Testimony of THOMAS D. LEVY before the Senate Committee on Homeland Security and Governmental Affairs, September 6, 2011

U.S. Postal Service in Crisis: Proposals to Prevent a Postal Shutdown

My name is Thomas D. Levy. I am Senior Vice President and Chief Actuary of The Segal Company, an international benefits consulting firm. I was the principal author of Segal's June 29, 2010 "Report to the Postal Regulatory Commission on Civil Service Retirement System Cost and Benefit Allocation Principles," and am here today with the encouragement of the PRC to discuss Segal's recommendations with respect to this important issue.

When USPS was established as an autonomous Federal entity effective in 1971, an important issue was the allocation of Civil Service Retirement System (CSRS) costs between the Federal government (for workers' service in the Post Office Department - POD) and the USPS. OPM has consistently done this allocation in accordance with P.L. 93-349 (1974). Essentially, that allocates to the Federal Government the cost of a frozen pension benefit for each worker as of June 30, 1971 based on service, rate of compensation, and the CSRS benefit formula at that time. The entire balance of that worker's pension (the effect of all service and compensation changes after that date) has been charged to USPS. Because the benefit design of CSRS has more generous benefits in the later years of a worker's career, and since the USPS was always the second employer, the benefit accrual charged to USPS for a year of service was usually higher than for POD service. Also, because the CSRS benefit is based on the high three-year-average salary for all years of service, USPS was in fact paying for the impact of post-1971 salary increases on POD pension accruals. In a report for the USPS Office of the Inspector General dated January 11, 2010, actuaries for The Hay Group concluded that this allocation was inequitable in both respects. They estimated that an equitable allocation, accumulated with interest, would have resulted in lower contributions paid into CSRS for all subsequent years - the USPS' share of the CSRS assets being lower by $75 billion for past payments at the end of FY2009, with about $10 billion of savings anticipated in future years. USPS requested PRC's opinion on the fairness and equity of the OPM method. After taking competitive bids, The Segal Company was selected by PRC to analyze and make recommendations.

We met with the stakeholders and reviewed the actuarial and accounting standards, and we concluded that the most relevant benchmark was the accounting standard applicable to private companies. This was the only approach that had as a primary objective the matching of revenues with the labor costs to produce those revenues – our assessment of the appropriate basis for evaluating the fairness of the CSRS cost allocation. That standard provides clear and non-discretionary direction. With regard to plans such as CSRS that provide non-uniform benefit accruals, the expense charge requires following the plan's accrual formula, as OPM was doing. However, it also requires that the cost allocation to a time period for a final average salary plan like CSRS must reflect the anticipated future salary at termination or retirement, and may not be limited to the cost based on the compensation at the time the work is done. These future compensation increases were not reflected in the POD allocation as part of the OPM methodology.

Based on this analysis, we concluded that the preferred method to allocate CSRS benefits to the Federal Government was to reflect post-1971 salary increases but otherwise to follow OPM's methodology. We indicated that we did not believe that the omission of future salary increases with respect to POD service was fair and equitable. We also noted that a pro-rata reflection of benefit accruals that did not follow the CSRS accrual formula (effectively, use of an "average" accrual rate over the participant's working career) was within the range of fair and equitable alternatives, but it was not our preferred methodology. We did not do any calculations of our own, but roughly estimated that as of the end of FY2009 our recommended allocation would result in accumulated savings of $50-$55 billion for past allocations compared to the OPM methodology, with an additional savings with respect to future payments of $6-$8 billion.

Thank you. That concludes my statement and I would be happy to take any questions.