

**Testimony of**  
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**to a Hearing on “Reforming the Postal Service: Finding a Viable Solution”**  
**by the House Committee on Oversight and Government Reform**  
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**I. Introduction**

My name is Fred Rolando, I am a letter carrier from Sarasota, Florida and I serve as the President of the National Association of Letter Carriers (NALC). NALC represents in collective bargaining nearly 200,000 active Letter Carriers who work for the Postal Service across the United States. More than 90 percent of active city letter carriers voluntarily belong to our organization, making it among the best organized open-shop unions in America. We also represent nearly 90,000 retired letter carriers who maintain their membership in NALC as federal annuitants.

Thank you, Chairman Chaffetz and Ranking Member Cummings, for the opportunity to participate in today’s hearing as a representative of the NALC as well as the other three postal unions, which include the American Postal Workers Union, the National Rural Letter Carriers Association and the National Postal Mail Handlers Union. At the outset, we want to acknowledge and express our appreciation for the interest and engagement on postal issues

shown by Government Operations Sub-Committee Chairman Mark Meadows and his ranking member, Rep. Gerry Connolly – as well as by Rep. Steven Lynch, a long-time member on this committee with special expertise on the Postal Service.

Mr. Chairman, you have asked me to discuss the urgent need for postal reform legislation and to identify the provisions we believe are necessary in any postal reform legislation. I am happy to do that today.

There is broad agreement among all the major stakeholders – including many members of this Committee – that legislation is urgently required to strengthen the Postal Service. The huge reported financial losses incurred since 2007, and the 25 percent decline of First Class letter mail resulting from internet diversion, have driven this consensus. However, although many observers have wrongly ascribed the Postal Service's financial crisis entirely to technological factors, the principal cause of the Postal Service's financial woes is a policy mandate imposed on the Postal Service by Congress in 2006. This mandate requires the Service to prefund future retiree health benefit premiums decades in advance. As I will explain below, this mandate, and this mandate alone, accounts for nearly 90 percent of the Postal Service's losses since 2007. This mandate – along with other damaging legislative and regulatory burdens – was imposed by the Postal Accountability and Enhancement Act (PAEA) of 2006.

Confusion about the relative contributions of technology, recession and public policy to the Postal Service's financial health has obscured the reality of today's Postal Service. That reality has changed dramatically – for the better – in recent years. It is not 2008-2009 anymore when the Great Recession sent mail volume plummeting, and the mandate to pre-fund retiree health crushed the Postal Service's finances, raising doubts in the minds of some about the long-term

viability of the Postal Service. It led some of these doubters to propose radical service cuts and a general dismantling of one of America's oldest and most beloved institutions.

Although America's letter carriers and other postal employees never shared those doubts, and urged Congress to resist counter-productive service cuts, we worked with the Postal Service to reorganize and adapt to changing postal needs of the country, both the decline in letter mail due to technological change and the boom in e-commerce that reflects the other side of the internet coin. Over the past nine years, postal employees have made huge sacrifices to help the Postal Service to become more efficient and to "right-size" in response to the fall in mail volume. Postal employment has been slashed by more than 200,000 jobs since 2006, postal productivity has increased dramatically and postal labor costs have been sharply reduced through very difficult rounds of collective bargaining. A white paper report issued on April 18, 2016 by the Postal Service's Office of Inspector General summarizes these cost cutting efforts. (See <https://www.uspsoidg.gov/document/peeling-onion-real-cost-mail>.)

Thanks to these efforts and to the recovery from the Great Recession, the Postal Service has been returned to operational profitability over the past three years – earning \$2.9 billion in controllable income (to use the Postal Service's term for operating profits) during Fiscal Years 2013, 2014 and 2015. Of course, these operating profits were totally wiped out by the \$5.5 billion annual prefunding charges in the Postal Service's official results. But that should not obscure the underlying strengths of the Postal Service. As the economy has recovered, it has seen its package business grow by more than 10 percent annually and both its direct mail and catalogue products grow solidly even as the rate of decline in First Class Mail volume steadily moderated (from -8.8% in 2009 to -2.2% in 2015). Overall mail volume declined by less than one percent in 2015 as total revenue increased to \$66.8 billion.

