Historical Analysis of USPS Retirement Fund Returns

RISC REPORT

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Executive Summary

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Career Postal Service employees participate in one of two main defined benefit pension programs for federal workers: the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). In addition, eligible Postal Service employees can remain enrolled in the Federal Employees Health Benefits program, which provides employer-sponsored group health insurance, after retirement. The Postal Service Retiree Health Benefits Fund (PSRHBF) holds funds for Postal Service retirees enrolled in the program. At the end of fiscal year (FY) 2022, the Office of Personnel Management (OPM) estimated that the Postal Service's retiree assets in these three plans totaled $298 billion.

Under current law, these retiree assets are managed jointly by the OPM and the U.S. Treasury – not the Postal Service. Funds can be invested only in Treasury securities, which are stable investments that typically generate lower rates of return compared to other common kinds of investments. All three retirement plans carry an unfunded liability, meaning they do not currently have enough money to cover the estimated liability for future retiree benefits.[1] Diversifying how the assets are invested could reduce the unfunded liability by increasing investment income. Asset diversification is standard practice among state, local, and private pension systems, which have higher average rates of return than the postal retiree funds. In addition, several federal agencies have their own retirement systems outside of CSRS or FERS that invest assets in a more diversified way.

To better understand how diversifying retiree investments might impact the Postal Service, the OIG compared actual historical fund returns of the Postal Service's retirement funds to a simple hypothetical investment portfolio consisting of 40 percent U.S. investment-grade bonds and 60 percent U.S. stocks. This fund allocation represents a balanced mix of less volatile bonds with more volatile stocks. The analysis was conducted in partnership with Segal Marco Advisors, a firm with expertise in actuarial science and pension plan management. The OIG estimated that CSRS, FERS, and PSRHBF would all have higher balances today if their assets had been invested in the alternative portfolio. Across the three funds, the OIG estimated total retirement assets of $1.2 trillion, with the following breakdown:

- **CSRS:** If funds were invested in the 60 percent stock portfolio in FY 1972, the estimated balance was $878 billion, or 7.1 times the current value.
- **FERS:** If funds were invested in the 60 percent stock portfolio in FY 1988, the estimated balance was $240 billion, or 1.8 times the current value.
- **PSRHBF:** If funds were invested in the 60 percent stock portfolio in FY 2007, the estimated balance was $74 billion, or 2.1 times the current value.

Diversification is the norm in pension funds, with private sector, state, and local government pension funds investing in a mixture of stocks, bonds, and other assets. The OIG's analysis suggests that there could be significant benefits for the Postal Service if it could diversify its retirement investments, particularly for FERS, which receives steady contributions because of the large number of active employees participating in the plan. Importantly, it cannot be predicted with certainty if a diversified portfolio will yield similar strong returns in the future or outperform the current strategy over a given period of time. Consequently, limiting risk exposure may be advisable for mature funds, such as CSRS and PSRHBF, which are primarily in their drawdown phases as they make payments to meet their obligations; these plans cannot easily recover from a market downturn. Mature funds like CSRS that are closed to new enrollees and preparing to pay out their remaining benefit obligations can adjust their asset allocations to reduce risk exposure to investment losses in accordance with their level of funding.

1 The Postal Service's FY 2022 10-K report stated that at the end of FY 2022, OPM estimated that CSRS was 76 percent funded, FERS was 81 percent funded, and PSRHBF was 60 percent funded. In comparison, state and local pensions in the U.S. had an estimated aggregate funded ratio of 74 percent in 2022, according to: Jean-Pierre Aubry, "Public Pensions Contend with Falling Markets and Rising Inflation," Center for Retirement Research at Boston College, August 2022, https://crr.bc.edu/wp-content/uploads/2022/08/IB_22-13.pdf.

This analysis does not represent how the Postal Service's finances would look today if investment diversification had been an option. If it had been able to invest differently, the greater returns would have improved funding levels and allowed USPS to pay less into the funds to meet its retirement obligations. That reduced expenditure could have freed up money for USPS to use in other ways. Going forward, greater returns could help USPS reduce its unfunded liability and increase the agency's ability to meet its future obligations to retirees. Higher returns could allow USPS to invest more money in its processing and delivery network and expand its workforce. Reduced spending on retirement obligations could also help minimize rate increases for both competitive and market dominant products.

Observations

Introduction

Career Postal Service employees participate in one of two main federal defined benefit pension programs: the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Defined benefit programs provide eligible employees with retirement income, most commonly based on a set formula; for federal employees, the formula is based on salary and years of federal service.

In addition to these two retirement plans, eligible Postal Service employees can remain enrolled in the Federal Employees Health Benefits program after retirement.[2] Funds for Postal Service retirees enrolled in the program are held in the Postal Service Retiree Health Benefits Fund (PSRHBF). The PSRHBF funds health care premiums specifically for Postal Service retirees.

The Postal Service is in a unique and challenging position with its retirement funds. Currently, all three plans do not have enough money to cover the future cost of benefit payments.[3] Unlike most federal agencies, the Postal Service funds itself through revenue and does not rely on regular congressional appropriations. The performance of its retirement investments, which must be invested exclusively in low-risk U.S. Treasury bonds, has a direct impact on its financial viability. Diversifying the investment strategy could potentially help ensure plan funding but the Postal Service does not have the authority to change how this money is invested. Congressional action would be required to allow the Postal Service to pursue a different investment strategy.

To better understand how diversifying retiree investments might impact the Postal Service, the U.S. Postal Service Office of Inspector General (OIG) compared actual historical fund returns of the Postal Service's retirement funds to a hypothetical investment portfolio consisting of 40 percent U.S. investment-grade bonds and 60 percent U.S. stocks. The analysis was conducted in partnership with Segal Marco Advisors, a firm with expertise in actuarial science and pension plan management. The OIG also researched the investment strategies and investment returns of state, local, and private pension funds, as well as federal examples of more diversified retirement funds. Finally, the OIG considered the implications of generating increased investment income for the Postal Service. See Appendix A for details of the paper's scope, objective, and methodology.

