Postal Retirement Funds in Perspective: Historical Evolution and Ongoing Challenges

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Executive Summary

Career Postal Service employees participate in one of two defined benefit pension programs – the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). In addition, eligible postal retirees can retain Federal Employee Health Benefits (FEHB) enrollment into retirement. Currently, the government share of retiree health premiums for Postal Service retirees is paid from the Postal Service Retiree Health Benefits Fund (PSRHBF).

The Postal Service is treated differently from other federal agencies in regard to the funding of its retirement benefit programs. While other agencies receive annual congressional appropriations to make required employer contributions, the Postal Service generally receives no direct tax dollars and pays its contributions through revenue. In addition, the U.S. Treasury makes amortization payments to cover unfunded CSRS and FERS liabilities for non-postal agencies. Again, the Postal Service pays for these costs through revenue and has been unable to fully make these payments in recent years.

Retirement costs represent a significant share of the Postal Service's overall expenses – 11.7 percent, or $10 billion, in FY 2023. Even though the Postal Service must pay these costs through revenue, the Postal Service has no control over levers that might lower retirement-related costs or generate higher fund balances. For instance, the Postal Service does not control annual cost of living adjustments (COLAs), the funds' investment strategy, actuarial assumptions, or contribution rates. Congressional action would be required to give the Postal Service more control over any of these factors.

The Postal Service pays a disproportionate share of CSRS costs for employees who worked for both the Post Office Department (the cabinet-level agency that existed until 1971) and the U.S. Postal Service (the independent, self-sustaining agency formed in 1971). The Postal Service shares the CSRS costs for these employees with the federal government. However, the methodology used to allocate costs assumes that an employee never received a salary increase after 1971. In addition, the Postal Service is expected to cover the full cost of CSRS benefits while other federal agencies are not. Using alternative methodologies to more fairly allocate costs would dramatically increase the Postal Service's CSRS fund balance. Administrative reform to change the allocations and eliminate CSRS amortization payments is a key component of the Postal Service's Delivering for America 10-year plan. As of the writing of this white paper, this reform has not yet been addressed through administrative action.

Current and Future Retirement Fund Challenges

Recent high inflation has impacted the Postal Service's retirement funds in several ways. First, in FYs 2021 and 2022, the inflation rate exceeded the interest rate on the funds, resulting in a negative real return. Second, inflation drove up annual COLAs and increased USPS's costs. Inflation impacted USPS's retirement funds more than many state and local pension funds because state and local funds typically set limits on the maximum annual COLA increase. The Office of Personnel Management links CSRS and FERS COLAs directly to the Consumer Price Index and there is no cap on the annual COLA percentage.[1] The Postal Service also does not have control over the investment of its retirement funds, which by law are solely invested in U.S. Treasury bonds. This means that the Postal Service cannot diversify its investments into other assets that may see a higher rate of return and mitigate the impacts of inflation over the long term.

Looking ahead, the depletion of the PSRHBF is expected to occur in FY 2031, at which point USPS must make annual payments to cover retiree health premiums. Retiree health costs are estimated to be $6 billion in FY 2032 – the first full fiscal year after the depletion of the PSRHBF. USPS estimates its combined annual agency costs for retirement funds and retiree health benefits will increase to nearly $18 billion in FY 2032, compared to $10 billion in FY 2023.

1 The Office of Personnel Management jointly administers and manages CSRS, FERS, and PSRHBF with the U.S. Treasury

Because the Postal Service must draw on its revenues to cover shortfalls in its retirement funds, increasing retirement costs can divert money away from making improvements to USPS's vast retail and delivery network. For example, required retirement payments following the passage of the Postal Accountability and Enhancement Act of 2006 were a major factor limiting capital investment. Increasing retirement obligations could also contribute to higher rate increases for both competitive and market dominant products. It is therefore important for postal stakeholders and policymakers to consider potential strategies to mitigate future costs, including options previously noted by the OIG, such as reform of USPS's CSRS allocations and diversification of retirement investments.

Observations

Introduction

With more than half a million active career employees, and over 700,000 retirees and survivors relying on pension benefits, safeguarding the Postal Service's retirement funds is critical to the agency's financial condition and operations.[2] Career postal employees participate in one of two defined benefit pension programs for federal workers: the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). In addition, the Postal Service Retiree Health Benefits Fund (PSRHBF) funds the Postal Service's share of health insurance premiums for postal retirees.[3] Between the two defined benefit pension programs and the PSRHBF, the Postal Service had $290 billion in assets and a total liability of $409 billion at the end of fiscal year (FY) 2022.

Funding for the Postal Service's retirement obligations has had a complex history since the agency's creation from the Post Office Department (POD) more than 50 years ago. Over decades, legislation has changed the Postal Service's share of costs and liabilities, and USPS has a distinct funding arrangement compared to other agencies. To better understand the history of the three retirement funds and the current and future retirement-related challenges faced by the Postal Service, the U.S. Postal Service Office of Inspector General (OIG):

- Reviewed prior reports from the OIG and other agencies regarding USPS's retirement funds.
- Reviewed legislation that defined and changed USPS's retirement benefit obligations.
- Analyzed financial reporting regarding historical funding levels and liabilities.
- Researched the structure and investment strategy of other private and public pension funds.

See Appendix A for details of this white paper's objectives, scope, and methodology.

Background on the Postal Service's Retirement Funding

Retirement expenses are a significant portion of the Postal Service's costs, comprising 11.7 percent of USPS operating expenses, or $10 billion, in FY 2023.[4] All three funds have an unfunded liability, meaning that the future amounts owed to retirees are more than the current assets held in the funds. Unlike other federal agencies that participate in CSRS, FERS, and FEHB, the Postal Service must cover retirement-related costs through revenue.

The three retiree benefit programs are administered and managed jointly by the Office of Personnel Management (OPM) and the Department of the Treasury. The Postal Service has no control or decision-making authority over the funds themselves or over the federal retiree benefit programs more broadly. This includes contribution rates, investment strategy, annual cost-of-living adjustments for retirees, or the actuarial assumptions used to calculate retirement liabilities. Congressional action would be required to give the Postal Service more authority over any of these factors.

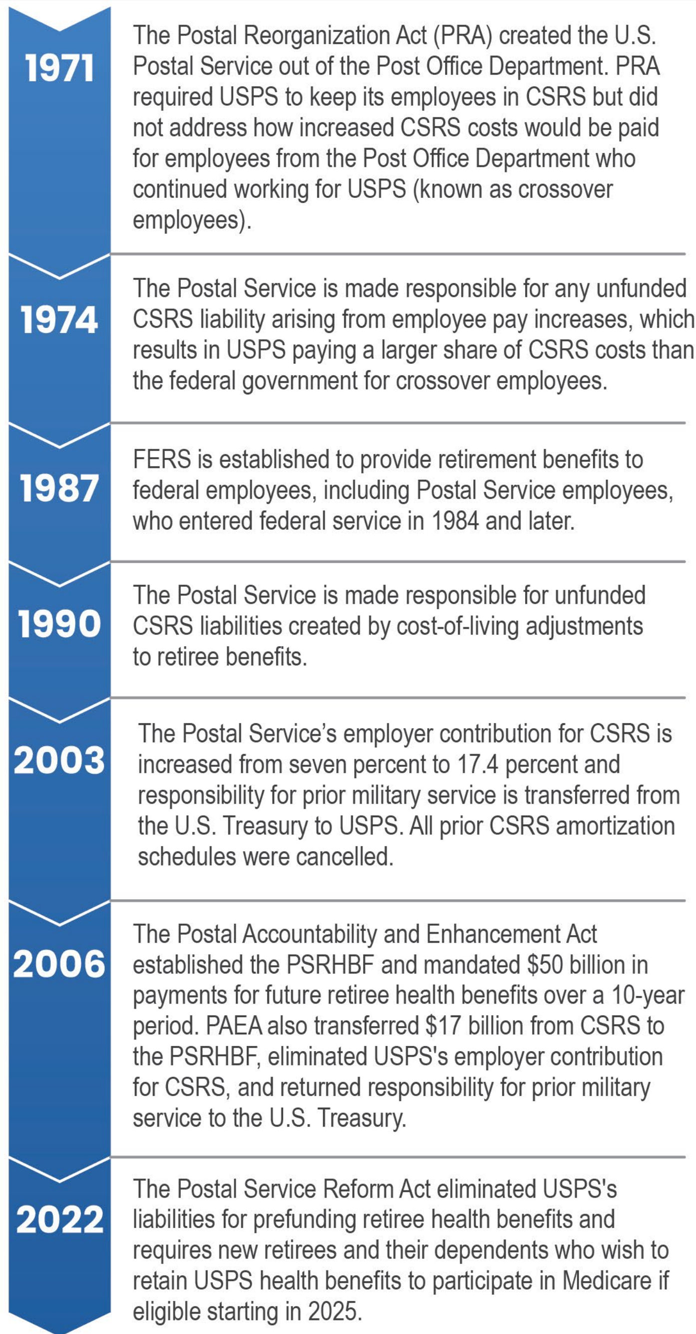
Funding of USPS Retirement Benefits Differs from Most of the Federal Government

