



The Postal Service's Share of CSRS Pension Responsibility

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The following paper demonstrates that the current system of funding the Postal Service's Civil Service Retirement System pension responsibility is inequitable and has resulted in the Postal Service overpaying \$75 billion to the pension fund. If this amount were returned to the Postal Service, it would create a pension surplus that could be transferred to the Postal Service's health benefits fund. The transferred amount would fully meet all of the Postal Service's accrued retiree health care liabilities and eliminate the need for the required annual payments of more than \$5 billion. Also, the health benefits fund could immediately start meeting its intended purpose — paying the annual payment for current retirees. This payment was \$2 billion in 2009.

For the third time, the Postal Service has been overcharged for its pension obligations. In 2002 it was determined the Postal Service would overfund CSRS by \$78 billion. Legislation in 2003 corrected this overfunding. Then it was determined the Postal Service was overcharged \$27 billion for CSRS military service credits. In 2006 these funds were returned to the Postal Service by Congress and the surplus was used to fund retiree health care liabilities.

This paper is part of a series my office has developed on disadvantageous entanglements between the Postal Service and the federal government. The first, *Estimates of Postal Service Liability for Retiree Health Care Benefits*, showed the Postal Service will have overfunded its retiree health care obligations by 2016 under a more normally-accepted assumption of the health care trend rate. The second, *Federal Budget Treatment of the Postal Service*, described the adverse impact of budget scoring on the Postal Service's finances and legislative reforms.

The common theme of these reports is that the legacy entanglement between the Postal Service and the federal government has adversely affected the Postal Service's financial position, hindered its ability to operate efficiently in a business-like matter, and retarded its transformation under the Postal Accountability and Enhancement Act.

The Postal Service was intended to be self-sufficient. More importantly, ratepayers should pay no less and no more than what is required to fund the Postal Service's operations. Now, as the Postal Service faces a challenging future, it is particularly important that the Postal Service's responsibilities be clearly delineated and separated from those of the federal government. The true costs of funding postal operations ought to be absolutely clear.

A handwritten signature in black ink, reading "David Williams", is positioned above the printed name.

David C. Williams
Inspector General

The Postal Service's Share of CSRS Pension Responsibility

When the Post Office Department became the Postal Service on July 1, 1971, there was no change to postal employees' retirement benefits. Employees continued to participate in the Civil Service Retirement System (CSRS), and the Postal Service continued to make the same contributions that federal agencies did to the Civil Service Retirement and Disability Fund.¹ The CSRS had historically been underfunded by agency contributions. As a result, the Postal Service was required to increase the funding of its employees' pensions several times.

The Postal Service is currently responsible for meeting any CSRS liability for employees who started after 1971. For employees with service both before and after the Postal Service's establishment, the federal government and the Postal Service share responsibility for CSRS pensions. The federal government pays for service through 1971, and the Postal Service pays for service after 1971.

Responsibility for paying the CSRS costs resulting from inflationary salary increases since July 1, 1971, shifted from the federal government to the Postal Service by statute in 1974. In the late 1980s and early 1990s, a series of laws obligated the Postal Service to fund retiree cost-of-living adjustments (COLAs) since 1971.

Even though the Postal Service was making the newly required payments towards funding its CSRS liabilities in full, no one calculated how well it was meeting this goal until the Government Accountability Office (GAO) drew attention to the issue.² The Office of Personnel Management (OPM) then evaluated the Postal Service's assets and liabilities in 2002 and discovered that the Postal Service would overfund its CSRS obligations by nearly \$78 billion unless the required payments were reduced to reasonable levels.³ The Postal Service's CSRS contributions had earned an interest rate much higher than the 5 percent assumed by OPM, resulting in a large surplus.

OPM established assumptions about how the Postal Service and the federal government would divide the CSRS obligations for postal employees who worked before and after July 1, 1971.⁴ Under OPM's methodology, the Postal Service is responsible for *all* pay increases since 1971. OPM assumes no responsibility for inflationary increases to salaries from the Post Office Department era. In effect, OPM

¹ The Postal Reorganization Act, however, did require the Postal Service to pay administrative costs to the Civil Service Commission, the forerunner of the Office of Personnel Management. This requirement was later removed.

² GAO, *United States Postal Service: Information on Retirement Plans*, (GAO-02-170, December 2001).

³ The amount of the overfunding was initially estimated as \$71 billion and later revised to \$78 billion. In addition, OPM's estimate made the Postal Service responsible for CSRS military service credits. The GAO reported that the overfunding increased to \$105 billion if the federal government retained responsibility for CSRS military service credits. The Postal Accountability and Enhancement Act returned the amount the Postal Service had been overcharged for CSRS military service credits to the Postal CSRS Fund.

⁴ This allocation of CSRS liabilities concerns employees with service prior to 1971.

calculates the federal government's share for these employees as if they retired in 1971 at their 1971 salaries.

Under the current OPM system for federal retirees, CSRS retirees receive a percentage of their highest 3-year average salary for every year they served. Thus, the critical factors for determining the size of the annuity are years of service and the high-3 salary. The fact that lower salaries were received early in an employee's career is irrelevant to the final pension calculation, because salaries increase throughout that career. This method of calculating the annuity is highly suggestive that years of service is the appropriate basis for allocating CSRS pension responsibility.

The U.S. Postal Service Office of Inspector General (OIG) commissioned the actuarial firm Hay Group to review the allocation of CSRS liabilities between the Postal Service and the federal government. The following report, *Evaluation of the USPS Postal CSRS Fund for Employees Enrolled in the Civil Service Retirement System*, describes the results of Hay Group's analysis.

Several key points emerge from the report and the OIG's analysis:

- OPM's use of years of service and the high-3 salary as the basis for determining CSRS pension benefits strongly suggests that responsibility for CSRS pension payments should be divided between the Postal Service and the federal government based on years of service.
- The current methodology used to allocate CSRS obligations for employees with service prior to July 1, 1971, is not based on years of service and is inequitable to the Postal Service. For example, Hay Group shows how the Postal Service could be responsible for 70 percent of the pension of an employee who worked only 50 percent of his or her career for the Postal Service.
- Every time postal employees receive a pay increase, their CSRS benefits, including any earned at the Post Office Department, grow in value. The Postal Service must pay for this increase not only for post-1971 service but also for the years of service before 1971. An allocation methodology that assumes employees will receive no pay increases — not even to offset inflation — is not reasonable.
- Furthermore, had new pension plans been created for postal employees on July 1, 1971, and the Postal Service made responsible for all liabilities, it would have paid less than under the current methodology. The Postal Service would not have had to fund the additional liability that results when a pay raise increases the value of the years of service performed for the Post Office Department.
- It is instructive that OPM uses a years-of-service methodology to allocate the cost of retiree *health care* premiums for retirees who split their careers between the Post Office Department and the Postal Service.

- Allocating pension responsibility on a years-of-service basis would align the *pension* methodology OPM uses with the methodology OPM uses for retiree *health care* obligations. Currently, they are at odds with each other as they are applied to the Postal Service.
- Had the more equitable years-of-service allocation methodology been used to determine the value of the Postal CSRS Fund, the OIG estimates its value on September 30, 2009, would have been approximately \$273 billion rather than \$198 billion — a difference of \$75 billion.⁵
- It has been determined that a \$10 billion unfunded liability currently exists for the CSRS pension fund. Reducing the \$75 billion overpayment by \$10 billion still leaves a \$65 billion surplus.
- If the \$65 billion pension surplus were transferred into the Postal Service Retiree Health Benefits Fund and combined with the \$35 billion already set aside, the total value of the *health benefits* fund would grow to \$100 billion. Moreover, even at 5 percent interest, the balance of the fund would increase \$5 billion or more each year.
- The \$100 billion balance in the retiree health benefits fund would be more than sufficient to cover the \$87 billion OPM estimates the Postal Service has accrued in retiree health care liability as of the end of 2009. No further payments to the fund would be needed to cover this liability.
- Since all of the Postal Service's accrued liabilities for retiree health benefits would be fully funded, the seven remaining annual payments to the retiree health benefits fund, which average \$5.6 billion each, could end.
- In addition, Postal Service payments for the health benefit premiums of current retirees could start coming from the retiree health benefits fund immediately.
- The annual evaluation of the Postal Service's retiree health benefit assets and liabilities would continue, and the Postal Service could be assessed if there were any future unfunded liability.