The Postal Service's Current Retirement Assets

Between the three retirement plans – CSRS, FERS, and PSRHBF – the Postal Service had an estimated $298 billion in assets at the end of FY 2022 (Figure 1). CSRS and FERS assets are held in a single trust fund, the Civil Service Retirement and Disability Fund (CSRDF). CSRDF holds funds for all participating federal employees. The Office of Personnel Management (OPM), the plan administrator, estimated that the Postal Service's share of that fund was $262 billion.[4] At the end of FY 2022, PSRHBF held $36 billion in assets, bringing the total estimated sum of USPS retiree assets to $298 billion.

2 The Postal Service Reform Act of 2022 established a new Postal Service Health Benefits (PSHB) program for Postal Service employees, annuitants, and their families within the Federal Employees Health Benefits Program. The PSHB will be administered by OPM and implemented on January 1, 2025.
3 U.S. Postal Service, Form 10-K FY 2022, https://about.usps.com/what/financials/10k-reports/fy2022.pdf, pp. 29, 32.
4 This is OPM's estimate of the balance at the end of FY 2022. Actual figures will not be available until later in 2023. In the OIG's analysis below, we estimate a lower valuation because we exclude amortization payments and assume a lower interest rate.

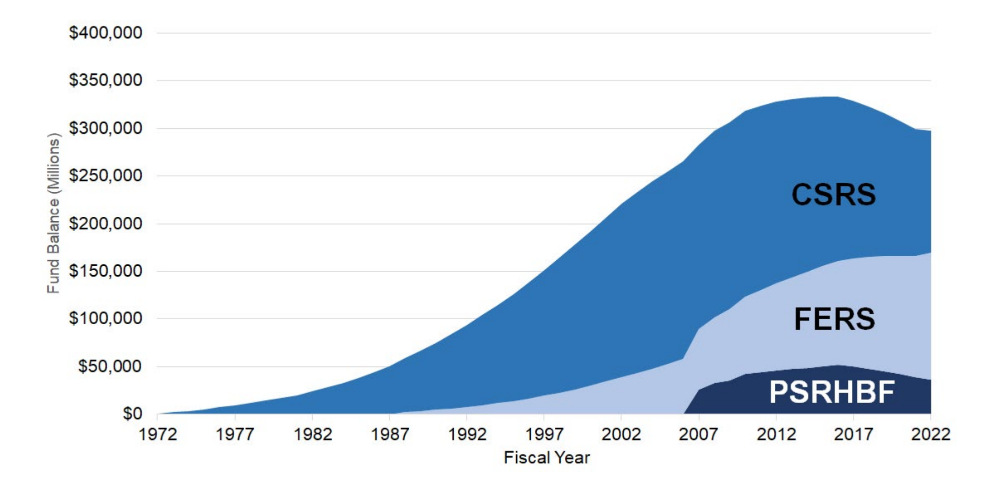
Figure 1: USPS Retiree Assets FYs 1972-2022

USPS RETIREE ASSETS TOTALED $298 BILLION IN FY 2022

At the end of FY 2022, the Postal Service's retiree assets totaled $298 billion between CSRS, FERS, and PSRHBF. CSRS made up 43 percent of assets, FERS made up 45 percent, and PSRHBF made up 12 percent.

Note: Amounts reflect the Postal Service's share of CSRS and FERS funds. FY 2022 CSRS and FERS totals reflect OPM estimates and not actual fund balances.

Source: Office of Personnel Management.



Current Investment Strategy is Low Risk and Low Return

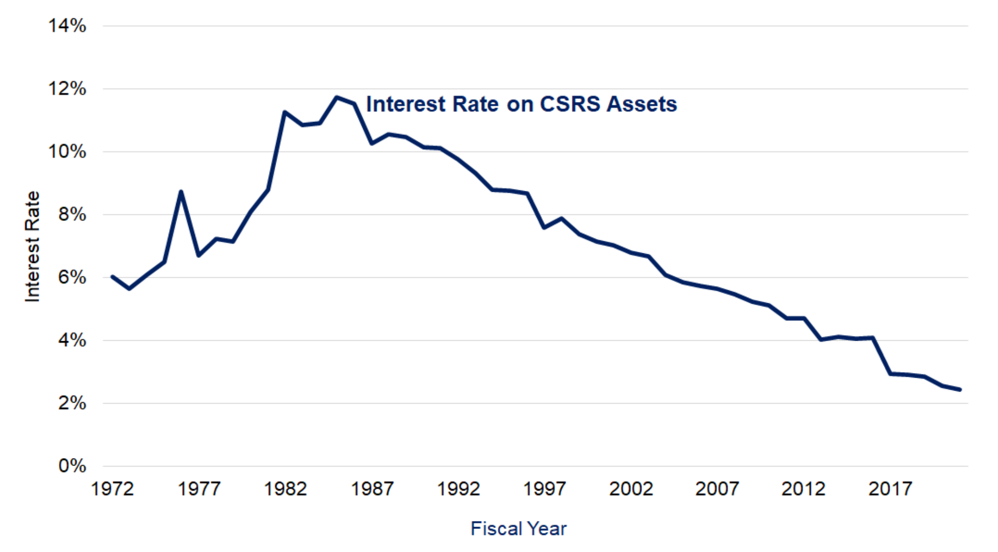
Current law requires assets in each of the three funds to be invested exclusively in Treasury securities. The Postal Service does not control the investment strategy of its retirement funds. The Treasury and OPM jointly oversee and manage CSRS, FERS, and PSRHBF, including investment selection.[5] The low rate of return of these securities compared to other potential investments puts the Postal Service at greater risk of not being able to meet its funding obligations. Investment returns on the Postal Service's retirement funds peaked at just under 12 percent in the mid-1980s but steadily declined in the decades since to around 2.5 percent in FY 2021 (Figure 2). As a result of consistently declining interest rates, the investment income USPS has earned on its retirement assets has steadily decreased in recent years.

Figure 2: CSRS Interest Rates, 1971 - 2021

INTEREST RATE ON RETIREMENT ASSETS IS STEADILY DECLINING

The interest rate on USPS retirement assets peaked in the mid-1980s and then steadily declined, reaching its lowest point in 50 years in FY 2021.

Source: OPM and USPS OIG.



