addressed:

1. **According to the Postal Service's published financial statements, the Postal Service has lost money each of the last 5 years? Is that true?**

   Answer:

   Yes, it is true that the Postal Service has incurred a net loss in each of the last five years. The following table provides a summary of those losses.

	2013	2012	2011	2010	2009
Net Loss (Dollars in billions)	**$4.98**	**$15.91**	**$5.07**	**$8.51**	**$3.79**

2. **However, the same financial statements show that most Postal Service products and services are covering their costs – is this correct?**

   Answer:

   Yes. Most products do cover their attributable costs, but there are some that do not. For instance, In County and Outside County Periodicals, and Standard Mail Flats do not cover their attributable costs.

3. **How can you reconcile the answers to Questions #1 and #2?**

   Answer:

   In compliance with both the *Postal Accountability and Enhancement Act of 2006* (PAEA) and the Postal Regulatory Commission's rules and procedures, the Postal Service assigns to products and services the "attributable" costs, which are costs that are directly and indirectly caused by those products and services. *See* 39 U.S.C. § 3631(b) (defining "attributable" costs for a product as "the direct and indirect postal costs attributable to such product through reliably identified casual relationships.") In other words, these are primarily the volume variable costs that are incurred as a result of a given product moving through postal networks.

   The costs that do not vary with the volume of products and services handled, and are not caused directly or indirectly by the changes in the volumes, are termed "institutional" costs. Institutional costs include "fixed" costs as well as costs associated with the Postal Service's networks. As the Postal Service is a multi-product network, a large portion of postal costs

(approximately 45 percent in FY 2013) are not directly or indirectly caused by any individual product and are appropriately considered to be institutional costs. For instance, the nature of delivery costs is such that growth or reduction in volume does not cause costs to change proportionally.

A substantial portion of delivery costs are fixed irrespective of volume (e.g., the costs associated with driving to the start of a delivery route are unaffected by the volume of mail to be delivered). As a result, not all delivery costs can be attributed to products. A substantial portion of institutional costs is also due to the requirement to prepay the costs of retiree health benefits (RHB).

While most products are generating sufficient revenue to cover their attributable costs, the products are not collectively generating sufficient revenue to cover both their attributable costs as well as all of the institutional costs. As has been the situation with the unprecedented volume losses occurring since the Great Recession, when mail volumes decline, attributable costs can be adjusted in response, but the institutional costs, which are not caused by or attributable to any particular product and do not respond to the changes in volume, remain. Rather, these institutional costs are a result of non-volume factors such as the Postal Service's universal service obligation and other statutory obligations.

It is the lack of sufficient revenue to cover both the attributable and the sizable and intransigent institutional costs, including the prepayment requirement for health benefits, that leads to the Postal Service losing money overall. See pages 23-24 of the PRC Financial Analysis, 2013: Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013 (March 18, 2014).

4. **I have heard that the Postal Service only attributes approximately 50% of its costs to specific products – is this true?**

Answer:

As described in the response to Question #3, about 45 percent of total postal expenses in FY 2013 were not caused by any individual product or service and are, in compliance with PAEA, the Postal Regulatory Commission's rules and regulations, and Supreme Court precedent, treated as "institutional" expenses.

5. **If so, then how can the Postal Service determine which products are really making money versus products that are losing money?**

Answer:

Using the costing methodologies prescribed by the PAEA and the Postal Regulatory Commission's rules, the Postal Service determines what portions of the different types of costs are attributable to products and services. Each product is expected to cover the costs that it directly or indirectly causes, and to contribute additional revenue toward the coverage of the institutional cost burden. Through the development of the attributable cost estimates for each product and a comparison of those attributable costs to each product's revenues, the Postal Service reports in the Cost and Revenue Analysis (CRA) report every December whether the products' revenues covered their attributable costs in the most recent fiscal year. The Postal Regulatory Commission reviews the CRA as part of the Annual Compliance process, and determines if the appropriate analytical methods were used to estimate the costs.

6. **Without allocating 50 percent of your costs, how are you confident that competitive product revenues are actually profitable and cover the entire costs that they create?**

   Answer:

   The methodology for cost attribution, dictated by the PAEA and the Postal Regulatory Commission's rules, provides the guidelines for each type of cost such that the Postal Service can determine which costs were directly or indirectly caused by each product. Thus, each competitive product's share of costs is computed on an annual basis.

   The methodologies used to attribute costs to products, including the Competitive products, have been developed over the span of forty years of litigation in public hearings at the Postal Regulatory Commission (previously, the Postal Rate Commission), providing ample opportunity for consideration of alternate views of appropriate cost allocation methods. The Competitive products are required, by PRC rule, to cover their attributable costs and generate sufficient revenue that they make a collective contribution toward covering at least 5.5 percent of institutional costs.

   In fact, in FY 2013, the Competitive products produced sufficient revenue to cover all of their attributable costs and also cover 11.8 percent of institutional costs. The PRC also determined that, in FY 2013 (as it has for every year that it has considered the issue), market-dominant product revenues did not subsidize the provision of competitive products.

7. **Have any revenues from monopoly products been used to pay for operating costs or investments made for services that compete with the private sector?**

   Answer:

   PAEA required that the Postal Regulatory Commission (PRC) enact regulations to "prohibit the subsidization of competitive products by market-dominant products." 39 U.S.C. § 3633(a)(1). The PRC annually determines (as part of the Annual Compliance Determination under 39 U.S.C. § 3653) whether the Postal Service has complied with this requirement. The Commission has consistently concluded that no revenue from Market Dominant products was necessary to pay for services in the Competitive category. For the most recent discussion of this issue, see pages 79-80 of the FY2013 Annual Compliance Determination (March 27, 2014).

   In fact, although the Competitive products are required to produce sufficient revenue to cover their costs and cover 5.5 percent of total institutional costs, in FY 2013, the revenue from Competitive products collectively covered all of their attributable costs and contributed toward covering 11.8 percent of institutional costs.