Indeed, the Postal Service remains a vital component of this country's economic and communications infrastructure. In 2015, the Service delivered more than 150 billion pieces of mail and became an even bigger player in the booming e-commerce sector, now offering 7-day delivery. Almost one half of all bills are still paid by mail. The majority of bills and statements received by households are still delivered by mail. Trillions of dollars move through the postal system every year. The Postal Service's \$67 billion in revenue is only a small part of the \$1.4 trillion of GDP accounted for by the U.S. mailing industry, which now employs 7.5 million Americans. The health of that huge industry depends on a healthy Postal Service.

Although the Postal Service's finances remain fragile and technological challenges will persist long into the future, it should be clear that the Postal Service remains a vital part of the nation's infrastructure. We believe it can thrive in the 21<sup>st</sup> Century with the right public policies. We have done our part to preserve the Postal Service, which enjoys an 84% approval rating with the American people according to a November 2015 Pew Research survey. Now we need Congress to do its part to strengthen it for the future.

## II. Three Essential Reforms

There are three significant legislative/regulatory burdens placed on the Postal Service under current law that should be removed or reformed by this Congress.

### **The prefunding mandate**

The most significant burden is the legislative mandate included in the Postal Accountability and Enhancement Act of 2006 (PAEA) that requires the Postal Service to massively prefund future retiree health premiums -- decades in advance. Congress adopted this mandate during the administration of George W. Bush in the most inflexible manner possible. It required the Postal Service to make 10 fixed payments of between \$5.4 billion and \$5.8 billion annually

between 2007 and 2016 – and then to begin making actuarial-based pre-funding payments over 40 years, beginning in 2017. The actuarial-based payments are comprised of two parts: a normal cost payment to cover the future cost of retiree health accrued each fiscal year, and a payment calculated to amortize any remaining unfunded liability over the next 40 years. Unfortunately, in the absence of legislative change, the cost of pre-funding is actually expected to increase after 2016 as a result of these actuarial-based payments – beyond the unaffordable levels of recent years.

No other enterprise in America (public or private) faces a legal mandate to pre-fund future retiree health insurance benefits – though Congress does appropriate money to the Department of Defense to partially pre-fund such benefits for certain Pentagon retirees. According to an annual survey of Fortune 1000 companies by Towers Watson, only 38 percent of such firms pre-fund retiree health at all, and 62 percent don't pre-fund at all. (See *Perspectives: Accounting for Pensions and Other Post-Retirement Benefits*, 2015.) Those companies that voluntarily pre-fund typically make contributions only when the companies are profitable.

The Postal Service pre-funding payments, which could not be suspended when the Great Recession hit, were so onerous that the Postal Service exhausted its \$15 billion borrowing authority in order to make the payments. Since 2012, it has not been able to make the payments at all – though the expenses associated with the missed payments have continued to be recognized, driving the Postal Service deep into the red. All told, \$50.4 billion of the Postal Service's reported losses of \$56.5 billion since 2007 – 89.2 percent -- are due to the pre-funding mandate. See Attachment 1.

The damage this policy has inflicted goes way beyond the adverse financial effects. This policy has starved the Postal Service of needed investments, most notably the urgent need to replace its obsolete fleet of vehicles. (As the OIG report in Attachment 1 makes clear, Postal

Service annual investment in its own networks and infrastructure has declined by 16 percent in real terms between 2008 and 2015.) It has also caused the Postal Service to excessively downsize in ways that are short-sighted and counter-productive. For example, the Postal Service made it more difficult for Americans to access its services by: removing tens of thousands of mail collection boxes; slashing the operating hours of thousands of post offices; and reducing its service standards in order to dramatically downsize its network of mail processing plants. The quality of service has suffered – and we fear the Postal Service has driven significant business away as a result.

Over the years, we have suggested a number of legislative measures to address the crisis caused by the pre-funding mandate – for example, repealing the mandate, reducing the pre-funding target percentage to match private sector best practice (33%-50% prefunding) or adopting private sector pension valuation standards so that USPS pension surpluses could be transferred into the Retiree Health Fund. Those proposals failed to advance. Fortunately, the Senate Homeland Security and Governmental Affairs Committee reached bipartisan consensus on a concept for addressing the prefunding burden during the last Congress, which was included in a bill adopted by the Committee but not by the full Senate (S.1486). It included reforms to the FEHBP program as it relates to postal employees and Medicare coverage that would all but eliminate the Postal Service's unfunded liability for future retiree health benefits.

