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U.S. Postal Service Should Continue to Prefund Retiree Health Benefits

Practice Strengthens Benefit Security for Retirees and Today's Employees, Lowers Costs, and Promotes Management Accountability

By Paul Steidler

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Executive Summary

One of the biggest myths about the U.S. Postal Service (USPS) is that its financial problems would be largely eliminated if it did not have to “prefund,” i.e., set aside money and invest it, for its generous retiree health benefits program. Even comedian John Oliver spoke extensively about this during a May 2020 HBO segment.[1]

Prefunding is synonymous with saving and investing for retirement. It is a responsible, time-tested, and essential practice to ensure today’s more than 600,000 postal employees and nearly 500,000 postal retirees receive low-cost, quality health care for years or even decades after they retire. As with quality pension plans for state government workers, money is put into a dedicated fund where the assets grow in value.

In the early 2000s, USPS, the Postal Regulatory Commission (PRC), and the U.S. Government Accountability Office (GAO) all recognized the need to protect the Postal Service’s retiree health benefits. The best way to do this, while also lowering costs, was to set aside money and invest it, or prefund. And Congress overwhelmingly agreed.

The 2006 Postal Accountability and Enhancement Act (PAEA) established a Retiree Health Benefits Fund (RHB Fund). It front-loaded payments through Fiscal Year 2016, to aggressively reduce a $54 billion unfunded liability.

Many falsely charge PAEA mandated pre-paying 75 years of benefits. Another common claim is that prefunding is part of a deliberate, nefarious plot to harm USPS so that it would be privatized. There is no basis to either claim, as this report documents.

Postal employees earn significant retiree health benefits for each year they work. As such, a portion of these benefits should be paid by USPS as they are earned and then invested. Yet, USPS has not contributed to the RHB Fund since 2010, defaulting on $51.9 billion, even though it has $14.4 billion in cash as of September 30, 2020.

Without USPS contributions to the RHB Fund, there is a high likelihood that benefits would be cut to postal employees and retirees; that taxpayers would have to assume a large amount of these costs; or both. Furthermore, cutting Postal Service retirees’ health benefits should be off limits. These retirees met their end of the deal by delivering mail and performing other vital services through snow, rain, heat, and gloom of night.

Eliminating USPS’s prefunding requirement would improve USPS’s balance sheet and reduce its annual net losses. Yet, it does not address USPS’s underlying fundamental financial challenges, which include a broken business model. As such, it might even breed a temporary sense of complacency and make things worse by postponing holistic postal reform.

In sum, the RHB Fund needs to be mended, not ended. USPS should make regular contributions to the Fund, though less than those required through Fiscal Year 2016. Like state pension funds for government workers, the funds should be invested in quality stocks and bonds. New actuarial approaches are also necessary given the defaults. These problems are eminently solvable.

Historic Recap of USPS's Retiree Health Benefits

When Congress enacted the Postal Reorganization Act of 1970, a key aim was to have USPS be self-supporting. USPS was to raise money from stamps and the sale of postal services in lieu of receiving direct taxpayer assistance. It would also be responsible for financing its retirement benefits.

From 1970-2007, USPS did not set aside any funds for its retiree health benefits program. This "pay-as-you-go" approach corresponded with a growth in mail volume and revenue, though it created a $54 billion liability at the end of fiscal year 2003.[2]

A 2003 bipartisan postal task force report warned, "Costs for retiree health care and pension plans are skyrocketing for all employees," while noting that 45 percent of the Postal Service's employees would be eligible to retire within a decade.[3]

In November 2003, in response to the April 2003 enactment of the Postal Civil Service Retirement System Funding Reform Act, USPS put forward two proposals to address its retiree health benefits liabilities. Its preference was for an approach that provided large amounts of savings and investing, i.e., prefunding, in the coming years.[4]

The Postal Regulatory Commission (PRC) also supported prefunding and better management of retiree health obligations. "The Commission strongly urged the Service to consider funding a reserve account to begin paying down the retiree health benefits obligation so future ratepayers are not forced to pay for costs associated with postal services delivered today," said GAO in a November 2003 report.[5]

Like the PRC, GAO supported this approach, saying, "We also believe it is critical to the Service's future viability that it continue to make progress on addressing its financial challenges, such as prefunding retiree health obligations."[6]

Congress enacted this approach as part of the 2006 Postal Accountability and Enhancement Act (PAEA), the last major postal reform measure enacted. One of PAEA's central aims was to make retiree health benefits more secure as the obligations were soaring.