As an independent agency within the federal government, the Postal Service is expected to be self-sustaining and cover costs – including retirement costs – through revenue. Thus, while other federal agencies receive annual congressional appropriations to fund retiree pension and health care benefits, the Postal Service generally receives no direct tax dollars and pays for these expenses from the sale of postal products and services. These costs are ultimately passed to postal customers through

2 U.S. Postal Service, *Form 10-K FY 2023*, https://about.usps.com/what/financials/10k-reports/fy2023.pdf, p. 13.
3 Postal Service employees can participate in the Federal Employees Health Benefits program (FEHB) and can keep their federal health benefits into retirement. On January 1, 2025, USPS employees participating in FEHB will be transferred to the Postal Service Health Benefits program, a subset of FEHB specific to USPS employees.
4 Retirement benefits include FERS normal costs and amortization expenses. Total operating expenses were $85.4 billion in FY 2023. U.S. Postal Service, *Form 10-K FY 2023*, https://about.usps.com/what/financials/10k-reports/fy2023.pdf, p. 46. The Postal Service does not currently incur any costs for retiree health benefits because retiree health premiums are paid from the PSRHBF.

higher rates. Each of the three retirement benefit funds differs in its legislative history, structure, and financing; these differences are discussed in more detail below. Figure 1 highlights key changes to USPS retirement funding since 1971.

Figure 1: Timeline of Legislative Changes to the Postal Service's Retirement Funds



Civil Service Retirement System

CSRS is a defined benefit pension program for civilian federal employees who began their federal careers prior to 1984. Employees of both the former POD and the new U.S. Postal Service participate in CSRS. The expectation that the Postal Service cover all costs through revenue created challenges for how to handle CSRS-related costs, particularly the costs for employees who worked for both the POD and USPS.

Several Laws Increased USPS's CSRS Liability Compared to Other Federal Agencies

In July 1971, the Post Office Department became the U.S. Postal Service. A key component of the reorganization was that instead of receiving congressional appropriations, the Postal Service was expected to be self-sustaining and cover its costs through revenue. However, at the time of its formation, the Postal Service's contributions to CSRS followed the same funding model as the entire federal government. This model, which was established in 1969, included a seven percent employee and a seven percent employer contribution to CSRS.[5] However, the combined 14 percent of pay did not cover the full cost of the CSRS retiree benefit, and the U.S. Treasury was and still is responsible for covering additional CSRS costs.

In 1974, legislation made the Postal Service responsible for any unfunded CSRS liability arising from employee pay increases.[6] In addition to the seven percent employer contribution, the Postal Service would also make an annual amortization payment to cover the additional liability. The Postal Service supported the bill at the time because of the expectation that it would cover costs through postal revenues.[7] Other government agencies continued to pay the seven percent employer and seven percent employee contributions, with employer contributions coming from congressional appropriations to agencies. In addition, the U.S. Treasury – not individual agencies – made any necessary amortization payments for non-postal agencies.[8]

5 Civil Service Retirement Amendments of 1969, Pub. L. No. 91-93, Sec. 102.
6 Pub. L. No. 93-349.
7 Continuing to Deliver: Joint Hearing before the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia and the Committee on Oversight and Government Reform, 111th Congress 179 (2009) (testimony of John O'Brien), https://www.congress.gov/111/chrg/CHRG-111hhrg58338/CHRG-111hhrg58338.pdf.
8 Congressional Research Service, *Federal Employees' Retirement System: Budget and Trust Fund Issues*, Report No. RL30023, December 19, 2019, https://crsreports.congress.gov/product/pdf/RL/RL30023, p. 13.

In 1990, legislation made the Postal Service additionally responsible for any unfunded CSRS liability created by cost-of-living adjustments (COLAs) to retiree benefits.[9] This meant that the Postal Service would pay the seven percent CSRS employer contribution, amortization payments related to pay raises, and a new set of amortization payments related to COLAs. Other federal agencies did not have to cover these additional payments beyond the seven percent employer contribution.

Thirteen years later, the Postal Civil Service Retirement System Funding Reform Act of 2003 made several key changes to the Postal Service's CSRS funding.[10] These changes were in response to OPM's finding that the Postal Service was on track to overfund its CSRS liabilities.

- First, OPM was required to calculate the Postal Service's CSRS liability on a "dynamic" basis, incorporating assumptions of inflation, pay increases, and interest rates. Previously, the Postal Service's liabilities were calculated on a "static" basis which assume no pay raises or inflation.
- Second, the Postal Service's employer contribution was increased from seven percent to 17.4 percent.
- Third, responsibility for prior military service was transferred from the U.S. Treasury to the Postal Service.
- Finally, all previous amortization payment schedules were cancelled, and a new schedule was established to pay off any remaining unfunded CSRS liability.

The 2003 law made no changes to CSRS funding for other federal agencies. CSRS liabilities for the rest of the federal government currently continue to be calculated on a static basis.

Finally, the Postal Accountability and Enhancement Act of 2006 (PAEA) made further changes to the Postal Service's CSRS funding. PAEA eliminated the Postal Service's employer contributions, transferred $17 billion from a surplus in the CSRS fund to the newly formed PSRHBF, and returned responsibility for military service back to the Treasury. PAEA also called for amortization payments to begin in 2017 if there was any unfunded liability. By 2017, the Postal Service's CSRS fund was in a $24 billion deficit and OPM initiated a series of amortization payments. The Postal Service has defaulted on all of these payments, totaling $13.8 billion at the end of FY 2023.[11]

Table 1: Comparing CSRS Funding and Costing for USPS and Other Federal Agencies

	Postal Service	Other Federal Agencies
Funding Source	Employer contributions (from 1971-2006) which came from revenue. Employee contributions. USPS is also billed for amortization payments, which are paid from revenue. USPS has defaulted on CSRS amortization payments since 2017.	Employer contributions which agencies receive through congressional appropriations. Employee contributions. The U.S. Treasury makes amortization payments to cover unfunded liabilities.
Costing Method	Dynamic (Assumes salary increases, inflation)	Static (Assumes no salary increases or inflation)
Funding amount	Full cost. The normal cost of CSRS is 32% of payroll for the Postal Service.	Less than the full cost. Employees and employers each contribute 7% of pay (for a total of 14%). The normal cost of CSRS for non-postal agencies is 37.8%.[12]

The Postal Service Pays a Disproportionate Share of CSRS Costs

Intertwined in the legislative history of CSRS is how liabilities are allocated between the federal government and the Postal Service for employees who worked for both the POD and USPS. When the POD became USPS in 1971, employees retained their CSRS retirement benefits. The federal government and the Postal Service share the CSRS liability for the

9 Omnibus Budget Reconciliation Act of 1990, Pub. L. No 101-508 Sec. 7101.
10 Postal Civil Service Retirement System Funding Reform Act of 2003, Pub. L. No. 108-18.
11 USPS, *2023 Report on Form 10-K*, November 14, 2023, https://about.usps.com/what/financials/10k-reports/fy2023.pdf, p. 38.
12 OPM, *Civil Service Retirement and Disability Fund Annual Report – Fiscal Year Ended September 30, 2022*, June 2023, https://www.opm.gov/about-us/budget-performance/other-reports/2022-csrdf-annual-report.pdf, p. 35.

employees who carried over from the POD. However, OPM's method for allocating these liabilities – which are based heavily on a worker's salary – assumes that an employee never received a pay increase after 1971. As a result, the Postal Service bears the entire cost of all salary increases from 1971 onward. In addition, the Postal Service is expected to bear the full cost of CSRS benefits whereas other agencies are not. The U.S. Treasury makes amortization payments to cover unfunded CSRS liabilities for non-postal agencies.