Under this approach, FEHBP plans would segregate postal employees and postal annuitants into a separate risk pool and all postal annuitants would enroll in Medicare Parts A&B when they reach age 65, with an opt-out option for hardship cases. (At present, 80-90% of postal annuitants already voluntarily enroll in the two main parts of Medicare.) The proposal would also give FEHBP plans access to low-cost prescription drugs made possible by the Medicare Modernization Act. That is the 2006 law that created Medicare Part D plans. However, postal retirees would not have to enroll in Part D plans to gain access to these

cheaper drugs. Instead, FEHBP plans would arrange to get the inexpensive drugs and the savings would help reduce FEHBP premium costs. About half the reduction in the Postal Service's unfunded liability would come from lower cost drugs; the rest from maximizing the participation in Medicare Parts A and B.

This approach ensures that the Postal Service and its employees fully benefit from the \$29 billion they have contributed in Medicare taxes since 1983 and adopts the standard practice of large private companies that provide retiree health insurance. Although it would raise Medicare spending by less than one-half of one percent over the next 10 years (again financed by Medicare taxes already paid), it would effectively resolve the prefunding burden that threatens the financial health of the Postal Service.

We can support this approach in the context of targeted postal legislation that does not weaken our networks or diminish services to the public. In this spirit, we urge this Committee to embrace it in any legislation you consider this year. I will return to this idea in the final section of my testimony.

### **Restrictive investment policies for postal retirement funds**

In general, the Postal Service has incredibly well funded retirement plans, although declining interest rates in recent years have temporarily inflated liabilities and created relatively small unfunded liabilities. At the end of 2014, the Postal Service's CSRS and FERS pension funds were 92.4 percent funded – well into the healthy “green zone” under the private sector Pension Protection Act and much better than the 81.7 percent funded percentage for the 100 largest pension plans according to the 2015 Pension Funding Survey conducted by the Milliman Company. (The USPS funded percentage at the end of FY 2015 was 92.2 percent.) At the same

time, while the median level of funding for retiree health benefits among Fortune 1000 companies is zero percent (0%), the Postal Retiree Health Benefit Fund is nearly 50 percent funded.

These strong funding positions are all the more remarkable given the restrictions placed on the investment of the Civil Service Retirement and Disability Fund (which holds the federal and postal accounts for both CSRS and FERS) and the Postal Service Retiree Health Benefits Fund (PSRHBF). By law, the pension funds and the PSRHBF must be invested in low-yielding Treasury bonds. Together, the CSRS and FERS postal accounts and the PSRHBF hold nearly \$340 billion in Treasury securities – making us, the Postal Service and its employees, the third largest creditor of the U.S. federal government just behind the governments of China and Japan. No private company in America would invest 100 percent of their pension and post-retirement health funds in such a conservative way, especially during a period when Treasuries are yielding 2-4 percent returns. When your investment time horizon stretches out over decades, best practice in the private sector is to invest in a well-diversified portfolio of private sector stocks, bonds and real estate as well as government bonds. Such a portfolio is provided by the Thrift Savings Plan's Lifecycle 2040 Fund. If the Postal Service's FERS and CSRS accounts could have been invested the 2040 Fund between 2007 and 2014, their combined balance would be \$32 billion greater today – enough to cover the total combined unfunded liability of \$23 billion in 2014.

Given that the postal accounts in CSRS and FERS are commingled pensions, covering both federal and postal employees, it might be difficult to invest the postal accounts more sensibly. However, Congress should direct the Office of Personnel Management to invest the Postal Service Retiree Health Benefits Fund the way a private sector company would invest such a



fund – again, in a well-diversified portfolio of private sector stocks and bonds as well as government securities.

Although, such a mandate would represent a break with past policy, the retiree health fund is a stand-alone, one-agency trust fund in the U.S. government's accounts. Its assets are funded by postage rate-payers to cover the cost of future retiree health insurance premiums payable by the Postal Service. The cost of these premiums, like medical services in general, is expected to rise by 5.0-7.0 percent annually over the next several decades. It makes no financial sense to invest in assets that yield less than the trend rate of medical inflation. The PSRHBF investment policy in current law – which effectively mandates a low-cost loan from business mailers to the Federal government -- unnecessarily raises the cost of pre-funding and puts pressure on the Postal Service to raise postage rates or to adopt misguided service cuts. There is a better way.