The Postal Service was intended to be an independent, self-sufficient entity, yet during the period when postal rates were set to cover costs, citizens and businesses were charged far in excess of what was needed to fund CSRS benefits. Today, the Postal Service continues to be assigned an unfair share of CSRS liabilities. Postal ratepayers should not be burdened with federal liabilities. Instead, they should be credited for their previous overpayments. Ending the unfair allocation of CSRS liabilities would result in a

⁵ Hay Group estimates the difference in the value of the Postal CSRS Fund as of September 30, 2006, to be \$58.7 billion. The OIG's estimate extends Hay Group's analysis to 2009. Both estimates only measure the change in the value of the Postal CSRS Fund and do not include the reduction in liability from allocating a smaller share of CSRS payments to the Postal Service in the future. This change in liability would further increase the Postal Service's CSRS surplus.

CSRS surplus that could be used to fully discharge accrued retiree health care liabilities. This would put the Postal Service on a sound financial footing. All of its current obligations to its retirees (both pension and health care) would be fully funded.

Freeing the Postal Service from unjustified legacy costs is critical if the Postal Service is to have the agility it needs to face an uncertain future. A new, equitable CSRS cost allocation methodology should be established based on years of service. The resulting CSRS surplus can then be transferred into the retiree health benefits fund. Such a transfer is not unprecedented. A similar transfer happened in 2007 and is scheduled to occur for any CSRS surplus in 2015.

January 11, 2010

U.S. Postal Service

Evaluation of the USPS Postal CSRS Fund for
Employees Enrolled in the Civil Service
Retirement System

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I. EXECUTIVE SUMMARY

The United States Postal Service (USPS) and the Federal government share responsibility for the Civil Service Retirement System (CSRS) pension obligations of postal employees who were hired prior to the establishment of the Postal Service on July 1, 1971, and continued working after 1971. The current method of allocating these obligations, as developed by the Office of Personnel Management (OPM), is inequitable to the Postal Service. As demonstrated in this paper, for employees who worked half of their careers with the United States Post Office Department (USPOD) and half with the USPS, the Postal Service is assigned approximately 70 percent of the cost and the Federal government 30 percent. For an employee who worked 30 years, 20 years before 1971 and 10 years with the USPS, the Postal Service is assigned 50 percent of the cost.

Under the current methodology, the Federal government's portion of the liability is calculated using employees' salary levels as of June 30, 1971. Since the highest salaries earned over a career are the only salaries used to calculate the amount of an annual CSRS pension, 1971 salary levels should not be considered in the allocation of liabilities. The methodology currently employed results in a significantly higher proportion of the liability being placed upon the Postal Service than would be the case if other, more equitable approaches were to be used.

In a similar manner, pension obligations for District of Columbia (D.C.) employees were transferred from the Federal government to the D.C. government without sufficient funds to cover salary increases. The resulting obligation, described in a report by the Brookings Institution as a "massive, federally created pension liability", threatened to bankrupt the city. Ultimately, the pension liabilities associated with D.C. employees' prior Federal service were returned to the Federal government.

Instead of using OPM's methodology, a more equitable and financially sustainable "years of service" methodology could be used to allocate liabilities. In this case, the total pension liability for each beneficiary would be allocated based on the number of years of service rendered to each entity. This approach would be consistent with the methodology OPM applied for cost-of-living adjustments (COLAs) prior to the enactment of Public Law (P.L.)108-18 in 2003.

The Postal Service appealed to the CSRS Board of Actuaries on the use of frozen 1971 salaries for the allocation of obligations between the USPOD and USPS. The Board noted that the approach used was common practice in the private sector and upheld the use of the OPM

methodology. However, unlike the private sector, the USPS did not and does not have the ability to modify the pension benefit levels earned after 1971. Furthermore, typical private sector practice on sales and acquisitions includes asset purchases where other elements in the transaction compensate for legacy pension obligations.

This paper identifies private sector situations where continuity of business with the same employees receiving the same benefits was a key consideration for the “new” employer – in situations similar to the USPOD/USPS transition. The private industry examples are in the telecommunications industry which, like the USPS, provides a utility service to a national set of customers and relies on continuity of labor contracts to ensure uninterrupted service. In both situations, the pension assets transferred to the new employer were sufficient to cover the benefits earned by the former employer with allowance for projected salary increases to retirement.

Using this more equitable allocation methodology, the value of the Postal CSRS Fund, as of September 30, 2006, would increase from \$207.6 billion to \$266.3 billion, a difference of \$58.7 billion.

II. BACKGROUND

The United States Postal Service was established on July 1, 1971 as an independent establishment of the Executive branch. Prior to its reorganization as an independent government entity, the Postal Service had been a line agency of the Federal government known as the United States Post Office Department (USPOD).

Employees of the USPOD who were participants in the CSRS remained covered for retirement benefits when they became employees of the Postal Service.

Pension benefits are provided to employees of the USPOD and the Postal Service under CSRS based on their combined service. The benefit paid to retirees is a function of the employee's final average salary as well as the number of years of employment. Employees contribute a fixed percent of their salary towards the cost of the benefit and the employer funds the balance of the cost. Employees who were participants in the CSRS are generally not participants in the Social Security system.

Prior to 2003 the Postal Service's funding obligations were governed by three requirements. The first requirement, which was the same funding requirement as other Federal agencies, was an employer contribution or Normal Cost amount. The Normal Cost is the amount deemed sufficient to fund the benefit earned in the year, based on the employee's current salary. The Normal Cost contribution was determined using an actuarial funding model that did not anticipate future pay increases.

The second requirement took effect in 1974 with the passage of P.L. 93-349. This law required that, in addition to the Normal Cost payments, the Postal Service would be required to fund the increases in pension liabilities resulting from pay increases. As the pension benefit is based on the employees' final average salary, when employees received a salary increase, this increased the value of the accrued benefit. This increase in liability is attributable to the pay increase applied to benefits earned in all prior years. These increases in liability were funded by level dollar payments over 30 years from the date of each measurement.

The third pension funding obligation became effective in 1989 through the passage of P.L. 101-239 and in 1990 through the passage of P.L. 101-508. Under the statutes, the Postal Service was required to fund, in 15 equal annual payments, increases in pension liabilities resulting from cost-of-living allowances (COLAs) granted to Postal Service retirees in 1990 and later years. For employees who had been employed by the USPOD prior to 1971, this liability would be split between the Federal government and the Postal Service based on the number of years of

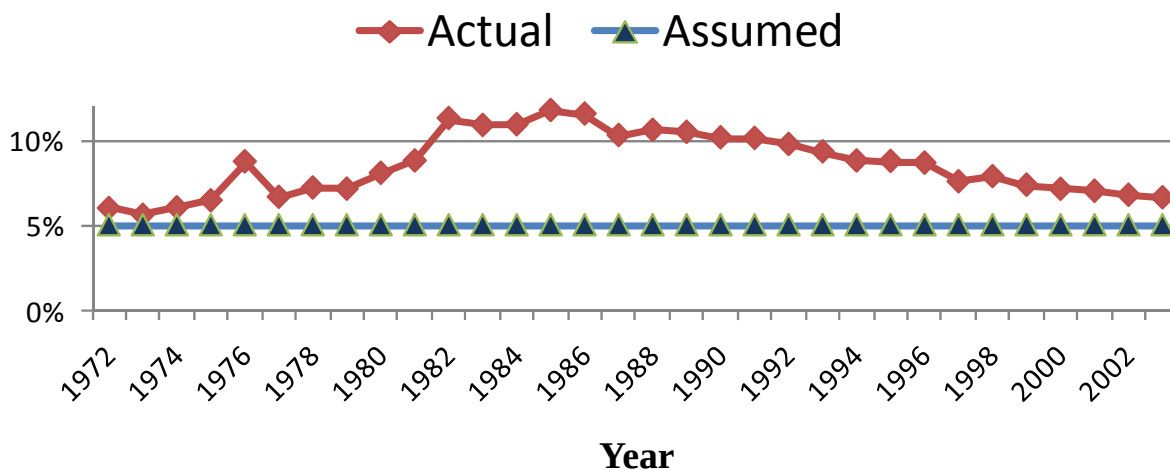
employment under each entity. Under P.L. 101-239, this obligation was effective upon the Postal Service only for employees who retired after September 30, 1986. In 1990, P.L. 101-508 required that the Postal Service assume responsibility for this liability for all employees who had retired since July 1, 1971 and to make retroactive payments for COLAs already paid by the Federal government. In 1993, P.L. 103-66 made the Postal Service responsible for paying interest on these retroactive payments.