8. **The Postal Accountability and Enhancement Act of 2006 prohibits monopoly product revenues or profits from being used for services that compete with the private sector? Isn't this true?**

   Answer:

   As noted in the answer above, PAEA requires that revenues from market-dominant products not subsidize competitive products, and the PRC has found that the Postal Service has complied with this requirement.

9. **Can you please provide an outline of investments you have made in the last 5 years for the following:**

   a. **Significant investments (over $10 million) for market dominant products, including amounts spend for flats sortation and sequencing equipment and related capital expenditures, including facility reconfiguration.**

      Answer:

      Please see the chart below for details regarding the investments. As can be seen from the chart, the nature of the investments is such that it is often not possible to differentiate between the investments that would be solely for Competitive or Market Dominant products. However, with regard to expenditures made in FY 2009 to FY 2013, the associated depreciation was included in the FY2013 attributable costs for market dominant and competitive products through the PRC-approved procedures.

      For instance, in the case of FSS, the annual depreciation associated with FSS is distributed to the products that utilized this equipment, as determined by our data collection systems, and therefore the attributable costs for all products reflect FSS depreciation to the degree appropriate. It is this process that enables attributable costs for each product to include the appropriate capital costs. The distribution of the depreciation for Fiscal Year 2013 can be seen in the Postal Service's filing, Docket No. ACR2013, USPS-FY-13-8.zip in the workpaper fy13equip.xls.

Project	Approval Date	Approved Capital (in Millions)	Summary (Description at Time of Approval)
FY 2014 Vehicle Acquisition (3,509 Carrier Route Vehicles)	3/11/2014	$88.4	The Decision Analysis Report (DAR) was approved by the Postmaster General, Chief Executive Officer, on March 11, 2014, to purchase 3,509 carrier route vehicles in fiscal year 2014. The new vehicles purchased under this program will be placed on park and loop city routes that do not require right-hand drive (RHD) vehicles. This allows the redeployment of postal-owned right-hand drive vehicles to 3,374 rural routes and provides 135 maintenance reserve vehicles to support rural routes while vehicles are being serviced. This acquisition will allow the Postal Service to fulfill the organization's obligation under the terms of Memorandum of Understanding 13 of the National Agreement between the National Rural Letter Carriers' Association (NRLCA) and the USPS.
Storage Tanks Removal & Replacement to Support National Fueling Network	2/28/2014	$27.3	The Postal Service will strategically remove fuel storage tanks based on environmental risk and tank failure criteria and will replace (where needed) with new tanks designed per EPA and industry standards. The complete removal and replacement program will address 298 storage tanks over five years starting in FY2014. Under the direction of the Chief Sustainability Officer, USPS will be implementing a range of compliance actions related to the removal and replacement of underground storage tanks. The program will continue as a five-year strategic effort to ensure the Postal Service has a compliant and centrally monitored Storage Tank Program.
Mobile Delivery Device (MDD) Program	1/30/2014	$137.9	The Postal Service is investing in new scanning technology to improve package tracking. The next generation of hand-held electronic devices will be used by carriers and mail processing employees. The new device — known as the Mobile Delivery Device (MDD) — will support current real-time scanning needs of postal products and services as well as future scanning requirements. The MDD will be equipped to use multiple wireless networks for real-time tracking. It also can access local wired and wireless communications, consolidate transactional data and transmit collected data to applications requiring such information. The device will replace paired devices — the aging Intelligent Mail Device and a clamshell cell phone — currently used by letter carriers. This investment in technology will help to improve the Postal Service's commitment to timely package delivery and reliable tracking information.
Delivery Unit Infrastructure Technology (DUIT) Program	11/22/2013	$128.8	The funding approved for this program will be used to purchase and deploy technology that will allow more efficient distribution of packages to routes and enable creation of optimally sized (dynamic) routes to support several initiatives including Sunday package delivery, improved city and rural route planning, and Saturday package delivery. It will apply technology more broadly to the Postal Service's package business by expanding the use of barcodes and automation capabilities for sorting, routing, and delivering packages far beyond those available today.
Distribution Quality Improvement (DQI) Program - Phase 4	11/22/2013	$29.0	Improves automated reading of addresses and follow-on sorting. Fourth phase of an incentive-based pay-for-performance program that improves Remote Computer Reader (RCR) encode rates and reduces error rates through use of a commercially available name and address database to increase the proportion of letters sorted to the correct delivery point. This reduces both the keying hours in Remote Encoding Centers and the work hours for manual distribution in delivery units and mail processing plants.
National Recycling Program 2014	10/16/2013	$18.1	Approximately one-third of Post Offices use some form of backhaul recycling in the current operating environment. Backhaul recycling is returning mixed paper recyclables (e.g. undeliverable mail pieces) and packaging materials using empty mail transport equipment for consolidation to achieve economies of scale and the highest revenue generation market prices. Cost savings are realized for participating post offices by reducing their disposal costs through recycling. This program expands this backhauling to the rest of the network to achieve substantial savings.
Flat Recognition Improvement Program (FRIP) - Phase 3	9/20/2013	$23.5	This program will improve the flat mail recognition software used at Remote Encoding Centers (RECs) and alter the Flats Sequencing System (FSS) image flow so that these images are processed by software instead of simply being passed for REC keying. The recognition improvement will be achieved through new software that applies Distribution Quality Improvement (DQI) technology (use of a commercially available name and address matching database), as well as improved algorithms for handling double feed and improperly faced images. The program will use existing hardware and be strictly limited to software-only improvements. In addition to intercepting mail and finalizing a greater portion of it that would otherwise need to be resolved by REC keying, it further reduces the workload going to a REC keyer by identifying and finalizing non-improvable mail.
North Houston P&DC Expansion	8/5/2013	$73.0	This project was approved to expand the North Houston Processing and Distribution Center (P&DC) by 319,115 square feet to support the consolidation of operations from the Houston Processing and Distribution Center (P&DC) and the Beaumont Processing and Distribution Facility (P&DF). It also includes expanding the Business Mail Entry Unit (BMEU) to support the consolidation of BMEU operations from the Houston P&DC. The expanded North Houston P&DC will also allow for the relocation of plant administrative offices, the Office of the Inspector General (OIG), and Postal Inspection Service from the Houston P&DC.
SASP Infrastructure Upgrade (SASP)	4/9/2013	$43.1	The Seamless Acceptance and Service Performance (SASP) Infrastructure to support Full-Service Intelligent Mail barcode (IMb®) was put in place in May 2009. The functionality, data retention, and performance requirements expanded beyond the original scope. The SASP infrastructure upgrade is needed to support projected growth in throughput and volume that far exceeds the original requirements for the Full-Service IMb®. The expanded SASP infrastructure needed to be in place and fully functional by the end of FY13 to support the mandatory Full-Service IMb® adoption which was scheduled for January 2014.
Flat Postal Automated Redirection System (FPARS)	4/9/2013	$36.8	The FPARS system will automate the processing of Undeliverable-as-Addressed (UAA) flat mail on the Automated Flat Sorting Machine 100 (AFSM 100) equipment, thereby improving operational efficiency and reducing the flat workload at Computerized Forwarding Site (CFS) units. AFSM 100 feeders will be retrofitted and connect to the facility's existing PARS infrastructure. The retrofitted AFSM 100s, referred to as Flat Combined Input Output Sub-System (FCIOSS) machines, will process all Carrier Identified Forwards (CIF) and Return to Sender (RTS) flat volumes received from the delivery units using two passes. The first pass will capture an electronic image of each flat. During the second pass, a white label with appropriate forwarding address and barcode, or RTS barcode and message will be affixed, and the labeled mail will then be sorted into the machine's output bins.
Accounting Service Center Payroll Automation Reengineering	11/28/2012	$11.5	On November 28, 2012, the Postmaster General and Chief Executive Officer approved this program to implement a new software tool and reengineer Accounting Service Center Payroll Automation (ASCPA) applications. The ASCPA is a suite of 14 applications maintained by the Eagan Integrated Business Systems Solution Center. The applications are integral to accurately calculating and processing hundreds of thousands of payments, payroll-related adjustments, and legally-required deductions each year.

