Appendix D

APPENDIX D — Escalating Retirement Costs

Issue

Postal Service retirement costs will continue to escalate during the next ten plus years due to the overlap in funding requirements under the retirement systems that cover current employees and postal annuitants.

Background

Postal Service employees are covered under either the Civil Service Retirement System (CSRS), the Dual System, or the Federal Employees Retirement System (FERS). Coverage is based upon the starting date of employment with the Postal Service. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan.

Civil Service Retirement System. Under the Postal Reorganization Act, career employees are covered by the Civil Service Retirement System, which provides a basic annuity, at a minimum retirement age of 55, determined by the combination of years of service and high-three years average salary. The CSRS covers substantially all employees hired before January 1, 1984.

Dual Civil Service Retirement System (Dual System)/Social Security System. Employees with prior U.S. government service who were hired between January 1, 1984 and January 1, 1987 are covered by the Dual Civil Service Retirement System/Social Security System.

Federal Employees' Retirement System. Effective January 1, 1987, career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees' Retirement System. This system provides a basic annuity, at a minimum retirement age of 62, determined by the combination of years of service and high-three years average salary. An additional annuity in the form of Social Security benefits is also received, as well as benefits from the Thrift Savings Plan. Only under the FERS plan does the Postal Service contribute to the Thrift Savings Plan. A minimum contribution of 1 percent per year of basic pay is made. Employee voluntary contributions up to 3 percent of basic pay are matched, as well as 50 percent of contributions between 3 percent and 5 percent of basic pay, for a possible match of up to 5 percent.

Funding. While different benefit levels are provided under these three programs, the primary difference in these plans relates to how they are funded. Under CSRS, funding is made during an employee's years of service, as well as during retirement and after death (pay later funding). Funding is based on a percentage of basic pay during employment and is paid by both the employee and the Postal Service. Additional funding is required for general pay increases and for cost-of-living adjustments received after retirement. These costs are paid for by the Postal Service. With FERS, full funding is provided during an employee's years of service and is based on a percentage of an employee's basic pay during employment. It is paid by both the employee and the Postal Service (*pay now* funding). Employee contributions for the basic annuity and Social Security are fixed at 7 percent of basic pay under each plan. The Postal Service contributions on basic pay are as follows:

	CSRS	FERS	Dual
Annuity	7.0%	10.7%	7.0%
Social Security	n/a	6.2%	6.2%
TSP	n/a	1.0% to 5.0%	n/a
Total	7.0%	17.9% to 21.9%	13.2%

The number of employees covered by each of the retirement plans at the end of the last three years are as follows:

	2001	2000	1999
CSRS	248,347	263,383	281,062
Dual	11,440	12,021	12,598
FERS	514,870	510,509	503,233

These numbers reflect the natural reduction of the number of employees covered under CSRS as older employees retire and the increase in the number of employees covered under FERS as new employees are hired.

Deferred Retirement Costs – Civil Service Retirement System. Because the percentage funding of basic pay under CSRS does not provide for general pay increases, additional funding is required when general pay increases are provided. Each general pay increase creates a deferred retirement liability. Each $1 increase in basic pay in 2001 created a $4.279 deferred retirement liability. This amount is amortized and paid in 30 equal annual installments, which include interest computed at a rate of 5 percent per year. The first payment is made at the end of the year in which the general pay increase is granted.

Deferred Retirement Liability – CSRS Retirees' and Survivor Cost-of-Living Adjustments (COLAs). Similar to general pay increases, the percentage funding of basic pay under CSRS does not provide for increases in annuities after retirement. The Omnibus Budget Reconciliation Act of 1990 made the Postal Service liable for its share of cost-of-living adjustments granted to those retirees and their survivors, retiring on or after July 1, 1971. The Postal Service is not responsible for any costs due to federal civilian service before that date. Each year the Office of Personnel Management determines the estimated increase in the Postal Service retirement liability for COLA increases granted by Congress to CSRS annuitants. This amount is amortized and paid in 15 equal annual installments, which include interest computed at a rate of 5 percent per year. The increase in deferred retirement liability for retiree COLAs was $1,668 million in FY 2001.

