POSTAL SERVICE HEALTH BENEFITS AND RETIREMENT PROGRAMS

I. INTRODUCTION

The United States Postal Service is the cornerstone of an industry that employs over seven million Americans. Mail service providers, fulfillment companies, shipping firms, printers, transportation companies, and "Mom-and-Pop" small business owners all combine to use the mail and generate over $1 trillion in sales and revenue for the nation's economy. This important segment of the business world represents seven percent of the total Gross Domestic Product (GDP) in the United States.

Today, despite unprecedented cost and staffing reductions over the past decade, the Postal Service is facing the equivalent of Chapter 11 bankruptcy. While our business remains vital to the U.S. economy, we are on the brink of insolvency. Since 2007, the Postal Service has faced the financial strain of steep declines in volume and revenue, combined with increases in network costs, wages and benefits, and new legal requirements. From 2007 to 2010, volume declined 20%, from 213 billion to 171 billion pieces, while prices remained capped at the rate of inflation—resulting in net losses over the period of just over $20 billion, including a loss in FY2010 of $8.5 billion. The decline in First-Class Mail—by 20% during that four-year period—has had a particularly significant negative impact on the bottom line as that one mail class provides two-thirds of the Postal Service's income contribution. In total, the volume decline and change in mail mix outpaced even the most pessimistic forecasts and, along with unique legislative mandates, has now placed the Postal Service at the precipice of insolvency.

These volume declines are the result of the recent economic slowdown, the shifting of hardcopy communications to digital alternatives, and the interaction between the two. Going forward, the volume that has been lost will not return, because the movement to electronic alternatives—accelerated by the recession—constitutes a fundamental and permanent change in mail use by households and businesses. Hardcopy communication of all types continues to shift to digital alternatives. More people are paying bills and transacting business online. Advertisers are switching from print to internet and mobile channels. And while online purchases have increased the volume of packages, this part of the Postal Service's revenue stream is not large enough to offset overall mail volume trends. Moreover, unlike a private sector business, the Postal Service is restricted by law from taking steps—such as entering new lines of business--that might generate enough revenue to make up for the loss of revenue from First-Class Mail. In short, there is no revenue growth solution to the Postal Service's life threatening financial problem.

The Postal Service has carefully examined the volume and revenue trends and it is clear that the only way it can survive as an institution and remain the hub of a one trillion dollar mailing industry is to be provided with the tools to reduce network and labor costs to reflect the declining demand by consumers for its products and services. The Postal Service has already identified a set of needed legislative changes. However, it is evident that further tools to dramatically and quickly reduce costs below projected revenue are now required. Given the significant impact of the postal industry on our nation's economy, the number of businesses and jobs in the postal industry and our mounting liquidity crisis, extraordinary steps must now be taken as quickly as possible to restore the Postal Service to a sound financial footing, so that there is no disruption in the nation's mail service. Therefore, we have continued to review additional steps to address our financial challenges beyond those already discussed with the Congress. This paper discusses two new steps that would allow us to address two of our biggest costs, employee health benefit and pension expenses.

First, here is a brief review of the steps we have already asked Congress to take and the actions we have already taken or are planning to take to address our financial challenges. We have asked Congress to take the following steps:

- Resolve the Retiree Health Benefits pre-funding requirement (both long and short term).
- Solve the inequities present in the current CSRS pension methodology.
- Repay the FERS overfunding of $6.9 billion.
- Eliminate the requirement to maintain six-day delivery.
- Allow the Postal Service to make decisions more quickly and in a more business-like fashion regarding its retail facility and mail processing networks.