Project	Approval Date	Approved Capital (in Millions)	Summary (Description at Time of Approval)
Commercial Mail Acceptance Transformation	8/1/2012	$18 8	The commercial mail entry channel is the essential touch-point between the Postal Service and business customers Commercial Mail Acceptance Transformation (CMAT) was envisioned to automate this link Under the Mandated Full Service scenario, mailers are required to use unique Intelligent Mail barcodes on mail pieces, Intelligent Mail tray barcodes, Intelligent Mail container barcodes, and they must electronically submit postage statements and mailing documentation through the PostalOne! System Under the Non-Mandated scenario much of this activity remains manual
Network Rationalization	8/1/2012	$264 2	By instituting service standard revisions the Postal Service will significantly improve the efficiency of and lower the costs of its mail processing network This will be accomplished by reducing both the number of mail processing locations that the Postal Service needs and the amount of mail processing equipment at the remaining locations These changes in service standards will allow the Postal Service to expand the processing windows for primary and secondary operations The expanded processing windows will reduce the number of mail processing machines needed to handle the volume of mail This reduction in equipment will then enable the Postal Service to consolidate operations and reduce the current network of mail processing locations from over 500 locations to approximately half that number When fully implemented these plant consolidations and the associated labor work hour savings will lead to significant cost savings in mail processing The changes to the mail processing network will also improve the efficiency and reduce the costs of the Postal Service s transportation network
Intelligent Mail Barcode (IMb) Printing Upgrade	5/8/2012	$10 6	Intelligent Mail Barcode (IMb) is replacing both the Postal Numeric Encoding Technique (POSTNET) and Postal Alpha Numeric Encoding Technique (PLANET) barcodes The IMb is about the same size as the traditional POSTNET symbol and combines the ZIP Code data of POSTNET and the tracking data of PLANET into a single barcode that provides greater data capacity and end-to-end visibility into the mailstream This program will provide software, firmware, and hardware upgrades to letter automation equipment These upgrades are necessary to support the implementation of Full-Service IMb automation requirements and the planned retirements of the POSTNET and PLANET barcodes The printing upgrades to be implemented under this program will cover a subset of letter mail processing equipment that currently reads and/or applies POSTNET barcodes
Customer Contact Centers Insourcing Deployment	5/7/2012	$20 8	This initiative will meet the terms of the 2010-2015 American Postal Workers Union (APWU) Corporate Call Center Memorandum of Understanding (MOU) which states that management will staff the call center with no fewer than 1,100 bargaining-unit clerk craft employees The Postal Service may be able to utilize the customer contact centers in-sourcing agreement to potentially resolve a 1994 APWU grievance resulting from the outsourcing of customer contact centers While the liability to the USPS was not considered probable there would be no additional potential liability once the customer contact centers are staffed with postal employees The Postal Service will deploy three Customer Contact Centers across the continental United States between August 2012 and May 2013 The investment will accomplish the following 1) meet the terms of the May 11, 2011 contract between the APWU and the Postal Service; 2) provide all USPS customers (individual and businesses) with a single point of contact as well as consistent and reliable information, 3) enhance small business through dedicated support, and 4) provide a platform for potential up-selling/cross-selling opportunities Further, the Postal Service expects to maintain if not increase customer satisfaction levels through a total call ownership strategy, reduce workers' compensation obligations, and increase operational efficiencies at local Postal Service facilities
PCI Compliance	5/7/2012	$62 8	Requirement to continue accepting card payments The Payment Card Industry (PCI) Compliance Project is intended to bring Postal Service card payment processing into compliance with the PCI Data Security Standard by implementing enhancements to all Postal Service payments processing infrastructure areas which address all of identified compliance issues
Retail Systems Software	1/22/2012	$27 0	This program is intended to upgrade and unify retail systems software by providing a single software solution and associated servers to support all retail channels replacing the four costly software maintenance contracts for the existing point-of-sale software applications used for Point of Service ONE, Automated Postal Center, Integrated Retail Terminal and the Contract Access Retail System Communication and data transmission from retail units will connect all automated locations to the postal network in real-time
Product Tracking Reengineering	5/17/2011	$89 3	Improve package tracking for senders and receivers Product Tracking Reengineering supports three primary goals 1) Creates capacity to support the projected growth of Package Tracking Volume, 2) Centralizes management of tracking information required for strategic growth initiatives, and, 3) Provides a flexible, extensible platform for future products
John F. Kennedy International Service Center (JFK ISC) - Facility Upgrades	1/26/2011	$15 9	The JFK ISC facility upgrade covers all of the work related to reconfiguring the JFK ISC to allow Building 250 to process Export International Priority Parcels previously processed and dispatched at the NJ Bulk Mail Center and to absorb operations performed in an annex (Building 197) at JFK Capital funding was approved to install a parcel sorter modify and relocate a loose mail preparation system, relocate automation equipment within the building and to Northeast Area (NEA) plants, and perform conveyor system modifications and make minor building modifications The lease for building 197 will not be renewed saving lease costs and operating costs, including shuttle transportation Relocating Export International Parcel processing to the JFK ISC will better align the processing of this mail to fit the International Mail Processing Network This change will also avoid transportation costs to truck International Export Parcels from New Jersey to NY ISC to meet airline flights to foreign countries that are not available at Newark's Liberty Airport
Automated Parcel and Bundle Sorter (APBS) - Service Life Extension Program	10/20/2010	$94.3	The APBS - Service Life Extension Program provides Barcode Readers and Optical Character Readers (BCR/OCR) to keying induction stations of 190 Small Parcel and Bundle Sorters (SPBS) This program also replaces aging electronic controls with newly developed hardware/software and installs a reject return conveyor The APBS machine will utilize about 80 percent of the existing SPBS machine components Productivity will increase as a result of replacing manual keying with BCR/OCR readers, which will reduce distribution work hours for package and bundle sorting operations The program is also expected to extend the useful life of SPBS machines by ten years
PARS/CFS Functional Upgrades	9/27/2010	$15 3	Funding was approved to develop a complete solution to the exhausted Service Type Indicator (STID) table, support USPS's timely development of new products and services, eliminate existing Mailer ID (MID) and STID constraints, and eliminate reliance on a vendor for incremental software changes Remote Performance Diagnostic Server (RPDS) modifications will allow the new mapped endorsements to correctly display in the mailpiece record as an option number (i e Address Service Requested Option 3) or specific treatment (Secure Destruction), and will allow the system to be queried by those new fields The redesign of National Customer Support Center (NCSC) Image Management System (IMS) is necessary to expand volume capacity and to provide a separation of the processing so that a failure of one process does not interfere with the other processes (e g collection of change of address data)
Capitol Heights, MD Southern Maryland NDC HVAC Upgrade	9/24/2010	$22 1	This project was approved to replace Air Handling Units (AHUs), replace Roof Top Units (RTUs), and related controls with new modular AHUs and packaged RTUs with variable frequency drives and controls to serve the NDC workroom The air distribution system in the workroom would be reused The office areas in the NDC will be also served by AHUs and variable air volume terminal units will provide individual heating/cooling zones similar to the P&DC