The deferred retirement liability at the end of the last two years is as follows:

	2001	2000
CSRS basic pay increases	$24,843	$25,857
CSRS retiree and survivor COLAs	7,180	6,326
Total	$32,023	$32,183

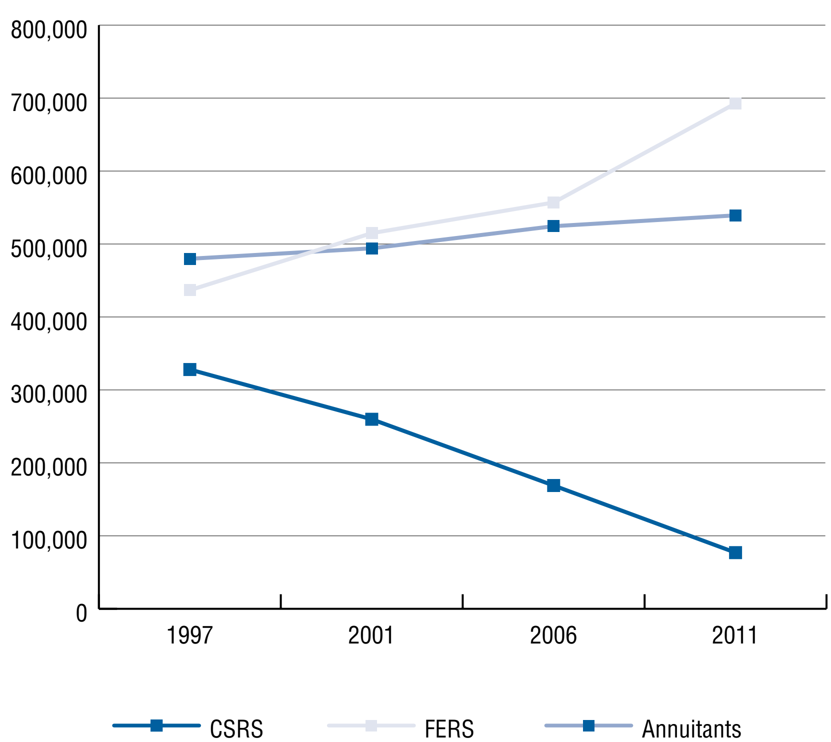
It should be noted that the cost of the annual payment on these deferred retirement costs, $3,750 million in FY 2001, is included in current postal prices.

Problem

The creation of the FERS *pay now* retirement system provides full funding of retirement costs during an employee's years of service. As employees retire under the CSRS *pay later* retirement system, they are replaced by *pay now* or higher current retirement cost FERS employees. The divergence of these retirement systems has created ever increasing retirement costs, since the postal work force is now comprised of more FERS employees while the number of CSRS annuitants continues to increase. The following graph depicts the change in employment levels under each of these retirement systems, as well as the number of CSRS annuitants.

This changing demographic profile of postal employees and CSRS annuitants is causing postal retirement costs to escalate. The following table provides the major components of retirement costs. It reflects the essential stabilization of the *pay later* CSRS costs as the number of CSRS employees decreases and combines with descending CSRS pay increase deferred retirement costs. These declining costs offset the increasing CSRS annuitant COLA costs. However, this stabilization does little to offset the increasing costs of the *pay now* FERS retirement system.

EMPLOYEES AND CSRS ANNUITANTS



MAJOR COMPONENTS OF RETIREMENT COSTS

($ millions)	**1997**	**2001**	**2006**	**2011**
CSRS	$870	$769	$582	$308
CSRS Pay Increase	2,396	2,624	2,465	2,235
CSRS Annuitant COLA	817	1,126	1,504	2,004
Dual	36	33	25	13
Total CSRS	**$4,119**	**$ 4,552**	**$ 4,576**	**$4,560**
FERS & TSP	2,142	2,835	3,567	5,162
Social Security	1,162	1,498	1,885	2,727
Total FERS	**$3,304**	**$ 4,333**	**$ 5,452**	**$7,889**
Total Retirement	**$7,423**	**$8,885**	**$10,028**	**$12,449**
Annuitant Health Benefits	548	858	1,725	3,325
Total	**$7,971**	**$9,743**	**$11,753**	**$15,774**

Options

Escalating retirement costs will exceed inflation rates in the near future, placing additional pressure on the Postal Service to find new ways to reduce costs.

One direct option to mitigate these escalating costs other than through productivity improvement relates to investment of CSRS and FERS retirement fund assets currently managed by the Office of Personnel Management.

Investment Options. The investment of retirement fund assets in other than federal securities at higher rates of returns could increase income generation and minimize the increase in CSRS deferred retirement costs. Private sector, state, and local government pension funds diversify investments to maximize investment return and minimize risk. Investments are made in a combination of fixed income securities, common stocks, real estate, etc. In fact, the federal retirement systems of the Tennessee Valley Authority and the Federal Reserve Board are not required by law to be invested in federal securities. Legislative change will be required to implement this option.