The funding requirements were based solely on the liabilities accrued for pension benefits and did not take into account actuarial gains or losses from investment earnings on the funds.

Chart 2.1 compares the actual annual return earned by the Postal Service's share of the Civil Service Retirement and Disability Fund (Postal CSRS Fund), to the assumed investment return used in the measurement of the liabilities.

Chart 2.1

Actual Return Far Exceeded the Assumed Investment Earnings on the Postal CSRS Fund



Prior to the public laws mentioned above, the funding of CSRS benefits for USPS employees was based on a “static” actuarial model that did not take account of pay increases (prior to P.L. 93-349) or cost-of-living-allowances (prior to P.L. 101-239 as amended by P.L. 101-508) until after they had been awarded. This funding model did not take account of the size of the Postal CSRS assets in the CSRS fund.

Transition to Actuarial Funding

P.L. 108-18 was signed into law in April 2003. With its passage, the Postal Service CSRS pension obligation was completely redefined. Under the new law, the Postal Service was required to fund CSRS pension benefits based on a “dynamic actuarial model”. A “dynamic actuarial model” anticipates the effect of inflation, which includes both increases in salary and cost of living adjustments on pensions in payment.

For employees hired on or after July 1, 1971, the Postal Service would be responsible for all CSRS benefits attributable to the service of its employees. For employees hired before July 1, 1971 who remained employed after the Postal Service’s reorganization, OPM was tasked with the development of a method by which to allocate the cost of pension benefits between the Federal government and the Postal Service.

Under the method developed by OPM, the first calculation is the total present value of future pension benefits. OPM then allocates the total cost between the Postal Service and the Federal government. The liability attributable to the Federal government is calculated as if employment had terminated upon reorganization in 1971; this calculation is based on the years of service up to June 30, 1971, and on the final salary earned as of June 1971. The Federal share is then subtracted from the total pension obligation, and the remaining amount is allocated as the responsibility of the Postal Service.

In 2004, the Postal Service requested that the method for allocating the CSRS pension liability under P.L. 108-18 be reconsidered. The request was denied by the CSRS Board of Actuaries based on the existence of P.L. 93-349. As previously stated, this statute, which was passed in 1974, required that the Postal Service finance all increases in retirement liabilities attributable to all salary increases granted on or after July 1, 1971. The rationale behind this requirement was that Congress has no control over the pay machinery in the Postal Service. The letter from the Board of Actuaries is included in Appendix B.

III. CALCULATION OF POSTAL SERVICE LIABILITY

The CSRS pension benefit amount received by each employee can be divided into portions earned through each year of employment. The amount received for each year is calculated based on the highest three consecutive salaries earned over an employee's career at the USPOD or Postal Service. Under current law, the Federal government's obligation for each pre-1971 year of service is calculated based on the salary earned as of June 30, 1971. The June 30, 1971 salary will, in almost all cases, be less than the highest three consecutive salaries earned over an entire career. In many cases, the average salary earned over a career can be significantly higher than the June 30, 1971 salary. Under the described methodology, for pre-1971 service, there is a gap between

- A. The pension amount calculated based on the June 30, 1971 salary, and
- B. The pension amount calculated based on overall career highest three consecutive salaries.

Item A above is the total liability which is allocated to the Federal government. Item B above is the amount actually received by the beneficiary for pre-1971 service. Under the current methodology, the liability associated with the gap between the two pension amounts is allocated to the Postal Service. This gap exists due to two factors: pre-1971 employment, and post-1971 salary increases.

No Pay Increase Assumption

It is unrealistic to assume that employees would have had no pay increases after 1971 had they remained employees of the USPOD. The enabling legislation that created the Postal Service included provisions and protections that ensured employees were treated fairly and that their pay and benefits remained comparable to the terms and conditions before postal reorganization.

Continuity of Service

The Postal Reorganization Act required that USPOD employees who were members of the CSRS remain covered for pension purposes under CSRS. If the USPS had been granted the freedom and flexibility to establish new and separate pension plans for its employees and provide benefits only from July 1971, then the gap would not exist, instead, the employees would have retired on smaller pensions.

As the gap described above is attributable to pre-1971 employment, the allocation of the associated liability to the post-1971 employer is inequitable.

A Technical Description of the Calculation of an Annual CSRS Pension

There are three steps in the process of determining a CSRS employee's annual pension benefit.

1. The highest three consecutive annual salaries earned over an employee's Postal Service career are averaged together. This average is referred to as the "high-three salary".
2. For each year employed, the high-three salary is multiplied by a specified percentage as follows. For each of the first five years of employment, the high-three salary is multiplied by 1.5 percent. For each of the next five years, the high-three salary is multiplied by 1.75 percent. For all subsequent years, the high-three salary is multiplied by 2 percent.
3. The results from step two are added together to arrive at the annual pension benefit.¹

The following table provides an illustration of the calculation. In this example, an employee worked for 12 years with a high-three salary of \$30,000.

Table 3.1 Calculation of CSRS Annual Pension Benefit for Employee with 12 Years of Service and High-Three salary of \$30,000			
Year	High-Three Salary	Benefit Earned	Pension Amount
(A)	(B)	(C)	(D) = (B) times (C)
1	\$30,000	1.50%	\$450
2	\$30,000	1.50%	\$450
3	\$30,000	1.50%	\$450
4	\$30,000	1.50%	\$450
5	\$30,000	1.50%	\$450
6	\$30,000	1.75%	\$525
7	\$30,000	1.75%	\$525
8	\$30,000	1.75%	\$525

¹ As a technical note, an employee's maximum pension is equal to 80 percent of high-three salary plus any amounts earned through unused sick leave at retirement. Thus if the calculation described above results in a value which is greater than the high-three salary multiplied by 80 percent, the employee will receive an annual pension benefit equal to the high-three salary multiplied by eighty percent, plus the pension amount earned through conversion of unused sick leave.

Table 3.1 Calculation of CSRS Annual Pension Benefit for Employee with 12 Years of Service and High-Three salary of \$30,000			
Year	High-Three Salary	Benefit Earned	Pension Amount
(A)	(B)	(C)	(D) = (B) times (C)
9	\$30,000	1.75%	\$525
10	\$30,000	1.75%	\$525
11	\$30,000	2.00%	\$600
12	\$30,000	2.00%	\$600
Total			\$6,075

In column (D) above, the high-three salary is multiplied by each of the yearly percentages. The total value of \$6,075 is the sum of the values in column (D) and is equal to the annual pension benefit received.

When calculating the Federal share of the liability, OPM's methodology uses a different high-three salary. The high-three salary used is equal to the last salary earned in 1971. The Federal share is then calculated by multiplying the revised high-three salary by each of the percentages specified previously as applied to pre-1971 service. The Postal Service then pays the difference between the pension benefit received and the Federal share.

IV. PRACTICAL EXAMPLES OF THE USE OF THE OPM METHODOLOGY

While there have been many occasions in which retirement liabilities have been allocated between two employers, there is no actuarial standard or statutory methodology to be utilized in the process. This section of the report includes three examples of the practical implications of the use of OPM's allocation methodology. We believe these examples highlight the inequity of the current arrangement.

Example 1:

A beneficiary had a high-three salary of \$30,000 in 1986 and was employed for a total of 30 years, 15 years with the USPOD (prior to July 1, 1971) and 15 years with the Postal Service (post-1971).

After 30 years, the benefit accrual is 56.25 percent of the high-three salary, as shown in the following table.

Table 4.1 Accrual of Pension Benefit Under Example 1		
Accrual Percentage	Years of Service	Benefit Accrual
1.50%	5	7.50%
1.75%	5	8.75%
2.00%	20	40.00%
Total	30	56.25%

The pension earned is therefore 56.25% times \$30,000, which is an annual benefit of \$16,875 at retirement.