Congress could raise the long-term rate of return on the retiree health fund's assets, improve the overall finances of the federal government (OPM's balance sheet), reduce the burden of prefunding, relieve upward pressure on postage rates, and lessen the threat of self-defeating service cuts by making one change: It could direct the OPM to invest PSRHBF assets in safe, low-cost index funds of the kind offered by the federal Thrift Savings Plan (TSP). As the table below indicates, had the fund's assets been invested in the Lifecycle 2040 Fund of the TSP since 2007, its value would exceed \$60 billion today –nearly \$10 billion more than its actual balance.

## Postal Service Retiree Health Benefits Fund: Assets and Earnings (\$mil.)

Year	Annual Prefunding Payment (\$mil.)	Investment Income (\$mil.)	PSRHBF Year-End Balance (1) (\$mil.)	Rate of Growth	L Fund 2040 returns	Projected PSRHBF year-End Balance if invested in L2040 Fund (\$mil.)
2007	\$5,400	\$287	\$25,745	--		
2008	\$5,600	\$1,265	\$32,610	4.9%	-31.53%	\$23,235
2009	\$1,400	\$1,472	\$35,482	4.5%	25.19%	\$30,488
2010	\$5,500	\$1,510	\$42,492	4.3%	13.89%	\$40,223
2011	\$0	\$1,626	\$44,118	3.8%	-0.96%	\$39,837
2012	\$0	\$1,626	\$45,744	3.7%	14.27%	\$45,693
2013	\$0	\$1,548	\$47,292	3.4%	23.23%	\$56,308
2014	\$0	\$1,538	\$48,850	3.4%	6.22%	\$59,810
2015	\$0	\$1,495	\$50,345	3.3%	0.73%	\$60,247

**Notes:**

(1) Explanation (from pg. 26, 2007 Annual Report): The initial balance in the PSRFB resulted from two transfers: a) the postal surplus in the CSRS Fund as of September 30, 2006 (\$17.1 billion transferred on June 29, 2007); and b) the funds held in the escrow account established by P.L. 108-18 (\$2.958 billion). The first pre-funding payment of \$5.4 billion was also made in 2007.

To show you how beneficial this change in investment policy could be, we asked our consultants at the Lazard Co. in New York to investigate the potential impact of investing the PSRHBF the way pension funds are invested in the private sector. Lazard found that if Congress were to adopt the postal FEHBP reforms and Medicare integration we suggest, the percentage of liabilities funded would rise from 50 percent to 94 percent right away. More importantly, it found that if the USPS subsequently made regular normal cost contributions and the retiree health fund were invested according to the average 2014 “private sector allocation” in last year’s Milliman pension survey, the Postal Service’s retiree health liabilities could be more than fully funded within a few years. That private sector allocation was expected to earn more than 7.0 percent annually. (See Attachment 2 for additional information.)

While no pension fund achieves its long-term target rate of return every year and sometimes even loses money in market downturns, the Lazard analysis shows that the PSRHBF could be fully funded over the long run. Over time, such an investment policy might eliminate the need for any amortization payments and could justify the suspension of normal cost payments as well. We urge this Committee to adopt this investment proposal, while making it clear that no amortization payments would be required should the PSRHBF funding ratio exceeds 80 percent (the funding target in S. 1486) and no normal cost payments would be required if the funding ratio topped 100 percent.

There are two common objections to this investment proposal: (1) is the risk of loss associated with investments in private stocks and bonds; and (2) is the long-standing policy of the Treasury department against investing government trust funds (such as the Social Security Trust Fund) in private securities. Neither of these objections should hold in the case of the PSRHBF. I will address both.

First, given the long investment horizon of the PSRHBF and the relatively modest annual outlays from the fund (\$3.0-\$4.0 billion for the foreseeable future), the risk of a short-fall in a prudently invested PSRHBF is extremely small. In fact, the OPM projects future retiree health liabilities over a period of 90 years. So the Fund would have decades to make up for any sharp losses. Indeed, the experience of the L 2040 Fund since the 2008 financial crisis provides a real life test of this resiliency. The L 2040 Fund has more than bounced back from the 2008 stock market crash.