Project	Approval Date	Approved Capital (in Millions)	Summary (Description at Time of Approval)
Distribution Quality Improvement (DQI) Program - Phase 3	6/23/2010	$78 6	Improves automated reading of addresses and follow-on sorting. Third phase of an incentive-based program that improves Remote Computer Reader (RCR) encode rates and reduces error rates through use of a commercially available name and address database to increase the proportion of letters sorted to the correct delivery point. This reduces both the keying hours in Remote Encoding Centers and the work hours for manual distribution in delivery units and mail processing plants
Passive Adaptive Scanning System (PASS)	6/23/2010	$43 9	PASS supplants manual scanning by hand-held scanners at high-package volume Delivery Units to capture and transmit scans in real-time, making tracking data immediately available to customers. The program was expanded to include 1,500 PASS Life Ring Scanner systems in addition to 1,000 PASS overhead scanning units. PASS units incorporate the combined use of camera and ring scanner technology to increase the coverage in field delivery units. PASS also incorporates carrier route response back to the operator to facilitate carrier route sort distribution. This enables employees to sort mail without knowledge of local schemes
Chicago, IL, J.T. Weeker ISC, ISC Annex, AMC, Facilities Relocations	6/15/2010	$14 7	Renovate the Irving Park Road Processing and Distribution Center (P&DC), Chicago Mail Surface Hub (CMSH), Network Distribution Center (NDC), and former Airport Mail Center (AMC), to house realigned international and domestic operations. This includes moving, purchasing and installing equipment such as a new Low Cost Tray Sorter (LCTS), moving a Linear Integrated Parcel Sorter (LIPS) from the existing leased ISC to the new ISC, moving and installing an Automated Package Processing System (APPS), moving the Surface Transfer Center (STC) operation to the NDC, installing a Small Parcel Bundle Sorter (SPBS) from Cardiss Collins and moving the Terminal Handling Service (THS) operation from the AMC. This project permits the Postal Service to save approximately $61,605,000 in operating expenses over the 10-year analysis period while continuing to provide excellent service in the Great Lakes Area
Postal Automated Redirection System (PARS), Phase 4	6/1/2010	$90 8	Undeliverable-As-Addressed (UAA) mail must be forwarded, returned to sender, or disposed of as waste. Address corrections must be based on all the attributes of the individual mail piece and the associated change of address or reason for non-delivery. This program will allow more UAA mail to be processed successfully on automation equipment to result in fewer letter-sorting operations and reduced keying workload at the Remote Encoding Centers (RECs)
Springfield, MA Network Distribution Center (NDC) - Facility Upgrades	4/22/2010	$15 0	This program supports the Bulk Mail Center (BMC) network transformation (to NDCs) and will allow operations from three facilities - Springfield Logistics and Distribution Center (L&DC), New England Surface Transfer Center (STC), and Springfield NDC - to be consolidated. This will enable closure of the L&DC before its lease expires on July 31, 2013, and the sale or other use of the postal-owned STC. The program includes completing the work required at the Springfield NDC to support processing of the volumes being relocated from the L&DC and the STC. It covers necessary upgrades to the NDC facility and existing equipment, relocation of an existing High Speed Tray Sorter (HSTS) from the STC, purchase of an additional HSTS, and relocation of two Automated Package Processing System (APPS) machines from the L&DC to the NDC
San Mateo, CA IT Accounting Service Center HVAC/Electrical Upgrade	1/25/2010	$21 9	This project will allow the facility to meet the required power and cooling capacity issues for the IT/ASC operations by upgrading the electrical system, removing the existing three 285-ton chillers and installing four new 450-ton chillers and matching cooling towers, constructing an enclosure for two of the four new chillers, installing new switchgear to support the electrical service, upgrading existing electrical service, installing new Uninterruptable Power Source system with associated batteries, installing three new generators, constructing a utility gallery on the east side of the building and constructing an enclosure for the new generators