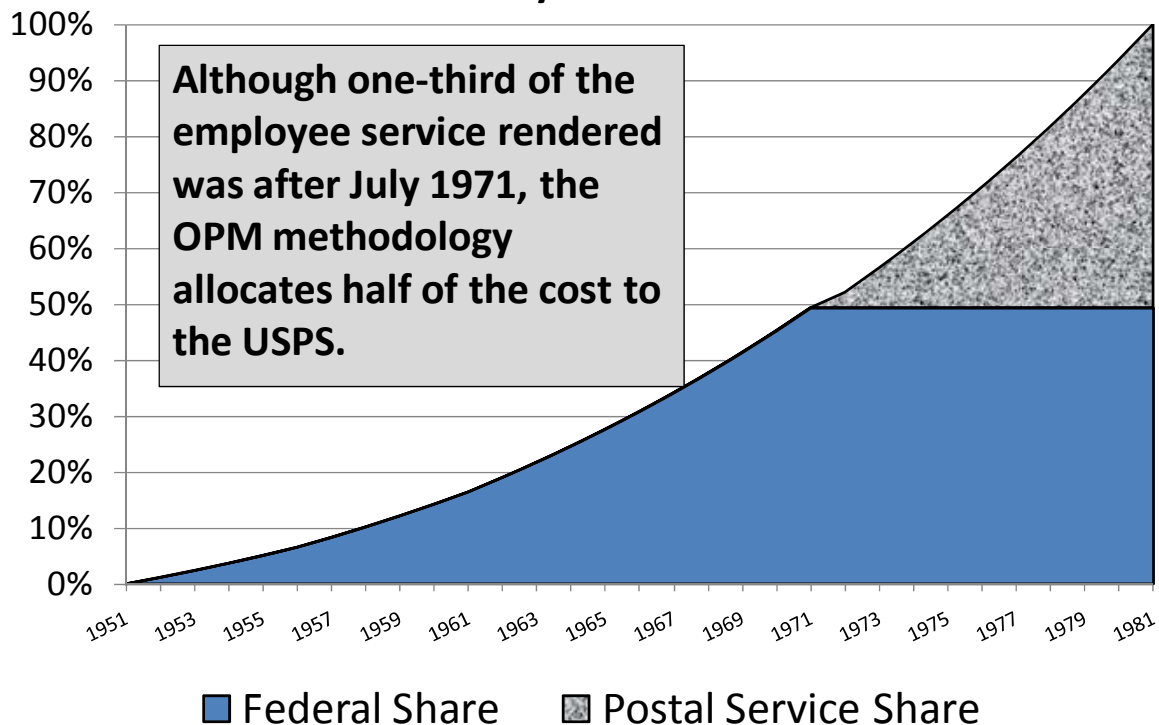
Under the OPM approach, when calculating the Federal share of the liability, a different high-three salary is used. The high-three salary used is equal to the June 1971 salary. For an employee whose salary increased every year by 3.25 percent, the June 1971 salary would be \$19,165. The Federal share is then calculated by multiplying \$19,165 by each of the percentages specified previously. This calculation is done only for the years while employed by the USPOD.

Table 4.2 Calculation of the Federal Share of the Liability in Example 1		
Accrual Percentage	Years of Service	Benefit Accrual
1.50%	5	7.50%
1.75%	5	8.75%
2.00%	5	10.00%
Total	15	26.25%

Of the total pension, the portion deemed to be the responsibility of the Federal government is \$5,031 (26.25% times \$19,165). Thus while the beneficiary was employed by each entity for equal number of years, 30 percent of the liability is allocated to the Federal government while the remaining 70 percent is allocated to the Postal Service.

Chart 4.1 shows the annual pension for this employee after each year of service. The solid area of the chart shows the amount of the annual pension allocated to the Federal government while the marbled area shows the amount allocated to the Postal Service.

Chart 4.1

OPM Method Unfairly Allocates the Pension Benefit

After 30 years of service, the employee has earned an annual pension benefit of close to \$17,000. Upon retirement, the Federal government is responsible for \$5,031 of the annual pension, or 30 percent as shown above. The illustration is based on annual salary increases of 3.25 percent. The average actual salary increases after 1971 were substantially higher than 3.25 percent, as this was a period of abnormally high inflation. Using actual salary increase rates lowers the Federal share to 20 percent and increases the Postal Service share to 80 percent.

Example 2:

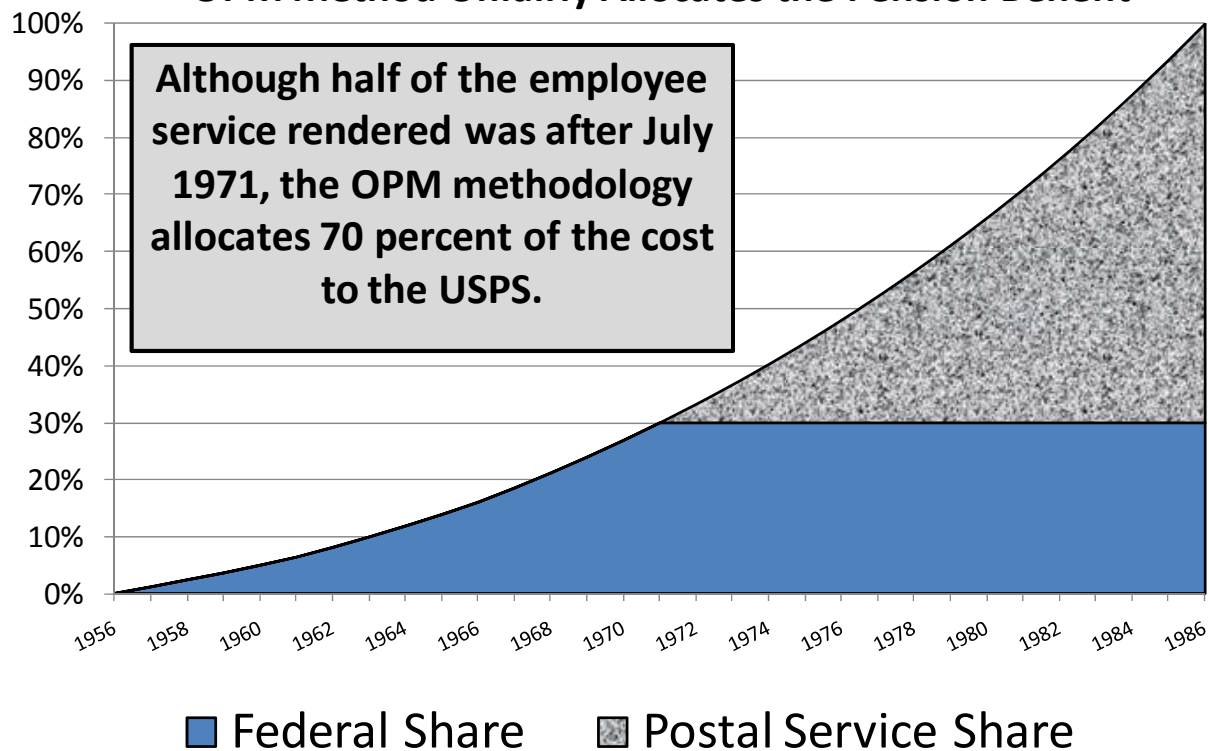
An employee had a high-three salary of \$30,000, 30 years of service, was hired before July 1, 1971, and retired after July 1, 1971. Hay Group performed an analysis to determine, using OPM's methodology, the number of years of Federal service at which point 50 percent of the total pension liability would be allocated to the Federal government and 50 percent to the Postal Service. The result was that, for an employee with approximately 20 years of pre-1971, and 10 years of post-1971 service, the pension liability was split evenly. Thus, despite the fact that this

beneficiary's employment under the Federal government was twice as long as employment under the Postal Service, 50 percent of the pension liability would be allocated to the Postal Service.

Chart 4.2 shows the annual pension for this employee after each year of service. The solid area of the chart shows the amount of the annual pension allocated to the Federal government while the marbled area shows the amount allocated to the Postal Service.