OPM's allocation methodology places a disproportionate share of the CSRS liability on the Postal Service. OIG analyses conducted in 2010 and 2018 showed how an employee could work half their career at POD and half at USPS, but that USPS would bear 70 percent of the CSRS cost for that employee. In 2018, the OIG estimated that the USPS's CSRS fund balance would be $80 to $111 billion larger using an alternative methodology.[13]

CSRS Reform is a Key Component of the Delivering for America Plan

As part of its *Delivering for America* plan, the Postal Service is seeking CSRS reform to update the allocation methodology and eliminate amortization payments. The plan's projections of achieving financial sustainability within 10 years assumed that administrative reforms would correct CSRS overfunding; the Postal Service estimated that the CSRS adjustment would have a $14 billion financial impact over 10 years.

Federal Employees Retirement System

The FERS program covers civilian federal employees who entered federal service in 1984 and later. Funding of FERS benefits for the Postal Service is more similar to the rest of the government than CSRS funding. For example, since its inception, OPM has calculated all FERS liabilities (both postal and non-postal) on a dynamic basis, incorporating varying estimates of inflation and interest rates based on economic trends. In addition, both the Postal Service and other agencies are expected to pay the full cost of FERS benefits.

The Postal Service estimated that administrative reform for CSRS overpayments would save $14 billion over 10 years.

Even though agencies – including the Postal Service – are supposed to fund the full FERS cost, there is still an unfunded liability. The U.S. Treasury pays amortization payments to cover the unfunded liability for non-postal agencies. The Postal Service must make these payments from revenue.

Compared to CSRS and the PSRHBF, Congress has not made significant changes to the Postal Service's FERS obligations over time. USPS had $131 billion in FERS assets at the end of FY 2022, and an unfunded liability of $42 billion. Since 2014, USPS has owed annual FERS amortization payments to OPM. USPS defaulted on these payments entirely from FYs 2014 to 2021 and made partial payments of $500 million and $600 million in 2022 and 2023, respectively. In total, USPS has defaulted on $8.8 billion in FERS amortization payments, allowing the organization to preserve its liquidity.[14] USPS is not seeking any legislative or administrative action for FERS as part of the Delivering for America plan.

13 USPS OIG, *The Postal Service's Share of CSRS Pension Responsibility*, Report No. RARC-WP-10-001, January 20, 2010, https://www.uspsoig.gov/sites/default/files/reports/2023-01/rarc-wp-10-001_0.pdf, and; USPS OIG, Update on the Postal Service's Share of CSRS Pension Responsibility, Report No. RARC-WP-18-009, May 7, 2018, https://www.uspsoig.gov/sites/default/files/reports/2023-01/RARC-WP-18-009.pdf, p. 1.

14 USPS, *2023 Report on Form 10-K*, November 14, 2023, https://about.usps.com/what/financials/10k-reports/fy2023.pdf, p. 8 and 38.

Table 2: Comparing FERS Characteristics for USPS and Other Federal Agencies

	Postal Service	Other Federal Agencies
Funding Source	Employer contributions which come from revenue. Employee contributions USPS is also billed for amortization payments, which are paid from revenue. USPS has defaulted or made partial payments for all FERS amortization payments.	Employer contributions which agencies receive through Congressional appropriations. Employee contributions. The U.S. Treasury makes amortization payments to cover unfunded liabilities.
Costing Method	Dynamic (Assumes salary increases, inflation)	Dynamic (Assumes salary increases, inflation)
Funding amount	Full cost. The FERS normal cost is 16.9 percent to 17.6 percent of payroll for the Postal Service.[15]	Full cost. The FERS normal cost is 19.2 percent to 19.9 percent of payroll for non-postal agencies.[16]

Postal Service Retiree Health Benefits Fund

The funding of retiree health benefits also differs for Postal Service retirees and other federal retirees. The Postal Service pays for the government share of retiree health premiums, whereas OPM pays for premiums for non-postal retirees from congressional appropriations.[17]

Congress created the PSRHBF in 2006 with PAEA. The fund pays the government's share of health premiums for Postal Service retirees. Initial funding came from a $17.1 billion CSRS surplus and $3 billion that the Postal Service transferred from an escrow account. The Postal Service was expected to provide additional funding through ten annual prefunding payments of about $5 billion each from 2007 through 2016. These prefunding payments coincided with a significant decline in mail volume and revenue in the wake of the Great Recession. Due to these financial constraints, USPS only made four of the ten payments, totaling $17.9 billion, before defaulting on the remaining six payments.[18]

The Postal Service Reform Act of 2022 (PSRA) relieved the Postal Service of its prefunding obligation. This legislative reform was a key component of the *Delivering for America* plan. However, because the Postal Service has not contributed to the fund since 2010, the agency expects the fund to be depleted in FY 2031.

The Postal Service's Historical Retirement Assets and Liabilities

As a result of the history and obligations explained above, the Postal Service is facing growing unfunded liabilities which will impact its financial position going forward. Prior work by the OIG indicated that a more diversified investment strategy could have resulted in an improved financial position for the Postal Service.[19]

USPS Retirement Funds Have Growing Unfunded Liabilities

Across the three funds, the Postal Service had $290 billion in assets at the end of FY 2022. The total liability was $409 billion, meaning that the Postal Service had an unfunded liability of $119 billion. The funded ratio declined since FY 2007, from 85 percent funded across the three funds, to 71 percent funded in FY 2022.

Diversified Investment Could Have Improved Retirement Financials

The Postal Service has no control over how its retirement funds are invested. The funds are managed jointly by the OPM and the U.S. Treasury and by law can only be invested in Treasury securities, which are stable investments that typically generate lower rates of return compared to other common kinds of investments. Prior OIG work found that if the Postal Service's funds were in a portfolio of 60 percent stocks and 40 percent bonds, the

15 OPM, *Civil Service Retirement and Disability Fund Annual Report Fiscal Year Ended September 30, 2022*, June 2023, https://www.opm.gov/about-us/budget-performance/other-reports/2022-csrdf-annual-report.pdf, p. 36.
16 OPM, *Civil Service Retirement and Disability Fund Annual Report Fiscal Year Ended September 30, 2022*, June 2023, p. 35.
17 Congressional Research Service, *Federal Employees Health Benefits (FEHB) Program: An Overview*, Report No. R43922, February 3, 2016, https://crsreports.congress.gov/product/pdf/R/R43922, p. 11.
18 The Postal Service also transferred nearly $3 billion from an escrow account to PSRHBF in FY 2007, bringing total USPS contributions to $20.9 billion. The defaulted amount was $33.9 billion.
19 See Appendix A for a list of prior OIG white papers and audits concerning the potential diversification of the Postal Service's retirement funds.