The Postal Service has already taken the following actions to match its costs with its revenues:

- Achieved cost reductions totaling $12 billion over the last 3 ½ years.
- Developed our March 2, 2010 Comprehensive Strategic Plan to identify future trends and close the gap between future revenue and costs, using a variety of techniques.
- Eliminated approximately 35 million work hours this year; adding to reductions totaling 240 million hours in the previous three years.
- Reduced the number of career employees to 563,401 at the close of Quarter Three; for a decrease of over 121,000 employees since 2007 and a total reduction of over 212,000 employees in the last ten years, without layoffs of bargaining unit employees. Total complement, including non-career employees, stands at 653,348, down from almost 900,000 a decade ago.
- Undertook an organizational redesign that will further streamline our work force by reducing 7,500 administrative positions.
- Reached an historic agreement with the American Postal Workers Union (APWU) that will enhance workforce and work hour flexibility.
- Continued to adjust our retail, mail processing and delivery networks by consolidating Post Offices and other retail facilities, conducting Area Mail Processing (AMP) studies and realigning delivery routes.
- Created dozens of new products and services, designed to grow volume and revenue; including the Flat Rate Priority Mail Box, Forever stamps, Every Door Direct Mail, Click-N-Ship, kiosks, digital apps and expanded access with retail partners like Office Depot.

Over the next months, we will take the following additional steps:

- Optimize consumers' access to our products and service by reviewing approximately 3700 Post Offices and other retail facilities for discontinuance and replacement with more convenient alternate access.
- Optimize our delivery network by consolidation of carriers into underutilized space.
- Optimize our mail processing network through a significant realignment of our mail processing facilities and transportation and more efficient use of our existing technology.
- More aggressively dispose of unneeded facility space.
- Continue to aggressively pursue employee cost reductions through collective bargaining and other steps to reduce our complement.
- Increase our focus on revenue generation.

As we continue to review our financial situation, it has become apparent that First Class Mail volume is declining even more rapidly than we had previously predicted. Therefore, in addition to the legislative changes we have already identified and the steps already taken or planned on matters within our control, additional steps must now be taken to enable the Postal Service to reduce costs at an accelerated pace.

As discussed below, it is imperative that we take control of our health benefit and pension costs which, combined, comprise one-third of our total labor costs. The Postal Service first discusses its proposal to establish its own health benefits program, and how establishing such a program promises to deliver comparable benefits to employees, while achieving cost savings for the Postal Service. The Postal Service then discusses its proposal to establish its own retirement program, which would protect benefits that are vested while giving the Postal Service the flexibility to adopt private sector best practices going forward. For both of these proposals, the Postal Service is willing to provide specific legislative language.

II. THE POSTAL SERVICE PLAN OF ACTION FOR ADMINISTERING ITS OWN HEALTH CARE PLAN

Right now, despite the fact that the law requires the Postal Service to provide employee compensation and benefits comparable to the private sector, the Postal Service does not control health care benefit programs for its employees or its retirees, other than bargaining for the apportionment of costs between active employees and the Postal Service. In all other respects the Postal Service is treated like any other entity of the federal government, in that employees participate in the Federal Employees Health Benefits program

(FEHB). The Office of Personnel Management (OPM) sets up, administers and controls this program. While the Postal Service has the theoretical ability to replace FEHB with a substitute plan, that ability is constrained by legal requirements, and a change of such magnitude would be unlikely to survive the interest arbitration process.

The Postal Service does not believe that FEHB meets the private sector comparability standard, nor does it adequately address the Postal Service's unique demographic and program needs across its offering of some 200 plans. A legislative change that allows the Postal Service to establish its own health benefits program would allow the Postal Service to fully incorporate private sector best practices, saving money while also providing comparable benefits to employees.

In the following paragraphs, we will address:

1.) Why the Postal Service should administer its own Health Benefits Program;
2.) A fair allocation of assets and liabilities;
3.) How the Postal Service would approach a Health Benefits Program going forward;
4.) Governance and oversight; and
5.) The role of the unions and management associations.