Chart 4.2

OPM Method Unfairly Allocates the Pension Benefit



Example 3:

An employee had a constant salary of \$30,000, worked for 15 years prior to 1971, and worked for 15 years after 1971. This employee's high-three salary would equal \$30,000 and a total pension benefit of \$16,875 would be earned. Using OPM's methodology to allocate the liability, 47 percent of the total liability would be allocated to the Federal government, while 53 percent would be allocated to the Postal Service. This uneven cost allocation occurs despite no salary increases and despite employment periods of equal durations.

The CSRS formula for calculating beneficiaries' yearly pensions is such that more dollar amounts are earned toward the pension for later years of service. For each of the first 5 years of service, 1.5 percent of the high-three salary is earned. For each of the next 5 years, a greater amount, 1.75 percent, of the high-three salary is earned. For subsequent years, 2 percent of the high-three salary is earned.

Table 4.3 illustrates this idea for a beneficiary with a high-three salary of \$30,000.

Table 4.3 Amount Earned Toward Annual Pension for Each Year of Service For an Employee with a High-Three Salary of \$30,000			
Years	Percent Earned	High-Three Salary	Earned per Year of Service
1-5	1.50%	\$30,000	\$450
6-10	1.75%	\$30,000	\$525
11+	2.00%	\$30,000	\$600

For each of the first 5 years, the beneficiary earned \$450 toward his annual pension. For each of the next 5 years, he earned \$525. For each subsequent year, he earned \$600. Using OPM's methodology, the liability associated with years 1 through 15 is allocated to the Federal government. Thus for each year of this beneficiary's employment, the Postal Service would be obligated to pay \$600 toward his pension, while the Federal government would pay lesser amounts for most years of service.

V. AN HISTORICAL EXAMPLE OF THE IMPACT OF AN UNFAIR ALLOCATION METHODOLOGY

We are aware of at least one situation in which a new retirement plan sponsor assumed pension responsibility from the Federal government and the allocation methodology used did not cover the expected increase in employees' salaries. The resulting impact was an increasing burden on the plan sponsor that caused the financing cost of the arrangement to become unaffordable, resulting in the need for a law change to transfer the liability back to the Federal government.

District of Columbia Government

Between 1916 and 1970, Congress established separate pension plans with funds deposited in the U.S. Treasury for police officers and firefighters, teachers, and judges in the District of Columbia (D.C.). The funding of these plans, however, was not actuarially sufficient to cover all of the liabilities. At the commencement of home rule in 1975, the unfunded pension liability was equal to \$2 billion. By 1979, when the District of Columbia Retirement Reform Act (P.L. 96-122) set up D.C. pension funds for these plans, the unfunded liability had grown to \$2.65 billion.

The Retirement Reform Act committed the Federal government to make payments for 80 percent of the liability for plan participants who retired normally prior to the start of home rule.² D.C. retained responsibility for the remaining pre-home rule liability and for all liability from participants whose service continued under home rule. Participants with continuing service accounted for the largest share of the unfunded liability, and D.C. was responsible for 76 percent of the total unfunded liabilities.

As a result of the allocation methodology, the D.C. pension plans had a large unfunded liability attributable to the past service. By 1996, even though D.C. paid far in excess of the normal cost each year, the associated pension liability had grown to \$5 billion mainly due to interest. The required pension payments cost the city \$337 million dollars, or nearly 8 percent of D.C.'s general expenditures that year. Furthermore, the existence of a liability so proportionately large made it difficult and expensive for the District government to borrow money. This liability had been primarily incurred through service to D.C. when it was run as part of the Federal government, so that at the start of home rule, the D.C. pension plans were already burdened by unfunded liabilities. The large unfunded liability transferred to the D.C. government had created an untenable financial burden which threatened to bankrupt the city.

² The Federal government was responsible for only 33.3 percent of disability retirements.

The resolution to this problem came through the enactment of the National Capital Revitalization and Self-Government Improvement Act of 1997 (P.L. 105-33). Under this act, the retirement plans for police officers and firefighters and teachers were frozen as of June 30, 1997, and all liabilities as of this date were transferred to the Federal government. D.C. created new pension plans for these employees for service starting on or after July 1, 1997. The pension plan for judges was transferred to the Federal government along with responsibility for the D.C. courts. The Revitalization Act specifically noted that “the growth of the unfunded liabilities of the three pension funds listed above did not occur because of any action taken or any failure to act that lay within the power of the District of Columbia government or the District of Columbia Retirement Board.”³

³ P.L. 105-33, Sec. 11002(a)(4).

VI. HISTORICAL EXAMPLES OF THE USE OF AN ALTERNATIVE METHODOLOGY

We are aware of several situations where the costs for pensionable service accrued prior to a transfer date were determined using projected final salary at retirement, rather than the accrued benefit at date of transfer. The primary goal of this alternative method was to ensure the ongoing costs for the new plan sponsor were reasonable and affordable.

AT&T Corp. Spinoff of Lucent Technologies

Effective October 1, 1996, AT&T Corp. (“AT&T”) spun off certain operations to a stand-alone company named Lucent Technologies, Inc. (“Lucent”). (Lucent has since merged with Alcatel to form Alcatel-Lucent.) As of October 1, 1996, actuarial calculations were performed to determine the amount of pension assets that would spin off from AT&T’s Group Pension Trust, which held the assets of the AT&T Management Pension Plan and the AT&T Pension Plan, to a pension trust established for the funding of Lucent’s two pension plans.

On September 30, 1996, both AT&T plans were in a surplus position based on the comparison of fair market value of assets to projected benefit obligation. In Lucent’s 10-K disclosure as of October 1, 1996, Lucent described that the pension obligations for Lucent’s active employees and retirees would be transferred to Lucent’s pension plans and that assets of AT&T’s Group Pension Trust would be divided between AT&T and Lucent trusts. In this way, “each plan’s participating master trust receives the legally required amount to meet the minimum requirements set forth in applicable benefit and tax regulations and a sufficient amount of additional assets to ensure, at October 1, 1996, compliance with AT&T’s previously established pension funding policy.”

The “minimum requirements” phrasing in the asset transfer description refers to requirements under the Employee Retirement Income Security Act (ERISA) for all private employer pension asset transfers, as specified in ERISA Section 4044 and related sections of the Internal Revenue Code and regulations. Thus, the minimum amount of assets transferred to Lucent would meet legal requirements.

The “compliance with AT&T’s previously established pension funding policy” part of the description was based on a complex set of actuarial calculations involving stochastic modeling of the plans’ assets. Basically, the funding goal for each AT&T pension plan was for each plan to be fully funded (assets fully covering plan liabilities) with a certain probability in five years and another probability in ten years, beginning at October 1, 1996. The asset transfer methodology

would determine the amount of assets as of October 1, 1996 necessary to meet these criteria, separately for AT&T and Lucent, and separately by plan. To the extent that the total asset amounts determined under the asset transfer methodology for each plan differed from the total assets for each plan, the excess or deficit would be split evenly between AT&T and Lucent.

Based on the liability and asset amounts disclosed in Lucent's 10-K as of October 1, 1996, the total impact of the asset transfer methodology was to provide Lucent assets in excess of its total projected benefit obligation, which, for plans featuring salary-based pension formulas, includes the impact of future salary increases. As of September 30, 1996, AT&T's total fair market value of pension assets was \$49.1 billion, compared with the projected benefit obligation of \$35.1 billion. This spinoff ensured that the assets allocated to Lucent (\$29.2 billion) were sufficient to cover the pension benefits accrued through service with AT&T with salaries projected to retirement (\$20.8 billion), and that the ongoing cost for both accounting and funding purposes did not strain the financial resources of the new Lucent company.

Subsequent Spinoff of Avaya from Lucent Technologies

A similar approach was used several years later when Lucent Technologies spun off Avaya. The assets transferred to Avaya were sufficient to cover the cost of pensions based, not on the salary at the date of the spin-off, but at the expected retirement date.