Negotiated Service Agreement Infrastructure	8/29/2009	$12 2	The purpose of this specific NSA is to provide incentives to encourage the Bank of America Corporation (BAC) to engage in voluntary changes in mail preparation. These changes would reduce operating costs for the Postal Service in handling BAC's First Class Mail and Standard Mail letters. The agreement was intended to achieve the following: (1) Improve mail processing performance of BAC's First-Class Mail and Standard Mail letters; (2) Reduce return rates for First-Class Mail and Standard Mail letters; (3) Reduce forwarding rates for First-Class Mail letters. The purpose was to give BAC incentives to reduce—by whatever means that BAC believes are cost-effective—the percentage of BAC First-Class Mail and Standard Mail letter-rated volume that cannot be read or accepted by USPS mail processing equipment, or which must be returned, forwarded, or discarded because it is undeliverable as-addressed (UAA)
Philadelphia, PA, Network Distribution Center (NDC) - Facility Upgrades	8/25/2009	$15 1	This program covers the work required to allow the Philadelphia NDC to process the originating Priority Mail flats and parcels being relocated from the L&DC due to its planned closure when the lease expires in March 2010. The project includes demolishing two Parcel Sorter Machines and two Sack Sorter Machines and relocating the control room and the computer room. In addition, a 200 bin Automated Package Processing System (APPS) will be transferred from another site and a Small Parcel and Bundle Sorter (SPBS) and SPBS feed system will be removed
Low Cost Reject Encoding Machine (LCREM) Program	6/26/2009	$21 1	This program will convert approximately 200 excess Carrier Sequence Bar Code Sorter (CSBCS) machines into letter mail labeling machines. The Low Cost Reject Encoding Machine (LCREM) will be deployed as a replacement for existing Letter Mail Labeling Machines (LMLMs) which are experiencing end-of-life issues. The LCREM will not only replace the existing LMLM functionality, it will also be able to encode reject letter mailpieces with a 9- or 11 digit barcode. The LCREM will have four operational modes: (1) apply a label to the POSTNET clear zone on all mailpieces; (2) apply a label to the POSTNET clear zone on all mailpieces and print an Intelligent Mail Barcode (IMB) if the mailpiece can be encoded; (3) apply a label to the POSTNET clear zone only if the mailpiece can be encoded and print an IMB; or (4) apply a label to the ID Tag clear zone on all mailpieces
Asset Management Integration, Phase 1	4/30/2009	$32 3	AMI is designed to significantly improve the Postal Service's ability to manage material inventories and physical assets, including vehicles, vehicle spare parts, stamps, post cards, envelopes, philatelic products, expedited packaging supplies, ReadyPost, and officially licensed retail products
Postal Automated Redirection System (PARS) - Letter Incentive	4/21/2009	$45 4	The PARS Letter Incentive program will further enhance PARS capabilities. It will provide upgrades to existing PARS software and equipment that will improve system performance. Seven specific performance parameters are targeted for improvement. Achieved improvements will be evaluated against the PARS baseline performance that exists at the time the proposed upgrades are presented to the Postal Service for evaluation
Multi-Channel Customer Experience Improvement Project - Project Phoenix	3/24/2009	$150 3	Project Phoenix will address these challenges by improving the underlying information technology (IT) that supports three key revenue generating channels within USPS: the website (USPS.com), the contact center, and retail. Project Phoenix will also fund enhancements to USPS.com and the contact centers. These improvements will support a more positive and consistent customer experience across channels by offering more products and services, and will positively impact customer satisfaction, retention, and revenue growth. The improvements will also reduce IT maintenance and integration costs over time. Specific back-end infrastructure improvements will include new Service Oriented Architecture (SOA) that will integrate and support the online (USPS.com), contact center, and retail channels. Improvements to USPS.com will include enhanced account services (address book and calendar), robust search features, dynamic ads, online surveys, an online chat feature, and the creation of a new mobile channel. Contact Center improvements will feature Agent Desktop updates that include customer history and account information, as well as a replacement for the Electronic customer care (eCC) services and Frequently Asked Questions (FAQ) application on USPS.com. The retail channel will have the ability to share core services utilized by both USPS.com and the contact center due to Project Phoenix improvements. Shared services will be targeted for integration with Point of Sale (POS), Automated Postal Center (APC) hardware configurations, and Contract Access Retail Systems (CARS). This future integration will achieve numerous efficiency and accuracy improvements, which include the following: quickly implementing changes in rates and fees across channels, providing automatic updates to all systems, and improving accuracy and availability of detailed data to support decision analysis