5 OPM is the plan administrator for CSRS, FERS, and PSRHBF, while the Secretary of the Treasury is responsible for investing the funds. Every June, CSRDF uses contributions from federal employees and agencies to buy Treasury securities with maturities spread over a 15-year period. Buying securities of different maturities is a strategy known as "laddering," which aims to produce steady cash flow over time and can minimize interest rate risk. A set of securities matures annually and the proceeds are used to pay out benefits or be reinvested in new Treasury securities. Health benefit contributions to the PSRHBF are financed in the same manner as investments in the CSRDF. The Treasury uses the money invested in these securities to help finance the costs of operating the federal government.

Current Funding Levels of the Postal Service's Retirement Assets

All three of the Postal Service's retirement plans carry an unfunded liability, meaning they do not currently have enough money to cover the estimated liability for future benefits. OPM estimated that at the end of FY 2022, CSRS was 76 percent funded, FERS was 81 percent funded, and PSRHBF was 60 percent funded.[6] In total, the Postal Service's estimated liability was $394 billion across the three funds, compared to $298 billion in current assets.

The unfunded liability for CSRS and FERS increased over the past 15 years. The Postal Service Reform Act (PSRA), passed in April 2022, significantly reduced the unfunded liability for PSRHBF. PSRA requires most future USPS retirees who keep their federal health benefits in retirement to enroll in Medicare.[7] By shifting some health-related costs to Medicare, USPS' future liability for these costs decreased. PSRA also repealed a requirement for USPS to prefund PSRHBF and forgave $57 billion in past due PSRHBF payments.[8] However, benefit payments continue despite no contributions into the fund since 2010.

Given the PSRHBF negative cash flows, the fund will eventually run out of money to pay retiree health benefits. The Postal Service estimates that the fund will be depleted in FY 2032. When the PSRHBF is exhausted, the Postal Service will switch to "pay-as-you-go funding," meaning that retiree health insurance premiums would come directly from USPS revenues instead of a separate fund. By the time PSRHBF is expected to be insolvent, the OIG projects that annual health premiums for retirees will be over $5 billion.

Diversified Asset Investment is Standard for Other Pension Funds

The Postal Service does not have the authority to invest its retirement funds in a diversified portfolio. For this reason, these funds, on average, have had lower annual rates of return than pension funds in the public and private sectors. For example, the rate of return on the Postal Service's share of FERS assets averaged 4.6 percent per year between FYs 2000 and 2021. In comparison, public pensions averaged an annual return of 7.9 percent for FYs 2000 to 2021.[9]

State, Local, and Private Pensions Invest in a Range of Assets

In contrast to most federal retiree benefit assets, state and local pension funds are diversified. As of 2021, only around one quarter of the total assets held by state and local pension funds were invested in fixed-income and cash holdings, in contrast with the funds containing the Postal Service's retirement benefit funds, which are entirely invested in fixed-income assets.

Other pension funds invest in a range of traditional equities and alternative investments. Nearly half – 47 percent – of state and local fund assets were invested in public equities (shares of companies publicly listed on a stock exchange). Over the past 20 years, pension fund managers increasingly allocated funds to alternative asset classes, such as hedge funds, private equity, and real estate funds. In 2021, 11 percent of state and local pension fund assets were invested in private equity, 8 percent in real estate, and 6 percent in hedge funds. In general, these alternative assets are riskier than traditional equity and fixed-income assets, but also have the potential to yield greater returns on investment.[10]

The actual annual rates of investment return for state and local pension plans are volatile while the funds' yearly expectations of future returns are slowly declining over time. Over the past 20 years, the annual return has exceeded 15 percent five times (in 2004, 2007, 2011, 2014, and 2021) but has also experienced negative returns in both 2008 and 2009. Plans' own annual projections of their expected returns dropped from eight percent in 2002 to seven percent in 2021.[11]

Investing in asset classes that provide higher rates of return than fixed-income Treasury securities is important for these pension funds as they try to cover increasing costs. Over the past 20 years, the ratio of retiree beneficiaries to active employees increased for public pension plans. In 2001, there were 0.6 retirees per active worker in those plans;

6 Funding ratios are for the Postal Service's share of CSRS and FERS assets and liabilities. For CSRS and FERS, FY 2022 data on funding levels and estimated liabilities are projections. Actual data for FY 2022 will be available later in 2023. FY 2022 projections assume the Postal Service made amortization payments for CSRS and FERS, which it either did not make at all or did not make in their entirety.

7 For more information on the PSRA's provisions and impacts on the Postal Service, see: USPS OIG, *Primer on Postal Reform*, RISC-WP-23-002, December 20, 2022, https://www.uspsoig.gov/sites/default/files/reports/2023-01/RISC-WP-23-002.pdf.

8 The Postal Accountability and Enhancement Act (PAEA) of 2006 required the Postal Service to make 10 annual prefunding payments into PSRHBF. The Postal Service made four prefunding payments totaling $17.9 billion and defaulted on the remaining $33.9 billion.

9 Data on state and local pensions available at: "National Data," Center for Retirement Research at Boston College and MissionSquare Research Institute, https://publicplansdata.org/quick-facts/national/.

10 Ibid.

11 Ibid.

in 2021, there were 1.3 retirees per active worker (a ratio higher than the Postal Service's ratio of 1.1 for the same year).[12] As a result of this trend, benefit payments to retirees have grown much faster than employee contributions. Pension funds have tried to maximize returns to meet these growing costs.

Private sector defined-benefit plans feature diversified mixes of assets similar to their public sector equivalents, including stocks, fixed-income securities, and alternative investments like real estate. The U.S. Department of Labor reported that across private sector defined benefit plans in 2020, 27 percent of assets were invested in stocks, 22 percent in corporate debt instruments (such as bonds), 12 percent in U.S. government securities, with the remaining assets in other investments.[13] Between 2001 and 2020, the aggregate rate of return on these investments was 6.5 percent.[14]

Retirement Investment Diversification in the Federal Government

Federal government trust funds, such as the Social Security Trust Fund, are generally invested similarly to CSRS, FERS, and PSRHBF. However, there are several examples of federal funds that can invest in assets other than Treasury securities.