1. WHY THE POSTAL SERVICE SHOULD ADMINISTER ITS OWN HEALTH BENEFITS PROGRAM

The Postal Service believes that it should have its own program for three principal reasons. First, fringe benefit costs constitute roughly 33% of total labor costs. As has been well reported, as a large service provider, approximately 80% of USPS total costs are labor costs. The Postal Service cannot address its current economic challenges without gaining control of its legacy costs, defining their breadth and scope, and setting up a reasonable program to fund them.

Second, under the Postal Reorganization Act, the Postal Service is obligated to provide wages and benefits comparable to those provided in the private sector. The private sector is adjusting constantly to changing market conditions with changes in plan design, care management, eligibility, cost management (including the availability of network discounts), and a host of other factors that reflect "best practices" in compensation and benefit policies. The Postal Service cannot fully meet the private sector standard as part of the FEHB system.

Third, the Postal Service believes it is in the interest of the federal government, our retirees and active employees, our stakeholders and the postal community as a whole to segregate once and for all the Postal Service's health benefit obligations—including the obligations for retirees as well as active employees and their families--from those of the rest of the federal government.

In particular, the Postal Accountability and Enhancement Act of 2006 (PAEA) imposed on the Postal Service the requirement that it prefund retiree health benefits by $59 billion in ten years through 2016, over and above continuing to make annual premium contributions on behalf of our retirees that are now approaching $2.5 billion. The sum of these premium contributions and prefunding obligations now exceed 12% of the Postal Service's annual revenue projected for FY2011. This required level of prefunding of retiree health benefits is not shared by any other public or private entity.

The Postal Service's contributions to the Retiree Health Benefits Fund plus accumulated interest have produced a fund balance of $42.5 billion as of the end of FY2010, which is already more than 100% of the liability for our 480,000 annuitants and their survivors. In the private sector, prefunding of retiree health benefits, if any, is usually directed by entities' governing bodies (e.g., by a board of directors), as there is no federal requirement for private sector firms to either offer or prefund these benefits. The majority of companies that elect to prefund do so because they pass through the costs to their government or rate-based customers, often collecting a profit margin on the pass through.

By assuming responsibility for the health care benefits of all of our current and future employees and annuitants, we believe we can emerge with a stronger program and achieve the flexibility to finance our health care obligations to our employees, annuitants and their families consistent with their needs for this vital benefit and the Postal Service's financial means. Our past payments provide a solid foundation for a new program, given that our obligations for retiree health benefits are already more than fully funded for our annuitants, and the assets of the Retiree Health Benefit Fund represent 47% of all future obligations, including both annuitants and active employees.

In particular, as a part of our assessment of this issue in connection with recent collective bargaining, we have identified numerous areas where there are opportunities for improvement and savings that will benefit the Postal Service and participants alike, including:

- Developing and maintaining health benefit choices in which there is a consistent alignment between the value of the plans and their cost;

- Simplifying plan structure with a more understandable set of choices available to plan participants;

- Adopting and investing in best practices used in the private sector, including:

    - Health promotion and wellness incentives;
    - Chronic condition and disease management programs;
    - Aggregating our purchasing power to achieve better network discounts for health care generally and especially for prescription drug benefits; and
    - Communicating benefits to enrollees more effectively; and

- Establishing incentives to ensure that retirees and their dependents who are Medicare eligible take full advantage of the benefits that are available to them under Medicare.

We believe that these changes would result in a health benefits program that is both more beneficial to participants, and more affordable for the Postal Service, participants and their families. In addition, savings achieved through these changes would serve to reduce the Postal Service's liability for retiree health benefits, resulting in a better alignment of liabilities and the assets committed to funding those benefits. The federal government would have no on-going financial responsibility for the program. Furthermore, the successful implementation of private sector best practices within the Postal Service would also provide a valuable "roadmap" to broader implementation throughout the federal government.