The broadly supported, bipartisan PAEA legislation required that $55.8 billion in funds be set aside from fiscal years 2007-16 in the Retiree Health Benefits Fund.[7] At the time, this was a reasonable approach particularly as the volume of first-class mail, USPS's most profitable service, was 86 percent bigger than it is today.

The Postal Service also enthusiastically embraced PAEA's retiree health benefits funding approach. In its 2007 annual report, USPS Chief Financial Officer H. Glen Walker said, "This is a farsighted and responsible action that places the Postal Service in the vanguard of both the public and private sectors in providing future security for its employees, and augurs well for our long-term financial stability upon successful completion of the payments."[8]

Severe problems began during the Great Recession, which led to a precipitous drop in mail volume. In fiscal year 2009, USPS defaulted on $4 billion in payments for the RHB Fund.

What the Postal Service Used to Say About Prefunding

"This is a farsighted and responsible action that places the Postal Service in the vanguard of both the public and private sectors in providing future security for its employees, and augurs well for our long-term financial stability."

H. Glen Walker
USPS Chief Financial Officer
2007 Annual Report

USPS has not made a payment to the Postal Service Retiree Health Benefits Fund (RHB Fund) since Fiscal Year 2010. Its $17.9 billion in principal payments is 32 percent of what was due from fiscal years 2007-16.[9] USPS has defaulted on $38.2 billion in principal payments with no penalties or consequences.

PAEA had a laudable, though overly ambitious goal: to make postal retiree health benefits largely "full funded" by the end of fiscal year 2016, in a dedicated, secure fund – the RHB Fund. Fully funded means that the sum of the money in the fund, combined with interest or other investment appreciation, will meet the obligations to workers and retirees at that time.

Significant additional annual payments are still necessary. Unless an organization ceases operations, and no longer has employees, its retiree health obligations will continue to grow as employees earn these retirement benefits. PAEA thus requires additional RHB Fund payments through fiscal year 2056 and beyond, though at a scaled down rate.

Related Retiree Benefits Cost Challenges to USPS

In addition to being required to set aside $56.1 billion for the RHB Fund, under PAEA the Postal Service had other retiree health care benefit obligations. From fiscal years 2007 through 2016, USPS was also required to continue "pay-as-you-go" payments for its share of premiums for current retirees.[10]

These costs were substantial, totaling $3.3 billion in fiscal year 2016; $3.1 billion in fiscal year 2015; and $2.9 billion in fiscal year 2014.[11] Starting in Fiscal Year 2017 these obligations were paid from the RHB Fund.

In fiscal year 2007, though, USPS received $20.1 billion in initial money for the RHB Fund from the Civil Service Retirement System (CSRS) Pension Fund. This was stipulated by PAEA and stemmed from pension overpayments that USPS had previously made.[12]

At the end of fiscal year 2020, the RHB Fund had assets of $42.1 billion. This is enough to meet 36% of retiree health benefit obligations. The unfunded obligations are $74.5 billion.[13]

Prefunding is but One of USPS's Many Financial Challenges

Moves to eliminate requirements that USPS prefund its retiree health benefits are largely symbolic at this point. In its Fiscal Year 2020 10-K, a comprehensive, legally required financial report, USPS says, "The cumulative amounts of defaulted Postal Service Retiree Health Benefits Fund prefunding, normal cost and amortization were $51.9 billion and $47.2 billion as of September 30, 2020 and 2019."[14]

U.S. Postal Service: Snapshot Since PAEA[15]