In 2001, Congress passed legislation allowing the federally-administered railroad employee pension system, which includes funds paid in by private sector railroads and Amtrak, to invest in assets other than government securities. The legislation established the National Railroad Retirement Investment Trust (NRRIT) to invest part of the Railroad Retirement Board's assets in a manner similar to most public- and private-sector pension funds. NRRIT is a tax-exempt entity independent of the federal government, overseen by a board of trustees appointed by railroad management and labor unions. The trust's assets are invested in a diversified portfolio of equity and fixed-income securities in the U.S. and abroad. From FY 2003 to FY 2021, the NRRIT's annual returns averaged 8.9 percent. At the end of March 2022, the market value of the NRRIT's assets was more than $28 billion. As of the end of FY 2019 (the latest data available), the Railroad Retirement Board's retirement funds were more than 100 percent funded.[15]

> From FY 2003 to FY 2021, the National Railroad Retirement Investment Trust's annual returns averaged 8.9 percent.

Employees of the Federal Reserve System have access to a pension plan managed by independent money managers. The Tennessee Valley Authority (TVA), an electric utility corporation owned by the federal government, is another federal entity that invests pension funds in a diversified portfolio. The Tennessee Valley Retirement System, a separate legal entity with an independent board of directors, manages the portfolio.[16]

The Department of Defense's Military Retirement Fund practices a more limited kind of diversification. While the fund's assets are entirely Treasury securities, 60 percent of the $1.3 trillion in the fund in FY 2022 was invested in Treasury Inflation-Protected Securities (TIPS), a form of Treasury security that is indexed to inflation to protect investors from a decline in the purchasing power of their money. The fund earned investment income of $74 billion in FY 2022 from investment in TIPS. Previous OIG work recommended that the Postal Service request approval from the Secretary of the Treasury and OPM to invest in TIPS.[17]

Historical Analysis of the Postal Service's Actual and Potential Fund Returns

The OIG commissioned a historical analysis of the Postal Service's contributions to its retirement benefits funds since their respective inceptions, the returns earned from those funds, and an estimate of fund balances over time if the Postal Service's retirement funds had been invested in a diversified portfolio including assets other than Treasury securities.

The analysis explored an alternative investment strategy for the Postal Service's contributions to CSRS, FERS, and PSRHBF with an allocation ratio

12 Equable Institute, *State of Pensions 2022*, https://equable.org/wp-content/uploads/2022/07/Equable-Institute_State-of-Pensions-2022_Final.pdf.
13 Data include plans with 100 or more participants. In addition to the asset allocations listed above, private defined benefit plans also invested 12 percent of assets in Registered Investment Companies, which are exchange-traded funds (ETFs) and mutual funds that offer further exposure to stocks and bonds. U.S. Department of Labor Employee Benefits Security Administration, *Private Pension Plan Bulletin*, October 2022, https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2020.pdf, pp. 25-26.
14 Data include plans with 100 or more participants. U.S. Department of Labor Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables and Graphs 1975-2020*, October 2022, https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf, p. 28.
15 Keith T. Sartain, "Twenty-Eighth Actuarial Valuation," Railroad Retirement Board, October 2021, https://www.rrb.gov/sites/default/files/2021-11/28%20Valuation%20and%20Tech%20Supp.pdf, p. 24.
16 The TVA's defined-benefit pension was closed to new employees in 2014, at which point new hires could only join a defined-contribution plan.
17 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.

of 40 percent U.S. investment-grade bonds and 60 percent U.S. stocks.[18] This asset mix represents a balanced mix of less volatile bonds and more volatile stocks. The analysis estimated that the CSRS, FERS, and PSRHBF funds would all have higher balances if their assets had been diversified in the alternative portfolio. Specifically, our analysis found that investing in a 60 percent stock portfolio would have yielded a total balance of approximately $1.2 trillion across the three funds at the end of FY 2022, compared to OPM's estimated balance of $298 billion. The improved performance is due to higher returns from investment in the U.S. stock market, which outperformed U.S. Treasury securities over the timespan of the analysis.

This analysis estimates alternative returns based on actual funding levels but does not represent how the Postal Service's finances would look today if investment diversification had been an option. In reality, higher returns would improve funding levels so that the Postal Service would have had to pay less into the funds to meet its retirement obligations. That reduced expenditure could have freed up money that USPS could use in other ways, such as investing in the postal network and workforce. In the future, higher investment returns could slow price increases linked to the Postal Service's retirement amortization payments.

Estimated Historical Returns on Alternative CSRS Investments

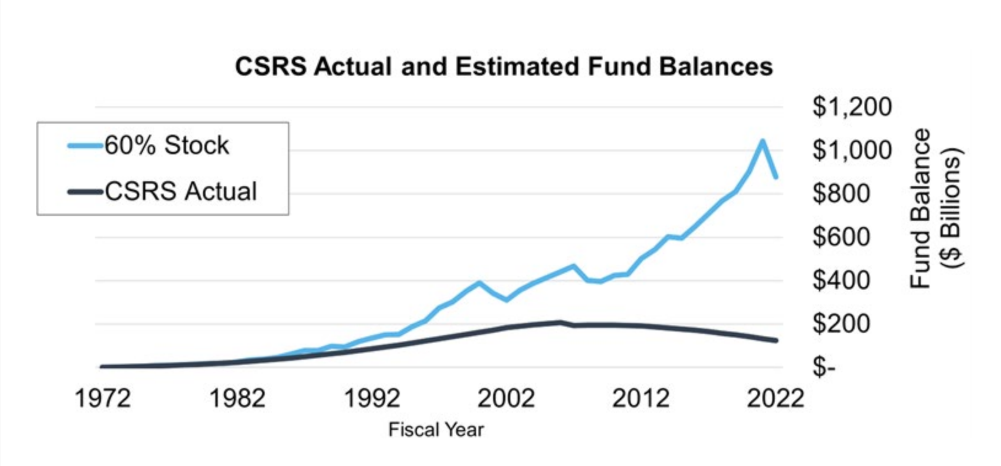
If CSRS assets had been invested in a portfolio of 40 percent U.S. bonds and 60 percent U.S. stocks in FY 1972, the estimated value of CSRS assets would be $878 billion at the end of FY 2022. This estimate is 608 percent higher than the estimated balance of $124 billion.[19] From 1972 to 2007, estimates from our analysis of the alternative portfolio showed steady fund balance growth, with rapid growth occurring over the past 10 years. See Figure 3 for a visualization of estimated CSRS fund balances over time.