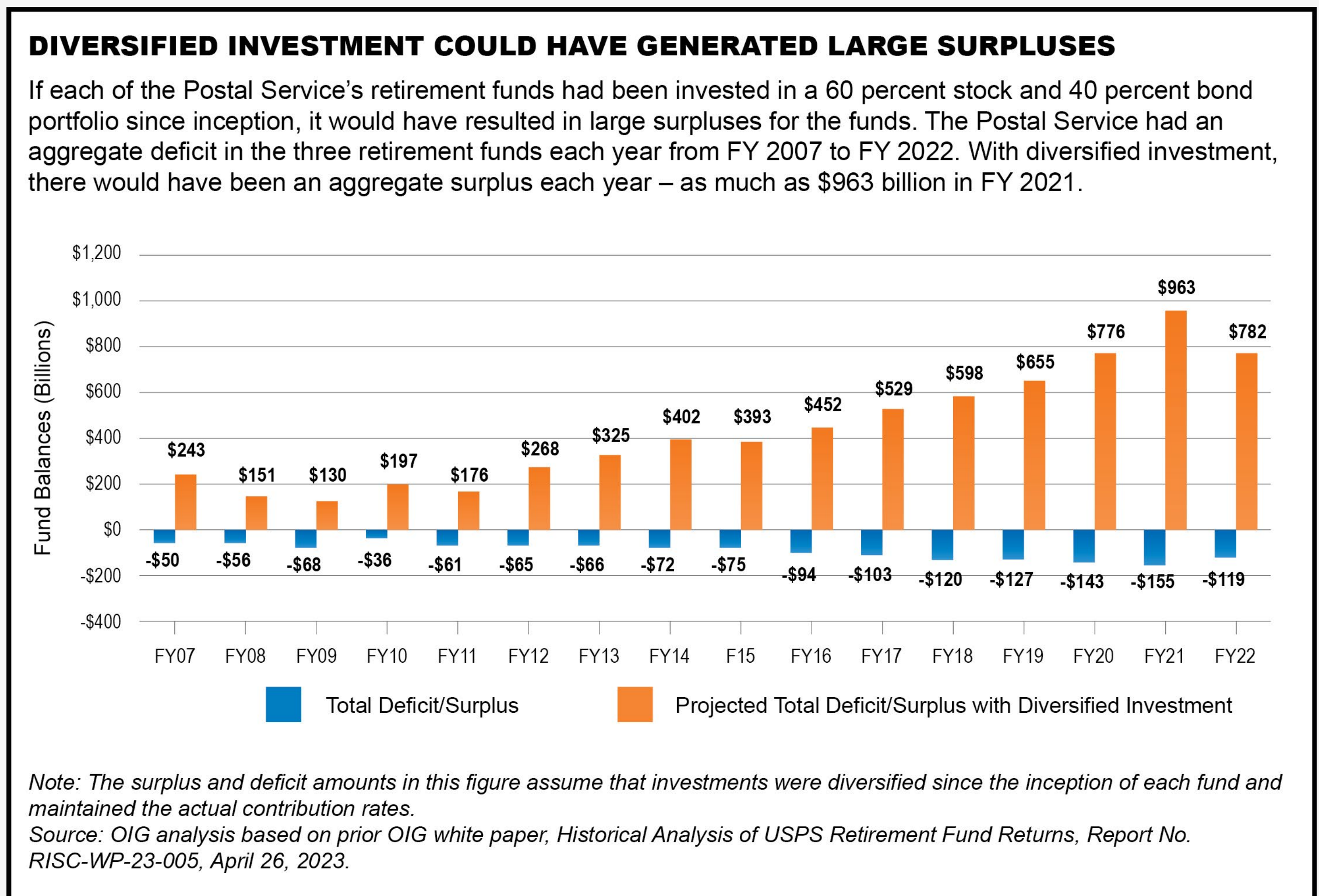
Diversified investment of the retirement fund assets would have resulted in significant retirement surpluses for USPS – as much as $963 billion in FY 2021.

assets in these funds could have had $1.2 trillion in FY 2022 and an aggregate surplus across the three funds (Figure 2).[20] When analyzing surpluses and deficits of the individual funds since the passage of PAEA in December 2006, CSRS and FERS would have had a surplus every year, and PSRHBF would have transitioned from a deficit to a surplus in FY 2022.[21]

For a detailed breakdown of annual surpluses and deficits of the three funds, see Appendix B.

Increased investment returns could have allowed USPS to maintain full funding of its retirement obligations with lower employer contributions. For example, at the end of FY 2012, the Postal Service's aggregate retirement funds totaled $328 billion with a deficit of $65 billion. The same year, the Postal Service first defaulted on PSRHBF prefunding payments. If the assets had been invested in a diversified portfolio since each funds' inception, the aggregate balance in FY 2012 would have been $662 billion with a surplus of $268 billion. The retirement fund surplus could have reduced the amount of required retirement-related payments or eliminated them altogether.

Figure 2: Estimated Annual Deficits and Surpluses with Diversified Investment, FYs 2007 – 2022



Note: The surplus and deficit amounts in this figure assume that investments were diversified since the inception of each fund and maintained the actual contribution rates.
Source: OIG analysis based on prior OIG white paper, Historical Analysis of USPS Retirement Fund Returns, Report No. RISC-WP-23-005, April 26, 2023.

20 USPS OIG, *Historical Analysis of USPS Retirement Fund Returns*, Report No. RISC-WP-23-005, April 26, 2023, https://www.uspsoig.gov/sites/default/files/reports/2023-04/risc-wp-23-005.pdf, p. 7.

21 The OIG analyzed annual surpluses and deficits from FY 2007 to FY 2022. Data limitations prevented us from analyzing surpluses and deficits prior to 2007; OPM was not required to and did not calculate a USPS-specific liability for CSRS and used "static" assumptions to calculate the funding of CSRS benefits for USPS employees.

The potential impact of diversified investments is further indicated by analyzing the effect it could have had on retiree health benefits if the funds were first diversified when PAEA took effect in 2007. Current law mandates that any CSRS surplus be transferred to the PSRHBF in 2015, 2025, 2035, and 2039. OIG analysis indicates that if the Postal Service's CSRS assets were invested in 60 percent stocks and 40 percent bonds starting in 2007, there would have been a deficit of about $4.2 billion in 2015, the first designated transfer year. The actual CSRS deficit was $16.7 billion at this time. But by FY 2022, the fund would have accumulated a surplus of $38.4 billion. The fund would be on track to have a surplus in 2025, the next transfer year.

Current law does not specify what the Postal Service must do with a FERS surplus. If the FERS assets were invested in a diversified portfolio in 2007 and similar rules about surpluses applied to both CSRS and FERS, the Postal Service would have had a $14.9 billion FERS surplus by 2015. This would have been transferred to the PSRHBF. If the surplus was transferred to the PSRHBF and the Postal Service continued to invest the remaining funds, FERS fund would have had a surplus of $17.4 billion by the end of FY 2022 and be on track to have a surplus in 2025, the next transfer year.

Investing CSRS and FERS assets in stocks and bonds and transferring any surplus to the PSRHBF could have significantly lowered the Postal Service's retirement costs. For example, fully funded pension funds do not have to pay amortization payments, which currently cost the Postal Service billions each year. Transferring excess funds to the PSRHBF would have improved the financial health of that fund and potentially lowered or eliminated the need for prefunding payments.

Current and Future Challenges to USPS Retirement Funds

Inflation rates have been a challenge to funding the Postal Service's retirement funds by driving up costs and eroding the funds' value. In addition, the depletion of the PSRHBF within 10 years will add significant additional costs for funding retirement benefits. These future cost increases could divert funds from other priorities, such as needed capital investment.

Inflation's Impact on Investment Returns and Retirement Costs

Higher-than-normal U.S. inflation starting in early 2021 and continuing through 2022 hurt the value of the Postal Service's retirement funds because the rate of inflation exceeded the return on fund investments. Inflation has also impacted the Postal Service's retirement funds through higher costs (for example, higher cost-of-living adjustments) which are outside of the Postal Service's control.