2. A FAIR AND PRACTICAL METHOD OF FINANCIALLY CREATING A USPS HEALTH BENEFITS PROGRAM

Although the Postal Service would be open to any reasonable approach, we believe the simplest and fairest method to the establishment of a Postal Service Health Benefits Plan is to withdraw our existing 480,000 annuitants and our 600,000 active employees from FEHB and place them in a new, Postal Service-administered Health Benefits Program. In order to do this, the Postal Service would have to receive the $42.5 billion of assets currently in the Postal Service Retiree Health Benefit Fund to offset the retiree health care liabilities assumed. The Postal Service would then have the flexibility to fulfill its obligations to provide health care consistent with best practices and the comparability standard of the Postal Reorganization Act, fund those obligations, and control them going forward.

3. THE POSTAL SERVICE HEALTH BENEFITS PROGRAM GOING FORWARD

While the Postal Service would need the flexibility to design a health benefits program that is appropriate to the varying needs of its participants, fairness and practical considerations would guide how the Postal Service designs a plan for different groups of prospective participants. The Postal Service would have three distinct categories of participants in the Health Benefits Program and would seek to devise a tiered program uniquely tailored to each group. First, for existing retirees, the Postal Service would continue to provide health benefits comparable to those offered by the most popular plan providers in the FEHB program, at equal or lower cost. However, as with current and future active employees, the Postal Service would seek to ensure that all Medicare-eligible annuitants and dependents fully utilize the Medicare benefits available to them.

Second, for current active employees, the Postal Service would, as a matter of fairness, benchmark against the leading FEHB plans, in an effort to maintain at the outset the existing benefit commitment through health benefit plans comparable in value and cost with those provided under FEHB. Initially, the Postal Service would capture cost savings by establishing a simpler, more cost-effective plan structure in line with private sector best practices. Moving forward, the Postal Service would pursue changes that bring the design of the program more fully in line with the private sector and adopt those changes that represent best practices that will benefit the Postal Service and participants alike. The Postal Service would also continue to bargain over the allocation of premium contributions between the Postal Service and its employees, after the initial establishment of the plan.

Finally, for new hires, the Postal Service would immediately establish a program that better reflects private sector trends than FEHB, including when those new employees retire.

4. GOVERNANCE AND OVERSIGHT

The Postal Service understands the importance of transparency and fiduciary responsibility. Moreover, we share a common interest with our employees and their families, as well as our other stakeholders, in assuring that the new Health Benefits Program is successful. To that end, commercial arrangements for administration (including especially claims administration), investment advice for the Retiree Health Benefits Fund, and related services must be competitive, at the outset and over time. The plan's benefits must also be provided and administered in alignment with best practices in the health care field. We also recognize that the oversight function now exercised over FEHB by OPM, with its staff of actuaries and experts, will no longer be available to us.

For these reasons, it is important to establish a solid structure for governance and oversight of the plan. Below are those key elements and the path we would suggest to get the Health Benefits Program in place.

* The Postal Service would be the plan sponsor. The Governors would establish benefit levels, eligibility criteria, and initial contribution levels.

* The governance and administration of plan assets would be placed in a Health Benefits Plan Management body whose members would be fiduciaries with respect to the plan.

* Standard principles of fiduciary responsibility, including rules about diversification and conflicts of interest, would apply to plan administration and investment decisions. The Plan Management body would provide an annual report to Congress on the performance of the plan.

* The Plan Management body would have members selected by the Postal Service, postal unions and management associations, and the Treasury Department. It will have the authority to engage independent experts as required.

There are also models in the private sector as to how to structure a governance and oversight model for a Company Health and Welfare Plan. The Fortune 500 companies provide ample precedent and the Postal Service would be pleased to adopt a best practices approach.

5. THE ROLE OF THE UNIONS

As noted, legislation could give the unions and management associations the right to participate in governance through representation on the Health Benefits Plan Management body. The Postal Service envisions future contribution levels following the initial levels set by the Governors upon establishment of the plan will be a subject for collective bargaining in accordance with the rights and limitations contained in the National Labor Relations Act.

