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U.S. POSTAL SERVICE

Action Needed to Address Unfunded Benefit Liabilities

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Applied Research and Methods

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GAO Highlights

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

U.S. POSTAL SERVICE

Action Needed to Address Unfunded Benefit Liabilities

Why GAO Did This Study

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

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

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

What GAO Found

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

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

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

Source: USPS.

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

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

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

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

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

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

Background

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

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

(Dollars in billions)

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

Source: USPS.

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

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

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

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

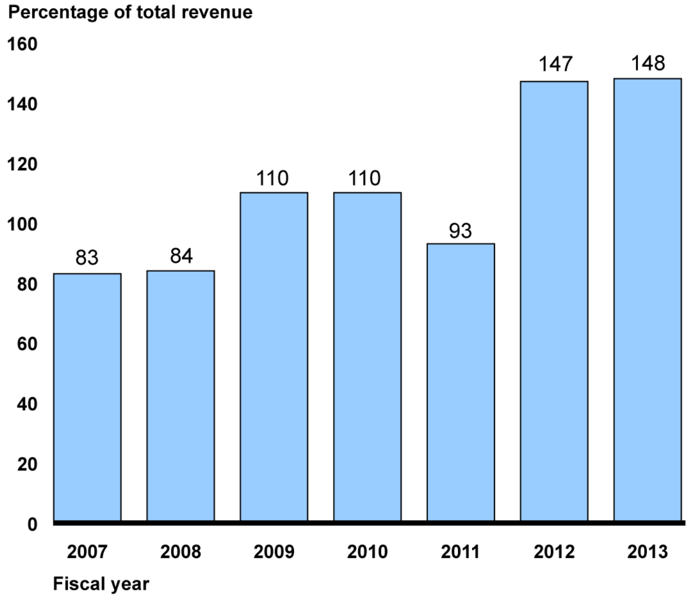
2011 through 2013.[3] In addition, USPS's outstanding debt to the U.S. Treasury increased from $2.1 billion at fiscal year-end 2006 to its current statutory borrowing limit of $15 billion.[4] As shown in figure 1, USPS's debt and unfunded liabilities have become a large and growing burden—increasing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

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

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

[4] 39 U.S.C. § 2005(a)(2).

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



Source: USPS.

USPS's Funding of Its Benefit Liabilities Varies by Program

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

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

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

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

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

Source: USPS.

What USPS's Liabilities Represent

USPS's benefit liabilities are actuarial estimates of the present value of a portion of the future benefits projected to be paid under each program based on formulas in current law. Specifically, for both the pension and retiree health programs, the liability includes two pieces: (1) the present value of all projected future benefits for current retirees and their beneficiaries, plus (2) the present value of a portion of the projected future benefits for current employees and their beneficiaries, based on employees' service to date (with each additional year of service adding to the liability, such that approximately the full liability is accrued when employees reach retirement).[6] Contrary to statements made by some employee groups and other stakeholders, these liabilities do not include any amounts for future USPS employees not yet hired or born. The workers' compensation liability represents the present value of all projected future benefits for former employees who have sustained an injury and are eligible for benefits; it does not include a provision for projected future injuries to current employees.

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

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

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

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

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

Different Funding Rules Apply to Different Programs

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

CSRS

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

FERS

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

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

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

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

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

Retiree Health

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

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

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

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

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

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

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

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

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

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

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

Workers' Compensation

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

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

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

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

[17] GAO-13-112.

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

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

Key Funding Considerations

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

[18] GAO-10-455.

[19] GAO-10-455.

[20] GAO-13-347T.

[21] GAO-13-112.

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

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

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

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

[22] GAO-13-112.

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

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

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

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

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

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

[24]GAO-13-658.

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

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

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

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

[25]GAO-13-872T.

[26]GAO-13-112.

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

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

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

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

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

[30]GAO-13-872T.

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

GAO Contact and Key Acknowledgments

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

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<u>Frank Todisco Biography</u>

Frank Todisco is Chief Actuary at the U.S. Government Accountability Office (GAO). As Chief Actuary, he serves as an expert advisor to GAO mission teams and the Congress on actuarial issues of national interest, including those related to retirement security, health care, life and casualty insurance, and major federal programs and policies in these areas. Mr. Todisco is a nationally recognized expert on retirement security issues, including those related to Social Security, traditional defined benefit pension plans (both public sector and private sector), defined contribution plans and lifetime income issues, and retiree health care. He has spoken and written frequently on these subjects. Mr. Todisco is also former chair of the Pension Committee of the Actuarial Standards Board (ASB); the ASB promulgates Actuarial Standards of Practice. In December, 2013, Mr. Todisco received a GAO Distinguished Service Award, which cited his "exceptional leadership and contributions in actuarial science to an increasing number of GAO engagements for multiple teams."

Prior to joining GAO, Mr. Todisco was the Senior Pension Fellow at the American Academy of Actuaries, where he served as the actuarial profession's chief policy liaison and media spokesperson on pension, Social Security, and other retirement security issues. As senior pension fellow, Todisco facilitated the formulation of sound retirement policy by providing nonpartisan technical assistance to Congress, federal regulators, and other public policymakers.

Prior to his service at the American Academy of Actuaries, Todisco was a principal for Mercer Human Resource Consulting in New York, where he was one of the firm's leading actuaries on retirement security issues. He also advised clients on design, financing, and regulatory requirements for large pension and retiree medical benefit programs.

Todisco is a Fellow of the Society of Actuaries (FSA), a Member of the American Academy of Actuaries (MAAA), and an Enrolled Actuary (EA). He has a bachelor's degree (AB), *cum laude*, in economics from Princeton University and a master's degree (MA) in economics from The New School for Social Research.