i. **Performance statistics on the flats sortation and sequencing equipment.**

Answer:

The Flats Sequencing System (FSS) enables the Postal Service to reduce labor-intensive manual casing of flats by sequencing flats in delivery order for carriers similar to what has been done for letters since the early 1990s. Using FSS to sequence flats reduces the amount of time carriers spend manually sorting mail and increases the time available to deliver mail. This permits the USPS to consolidate delivery routes and assists in managing growth. Overall this provides a greater opportunity for optimizing routes — enabling a more efficient and predictable delivery environment. Delivery is the largest cost center in the Postal Service and the FSS investment was funded to improve efficiencies and reduce delivery costs through sequencing flats into delivery point sequence.

Currently 2,428 zones (including PO Box only zones) receive FSS flats which involves 38,459 city routes and 7,276 rural routes. As of March 21, 2014, over 4,380 city delivery routes have been eliminated as a result of flats sequencing. Additionally, the carrier case footprint has been reduced, allowing more carriers to fit into existing space, contributing to the consolidation of 2,436 delivery units, while absorbing growth in possible deliveries.

While the performance of the Flat Sequencing System still does not meet the contractual standards, it has improved. Machine throughput, which is measured by dividing the pieces processed by the machine by the hours that the machine operates, has increased from 8,212 pieces per hour in FY 2011 up to 8,985 pieces per hour in FY 2013. At the same time, the acceptance rate, which measures the percentage of pieces sorted versus the pieces input, has also improved from 95.6 percent in FY 2011 to 96.1 percent in FY 2013. Another performance indicator, Pieces at Risk, which measures the percentage of mail which may be at risk of not making on-time service, has been reduced on the system from 6.01 percent in FY 2012 (first year measured) to 5.84 percent in FY 2013.

These operational improvements (although still not meeting the standards in our contractual statement of work) have resulted in improvements to delivery. Currently, 38,459 City Delivery Routes and 7,276 Rural Routes are serviced by the FSS. The percentage of flats that are sorted to carriers in walk sequence has climbed in FY 2013 to 57.9 percent in those offices which are sorted on the system. This is an increase from the previous year which saw 56.9 percent of the mail sorted in walk sequence.

All of these changes have contributed to a reduction in the cost to process flats. For Standard Flats, which represents the vast majority of the volume processed on the FSS, the cost per piece has been reduced from 46.3 cents in FY 2011 to 45.2 cents in FY 2013.

b. Significant investments (over $10 million) in competitive product equipment and infrastructure, including sortation equipment, scanning devices, etc.

Answer:

Please see the chart below for details regarding the investments. As can be seen from the chart, the nature of the investments is such that it is often not possible to differentiate between the investments that would be solely for Competitive or Market Dominant products. However, with regard to expenditures made in FY 2009 to FY 2013, the associated depreciation was included in the FY2013 attributable costs for market dominant and competitive products through the PRC-approved procedures.

For instance, in the case of FSS, the annual depreciation associated with FSS is distributed to the products that utilized this equipment, as determined by our data collection systems, and therefore the attributable costs for all products reflect FSS depreciation to the degree appropriate. It is this process that enables attributable costs for each product to include the appropriate capital costs. The distribution of the depreciation for Fiscal Year 2013 can be seen in the Postal Service's filing, Docket No. ACR2013, USPS-FY-13-8.zip in the workpaper fy13equip.xls.

Approved USPS Capital Investment Projects Over $10 Million from FY2009 - Quarter 1, FY2014 that are Active or were Completed prior to the end of Quarter 1, FY2014

Project Name	Approved Capital (in Millions)	Total Capital Cash Outlay (in Millions)	Status
Accounting Service Center Payroll Automation Reengineering	$11.5	$0.0	Active
Asset Management Integration, Phase 1	$32.3	$30.3	Active
Automated Parcel and Bundle Sorter (APBS) - Service Life Extension Program	$94.3	$60.4	Completed
Capitol Heights, MD Southern Maryland NDC HVAC Upgrade	$22.1	$20.8	Completed
Chicago, IL, J.T. Weeker ISC, ISC Annex, AMC, Facilities Relocations	$14.7	$13.3	Completed
Commercial Mail Acceptance Transformation	$18.8	$8.7	Active
Customer Contact Centers Insourcing Deployment	$20.8	$18.6	Active
Delivery Unit Infrastructure Technology (DUIT) Program	$128.8	$17.3	New
Distribution Quality Improvement (DQI) Program - Phase 3	$78.6	$71.6	Active
Distribution Quality Improvement (DQI) Program - Phase 4	$29.0	$0.0	New
Flat Postal Automated Redirection System (FPARS)	$36.8	$5.3	Active
Flat Recognition Improvement Program (FRIP) - Phase 3	$23.5	$0.0	Active
Intelligent Mail Barcode (IMb) Printing Upgrade	$10.6	$5.5	Completed
John F. Kennedy International Service Center (JFK ISC) - Facility Upgrades	$15.9	$12.9	Active
Low Cost Reject Encoding Machine (LCREM) Program	$21.1	$18.5	Completed
Multi-Channel Customer Experience Improvement Project - Project Phoenix	$150.3	$145.1	Completed
National Recycling Program 2014	$18.1	$0.0	New
Negotiated Service Agreement Infrastructure	$12.2	$12.2	Completed
Network Rationalization	$264.2	$94.4	Active
North Houston P&DC Expansion	$73.0	$0.9	Active
PARS/CFS Functional Upgrades	$15.3	$11.9	Completed
Postal Automated Redirection System (PARS) - Letter Incentive	$45.4	$45.0	Completed
Passive Adaptive Scanning System (PASS)	$43.9	$42.8	Completed
PCI Compliance	$62.8	$14.1	Active
Philadelphia, PA, Network Distribution Center (NDC) - Facility Upgrades	$15.1	$13.9	Completed
Postal Automated Redirection System (PARS), Phase 4	$90.8	$85.3	Active
Product Tracking Reengineering	$89.3	$58.3	Completed
Retail Systems Software	$27.0	$17.5	Active
San Mateo, CA IT Accounting Service Center HVAC/Electrical Upgrade	$21.9	$21.8	Completed
SASP Infrastructure Upgrade (SASP)	$43.1	$28.3	Completed
Springfield, MA Network Distribution Center (NDC) - Facility Upgrades	$15.0	$14.5	Completed

Projects identified as "New" were approved in Quarter 1, FY2014.