VII. FINANCIAL IMPACT

There are other, more equitable, methodologies which can be used to allocate pension liabilities between the Postal Service and the Federal government. One such methodology would be based upon the proportion of total years of service which were rendered to the USPOD and the Postal Service respectively. In this case, the percentage of the total number of service years which were spent under the employment of the Federal government prior to July 1, 1971, would be calculated. This percentage of the total pension (and therefore the total liability) would be allocated to the Federal government. The same process would be used to calculate the portion of the pension attributable to the Postal Service (and therefore the Postal Service liability). For example, an employee who was hired 10 years prior to the establishment of the Postal Service and who retired 30 years after its establishment has 40 years of service in total; 10 as a USPOD employee and 30 as a Postal Service employee. Of the employee's total pension benefit, 25 percent ($10 / 40 = 25\%$) would be the responsibility of the Federal government, and 75 percent ($30 / 40 = 75\%$) would be the responsibility of the Postal Service.

This "years of service" approach is the same approach which is currently used in allocating the health care premiums for retirees with both USPOD and USPS employment service periods. OPM already calculates the years of service for each retiree and assigns the appropriate portion of the employer premium to the USPS.

Hay Group calculated the value of the Postal CSRS Fund using the years of service methodology. The calculation entailed the following process.

For the years 2005 through 2009, each year's pension liability was allocated based on the actual known percentages of the retiree healthcare premiums which OPM allocated between the Postal Service and the Federal government. The share of the retiree healthcare premiums attributable to the USPS (for post-1971 service) has increased steadily. For the years 1971 through 2004, the percentage of the total liability allocated to the USPS was calculated as a flat percentage decrease from the 2005 value to 0 percent in 1971. The rate of change was found to be just less than 2 percent per year.

Using these proportions for allocating the CSRS pension benefits, Hay Group updated the projection of the Postal CSRS Fund, using the actual employer and member contributions and the actual annual investment returns.

Table 7.1 shows the results of these calculations on the Postal CSRS Fund. Note that the Postal Liability would change too, however this analysis is limited to the analysis of the years of service

methodology on the Postal CSRS Fund. The first row shows the surplus determination using the OPM methodology. The Postal CSRS Fund was found to be \$207.6 billion, the Postal Liability was determined to be \$190.5 billion, resulting in a surplus of \$17.1 billion that was transferred to the Postal Service Retiree Health Benefits Fund (PSRHB). The second row shows the surplus determination using the years of service methodology. The Postal CSRS Fund is \$266.3 billion, subtracting the Postal Liability (determined using the OPM methodology) results in a surplus of \$75.8 billion, or \$58.7 billion more than was transferred to the PSRHB.

Table 7.1 Surplus Determination as of September 30, 2006 (\$billions)			
	Postal CSRS Fund	Postal Liability	Surplus
OPM Methodology	\$207.6	\$190.5	\$17.1
Years of Service Methodology	\$266.3	\$190.5	\$75.8
Difference	\$58.7	-	\$58.7

Chart 7.1 shows the progress of the Postal CSRS Fund under the OPM methodology and under the years of service methodology.

Chart 7.1

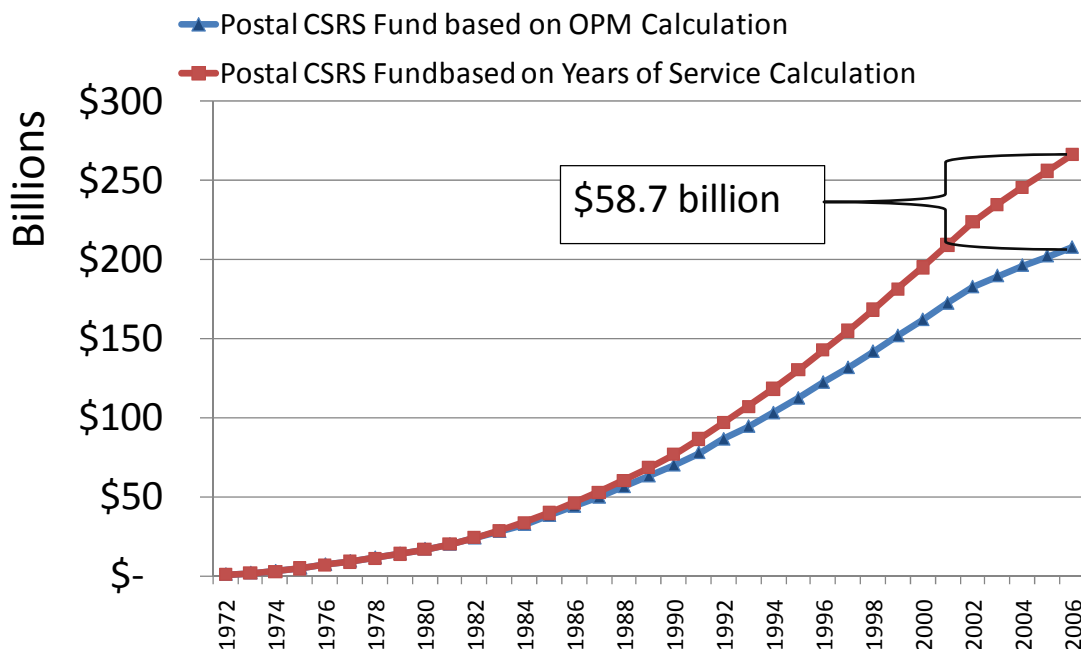


Table 7.2 shows the value of the Postal CSRS Fund (in \$millions) under the two methodologies. The line labeled “OPM Calculation” shows the yearly value of the Postal CSRS Fund as calculated using OPM’s methodology. The line labeled “Years of Service Calculation” shows the yearly value of the Postal CSRS Fund as calculated using a years of service methodology

Table 7.2 Value of Postal CSRS Fund as Calculated Under the OPM and Years of Service Calculations (\$millions)		
Year	Postal CSRS Fund based on OPM Calculation	Postal CSRS Fund based on Years of Service Calculation
1972	\$925	\$925
1973	1,903	1,892
1974	3,062	3,027
1975	4,892	4,819
1976	7,225	7,100
1977	9,317	9,171
1978	11,522	11,382
1979	14,107	14,009
1980	16,964	16,967
1981	19,989	20,186
1982	23,874	24,319
1983	28,087	28,843
1984	32,533	33,702
1985	38,117	39,843
1986	43,964	46,396
1987	49,733	52,998
1988	56,365	60,674
1989	63,114	68,662
1990	70,047	77,043
1991	77,870	86,575
1992	86,421	96,980
1993	94,518	107,403
1994	103,000	118,306
1995	112,314	130,221
1996	122,292	142,991
1997	131,625	155,147
1998	141,835	168,482
1999	151,780	181,675
2000	161,932	195,283
2001	172,305	209,376
2002	182,696	223,705

Table 7.2 Value of Postal CSRS Fund as Calculated Under the OPM and Years of Service Calculations (\$millions)		
Year	Postal CSRS Fund based on OPM Calculation	Postal CSRS Fund based on Years of Service Calculation
2003	189,698	234,890
2004	196,274	245,758
2005	202,233	256,195
2006	207,638	266,320

As can be seen from Table 7.2, as of September 30, 2006, the Postal CSRS Fund had a value of \$266 billion using a years of service approach, compared with a value of \$208 billion using the OPM method.

APPENDIX A – Calculations Under a Years of Service Methodology

This appendix provides details on the process used in calculating the value of the Postal CSRS Fund using a years of service methodology.

Post Service employees participate in the Federal Employees Health Benefit Program (FEHBP). The annual cost of the premiums is shared by the employer and the retiree. For retirees who were first hired after July 1, 1971, USPS pays the full amount of the employer premium. For retirees who were hired before July 1, 1971, the employer retiree medical premiums are shared between the Federal government and the Postal Service. The portion allocated to the Postal Service is determined using a years of service approach. Table A-1 shows, for the years 2005 through 2008, the total employer portion of the retiree medical premium for the month of March (labeled Total Cost), the portion of the premium allocated to the Postal Service (labeled USPS Cost), and the calculated percentage of the total cost which this allocation represents.

Table A-1 Historical Post-Retirement Medical Costs and the Amounts Allocated to the Postal Service (Amounts in \$000s)			
Year	Total Cost	USPS Cost	USPS Percentage
2005	\$197,132	\$127,380	65%
2006	209,248	139,072	66%
2007	211,895	144,271	68%
2008	216,974	151,713	70%

The retiree medical premium costs were allocated using a years of service approach. In order to allocate each year's CSRS pension liability using a years of service approach, Hay Group used the same percentages which were used to allocate the retiree medical premium. For example, for the year 2005, as 65 percent of the retiree medical premium liability was allocated to the Postal Service, Hay Group allocated 65 percent of the total 2005 pension cost to the Postal Service.