The Postal Service's contributions to the fund varied from year to year and the timing of when cash flowed into and out of the fund has a significant impact on the results of the analysis. For example, a large amount of money contributed into the fund shortly before a market upswing would result in a more significant increase than the same amount of money contributed before a market downswing. For this reason, it is helpful to also present another set of estimates that focuses purely on the rate of return provided by the portfolio and does not consider the contributions into the fund and payments out of the fund over time. This can be measured by projecting the fund balance if one dollar had been deposited in 1971, the year the Post Office Department became the U.S. Postal Service. If it was invested similarly to the actual investment mix, that dollar would have grown to $30.5 by the end of FY 2022. If the dollar was invested in the 40 percent U.S. bonds and 60 percent U.S. stocks portfolio, that dollar would be worth $90.4 at the end of FY 2022 – about three times what the current strategy yielded (Figure 4).

Figure 3: Estimated CSRS Values, FY 1972-2022

If the Postal Service's CSRS assets had been invested in the diversified portfolio in FY 1972, the current fund balance could have been $878 billion – more than seven times higher than the actual current balance.

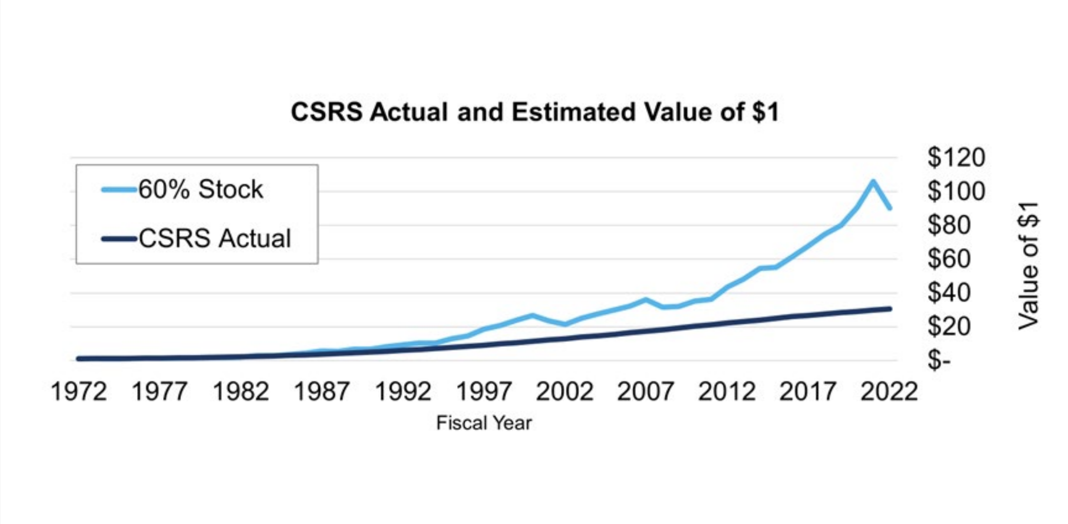
Source: Segal Marco Advisors analysis.



18 The analysis used the S&P 500 index as a proxy for investment in the stock market and an aggregate index of U.S. core fixed income for bonds.
19 This represents the OIG's estimate of the CSRS balance at the end of FY 2022. It is lower than OPM's estimate of $128 billion because it does not include an amortization payment (which the Postal Service did not make) and assumes a lower rate of investment return.

Figure 4: CSRS Value of $1 1972-2022

Source: Segal Marco Advisors analysis.



Estimated Historical Returns on Alternative FERS Investments

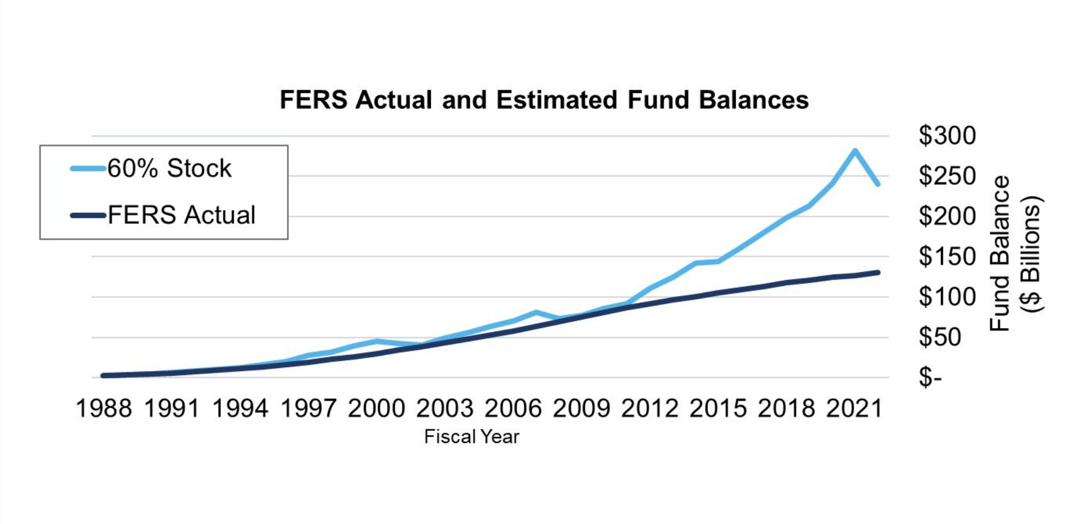
Estimates for the Postal Service's assets in FERS, which began in 1987, also showed that the 40 percent U.S. bonds and 60 percent U.S. stocks portfolio yielded stronger returns over time. That portfolio resulted in an estimated FY 2022 end-year balance of $240 billion, compared to the actual balance of $130 billion.[20] This estimate is 85 percent higher than the actual balance. See Figure 5 for a visualization of estimated FERS fund balances over time.

Using the analysis for one dollar invested in FERS at fund inception without any further contributions or payments, our analysis shows that the diversified portfolio would have provided a higher rate of return on investment. The actual returns would yield $7.1 in 2022, while the 40 percent bonds and 60 percent stocks portfolio projected a value of $16.2, more than twice the actual (Figure 6).

Figure 5: Estimated FERS Values, FY 1988 - 2022

As with CSRS, investing FERS assets in the alternative portfolio would have yielded higher fund balances at the end of FY 2022 than the actual balance. The estimated FERS balance was $240 billion, compared to the actual balance of $130 billion at the end of FY 2022.