Although the Flats Sequencing System (FSS), Phase 1 program was approved in FY2007, there were considerable capital cash outlays in FY2009 - Q1, FY2014.

Project Name	Approved Capital (in Millions)	Total Capital Cash Outlay (in Millions)	Status
Flats Sequencing System, Phase 1	$1,468.4	$1,238.0	Active

New Projects Approved in Quarter 2, FY2014

Project Name	Approved Capital (in Millions)
FY 2014 Vehicle Acquisition (3,509 Carrier Route Vehicles)	$88.4
Storage Tanks Removal and Replacement to Support National Fueling Network	$27.3
Mobile Delivery Device (MDD) Program	$137.9

10. Where does the Postal Service disclose significant investments in capital? Were any capital investments for infrastructure or equipment used for either monopoly or competitive products not itemized and disclosed to the public? If so, can you identify them?

Answer:

The Postal Service tracks all programs with approved capital funding over $5 million and publishes the Investment Highlights (semi-annually), the Detailed Capital Investment Report (quarterly), and the Project Index Summary Report (quarterly). A description of each report has been provided below.

Investment Highlights
Provides an overview of investment projects with approved capital funding over $25 million. These projects typically take two or more years from the time they are approved to be fully implemented and begin capturing savings. The Investment Highlights report, once approved by the Postmaster General, is provided to the Postal Service Board of Governors, the Government Accountability Office (GAO), and the Postal Service Office of Inspector General (OIG).

Detailed Capital Investment Report
Includes in-depth information on all active programs over $5 million in capital. Information is presented by quarter to show progress since approval. The quarterly compliance information submitted by program managers and executive sponsor managers is compiled and presented in this report to provide a historical account of how each program progressed over time and how actual program deployment compared to the original plan in the Decision Analysis Report (DAR) Business Case. The DCIR is provided to the OIG quarterly.

Project Index Summary Report
Presents high-level schedule data for all programs over $5 million in capital. Projects are presented in four main categories (projects in pre-deployment/pre-construction, projects in deployment/construction, projects in post-deployment/post-construction, and completed projects). From this report a determination may be made as to whether an individual program is on-time, behind schedule or late. The report also shows the current milestone, overall percent complete, whether a DAR Business Case Modification

Request has been approved, the target return on investment (ROI), the anticipated investment variance, etc. The Project Index Summary Report is provided to the OIG quarterly

The Investment Highlights, Detailed Capital Investment Reports, and Project Index Summary Reports are all posted to a SharePoint site and are available to senior management and program managers.

Conclusion (from Rep. Doug Collins): I believe in a healthy and viable Postal Service for years to come. However, without having a complete understanding of how the Postal Service is spending its money, it makes it very challenging to entertain their requests for relief. As an organization that enjoys monopoly power, they should demonstrate complete transparency and accountability for all expenses, certainly for market dominant products, and also at a reasonably detailed level for their products that compete against the private sector.

United States Government Accountability Office
Washington, DC 20548

April 2, 2014

The Honorable Blake Farenthold
Chairman
Subcommittee on Federal Workforce, U.S. Postal Service and the Census
Committee on Oversight and Government Reform
United States House of Representatives

Subject: *Responses to Questions for the Record;* Subcommittee on Federal Workforce, U.S. Postal Service and the Census, *March 13, 2014, Hearing on "At a Crossroads: the Postal Service's $100 Billion in Unfunded Liabilities"*

Dear Mr. Chairman:

This letter responds to your March 21, 2014, request that we address questions submitted for the record related to the March13, 2014, hearing entitled, *At a Crossroads: the Postal Service's $100 Billion in Unfunded Liabilities*. Our answers to these questions are enclosed and are based on our previous work, updates to that work, and our knowledge of the areas addressed. If you have any questions or would like to discuss our responses, please contact Frank Todisco at todiscof@gao.gov or call (202) 512-2834.

Sincerely yours,

Frank Todisco,
Chief Actuary, Applied Research and Methods

The undersigned meets the qualification standards of the American Academy of Actuaries to render the actuarial opinions contained in the answers to these questions for the record.

Frank Todisco, FSA, MAAA, EA
Chief Actuary

Enclosure

Post-Hearing Questions for the Record
Submitted to Frank Todisco
From Chairman Blake Farenthold

"At a Crossroads: the Postal Service's $100 Billion in Unfunded Liabilities"

March 13, 2014

1. **Postal unions have argued that USPS has set aside enough money to cover the retiree health care benefit and should resume "pay-as-you-go."**

   a. **Is this wise? What happens if USPS resumes pay-as-you-go?**

   In our December 2012 report on the U.S. Postal Service's (USPS's) retiree health benefits, we examined the effects of a pay-as-you-go approach.[1]

   The Postal Service Retiree Health Benefit Fund (PSRHBF) had a balance of $47.3 billion at the end of fiscal year 2013. We first modeled a pay-as-you-go funding approach in which the fund would be drawn upon to pay USPS's share of premium payments for as long as possible. Under this approach, no additional contributions would be made to PSRHBF, the fund would grow with interest, and USPS's share of premium payments for retirees and beneficiaries would be paid out of PSRHBF until the fund was exhausted. Once PSRHBF was exhausted, USPS would pay these premiums directly as they become due. Our projections showed that PSRHBF would become exhausted in 14 years, in 2026; at that point, USPS would begin paying its share of premium payments from the Postal Service Fund. Under this approach, the projected unfunded liability in fiscal year 2040 would be about $250 billion, which would be about $130 billion in 2012 dollars.

   We found that once the PSRHBF became exhausted, annual pay-as-you-go payments would not become significantly more onerous than projected annual prefunding payments, at least through the end of our projection period in fiscal year 2040. However, this pay-as-you-go approach would produce a vastly bigger unfunded liability than any of the several prefunding approaches that we examined.