For the years 1971 through 2004, the percentage allocated to the Postal Service was determined by a straightline interpolation. Upon its establishment in 1971, the Postal Service was responsible for 0 percent of that year's pension liability. If the Postal Service were responsible for an additional 1.955 percent of the total liability every year, then in 2005, the Postal Service would be responsible for 65 percent of the liability, which is the percentage that should be

allocated to the Postal Service for that year, based on the years of service cost allocation data as shown in Table A-1.

Table A-2 shows the percentage of each year's total CSRS pension liability allocated to the Postal Service for the years 1972 through 2006 under the OPM calculation and the years of service calculation.

Table A-2 Percentage of CSRS Pension Liability Allocated to the Postal Service under the OPM and Years of Service Calculation Methods		
Year	OPM Calculation	Years of Service Calculation
1972	0.1%	0.1%
1973	1.1%	2.1%
1974	2.3%	4.0%
1975	3.7%	6.0%
1976	6.1%	7.9%
1977	9.3%	9.9%
1978	12.5%	11.8%
1979	15.7%	13.8%
1980	19.1%	15.7%
1981	22.8%	17.7%
1982	25.0%	19.7%
1983	27.5%	21.6%
1984	30.6%	23.6%
1985	34.0%	25.5%
1986	37.1%	27.5%
1987	40.1%	29.4%
1988	43.2%	31.4%
1989	45.9%	33.3%
1990	48.7%	35.3%
1991	51.5%	37.2%
1992	53.5%	39.2%
1993	58.4%	41.2%
1994	59.6%	43.1%
1995	61.0%	45.1%
1996	62.6%	47.0%
1997	64.4%	49.0%
1998	66.2%	50.9%
1999	68.1%	52.9%
2000	70.2%	54.8%
2001	72.2%	56.8%
2002	74.2%	58.8%

Table A-2
Percentage of CSRS Pension Liability Allocated to the Postal Service
under the OPM and Years of Service Calculation Methods

2003	76.2%	60.7%
2004	78.6%	62.7%
2005	80.3%	64.6%
2006	81.9%	66.5%

Using the same employer and member contributions and the same annual investment returns as used by OPM, as well as the above proportions for allocating the CSRS pension benefits, Hay Group updated the projection of the Postal CSRS Fund. The result of these calculations was that, as of September 30, 2006, the Postal CSRS Fund value was determined to be \$266.3 billion. This is \$58.7 billion more than the amount determined using the OPM approach.

Table A-3 shows the projection of the Postal CSRS Fund value. The columns labeled “OPM Methodology” were calculated by OPM using OPM’s methodology. The columns labeled “Years of Service Methodology” were calculated by Hay Group as described above. The column labeled “30-Year Payment” shows payments made by the Postal Service to fund the increase in the present value of future retirement benefits resulting from general pay increases. These payments are made in 30 equal annual installments. The column labeled “15-Year/ 40-Year Payment” shows payments made by the Postal Service to fund the increases in the present value of future retirement benefits resulting from the granting of annuitant cost of living adjustments. These payments are made in equal annual installments.

Table A-3
Calculation of Postal CSRS Fund
Using the OPM Methodology and a Years of Service Methodology
(\$millions)

Year	Employee & Agency Contribution	30-Year Payment	15-Year/ 40-Year Payment	Total Benefit	Interest Rate	OPM Methodology			Years of Service Methodology	
						Federal Share	USPS Percentage Allocation	Postal CSRS Fund	USPS Percentage	Postal CSRS Fund
1972	\$899	\$0	\$0	\$932	6.04%	\$930	0%	\$925	0%	\$925
1973	912	0	0	1,074	5.64%	1,063	1%	1,903	2%	1,892
1974	1,043	0	0	1,318	6.07%	1,288	2%	3,062	4%	3,027
1975	1,098	561	0	1,614	6.48%	1,554	4%	4,892	6%	4,819
1976	1,600	385	0	2,353	8.74%	2,210	6%	7,225	8%	7,100
1977	1,262	507	0	2,103	6.68%	1,906	9%	9,317	10%	9,171

Table A-3
Calculation of Postal CSRS Fund
Using the OPM Methodology and a Years of Service Methodology
(\$millions)

Year	Employee & Agency Contribution	30-Year Payment	15-Year/ 40-Year Payment	Total Benefit	Interest Rate	OPM Methodology			Years of Service Methodology	
						Federal Share	USPS Percentage Allocation	Postal CSRS Fund	USPS Percentage	Postal CSRS Fund
1978	1,319	470	0	2,360	7.22%	2,066	12%	11,522	12%	11,382
1979	1,483	658	0	2,659	7.15%	2,242	16%	14,107	14%	14,009
1980	1,573	697	0	3,095	8.07%	2,504	19%	16,964	16%	16,967
1981	1,609	722	0	3,650	8.79%	2,818	23%	19,989	18%	20,186
1982	1,743	850	0	3,993	11.25%	2,995	25%	23,874	20%	24,319
1983	1,784	967	0	4,219	10.84%	3,058	28%	28,087	22%	28,843
1984	1,803	917	0	4,430	10.89%	3,072	31%	32,533	24%	33,702
1985	1,990	1,355	0	4,695	11.71%	3,099	34%	38,117	26%	39,843
1986	1,948	1,353	0	4,975	11.51%	3,128	37%	43,964	27%	46,396
1987	1,984	1,353	0	5,169	10.26%	3,094	40%	49,733	29%	52,998
1988	2,036	1,618	350	5,641	10.56%	3,206	43%	56,364	31%	60,674
1989	2,006	1,618	0	5,935	10.45%	3,208	46%	63,114	33%	68,662
1990	1,930	1,659	74	6,297	10.13%	3,231	49%	70,047	35%	77,043
1991	1,888	1,752	637	6,693	10.10%	3,246	52%	77,870	37%	86,575
1992	1,946	1,919	757	6,685	9.74%	3,106	54%	86,421	39%	96,980
1993	1,713	1,938	867	7,446	9.31%	3,098	58%	94,518	41%	107,403
1994	1,714	1,996	1,036	7,466	8.79%	3,013	60%	103,000	43%	118,306
1995	1,739	2,134	1,160	7,573	8.76%	2,954	61%	112,314	45%	130,221
1996	1,810	2,362	981	7,631	8.66%	2,853	63%	122,292	47%	142,991
1997	1,793	2,396	1,048	7,853	7.58%	2,799	64%	131,625	49%	155,147
1998	1,748	2,435	1,090	8,000	7.88%	2,703	66%	141,835	51%	168,482
1999	1,718	2,509	903	8,097	7.38%	2,580	68%	151,780	53%	181,675
2000	1,692	2,602	980	8,291	7.15%	2,470	70%	161,932	55%	195,283
2001	1,604	2,629	1,126	8,598	7.03%	2,387	72%	172,305	57%	209,376
2002	1,544	2,635	1,240	8,861	6.80%	2,285	74%	182,696	59%	223,705
2003	1,918	0	0	9,072	6.66%	2,157	76%	189,698	61%	234,890
2004	2,390	0	240	9,430	6.07%	2,018	79%	196,274	63%	245,758
2005	2,233	0	290	9,811	5.85%	1,933	80%	202,233	65%	256,195
2006	2,118	0	257	10,236	5.73%	1,852	82%	207,638	66%	266,320

Table A-4 compares the Postal CSRS Fund Surplus as of September 30, 2006 under the two methodologies.

Using the OPM methodology, the Postal CSRS Fund is \$207.6 billion, the Postal Liability (present value of all future benefits less present value of future employee contributions) is \$190.5 billion. As the Fund assets exceed the liability, the result was a surplus of \$17.1 billion, which was transferred to the PSRHBF.

Using the years of service methodology, the Postal CSRS Fund is \$266.3 billion, which is \$58.7 billion more than the surplus that was transferred to the PSRHBF.