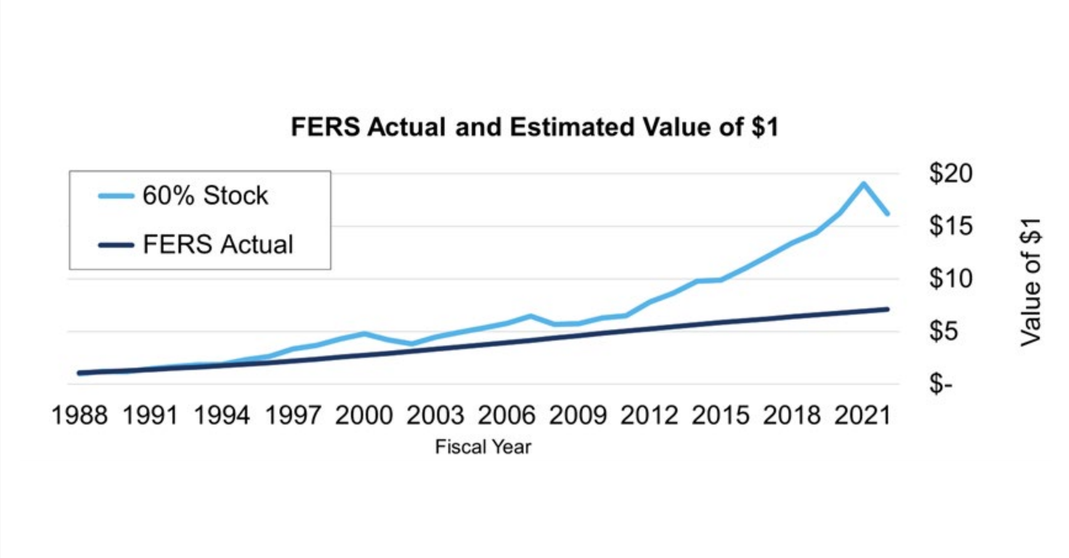
Source: Segal Marco Advisors analysis.



20 This represents the OIG's estimate of the FERS balance at the end of FY 2022. It is lower than OPM's estimate of $134 billion because it does not include a full amortization payment (the Postal Service made a partial payment) and assumes a lower rate of investment return.

Figure 6: FERS Value of $1, FY 1988 - 2022

Source: Segal Marco Advisors analysis.



Estimated Historical Returns on Alternative PSRHBF Investments

PSRHBF is the newest of the three funds, begun in 2007, but the analysis still shows that diversified investment could have yielded a significantly higher fund balance in 2022. The estimated fund balance for the 40 percent bonds and 60 percent stocks portfolio was $74 billion in 2022, a balance more than double the actual value of $36 billion. See Figure 7 for a visualization of estimated PSRHBF fund balances over time.

One dollar invested in PSRHBF in 2006 with no subsequent contributions or payments would yield a projected $2.8 in 2022 with the diversified portfolio, compared to $1.7 given the actual rate of returns for the fund (Figure 8).

Figure 7: Estimated PSRHBF Values, FY 2007 - 2022

The PSRHBF had the shortest time frame of all three funds, but diversified investment still would have yielded higher fund balances today. Diversification could have resulted in a balance of $74 billion at the end of FY 2022, compared to the actual balance of $36 billion.

Source: Segal Marco Advisors analysis.

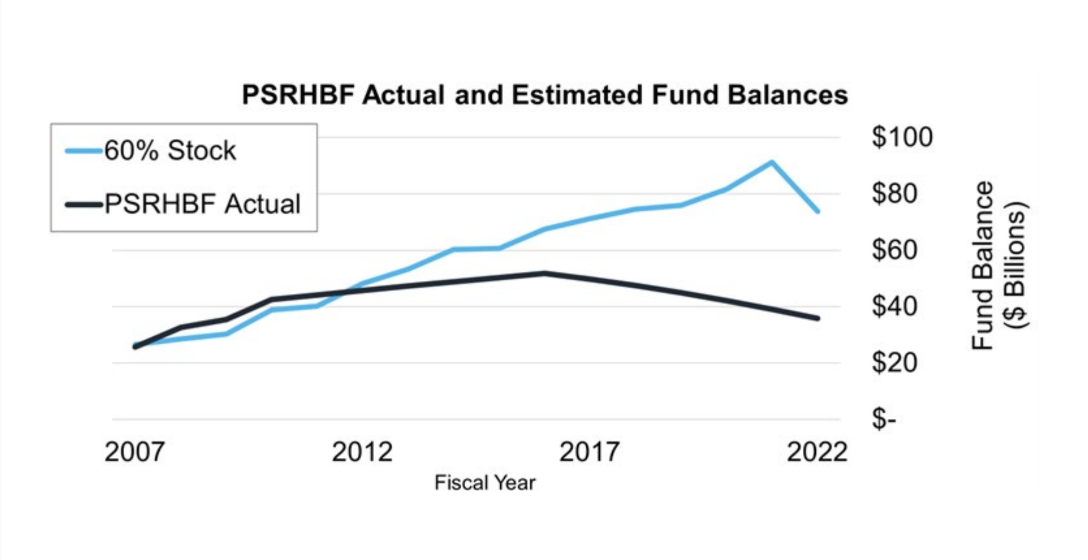
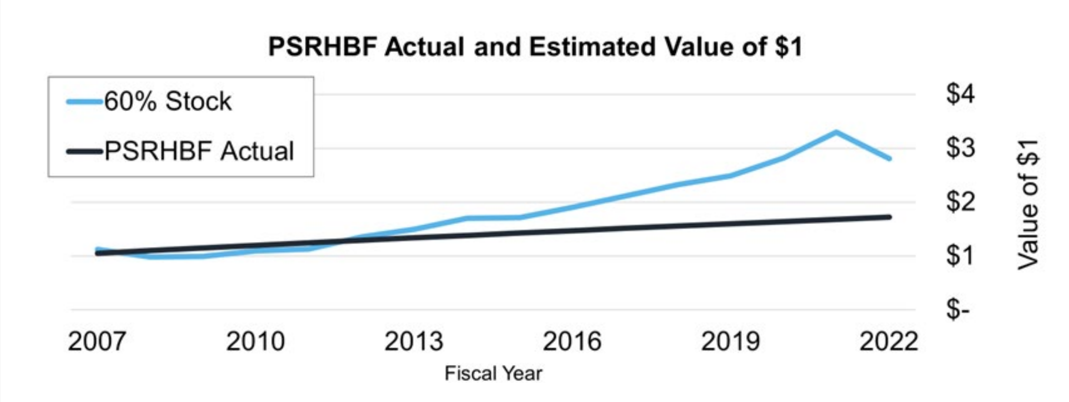


Figure 8: PSRHBF Value of $1, 2007 - 2022

Source: Segal Marco Advisors analysis.