Second, although the Treasury has traditionally invested government trust funds only in government bonds, the PSRHBF is a different kind of trust fund and there are several government entities that regularly invest in private securities.

The PSRHF is different from most trust funds because it does not involve federal taxpayer dollars. The funds in the PSRHBF come from postage rate-payers. They are collected to cover the cost of services rendered. As with the assets of the TSP's index funds, the PSRHBF is dedicated to providing post-retirement benefits for federal employees – in this case, the employees of the U.S. Postal Service. Although it is the only trust fund dedicated to cover the retiree health benefits of a single agency's employees, there are other retirement funds controlled by primarily self-funded federal agencies that are allowed to invest in private sector securities. These include: the National Railroad Retirement Investment Trust (NRRIT), the Pension Benefit Guarantee Corporation (PBGC), Amtrak and the Tennessee Valley Authority (TVA).

The ratepayer funds held by the postal retiree health fund should be invested the way these other agencies invest their funds. The OPM should hire well-qualified asset managers, chosen by trustees with fiduciary responsibilities to invest the fund wisely – maximizing returns while minimizing risk and investment fees.

Properly investing the PSRHBF's assets will, over the long run, improve the balance sheet of the OPM and reduce the cost of pre-funding for the Postal Service. This will allow for affordable postage rates and better service to the America's mailers and citizens. If the purpose of the Fund is to protect taxpayers against the need to cover future health care costs for retired postal employees, the best way to reduce that need is invest the PSRHBF prudently and intelligently. In our view, investing the PSRHBF in low-yielding Treasury securities actually

increases the risk that the PSRHBF would run out of money. Investing it in private sector securities would reduce that risk.

### **Pricing restrictions**

The final legislative/regulatory burden we would like to address is the overly restrictive Consumer Price Index-based price cap introduced by the PAEA to regulate postage rates charged for Market Dominant products (most letters, magazines and catalogues). One of the main goals of the PAEA was to simplify the rate-setting process, making it faster and less costly. A Senate bill passed in 2006 proposed to index all postage rates to inflation (CPI-All Items) and to allow for emergency rate increases in so-called "exigent" circumstances -- such as gas price spikes or severe recessions. The bill advanced in the House of Representatives called on experts at the PRC to create a new system of rate regulation based on best practice among regulators of other regulated industries, after conducting hearings to gather input from all the interested parties. As often happens in Congress, a little bit of both approaches was adopted in the PAEA – which called for the CPI index for 10 years and then authorizing the PRC to decide how to structure the rate-setting process after that. That is exactly what the PRC will do, beginning in December 2016.

The PAEA might have all worked out well but for two factors. First, the Postal Service decided not to exercise its option to hold one last old-fashioned rate case in 2007 to ensure rates covered all the relevant costs (including the massive cost of prefunding retiree health) before the new CPI price index was initiated. Facing a possible recession in 2007, the USPS did not want to raise postage rates by the extra 5 percent needed to build the cost of prefunding into the baseline rates before the index kicked in. It feared a rate shock would be especially damaging in the middle of a recession. That turned out to be a huge mistake--it should have

done the rate case, and asked the PRC to delay implementing the results until after the recession.

Then the second factor kicked in: the economic slowdown of 2007 turned into a global financial crisis. The operating profits of 2007 and 2008 turned into deep losses of 2009-2012 as the Great Recession took hold, mail volume plummeted and the \$5.5 billion annual prefunding payments kicked in. In response to the recession, the Postal Service sought and received a 4.3 percent exigent rate increase from the PRC. But USPS failed to convince regulators to make the increase permanent -- even though it was apparent to all that the Great Recession had permanently reduced the volume of First Class Mail as companies shifted to electronic billing to cut costs during the downturn.

As this committee thinks about the issue of pricing, it should remember that the overall Consumer Price Index (All items) has no real meaning as it relates to the costs of the postal industry. It is simply the average change in prices for thousands of different goods and services bought by American consumers – it is a statistical artifact.