Rate of Investment Return Needs to Exceed Inflation Rate

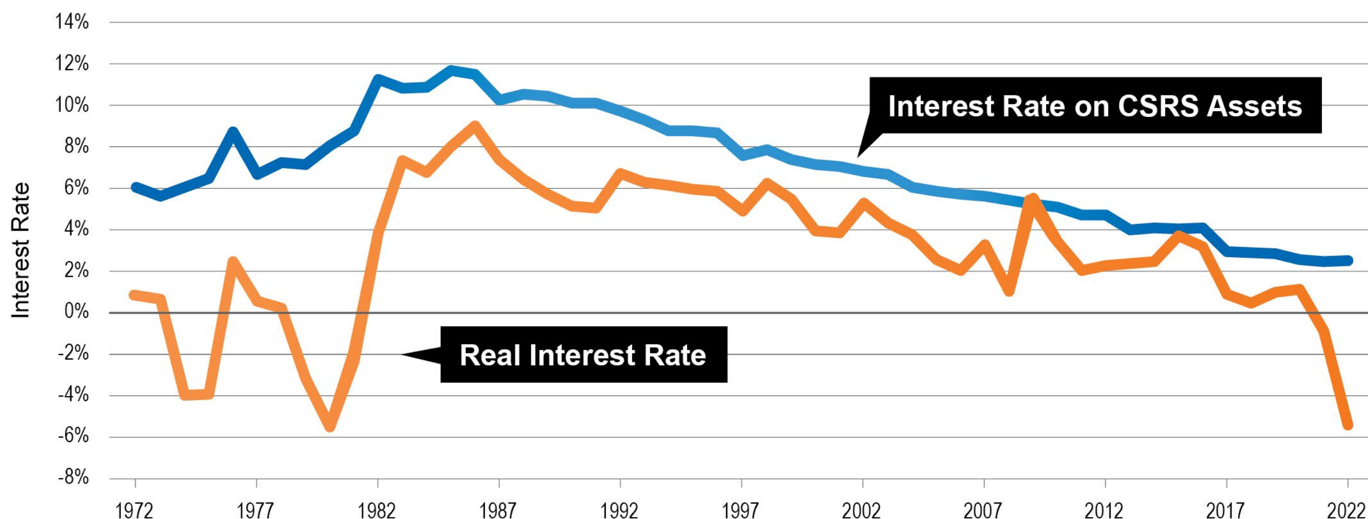
The average rate of inflation in FY 2022 was 7.9 percent, which exceeded the 2.5 percent interest rate on the Postal Service's retirement assets.[22] This resulted in a negative real return of -5.4 percent (Figure 3). The negative real return in FY 2022 followed a decades-long decline in the interest rate on USPS retirement assets, which led to slowing investment returns. Investment return rates must match the rate of inflation to maintain a fund's value and exceed the rate of inflation to grow.

22 This reflects the rate of return for CSRS assets. In FY 2022, the return rate on FERS assets was 2.3 percent and the return rate on PSRHBF assets was 2.4 percent.

Figure 3: The Impact of Inflation on Interest Rates

HIGH INFLATION LED TO NEGATIVE REAL RETURNS ON INVESTMENT

The interest rate on the Postal Service's retirement investments peaked in the mid-1980s and declined steadily since then. In FYs 2021 and 2022, inflation exceeded the interest rate on these investments, resulting in a negative real return. On any investment, the interest rate must match inflation for the assets to maintain value and exceed inflation to grow in value. The chart below compares the historical actual interest rate and real interest rate for CSRS. Interest rates for CSRS, FERS, and PSRHBF have tracked closely.



Note: The real interest rate is the actual interest rate minus the rate of inflation.
Source: Office of Personnel Management, USPS OIG, and Bureau of Labor Statistics (BLS). BLS data reflects the CPI-U for all items and is based on the fiscal year average (October-September).

If the Postal Service's retirement funds had been invested in a diversified portfolio, inflation would have still impacted the real investment return of the retirement funds. For example, in FY 2022, if CSRS funds were invested in a portfolio of 60 percent stocks and 40 percent bonds, the nominal return would have been -14.8 percent and the real return would have been -22.8 percent. Increased investment return volatility is a trade-off of a riskier investment mix. However, previous OIG analysis demonstrated that diversified investment over many years would have greatly outperformed the current low-risk, all-bond investment strategy.[23]

Inflation Impacts the Postal Service's Retirement Costs

Compared to other organizations, the Postal Service is unique in its limited ability to respond to inflation's impact on its retirement costs. In FY 2023, USPS saw a 19.6 percent increase in retirement benefits expenses, an increase of $1.6 billion over the previous year.[24] Additionally, inflation impacts USPS retirement costs by increasing the wages of current workers. Most current USPS employees receive regular COLAs to their wages twice a year that are tied to the CPI-W, which USPS expected to increase expenses by $604 million in FY 2024.[25] Since USPS pays employer contributions to FERS as a direct percentage

23 USPS OIG, *Historical Analysis of USPS Retirement Fund Returns*, Report No. RISC-WP-23-005, April 26, 2023, https://www.uspsoig.gov/sites/default/files/reports/2023-04/risc-wp-23-005.pdf.
24 Retirement benefit expenses include FERS normal costs (increase of nine percent), CSRS amortization payments (increase of 32 percent), and FERS amortization payments (increase of 32 percent). USPS, *2023 Report on Form 10-K*, November 14, 2023, https://about.usps.com/what/financials/10k-reports/fy2023.pdf, p. 25.
25 Ibid, p. 13.

of wages, the COLAs on wages also increase retirement costs.[26]

Retiree COLAs are also significantly impacted by inflation. Periods of high inflation result in higher COLAs for USPS retirees because the COLA rate is tied to inflation. In turn, fund assets are depleted more rapidly than expected and the actuarial liability increases. Currently, there is no cap to the COLA increases received by USPS retirees under either FERS or CSRS. Both funds are administered by OPM and linked to the rate of inflation measured by the CPI-W, the Consumer Price Index for Urban Wage Earners and Clerical Workers.

Other Pension Funds are Structured to Mitigate the Impact of High Inflation

For many pension funds in both the private and public sectors, the impact of the recent period of increased inflation has been smaller than might be expected. In the wake of the 2008 financial crisis, many pension funds changed their financial structure to incorporate caps on inflation-based cost of living increases for retirees, reduce employer contributions, or change the benefits offered to new employees. For example, the average COLA for public sector retirees in 2022 was 1.83 percent – much lower than the 8.7 percent CSRS increase and 7.7 percent FERS increase.[27] Caps on COLAs may limit adjustments to a set annual percentage, for example three percent per year, or cap the adjustment received as "x" percent less than inflation, or both. As a result of these policies, most funds were shielded from the full impact of inflation. Unlike other businesses, the Postal Service has no ability to renegotiate its retirement obligations because they are mandated by Congress.

There is no consensus as to how pension funds should respond to periods of high inflation and strategies may depend on factors specific to a particular fund. While the standard macroeconomic advice for pension funds facing rising inflation is to shift assets towards high yield-investments like stocks, determining the best way of dealing with inflation in practice is more complicated. One survey of public and private sector pension funds found that about two thirds had responded to the period of recent inflation by shifting their investments from financial assets to real assets and slightly less than two-thirds had moved assets from public markets towards private markets.[28] Both of these strategies are unavailable to the Postal Service.

USPS is More Constrained than Some Federal Pensions

While federal government trust funds, such as the Social Security Trust Fund, are generally invested similarly to CSRS, FERS, and PSRHBF, there are some federal pensions that do not face the same investment restrictions or extent of obligations as the Postal Service's funds. For example, the following federal pensions can implement different investment or benefits strategies, which can protect the funds from high inflation:

- The National Railroad Retirement Investment Trust – a federally-administered railroad employee pension system that includes funds paid in by private sector railroads and Amtrak – can invest in a diverse range of assets and funds two tiers of benefits.[29] Tier I benefits mimic Social Security payments and are adjusted at the same rate, while Tier II benefits are based on the employee's service and only raised by 32.5 percent of the annual Social Security adjustment.[30]