Past Performance May Not Be Predictive of the Future

Financial market conditions change over time. For example, the interest rates on Treasury securities vary from year to year and the yield of stock market index funds can fluctuate significantly. Given the many variables affecting the market, it is challenging to predict the future performance of investments in the stock market or other kinds of investments that include an inherent risk. For this reason, it cannot be assumed that adopting the diversified portfolio presented above will yield similar strong returns in the future or outperform the current strategy of investing exclusively in Treasury securities.

Different Strategies May Be Appropriate for Each Fund

It is also important to consider the maturity of each fund. A fund is considered "mature" if there is a large number of retirees per active worker or the balance of contributions into the fund is much lower than the payouts. A fund's investment strategy should reflect how mature the fund is. Since 1987, CSRS has been closed to new employees. Closed mature plans are more sensitive to investment volatility because contributions into these funds will decrease as participating employees retire, while benefit payments will be required throughout the lifetimes of participating retirees. Plan administrators may choose to take on less risk in their asset portfolios because riskier assets will lose value in a down market and a mature plan must maintain sufficient asset levels to pay out benefits. If a rebound in asset prices occurs after a downturn, that price return will apply to a smaller amount of assets, because the fund has to continue paying out benefits during the downturn; for this reason, recoveries are weaker for mature funds. The opposite is true for a "young" plan like FERS because new contributions into the fund during a downturn can buy assets at a lower price, leading to a stronger recovery when the market rebounds. Pension plans commonly adopt "glide path" investment strategies, changing the mix of assets in accordance with the plan's funded ratio. Under such a strategy, an underfunded plan could invest in a portfolio with more risky assets to improve its funding level and ensure it can meet its remaining benefit obligations; as that plan grows nearer to being fully funded, it could shift to a more risk-averse, bond-heavy portfolio to reduce the chance that a market downturn would deplete its remaining assets. Due to a wide variety of factors in individual plans, such as total assets, number of retirees, time frame, and funding level, there is no standard or ideal investment mix for these plans.

If the Postal Service were currently able to invest CSRS retiree funds in a diversified portfolio, it might wish to pursue a more conservative mix of assets than the 60 percent equity portfolio presented above to ensure it can meet its obligations to retirees and minimize risk from a market downturn. The risk considerations for PSRHBF could be similar because that fund no longer receives new contributions from USPS while continuing to pay out retiree benefits. FERS, however, continues to receive contributions from a large number of active employees and its balance increases from year to year, limiting its exposure to risk. Therefore, investing FERS assets in a portfolio with significantly more market risk than the current strategy but an opportunity for higher returns may be suitable because a downward market fluctuation would be less likely to affect the fund's long-term ability to meet its obligations to retirees.

Implications of Higher Rates of Return in USPS Retirement Plans

Absent any future reforms, the agency's ability to make future pay-as-you-go payments for retiree health premiums depends on the success of cost savings initiatives in its *Delivering for America* 10-year plan, such as transportation network optimization and mail processing consolidation.[21] If the Postal Service were able to invest its retirement assets in a diversified portfolio with higher returns, it could help extend the life of the funds and ensure the agency's ability to meet its future obligations to retirees. In addition, it could improve the Postal Service's financial situation by reducing amortization payments. Amortization payments are annual installment payments to pay down an unfunded liability over a set number of years.[22] Of particular importance is the Retiree Health Benefits Fund, which is expected to run out of money in the 2030s, when the OIG projects that retiree health premiums will be over $5 billion annually. At that point, the Postal Service will have to directly pay those costs, adding billions in annual expenses.

With reduced retirement expenses, the Postal Service could invest more money into its network. The Delivering for America plan includes more than $40 billion in capital investments over 10 years. The Postal Service is also investing billions in a new delivery vehicle fleet, including electric vehicle charging infrastructure to be installed at facilities throughout the country.

The Postal Service could also use additional funds to strengthen its workforce. The agency recently converted approximately 63,000 non-career employees to permanent positions, helping to stabilize the workforce and reduce turnover. A reduction in the necessary annual contributions to retirement funds would increase the resources USPS has available to convert more employees to career status or hire new employees, if the agency determines that either option would support its strategic goals.

Generating higher rates of return on retirement investments could allow the Postal Service to invest more in its processing and delivery networks or expand its workforce.

In addition to freeing up cash for network and workforce improvements, reduced spending on retirement obligations could help minimize rate increases for customers. The Postal Service must cover its costs with revenue, and higher retirement costs could contribute to rising market dominant and competitive rates without contributing to the improvement of the postal network.[23]

Conclusion

By law, the Postal Service's retiree assets must be invested in low risk and low return Treasury securities. Investing in a diversified mix of stocks, bonds, and other investment classes is a standard practice among state, local, and private pension systems. The current investment strategy is a contributing factor in the declining funded ratios of the two pension plans and the health benefit fund and places the Postal Service at risk of being unable to meet its future retiree obligations. Our analysis showed that investment in a diversified portfolio of stocks and bonds would have greatly increased investment income. At the end of FY 2022, OPM estimated that the Postal Service had $298 billion in total retiree assets. Using an investment strategy of 40 percent U.S. bonds and 60 percent U.S. stocks, the Postal Service could theoretically have had $1.2 trillion in assets across its three retiree plans (Table 1).

21 U.S. Postal Service, *Delivering for America: Our Vision and Ten-Year Plan to Achieve Financial Sustainability and Service Excellence*, March 2021, https://about.usps.com/what/strategic-plans/delivering-for-america/assets/USPS_Delivering-For-America.pdf, p. 48.

22 This paper does not estimate the extent to which diversification could increase the investment income of the Postal Service's retirement fund assets because the OIG's analysis did not include any such forecasting.