III. THE POSTAL SERVICE PROPOSED PLAN OF ACTION FOR REDUCING RETIREMENT COSTS

The Postal Service does not control retirement for its employees. While the law requires that compensation and benefits for postal employees be comparable to that in the private sector, the Postal Service is treated like any other entity of the federal government for purposes of retirement benefits. The federal government, through OPM, administers and controls the Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS) and Thrift Savings Plan (TSP) retirement programs, and our employees participate in those programs like any other federal employee. The Postal Service does not believe that the CSRS and FERS programs meet the private sector comparability standard, nor do they adequately address the Postal Service's unique demographic and program needs. By shifting to a Postal Service-administered retirement system, the Postal Service could more fully reflect private sector trends, and incorporate private sector best practices.

In the following paragraphs, we will address the following:

1.) Why the Postal Service should administer its own Retirement Program;
2.) A fair allocation of assets and liabilities;
3.) How the Postal Service would approach a Retirement Program;
4.) Governance and oversight; and
5.) The role of the unions and management associations.

1. WHY THE POSTAL SERVICE SHOULD HAVE ITS OWN RETIREMENT PROGRAM

The reasons underlying this proposal are similar to the reasons underlying the health benefits proposal. First, as noted above, fringe benefit costs constitute roughly 33% of total labor costs, and labor costs constitute approximately 80% of Postal Service total costs. The Postal Service cannot address its current economic challenges without gaining control of its legacy costs, defining their breadth and scope, and setting up a reasonable program to fund them.

Second, under the Postal Reorganization Act, the Postal Service is obligated to provide wages and benefits comparable to those provided in the private sector. The private sector constantly adjusts its pension plans to reflect market conditions through changes in plan design, portability, investment strategy, eligibility, provider services, cost management, and a host of other factors that reflect best practices in compensation and benefit policies. The Postal Service cannot meet the private sector standard if it is locked into the federal retirement programs.

Third, the Postal Service believes it is in the interest of the federal government, our retirees and active employees, our stakeholders and the postal community as a whole to segregate once and for all the Postal Service retirement obligation from that of the federal government. Since 1971, there have been ongoing disputes between the Office of Personnel Management (OPM) and the Postal Service concerning fair accounting of the Postal Service funding obligation from that of the rest of the federal government. On more than one occasion, Congress has been asked to step in to resolve the controversy through legislation. Indeed, even as this paper is being distributed, there is a dispute as to whether the Postal Service has underfunded CSRS (by $7.3 billion according to OPM) or overfunded CSRS (by $50 to 75 billion according to OIG and the PRC). Furthermore, the Postal Service has significantly overfunded its FERS obligations, but has not been able to access that overfunding, and has been required by OPM to increase its payments to FERS even though that action will only serve to exacerbate the overfunding. We believe such tensions will continue as long as the Postal Service's retirement programs remain intertwined with those for the rest of the federal government. This is especially true because, by any accounting, the Postal Service has funded at least 94% of its pension obligations while the federal government has funded only half.

2. A FAIR AND PRACTICAL METHOD OF FINANCIALLY CREATING A POSTAL SERVICE RETIREMENT PLAN

Although the Postal Service is open to any reasonable approach, we believe the simplest and fairest method to the establishment of a Postal Service Retirement Plan is to withdraw our existing 480,000 annuitants and our 600,000 active employees from CSRS and FERS and place them in a new Postal Service Retirement Program. In order to do this, the Postal Service would have to receive all of the assets associated with its payments over the years, together with accumulated earnings on investments, to offset the liabilities assumed. We know that the Postal Service has a current fund balance in the CSRS of $195.3 billion, and in FERS of $75.2 billion, as of September 2009. If an independent actuary concludes that total postal assets exceed postal retirement liabilities as of a certain date, the amount of the overfunding should be returned to the Postal Service to pay down debt, cover retiree health care, or address immediate cash needs.