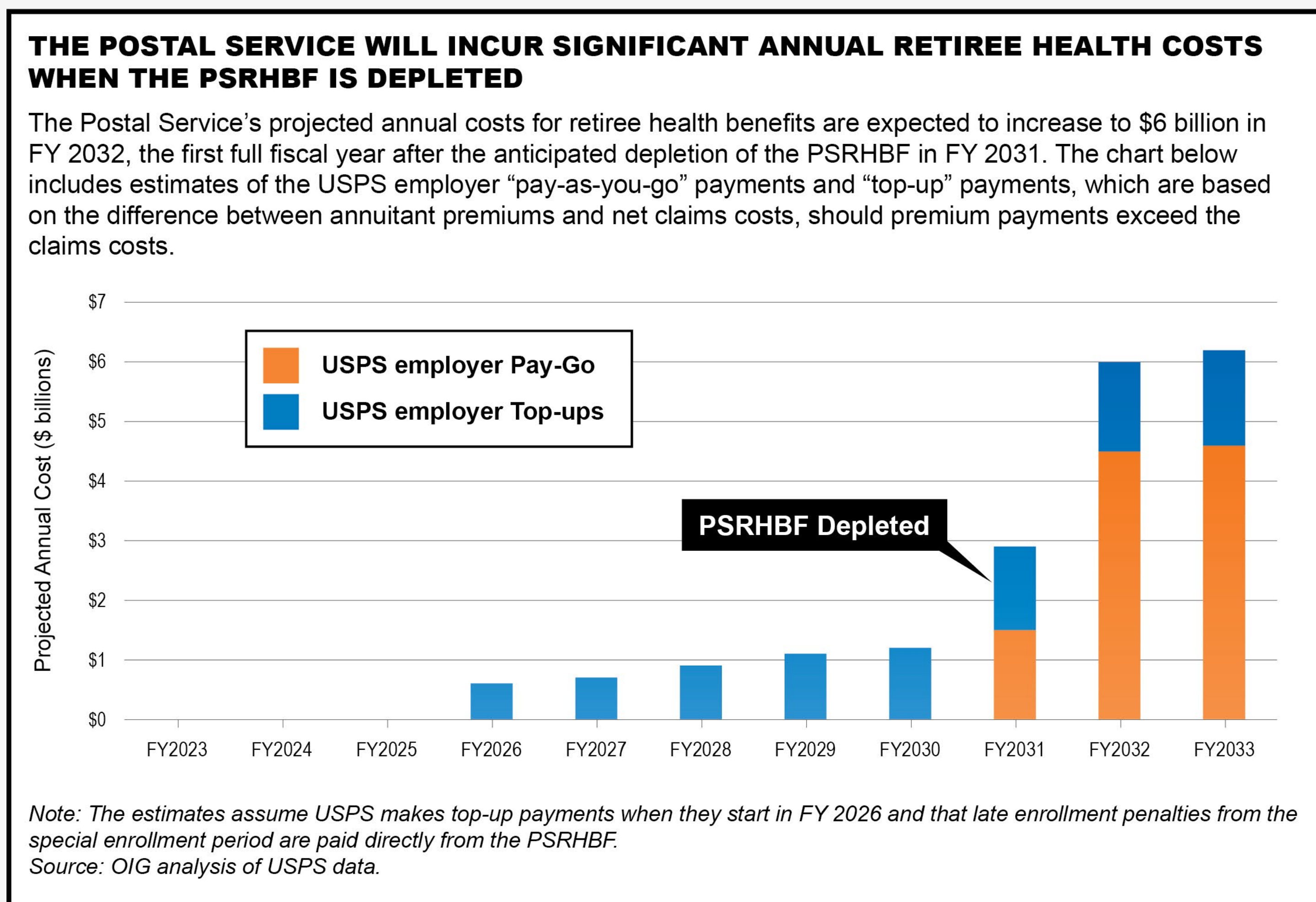
26 USPS OIG, *Inflation and the U.S. Postal Service*, Report Number RISC-WP-22-008, August 16, 2022, https://www.uspsoig.gov/sites/default/files/reports/2023-01/RISC-WP-22-008.pdf, p. 5-8.
27 Equable Institute, "Public Pension COLAs in 2022," September 28, 2022, https://equable.org/public-pension-colas-in-2022/.
28 Amundi Institute and CREATE-research, *Pension funds: reorienting asset allocation in an inflation-fuelled world*, December, 2022, https://research-center.amundi.com/article/pension-funds-reorienting-asset-allocation-inflation-fuelled-world, p. 17.
29 The National Railroad Retirement Investment Trust is an independent agency that manages the funds for pensions paid by the National Railroad Retirement Board.
30 House of Representatives, Congress. "WMCP 104-14 - Section 2. Railroad Retirement System". Government. U.S. Government Printing Office, November 3, 1996. https://www.govinfo.gov/content/pkg/GPO-CPRT-104WPRT23609/pdf/GPO-CPRT-104WPRT23609-2-2.pdf, p. 118-119.

- The Retirement System for Tennessee Valley Authority, an electric utility corporation owned by the federal government, also can invest in diversified assets and cost of living increases are limited to 0.25 percent less than inflation or capped at a maximum of six percent annually.[31] As previously stated, there is no cap on these increases for USPS's retirees.
- Employees of the Federal Reserve System have access to a pension plan managed by independent money managers.
- The Department of Defense's Military Retirement Fund invests heavily in Treasury Inflation Protected Securities (TIPS). TIPS are Treasury securities that increase in value with inflation.[32]

Annual Retirement Health Benefit Costs Will Increase Significantly with the Depletion of the PSRHBF

Currently, the Postal Service does not incur costs for retiree health premiums. Premium payments come from the PSRHBF, which USPS has not contributed to since 2010. USPS expects the PSRHBF to be depleted by FY 2031. Once the fund is exhausted, USPS will have to pay retiree health premiums from annual revenue, known as "pay as you go." USPS projects that its payments will be approximately $6 billion annually starting in FY 2032, the first full fiscal year following the estimated depletion of the PSRHBF (Figure 4). To make these payments, USPS will need to cut costs or increase revenue.

Figure 4: Estimated Annual USPS Contributions to Retiree Health, FYs 2023 – 2033

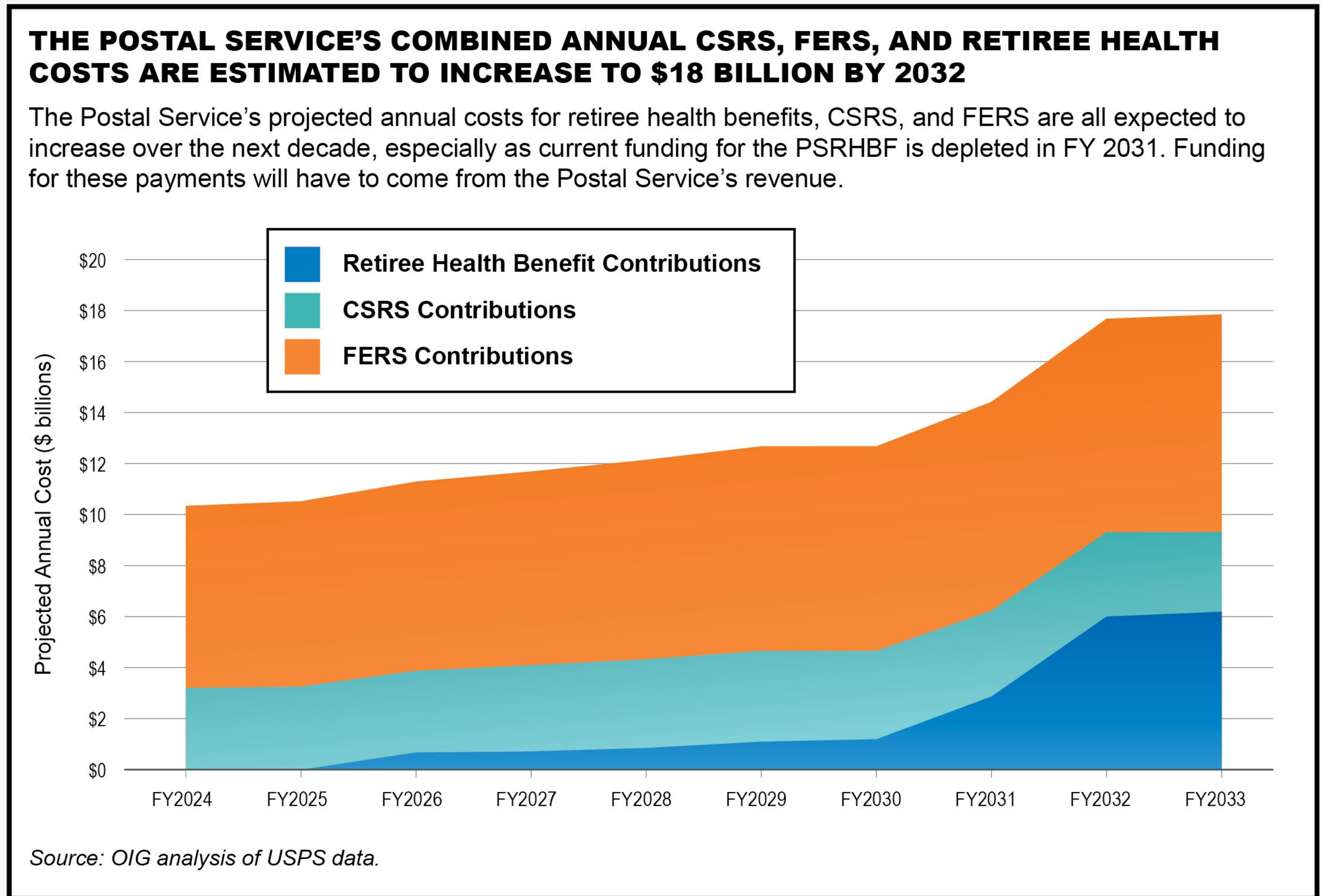


31 Tennessee Valley Authority Retirement System, *Cost-of-Living Adjustments*, December 2022 https://tvars.com/wp-content/uploads/faq-COLA.pdf, p. 1-2.
32 Previous OIG work recommended that the Postal Service request approval from the Secretary of the Treasury and OPM to invest in TIPS. USPS OIG, *Treasury Inflation-Protected Securities*, FT-AR-19-003, November 26, 2018, https://www.uspsoig.gov/sites/default/files/reports/2023-01/FT-AR-19-003.pdf.