   We examined a second variation of pay-as-you-go funding, an approach that the USPS Office of Inspector General (OIG) analyzed and reported on in February 2012.[2] Under this approach, USPS would stop making prefunding payments and pay its share of premium payments for retirees and beneficiaries as they became

[1] GAO, *U.S. Postal Service: Status, Financial Outlook, and Alternative Approaches to Fund Retiree Health Benefits*, GAO-13-112 (Washington, D.C.: Dec. 4, 2012). The projections referred to in this answer were based on available data and applicable assumptions at the time we made the projections for that report; an updated analysis could produce somewhat different results. The report contains more detail on data, assumptions, and methodology.

[2] Letter from USPS OIG Inspector General David C. Williams to Senator Bernie Sanders, February 6, 2012.

due. The existing PSRHBF fund would be left to grow with interest, with no other cash inflow or outflow.

Since this second approach maintains the existing PSRHBF fund rather than exhausting it, the projected unfunded liability is not as large as under the first pay-as-you-go approach described above. However, we found that the unfunded liability would also grow under this approach, and would result in a substantially larger unfunded liability than the full prefunding approaches that we analyzed.

b. What is the contingent liability of the taxpayer if USPS is unable to meet this obligation?

We have not researched the contingent liability of the taxpayer if USPS could not meet its obligations. According to the OPM Inspector General, the consequences if USPS could not pay for its retiree health benefits are unclear.[3]

2. There has been a lot of talk in recent years, about a surplus in USPS's FERS pension account and whether that money should be returned to USPS. However, left out of that conversation is any mention of USPS's other pension account, CSRS.

Currently, USPS's CSRS account has a projected deficit of $19.8 billion, while FERS has a projected surplus of just $500 million. While using USPS specific demographic assumptions may slightly change these numbers, it is unlikely to dramatically shift this imbalance.

a. As an actuary, do you think it makes sense to treat these and other employee benefit liabilities in a holistic manner?

Yes. Economically, USPS's various unfunded benefit liabilities all represent estimated bills for employee service already rendered. We have also noted that USPS's debt to the U.S. Treasury can be viewed together with its unfunded benefit liabilities in this larger (holistic) context. For example, we have noted that from fiscal years 2007 through 2010, USPS made prefunding payments to the PSRHBF of $17.9 billion while borrowing an additional $9.9 billion from the U.S. Treasury— essentially swapping one form of "debt" (broadly defined) for another.[4]

While debt and these various unfunded liabilities are economically similar, we noted in our testimony that the benefit liabilities are all subject to separate and different funding rules.

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[3] OPM Office of Inspector General, *A Study of the Risks and Consequences of the USPS OIG's Approaches to Change USPS's Funding of Retiree Benefits* (Washington, D.C.: Feb. 28, 2011).

[4] For example, from the perspective of financial economic theory, an unfunded pension liability is like debt, economically similar to a loan from employees and retirees to the plan sponsor. See Society of Actuaries and American Academy of Actuaries, *Pension Actuary's Guide to Financial Economics* (2006).

b. Also as an actuary, would it make sense to enact a provision that refunds a projected surplus in full each year one happens to exist?

We have reported that any provision that would refund a surplus each year that one happens to exist would likely eventually result in an unfunded liability. This is because pension and retiree health benefit liabilities are long-term estimates that are inherently uncertain and subject to significant revision and fluctuation as more information becomes available and as economic and demographic conditions change. A surplus can be viewed as a cushion against unfavorable changes. If surpluses were returned every time there was a change in a favorable direction, it would leave the fund exposed to an eventual change in an unfavorable direction.

c. Under current law, do you expect USPS to be able to make its CSRS amortization payments in 2017, if the current $20 billion deficit remains?

As we have previously reported, ultimately the viability of funding promised benefits depends on the financial viability of USPS's underlying business model. We continue to recommend that Congress adopt a comprehensive package of actions that will facilitate USPS's ability to align costs with revenues based on changes in the workload and the use of mail.

3. The American Academy of Actuaries has reported that an 80% funded ratio should not be used as the standard for determining whether a pension plan is in good financial health. In a paper titled "The 80% Pension Funding Standard Myth," the Academy concluded that "All plans should have the objective of accumulating assets equal to 100% of a relevant pension obligation, unless reasons for a different target have been clearly identified and the consequences of that target are well understood.

a. Do you agree that federal pensions – including pensions for Postal Service employees – should be required to achieve 100% funding?

We have concerns about proposals to reduce the ultimate funding target for USPS's retiree health liability from the current target of 100 percent down to 80 percent. Such a reduction would have the effect of carrying a permanent unfunded liability equal to roughly 20 percent of USPS's liability, which could be a significant amount. For the same reason, we support the current 100 percent funding target for USPS's pension liabilities. Full funding of benefit liabilities is consistent with USPS's mission as a self-sustaining entity. Also, we have noted that prefunding protects the future viability of the organization, protects the benefits of postal employees and retirees and their beneficiaries, and provides security to any third party in the event of USPS's inability to pay for any unfunded liability.

We have not reported on funding provisions for federal pensions for non-USPS employees. Other agencies typically rely on Congressional appropriations rather

than independently generated revenue, so that the implications and issues associated with prefunding may be different.

4. **According to your testimony, the Postal Service's unfunded liability for workers' compensation is approximately $17 billion.**

   a. **This represents the present value of all projected future benefits for already injured employees, and not projected future injuries to current or future employees. Correct?**

   Yes.

   b. **USPS represents roughly 40% of the federal government's total workers' compensation liability. What would happen to the solvency of the federal government's workers' compensation program if USPS were unable to pay?**

   USPS has stated that, based on discussions with DOL, USPS's failure to make its payments would leave DOL with insufficient funds to pay all workers' compensation benefits for USPS and other federal employees, absent some form of additional funding to replace USPS's contribution. We have not independently verified this information.