In 2006, we argued that a more appropriate index was the Consumer Price Index for Delivery Services (CPI-DS) – a sub-index within the CPI-All Items index that measures price trends for services provided by private delivery companies. That is, the prices charged consumers by companies like FedEx and UPS. As an indexing benchmark, the CPI-DS makes sense as it would hold the Postal Service to a rational private sector standard. And it captures the kinds of costs that affect delivery and postage prices – the cost of labor, the price of fuel, and inflation trends in a transportation/utility company. Another reasonable option would be the Producer Price Index for Delivery and Warehouse Industries. As you will note by reviewing

Attachment 3, these more comparable indices have increased significantly more than the CPI since the PAEA was passed.

We believe that the PRC is the appropriate venue for deciding the future regulation of postage rates. Indeed, it is the proper venue for sorting out any matters of cost accounting and rate structures. Fortunately, the rate setting review authorized by the PAEA will begin in a few months and will be able to address the shortcomings I have raised here. However, this Committee may need to address one rate issue that was not contemplated by the 2006 law – the recent expiration of the 4.3 percent exigent rate increase authorized by the PRC to help the Postal Service recover from the permanent decline in mail volume caused by the Great Recession of 2008-2010. Given this permanent decline, we believe that the PRC erred when it made the increase temporary. The PRC prevailed after years of litigation, and the exigent increase expired on April 10, 2016.

This complicates the task of stabilizing the Postal Service's finances. The loss of \$2 billion in annual revenue resulting from the expiration means that the Postal Service's modest, yet healthy operating profits in recent years (approximately \$1 billion annually) will turn into operating deficits of approximately \$1 billion annually. In January, before the April 10<sup>th</sup> expiration of the exigent increase, the four postal unions, the Postal Service and a significant number of major mailers, argued that Congress should freeze Market Dominant postage rates in place until the PRC review is completed (waiving the final two CPI-based increases) as part of a narrowly focused set of reforms to strengthen and stabilize the Postal Service. This would have effectively made the exigent increase permanent.

Now that the exigent increase has expired, our coalition is committed to working toward agreement on alternative revenue approaches. We look forward to working with this committee

to reach consensus. In our view, if Congress does not pass postal reform legislation, the 2016-17 PRC review of the rate-setting process will have to address both the burden of prefunding and the need to make up for the lost exigent increase revenues. That could lead to terrible rate shock that neither Congress nor the Postal Service's diverse group of stakeholders would welcome.

### **III. Key components to consensus legislation**

On behalf of more than 450,000 employees represented by all four postal unions – the NALC, APWU, NPMHU and the NRLCA – I wish to conclude by summarizing the key provisions we urge this committee to adopt in postal reform legislation to strengthen and stabilize the Postal Service. There is a remarkable degree of consensus across a broad range of stakeholders – including the unions, postal management and a cross-section of mailing industry associations – about the most important reform elements, which are outlined in a letter sent to this committee yesterday. In short, we support:

- Using postal-specific assumptions in valuations of the Postal Service's pension plans with any surpluses returned to the Postal Service over time;
- Reforming the Federal Employees Health Benefits Program as it relates to coverage of postal employees and postal annuitants to dramatically reduce the cost of retiree health benefits by fully integrating with Medicare;
- Directing the PSRHBF to be invested in index funds comprised of private sector stocks and bonds as well as government bonds with appropriate governance procedures;
- Permitting the Postal Service to provide non-postal products in limited circumstances; and



- If necessary, making an adjustment to the market-dominant base rates in order to ensure adequate revenue for the Postal Service through the period of the PRC review.

The common characteristic of the first two principles for reform is that they adopt standard practices used by large companies in the private sector. All the other principles were included in the Senate bill from the last Congress (S. 1486) or included in the bipartisan i-Post bill introduced in the Senate during this Congress. Although neither of those bills won the support of the members of our coalition for a variety of reasons, we can support these core principles.

Of course, our coalition could not agree on every issue – many of us support provisions about which there is not total consensus, and we know individual Members of Congress and groups of Representatives will want to address other issues. As a group we have agreed to work diligently to engage with this Committee on these other issues and to work in good faith to reach a fair resolution. The four unions pledge to work as long as it takes to make this happen.

Thank you, Chairman Chaffetz, Ranking Member Cummings and all the Members of the Committee for inviting me to testify on this crucially important matter.