Higher Retirement Costs Can Divert Funding from Capital Investment and Increase Prices for Customers

The Postal Service estimates the combined annual agency contributions to retirement funds and retiree health benefits to rise over the next decade, increasing to nearly $18 billion in FY 2032, compared to $10 billion in FY 2023 (Figure 5). These increased costs could divert funding away from other needed priorities, such as capital investments — compounding a problem of underinvestment that has impacted USPS in recent decades. Both the Postal Service and the Postal Regulatory Commission (PRC) have noted the problem of chronic underinvestment in the USPS retail and delivery network resulting from a lack of capital to make improvements.

Figure 5: Estimated Annual USPS Costs for Retirement Funds and Retiree Health, FYs 2024 – 2033



The Postal Service's *Delivering for America* plan set goals to improve its delivery network, modernize its vehicle fleet, and update its retail locations. These goals require significant capital investment, which has been made more difficult for the Postal Service because of its retirement obligations. USPS faced years of financial losses after the PAEA was enacted in 2007, which mandated the prefunding of PSRHBF. Following PAEA, USPS's capital commitments dramatically declined to a low of $644 million at the end of FY 2012 — the lowest amount since 1988.[33] During this same period, USPS paid $17.9 billion in mandated pre-funding to the PSRHBF, which was a major contributor to USPS's financial losses in the years following PAEA.[34] Once USPS began defaulting on its annual PSRHBF prefunding payments in 2012, capital investment increased.[35] While we can only speculate on what actions USPS would have taken in the absence of these obligations, one possibility could have been increased investment in the areas of chronic underinvestment noted above — the retail and delivery network or modernizing its vehicle fleet. Looking ahead, it is possible that the onset of billions of dollars in "pay-as-you-go" retiree health payments in the next decade could divert money away from capital improvements or lead to defaults on some contributions.

Increasing expenses for retirement obligations also could impact customers, as the Postal Service must balance its costs with revenue. Escalating retirement expenses might lead to increased rates for both market dominant and competitive products without enhancing the postal network. For market dominant products specifically, in 2020 the PRC approved new pricing authorities, one of which is directly tied to USPS's cost for amortization payments on unfunded retiree liabilities.[36] This authority allows USPS to increase prices above the rate of inflation, and all revenue earned from this pricing authority must be used for retirement amortization payments. As highlighted earlier, broadening retirement investment options and addressing the Postal Service's disproportionate share of CSRS costs are potential strategies to mitigate the challenges created by growing retirement costs. Pursuing either of these options would likely require congressional or administrative action.

Conclusion

While other agencies receive annual congressional appropriations to make required employer contributions, the Postal Service receives almost no appropriations for its retirement funds — CSRS, FERS, and the PSRHBF— and pays its contributions through revenue. In addition, USPS is treated differently in other ways regarding the funding of its retirement funds. For example, the U.S. Treasury makes amortization payments to cover unfunded CSRS and FERS liabilities for non-postal agencies, whereas USPS pays for these costs through revenue and has been unable to fully make these payments in recent years.

Retirement costs represent a significant share of the Postal Service's overall expenses – 11.7 percent, or $10 billion, in FY 2023. The recent period of higher inflation more broadly in the economy has impacted the value and cost of the Postal Service's retirement funds. Even though it pays these costs through revenue, USPS has no control over levers available to other pension funds that might lower retirement-related costs or generate higher fund balances. These levers include annual cost of living adjustments (COLAs), the funds' investment strategy, actuarial assumptions, or contribution rates. Congressional action would be required to give the Postal Service more control over any of these factors.

Another distinct challenge affecting the Postal Service is that it pays a disproportionate share of CSRS costs for employees who worked for both the Post Office Department (the cabinet-level agency that existed until 1971) and the U.S. Postal Service (the independent, self-sustaining agency formed in 1971). Significantly, USPS is expected to cover the full cost of CSRS benefits whereas other federal agencies are not. Using alternative methodologies to more

33 USPS, *2012 Report on Form 10-K*, November 15, 2012, https://about.usps.com/what/financials/10k-reports/fy2012.pdf, p. 50.
34 United States Government Accountability Office, *Postal Retiree Health Benefits: Unsustainable Finances Need to Be Addressed*, August 2018, https://www.gao.gov/assets/gao-18-602.pdf, p. 4-7, and 27.
35 Postal Regulatory Commission, *Notice of Proposed Rulemaking for the System For Regulating Rates and Classes for Market Dominant Products*, December 1, 2017, https://www.prc.gov/docs/102/102715/Order4258.pdf, p. 51.
36 Postal Regulatory Commission, *Order Adopting Final Rules for the System of Regulating Rates and Classes for Market Dominant Products*, November 30, 2020, https://www.prc.gov/docs/115/115227/Order%20No.%205763.pdf, pp. 100-101.

fairly allocate costs would dramatically increase USPS's CSRS fund balance. As part of its Delivering for America 10-year plan, the Postal Service is seeking administrative reform to correct the allocations and eliminate CSRS amortization payments.

Looking ahead, the Postal Service estimates its combined annual agency costs for retirement funds and retiree health benefits to increase to nearly $18 billion in FY 2032, compared to $10 billion in FY 2023. In particular, retiree health costs are estimated to be $6 billion in FY 2032 – the first full fiscal year after the depletion of the PSRHBF. Because USPS must draw on its revenues to cover shortfalls in its retirement funds, increasing retirement costs can divert money away from making improvements to the Postal Service's vast retail and delivery network. It is therefore important for postal stakeholders and policymakers to consider potential strategies to mitigate future costs, including options previously noted by the OIG, such as reform of USPS's CSRS allocations and diversification of retirement investments.

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Appendix A: Additional Information

Objective(s), Scope, and Methodology

The objectives of this white paper were to:

1. Review the history and legislative evolution of the Postal Service's retirement funds in CSRS, FERS, and PSRHBF.
2. Assess the current challenges experienced by the Postal Service's retirement funds and consider future challenges.

To accomplish these objectives, the OIG conducted desk research of prior reports from the OIG and other agencies on the Postal Service's retirement funds, reviewed legislation impacting USPS's retirement benefit obligations, analyzed USPS financial reporting regarding historical retirement funding levels and liabilities; and researched other state, local, and private pension funds.

The inspection was conducted in accordance with the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluation. We discussed our observations and conclusions with management on November 28, 2023, and included their comments where appropriate.