	Revenues (in billions)	First-Class Mail Volume (in billions)	Net Income/Loss (in billions)
2006	$72.6	98.0	+1.0
2020	$73.1	52.6	-9.2

Yet, USPS has not faced any consequences for these defaults nor is this likely. In the same 10-K document, USPS's auditor Ernst & Young says, "The Postal Service does not, at this time, anticipate any legal consequences, under current law, from its inability to make these required [retirement and retiree health benefits] payments."[16]

Fiscal Year 2016 marked the end of the large front-loaded RHB Fund payments and the end of USPS having to make separate pay-as-you-go payments for retiree health obligations. Since Fiscal Year 2017 those benefits have been paid from the RHB Fund. As such, in Fiscal Year 2020 and going forward USPS has significantly lower total costs for retiree health benefits, excluding what it has previously defaulted.

For fiscal year 2020, USPS again defaulted on its retiree health payment obligations. It failed to pay both the normal costs of these benefits for the year, $3.85 billion, and an $810 million amortized payment assessed by the Office of Personnel Management (OPM).[17] These total costs of $4.66 billion represent 6.3 percent of USPS's fiscal year 2020 revenues, while accounting for 50.7 percent of its $9.2 billion net loss.[18]

Cash-Flush U.S. Postal Service Still Not Contributing to Retirees' Health Benefits Fund[19]	
By the Numbers…	
Cash/Available Cash:	$24.4 billion
FY 2020 Default:	$4.7 billion
Cumulative Defaults:	$51.9 billion
Total Unfunded Obligations:	$74.5 billion

Why USPS Should Pre-Fund More Than A Corporation

USPS's retiree health benefits program, whereby retirees can purchase health insurance at quite attractive premiums, is a generous benefit and important to many employees and retirees. Today, few American corporations provide this benefit and those that do seldom fully fund.

In a 2018 report, the GAO found the percentage of all private and public organizations (e.g., state, or local governments) with more than 200 employees that offer employee health benefits is estimated to have declined from 40 percent in 1999 to 25 percent in 2017.[20] The prefunding level for these plans is likely well below 37 percent, which was the median funding level for plans at Fortune 1000 companies in 2010.[21]

USPS should have a higher funding level than its 36 percent amount at the end of fiscal year 2020. It has more than 600,000 retirees participating in and relying on the plan. The benefit is also important to current employees. Furthermore, unlike corporations USPS has not been able to grow its business as it did from 1970-2006, as mail volume has fallen. As the prospects for USPS growth are uncertain, the need for security is paramount.

GAO has made clear the need for large amounts of prefunding. It expressed concern if the RHB Fund was only 80 percent funded saying, "Although USPS payments with an 80 percent funding target would reduce USPS's required payments, fully funded benefits protect against an inability to make payments later, make promised benefits less vulnerable to cuts, and protect USPS's long-term viability."[22]

Postal Service Retirees' Health Benefits: Where is the Money?[23]			
	Invested Assets	Unfunded Obligations	Percent Funded
2003	$0	$54 billion	0%
2010	$42.5 billion	$48.6 billion	47%
2017	$49.8 billion	$62.2 billion	44%
2020	$42.1 billion	$74.5 billion	36%

Current Deficiencies and Ramifications

One proposal regarding USPS retiree health benefits is to integrate them with Medicare. In a May 2019 article, John Hatton, Director of Legislative and Political Affairs for the National Active and Retired Federal Employees Association (NARFE), which represents USPS retirees, said full Medicare integration, "requires postal retirees to pay additional premiums through Medicare Part B for mostly duplicative health insurance or lose their earned retiree health benefits."[24]

He adds that the retirees "earned valuable pension and retiree health benefits, in addition to their pay, in exchange for years of hard work. They justifiably expect the U.S. government to live up to its end of the bargain. Changing their health benefits – and adding cost – for postal retirees **after** they have retired and are living on a fixed income fails to do so."[25]

GAO has reported that the RHB Fund would be depleted of assets by 2030 if USPS makes no further payments, or contributions, to the fund. This would result in USPS then having annual obligations of approximately $6 billion a year with these costs likely to rise. GAO said, "Failure to address the poor financial outlook of the RHB Fund could pose serious consequences for retirees as well as USPS, postal customers, and other stakeholders including the federal government."[26]

Pursuing Higher Investment Returns

Under federal law, RHB Fund assets can only be invested in government bonds. This has led to dramatically low investment returns since the 2009 bull market began.