23 In 2020, the Postal Regulatory Commission (PRC) approved new pricing rules that gave the Postal Service the ability to raise market dominant rates beyond the rate of increase of the Consumer Price Index, a measure of inflation. One of these new rules addresses amortization payments on unfunded retiree liabilities, which the PRC views as beyond the Postal Service's control. The Postal Service can use this pricing authority to raise rates, and all revenue earned from this pricing authority must be used for retirement amortization payments.

Table 1: Summary of Actual and Estimated Balances of Postal Service Retirement Funds

	OPM Actual Estimates as of 9/30/22			Estimates with 60% Stock/40% Bond Investment as of 9/30/22*		
	Balance	Liability	Deficit/Surplus	Balance	Liability	Deficit/Surplus
CSRS	$128.1	$169.0	-$40.9	$877.8	$169.0	+$708.8
FERS	$133.7	$165.5	-$31.8	$239.7	$165.5	+$74.2
PSRHBF**	$35.8	$59.5	-$23.7	$73.8	$59.5	+$14.3
Total	**$297.6**	**$394.0**	**-$96.4**	**$1,191.3**	**$394.0**	**+$797.3**

Dollars in billions.

*The start date of fund investment varies by fund; analysis assumes that investment began during the first full year of each fund. For CSRS, this was FY 1972, for FERS, FY 1988, and for PSRHBF, FY 2007.

**OPM's FY 2022 valuations for PSRHBF reflect actual fund balances, whereas FY 2022 CSRS and FERS valuations are estimates.
Source: OPM; USPS OIG and Segal Marco Advisors analysis.

The analysis suggests that an alternative strategy – particularly one maintained over an extended time period – would increase investment income and benefit the Postal Service. Improving the funded balance of retiree pension funds could free up cash for the Postal Service to make other investments, such as improving its processing and delivery network or building its workforce. Further, reducing retiree-related spending may help minimize price increases tied to the Postal Service's retirement obligations.

Appendices

Appendix A: Additional Information

Objective(s), Scope, and Methodology

The objective of this white paper was to 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.

The scope of the white paper was fiscal years 1972 to 2022. We selected this time period because the Postal Service became a self-sustaining entity in July 1971 after the passage of the Postal Reorganization Act of 1970.

To accomplish the objective, the OIG:

- Contracted with investment consultancy Segal Marco Advisors to conduct the historical analysis of the Postal Service's retirement fund investment returns.
- Conducted desk research on the structure and investment strategy of state, local, and private pension plans. In addition, the OIG researched other pension funds within the federal government.
- Interviewed postal stakeholders and pension financing experts.

Segal Marco Advisors compared the actual investment returns of the Postal Service's retirement funds to the estimated returns from a portfolio invested in 60 percent U.S. stocks and 40 percent bonds. Segal Marco created the portfolio from a combination of U.S. equity (as proxied by the S&P 500) and U.S. core fixed income (as proxied by the Bloomberg Aggregate Bond Index). Together, this simple and low-cost portfolio reflected a broad index of U.S. companies and U.S. investment-grade bonds. Segal Marco included only U.S. stocks in the analysis and did not incorporate alternative investments – such as real estate – into the asset mix. The portfolio weights were constant and rebalanced quarterly. Returns were calculated on a Fiscal Year basis ending September 30. Segal Marco Advisors sourced historical investment returns from the Portfolio Analytics and Reporting (PARis) database.

To analyze investment returns, Segal Marco Advisors assumed that contributions, payments to retirees, and transfers were held constant between the actual scenario and the alternative scenario. The return rate for the alternative portfolio was applied to these cashflows to determine the alternative investment income and fund balance. The analysis of the alternative portfolio's investment returns did not include management fees or rebalancing transaction costs and assumed index funds were available for the entire scope period. To estimate the fund balance of the alternative portfolio, Segal Marco Advisors added a miscellaneous cashflow adjustment to ensure consistency between the actual and alternative fund balance projections.

For each of the three retirement plans (CSRS, FERS, and PSRHBF), Segal Marco conducted two analyses. The first analysis estimated the current value of the funds today given historical contributions to the fund, payouts from the fund, and rates of return. This approach modeled the potential current fund balance, but the accuracy of estimates may be affected by the fact that data used for the modeling does not specify the exact timing of when cash flowed into and out of the fund during the fiscal year. The second analysis ignores contributions and payouts and focuses solely on the value of one dollar had it been invested the alternative portfolio.

This research 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 March 15, 2023, and incorporated their comments where appropriate.

Prior Coverage

Title	Objective	Report Number	Final Report Date	Monetary Impact
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
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
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
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
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: Management's Comments

JOSEPH CORBETT
CHIEF FINANCIAL OFFICER
EXECUTIVE VICE PRESIDENT

UNITED STATES POSTAL SERVICE

April 19, 2023

CINDY COBHAM
DIRECTOR, RESEARCH AND INSIGHTS SOLUTION CENTER

SUBJECT: Management Response: Historical Analysis of USPS Retirement Fund Returns – White Paper (2023RISC001)

Thank you for the opportunity to review and comment on the Office of Inspector General's (OIG's) white paper: Historical Analysis of USPS Retirement Fund Returns.

United States Postal Service management agrees that the investment of retiree assets in a diversified mix of stocks, bonds, and other investment classes would have greatly increased the investment income within the Civil Service Retirement System, the Federal Employees Retirement System, and Postal Service Retiree Health Benefits Fund funds. Moreover, such expanded investment options with higher historical investment performance could help mitigate the Postal Service's annual retirement funding obligations. Improving the funded balance of retiree pension funds could free up cash for the Postal Service to make key business investments, such as improving our processing and delivery network and other infrastructure needed to support our Delivering for America plan.

We further agree that the current investment strategy which uses a mix of U.S. Treasury securities – with rates of return at historic lows over the past several years – was a contributing factor in the declining funded ratios of the two pension plans and the health benefit fund and places the Postal Service at risk of being unable to meet its future retiree obligations.

While fund performance under a diversified mix of investments is subject to numerous variables with no guarantees that past performance would indicate future performance, we do believe that diversification into additional investment asset classes would benefit the investment performance of Postal retiree and retiree benefit funds over the long-term.

Joseph Corbett

cc: Corporate Audit Response Management

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