Prior Coverage

Report Title	Objective	Report Number	Final Report Date	Monetary Impact
Historical Analysis of USPS Retirement Fund Returns	Analyze the historical fund returns of the Postal Service's retirement investments and determine the potential investment income that could have been earned from different investment strategies.	RISC-WP-23-005	April 26, 2023	$0
Postal Service Investment and Interest Rate Risk	Assess the Postal Service's investment of its cash balances and identify opportunities to improve investment and borrowing strategies and to reduce interest rate risk.	22-035-R23	January 18, 2023	$172 million
Options to Reduce Unfunded Retirement Liabilities	Explore two options for addressing unfunded retirement liabilities, including changing actuarial assumptions and generating higher returns on CSRS, FERS, and RHB assets.	19BG010FT000-R20	March 6, 2020	$4.2 billion
Treasury Inflation-Protected Securities	Determine the impact of investing Postal Service retirement fund assets in TIPS.	FT-AR-19-003	November 26, 2018	$2.8 billion
Foreign Posts' Retirement Asset Investments	Identify retirement asset investment options for the Postal Service for pension and RHB funds, as demonstrated in the practices of 11 foreign posts.	FT-WP-19-001	May 21, 2019	None
Postal Service Retiree Funds Investment Strategies	Determine alternatives to the current investment strategy of investing retirement assets by using a diversified portfolio to include bonds, equities, and alternative investments	FT-WP-17-001	September 20, 2017	None

Report Title	Objective	Report Number	Final Report Date	Monetary Impact
Update for Measuring Pension and Retiree Health Benefits Liabilities	Update and assess the impact of changes in assumptions on Postal Service retirement liabilities, in order to evaluate the reasons for the significant reduction in its pension funding position, and to update results produced through use of Postal Service specific assumptions	FT-AR-17-007	May 2, 2017	$6 billion

Appendix B: Annual Retirement Fund Valuations and Liabilities, FYs 2007 – 2022

The following tables show actual annual retirement fund valuations and liabilities from FYs 2007 – 2022, as well as estimated valuations had each fund been invested in a mix of 60 percent stocks and 40 percent bonds since inception. For further details on this analysis, see the OIG's April 2023 white paper, *Historical Analysis of USPS Retirement Fund Returns*.[37]

Table 3: CSRS Valuations and Liabilities, FY 2007 – 2022

Fiscal Year	Liability	Actual Fund Balance	Actual Surplus/ Deficit	Estimated Fund Balance with Diversified Investment	Estimated Surplus/ Deficit with Diversified Investment
All values in millions					
2007	$ 196,900	$ 193,742	$ (3,158)	$ 467,517	$ 270,617
2008	$ 204,100	$ 195,266	$ (8,834)	$ 401,679	$ 197,579
2009	$ 214,900	$ 195,569	$ (19,331)	$ 397,109	$ 182,209
2010	$ 193,000	$ 194,912	$ 1,912	$ 425,249	$ 232,249
2011	$ 210,800	$ 193,327	$ (17,473)	$ 429,060	$ 218,260
2012	$ 209,500	$ 191,000	$ (18,500)	$ 502,343	$ 292,843
2013	$ 204,400	$ 186,898	$ (17,502)	$ 543,679	$ 339,279
2014	$ 201,500	$ 182,404	$ (19,096)	$ 603,276	$ 401,776
2015	$ 194,100	$ 177,436	$ (16,664)	$ 596,474	$ 402,374
2016	$ 199,300	$ 172,443	$ (26,857)	$ 651,241	$ 451,941
2017	$ 189,500	$ 165,383	$ (24,117)	$ 709,727	$ 520,227
2018	$ 185,800	$ 158,022	$ (27,778)	$ 768,001	$ 582,201
2019	$ 182,700	$ 150,214	$ (32,486)	$ 809,929	$ 627,229
2020	$ 182,700	$ 141,752	$ (40,948)	$ 903,768	$ 721,068
2021	$ 174,500	$ 133,051	$ (41,449)	$ 1,044,119	$ 869,619
2022	$ 177,100	$ 123,967	$ (53,133)	$ 877,848	$ 700,748

37 *USPS OIG, Historical Analysis of USPS Retirement Fund Returns*, Report No. RISC-WP-23-005, April 26, 2023, https://www.uspsoig.gov/sites/default/files/reports/2023-04/risc-wp-23-005.pdf.

Table 4: FERS Valuations and Liabilities, FY 2007 – 2022

Fiscal Year	Liability	Actual Fund Balance	Actual Surplus/ Deficit	Estimated Fund Balance with Diversified Investment	Estimated Surplus/ Deficit with Diversified Investment
All values in millions					
2007	$ 55,100	$ 63,503	$ 8,403	$ 81,508	$ 26,408
2008	$ 62,800	$ 69,330	$ 6,530	$ 73,648	$ 10,848
2009	$ 72,300	$ 75,200	$ 2,900	$ 76,826	$ 4,526
2010	$ 69,900	$ 80,798	$ 10,898	$ 86,436	$ 16,536
2011	$ 84,000	$ 86,606	$ 2,606	$ 91,497	$ 7,497
2012	$ 90,800	$ 91,676	$ 876	$ 111,473	$ 20,673
2013	$ 96,600	$ 96,499	$ (102)	$ 124,706	$ 28,106
2014	$ 104,500	$ 100,892	$ (3,608)	$ 142,054	$ 37,554
2015	$ 109,000	$ 105,135	$ (3,865)	$ 144,039	$ 35,039
2016	$ 124,700	$ 109,381	$ (15,319)	$ 161,427	$ 36,727
2017	$ 130,700	$ 113,595	$ (17,105)	$ 180,075	$ 49,375
2018	$ 143,400	$ 117,566	$ (25,834)	$ 198,658	$ 55,258
2019	$ 146,300	$ 121,054	$ (25,246)	$ 212,834	$ 66,534
2020	$ 151,400	$ 124,299	$ (27,101)	$ 240,869	$ 89,469
2021	$ 159,400	$ 127,192	$ (32,208)	$ 281,619	$ 122,219
2022	$ 172,300	$ 130,628	$ (41,672)	$ 239,700	$ 67,400

Table 5: PSRHBF Valuations and Liabilities, FY 2007 – 2022

Fiscal Year	Liability	Actual Fund Balance	Actual Surplus/ Deficit	Estimated Fund Balance with Diversified Investment	Estimated Surplus/ Deficit with Diversified Investment
All values in millions					
2007	$ 80,786	$ 25,745	$ (55,041)	$ 26,620	$ (54,166)
2008	$ 86,082	$ 32,610	$ (53,472)	$ 28,491	$ (57,591)
2009	$ 87,472	$ 35,482	$ (51,990)	$ 30,238	$ (57,234)
2010	$ 91,059	$ 42,492	$ (48,567)	$ 38,884	$ (52,175)
2011	$ 90,337	$ 44,118	$ (46,219)	$ 40,222	$ (50,115)
2012	$ 93,575	$ 45,744	$ (47,831)	$ 48,235	$ (45,340)
2013	$ 95,614	$ 47,292	$ (48,322)	$ 53,271	$ (42,343)
2014	$ 97,740	$ 48,850	$ (48,890)	$ 60,308	$ (37,432)
2015	$ 105,162	$ 50,345	$ (54,817)	$ 60,725	$ (44,437)
2016	$ 103,981	$ 51,862	$ (52,119)	$ 67,549	$ (36,432)
2017	$ 112,055	$ 49,808	$ (62,247)	$ 71,285	$ (40,770)
2018	$ 114,000	$ 47,500	$ (66,500)	$ 74,570	$ (39,430)
2019	$ 114,400	$ 45,000	$ (69,400)	$ 75,997	$ (38,403)
2020	$ 116,600	$ 42,100	$ (74,500)	$ 81,735	$ (34,865)
2021	$ 120,400	$ 39,100	$ (81,300)	$ 91,265	$ (29,135)
2022	$ 59,500	$ 35,800	$ (23,700)	$ 73,841	$ 14,341

Appendix C: Management's Comments

LUKE T. GROSSMANN
SENIOR VICE PRESIDENT, FINANCE AND STRATEGY

December 19, 2023

JOHN CIHOTA
DIRECTOR, AUDIT SERVICES

SUBJECT: Management Response: Postal Retirement Funds in Perspective: Historical Evolution and Ongoing Challenges – White Paper *(*Report Number 2023RISC006)

Thank you for providing the Postal Service with an opportunity to review and comment on the findings and recommendations in the final review draft of the white paper, "Postal Retirement Funds in Perspective: Historical Evolution and Ongoing Challenges." We appreciate your detailed historical summary of our retirement benefit programs and the description of the challenges related to these programs.

As noted in this paper, administrative action is needed to fairly apportion responsibilities for CSRS payments between the Postal Service and the United States Treasury. This change would eliminate our CSRS amortization payments and is a key component of the Delivering for America 10-year plan.

The Postal Service agrees with your assessment that higher-than-normal inflation in 2021 and 2022 hurt the value of the Postal Service's retirement funds by increasing current and future benefits to be paid from the funds. The impact of this inflation could have been mitigated if we had the flexibility to diversify our investment portfolios into instruments other than Treasury securities. Congressional action would be needed to grant us this flexibility.

Sincerely,

E-SIGNED by LUKE.T GROSSMANN
on 2023-12-19 14:23:07 EST

Luke Grossmann
Senior Vice President, Finance & Strategy

cc: *Corporate Audit & Response Management*

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