The RHB Fund should be invested in a diversified mix of quality stocks and bonds. This is the same approach taken by pension managers for states and cities as they invest for teachers and government employees. Few if any people making long-term investments for retirement should be exclusively in low-interest bonds.

Recent trends show how costly the strictly government bond investing approach is. At the end of fiscal year 2017, GAO reported that the RHB Fund had $49.8 billion in assets.[27] If half of this amount – $25 billion – had been carved out and invested in the S&P 500, it would have gained 49.5 percent as of January 26, 2021.[28] Netting out the investment gains from government bonds and payments to postal retirees, a significant reduction would have been made to the RHB Fund's $74.5 billion in unfunded liabilities.

A Dire Warning from the U.S. Government Accountability Office

"Failure to address the poor financial outlook of the RHB Fund could pose serious consequences for retirees as well as USPS, postal customers, and other stakeholders including the federal government."

Postal Retiree Health Benefits – Unsustainable Finances Need to Be Addressed
U.S. Government Accountability Office, GAO-18-602
August 2018

Need for Actuarial Assessment

Congress should also commission an independent actuarial analysis to determine the best options for financing USPS retiree health benefits over the next 35 years. The goal should be to preserve benefits while reducing and eventually eliminating the liabilities that taxpayers face.

Following USPS's defaults on RHB Fund contributions since Fiscal Year 2010, OPM is providing USPS an annual bill and overall payment structure that aims to have 100 percent prefunding by 2056. As mentioned above, these costs were $4.66 billion in fiscal year 2020, an amount that USPS has the liquidity to pay, particularly considering it had $14.4 billion in cash at the end of Fiscal Year 2020 and received a $10 billion *de facto* grant from the December COVID package.

The actuarial analysis should determine:

- The estimated USPS annual payments needed, over the next 35 years, to get the RHB Fund 100 percent funded using just bonds versus using the more traditional, diversified investment approach that state government pension funds use.

- The same calculations if the fund is to be 80 percent funded by 2056.

- Three other alternatives with the focus on ensuring benefit security for postal retirees and workers, combined with protection for taxpayers.

Recent PRC Rate Ruling

In its November 30, 2020 Final Rule instituting a framework for significantly increased postal rates, the Postal Regulatory Commission granted USPS several avenues to increase rates. Several hundred million dollars a year can be added to costs if these revenues are dedicated solely to RHB Fund payments.[29]

While the Rule will be challenged in court, and it remains to be seen whether USPS will pursue all available rate increases, Congress should track these developments. It is especially important to make sure that these increases do in fact go to the RHB Fund, given that USPS has already defaulted on $51.9 billion in contributions.

Summary

There are 1.1 million postal retirees and current USPS employees who deserve high-quality retiree health benefits, and who rely on those benefits. The best way to secure those benefits is to fund them as the obligations are incurred, in a dedicated, stand-alone fund.

While USPS has defaulted on $51.9 billion of these obligations, and PAEA's original requirements for prefunding were not feasible, it would be reckless to go on a strictly "pay-as-you-go" approach. USPS has the capacity to make at least two years of contributions to the RHB Fund. Holistic postal reform should also preserve the RHB Fund and have it funded much higher than the current low rate of 36 percent. Through independent actuarial analyses, Congress can assess the costs and best options.

The solution to the current dangerous and reckless path of defaults is not to kick the can down the road and hope that the payments can somehow be made. Steps to increase assets in the funds, including by investing similarly to state pensions for government workers invest, are imperative and best serve postal workers, postal retirees, the U.S. Postal Service, and the American public.

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ENDNOTES

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[17] Ibid, p. 85 of PDF.

[18] Ibid, p. 21 of PDF. See Item 6 – Selected Financial Data.

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