Table A-4 Surplus Determination as of September 30, 2006 (\$billions)			
	Postal CSRS Fund	Postal Liability	Surplus
OPM Methodology	\$207.6	\$190.5	\$17.1
Years of Service Methodology	\$266.3	\$190.5	\$75.8
Difference	\$58.7	-	\$58.7

APPENDIX B – Letter from OPM in Response to the Postal Service’s 2004 Request to Revise the Pension Liability Allocation Methodology



United States
**Office of
Personnel Management**

Washington, DC 20415-9001

In Reply Refer To:

SEP 16 2004

STRA
MCH
2004 SEP 17 11:55
RECEIVED
CORRESPONDENCE # 119426
OFFICE OF PMG
Your Reference:

The Honorable John E. Potter
Postmaster General, CEO
United States Postal Service
475 L'Enfant Plaza, SW.
Washington DC 20260-0010

Dear Mr. Postmaster General:

This is in regard to your letter of January 26, 2004, addressed to the Board of Actuaries of the Civil Service Retirement System (Board of Actuaries), in care of the undersigned. In your letter, you requested that the Board of Actuaries reconsider the "Postal supplemental liability" and the methodology and computations for determining the amount of Postal Service obligations to the Civil Service Retirement System (CSRS) and the amount of Postal Service over funding of the Civil Service Retirement and Disability Fund (CSRDF) that resulted from computations in effect under prior law and which now, under the Act, are to be realized by the Postal Service as "savings." The "Act" refers to the Postal Civil Service Retirement Funding Reform Act of 2003, Public Law (P.L.) 108-18 (April 23, 2003).

In your letter, you maintain that the Office of Personnel Management's (OPM's) methodology understates the Federal share of the liabilities for pre-July 1, 1971, employees and proposed that a "service ratio" method should be used instead. Under your proposal, the Treasury would be allocated a share of the cost of retirement benefits attributable to salary increases granted by the Postal Service since June 30, 1971, while under the OPM methodology, the Postal Service would be responsible for these costs.

Your request for reconsideration fails to recognize the existence of P.L. 93-349 (July 12, 1974). Under this law the Postal Service was required to finance, through 30-year amortization payments, all increases in retirement liabilities that are attributable to salary increases granted by the Postal Service. The increases in liabilities were determined without regard to the amount of service the employees may have had before or after the Postal Service became independent on July 1, 1971.

House Report 93-120 (April 11, 1973), issued by the House Committee on Post Office and Civil Service, entitled "Postal Service Payments to Retirement Fund," on the legislation ultimately enacted as P.L. 93-349 states, at page 2, that "The purpose of this legislation is to clearly establish the responsibility of the U.S. Postal Service to finance increases in the liability of the Civil Service Retirement and Disability Fund, caused by administrative action of the Postal Service, as apart from increases in unfunded liabilities which are incurred by act of Congress." The Report continues by stating, at

RECEIVED

SEP 23 2004

Office of CFO/EVP
Finance, USPS

CON 114-24-3
April 2004

page 4: *"The situation with respect to the Postal Service is quite unique and results from passage of the Postal Reorganization Act. The Congress now has no control – no oversight whatsoever – with respect to the pay machinery in the Postal Service. Since each future pay raise, negotiated or otherwise granted to employees in the Postal Service, will result in a specific unfunded liability and a new drain on the Retirement Fund, the cost of this liability should properly and equitably be borne by the Postal Service."*

Under the static funding method used in the law in effect prior to the enactment of P.L. 108-18, not only was the Postal service required to finance the cost of increases in retirement liabilities attributable to the salary increases that it granted, but it was also required to finance the cost of COLAs for retired Postal employees. The financing of COLAs was established through a series of Omnibus Budget Reconciliation Statutes passed in the early 1990's. Unlike the method for determining the Postal Service liability for salary increases under P.L. 93-349, the pro-rata approach was used to determine the Postal service liability for COLAs.

The approach recommended in your appeal would determine the Postal Service's liability for salary increases for pre-1971 hires based on the pro-rata approach that had been used for determining the Postal Service liability for COLAs. However, we believe that it is inappropriate to apply the methodology that had been used for allotting the funding of COLAs, which are controlled by a formula which is a part of CSRS, for the purposes of determining the Postal Service's liability for salary increases that were exclusively under the control of the Postal Service. Under the provisions in effect prior to the enactment of P.L. 108-18, the question of how to determine the Postal Service liability for salary increases is specifically addressed in P.L. 93-349, and Congress chose not to apply a pro-rata approach with regard to salary increases.

You have asked that we submit your appeal of OPM's methodology to the Board of Actuaries, and we have done so, although OPM takes the position that the Board lacks specific jurisdiction to review the methodology developed by OPM under section 3(b) of the Act for computing the amount of any annual savings realized by the Postal Service. At best, the allowable review goes to the computations derived from the OPM methodology. However, we also conclude that the Act does not forbid the Board of Actuaries from again analyzing the methodology in conjunction with our response to your appeal.

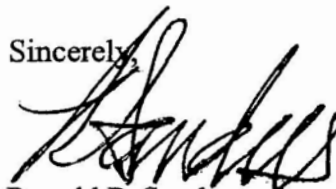
The Board of Actuaries has undertaken such analysis, and their conclusions are set forth in the enclosed letter to the undersigned. As you can see from that correspondence, the Board of Actuaries again considered OPM's methodology and approved that methodology, as well as the computation of the resulting Postal supplemental liability. The Board clearly concluded that the methodology OPM used this year is valid and follows the intent of the Act. We believe the Board of Actuaries' conclusion and OPM's

concurrence with that conclusion resolves all substantive issues between our different approaches both for fiscal year 2003 as well as for future years.

Although you addressed your January 26, 2004, letter to the Board of Actuaries, I am responding, on behalf of the Director of OPM, in order to avoid any possibility that a constitutionally suspect action be taken by the Board of Actuaries. As the President noted in his statement issued upon signing P.L. 108-18, the Supreme Court stated in Edmond v. United States, 520 U.S. 651 (1997) that final decision-making authority for the United States must be vested in, or be subject to the control of, a principal officer of the United States, i.e., one who is appointed by the President subject to confirmation by the Senate. Because the Board of Actuaries is not composed of principal officers, a decision on an appeal under 5 U.S.C. § 8348(h)(4) and/or § 3 (b) of the Act must be subject to review by the Director of OPM or her designee under 5 U.S.C. § 1103(a).

We trust that this determination by OPM concerning the methodology and computations of the Postal Service obligations, clearly consistent with the conclusions of the Board of Actuaries, will be accepted by the Postal Service at this time. If you or your staff have any additional questions or concerns, my staff and I would be pleased to further discuss this matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'R. Sanders', written over the word 'Sincerely,'.

Ronald P. Sanders
Associate Director
for Strategic Human Resources Policy

Enclosure

BOARD OF ACTUARIES
United States Civil Service Retirement System
U.S. Office of Personnel Management
Washington, DC 20415-0001

Douglas C. Borton, FSA, Chairman
A. Norman Crowder III, FSA
Mary S. Riebold, FSA

August 18, 2004

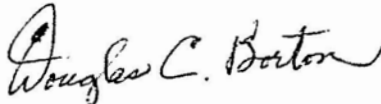
Dr. Ronald P. Sanders,
Associate Director for Strategic Human Resources Policy
U.S. Office of Personnel Management
1900 E Street NW, Room 6566
Washington, DC 20415

Dear Dr. Sanders:

The Board of Actuaries has reconsidered in detail the methodology used by the U.S. Office of Personnel Management to determine the obligations of the United States Postal Service under the United States Civil Service Retirement System. When private sector plans are transferring participants to a new employer, it is a common practice to allocate liabilities by using a method which reflects the fact that all obligations arising from future salary increases are the responsibility of the new employer. We find this approach to be the most appropriate way to determine the obligations of the Postal Service and further confirm our prior finding that this method clearly follows the intent of Congress in Public Law 93-349.

The OPM methodology was reviewed and described by the General Accounting Office in its report of January 31, 2003. This report was distributed to the Postal Service and members of Congress. Although the GAO suggested some adjustments to the OPM's calculations, it did not question the OPM methodology.

Sincerely yours,



Douglas C. Borton
Chairman, Board of Actuaries

cc: A. Norman Crowder, III
Mary S. Riebold
Michael R. Virga