Significantly, for the first time, the Postal Service would actuarially define its own retirement obligation, fund it, and control it going forward. There would be no prospective disputes with OPM because the Postal Service would own, manage and administer the program. The federal government would have no on-going financial responsibility for the program, and the Postal Service would have no further claim on CSRS or FERS assets in the future.

3. THE POSTAL SERVICE RETIREMENT PROGRAM GOING FORWARD

While the Postal Service would need the flexibility to design a retirement program that is appropriate to the varying needs of its participants, fairness and practical considerations would guide how the Postal Service would approach different groups of prospective participants. The Postal Service would have four distinct categories of participants in the retirement plan going forward and would propose a tiered program uniquely tailored to each group.

First, for existing annuitants, the Postal Service would continue the CSRS or FERS benefit levels consistent with the Federal Government plans, as a matter of fairness.

Second, for current employees who are CSRS eligible, and who are therefore likely to be near retirement, the Postal Service would maintain the existing benefit levels, except that future changes could be made to reflect broader changes to CSRS made by Congress, or to alter contribution levels or the cost-of-living adjustment (COLA) formulas from those set forth in CSRS.

Third, for current employees who are FERS participants, the Postal Service would distinguish by age. For those closer to retirement, the Postal Service would apply the same commitment as for CSRS participants. For employees who are not close to retirement, the Postal Service would not reduce any accrued benefits that have vested, but would reserve the right to make adjustments to benefits going forward, in consideration of federal sector changes to FERS, private sector comparisons, and the Postal Service's own financial position.

Finally, for new hires, the Postal Service would immediately reflect private sector trends by offering a defined contribution plan only, which incorporates private sector best practices concerning employer contributions, portability, investment options, eligibility, designated providers, and overall administration.

This tiered approach reflects the Postal Service’s sensitivity and fairness to a participant’s length of service, proximity to retirement, and expectations as to retirement.

4. GOVERNANCE AND OVERSIGHT

The Postal Service understands the importance of oversight, transparency, and fiduciary responsibility. Moreover, we share a common interest with our employees, retirees, and other stakeholders in ensuring that the new retirement plan is successful. To that end, the commercial arrangements for administration, investment advice, and related services must be competitive, at the outset and over time, and the plan's benefits must be provided and administered in alignment with best practices in the pension field. We also recognize that the oversight and administration function now exercised over CSRS and FERS by OPM, with its staff of actuaries and experts, will no longer be available to us.

For these reasons, it is important to establish a solid structure for governance and oversight of the plan. Below are key elements and the path we would suggest to get the elements in place.

* The Postal Service would be the sponsor of the plan, and the Governors would establish initial benefit and contribution levels consistent with the tiered approach specified above. As sponsor, the Postal Service would retain the right to modify or amend the plan as appropriate going forward.

* The governance and administration of plan assets and liabilities would be placed in a Plan Administration body whose members would be fiduciaries with respect to the plan.

* Standard principles of fiduciary responsibility, including rules about diversification and conflicts of interest, would apply to plan administration and investment decisions. The Plan Administration body would provide an annual report to Congress on investment performance.

* The Plan Administration body would have members selected by the Postal Service, postal unions and management associations, and the Treasury Department. The body would be empowered to retain outside experts in needed professional areas of expertise (e.g. legal, auditing, actuarial analysis, investment strategy).

There are also models in the private sector as to how to structure a governance and oversight model for a Company Pension Plan. The Fortune 500 companies provide ample precedent, and the Postal Service would be pleased to adopt a best practices approach.

5. THE ROLE OF THE UNIONS AND MANAGEMENT ASSOCIATIONS

As noted, the unions and management associations would participate in governance through representation on the Plan Administration body. The Postal Service envisions future retirement contribution levels following the initial levels set by the Governors upon establishment of the plan will be a subject for collective bargaining for active employees and new hires in accordance with the rights and limitations contained in the National Labor Relations Act.