OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

U.S. Postal Service Alternative Health Care Plan Proposal

Management Advisory Report

August 22, 2012

Report Number FI-MA-12-014

OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

HIGHLIGHTS

August 22, 2012

U.S. Postal Service Alternative Health Care Plan Proposal

Report Number FI-MA-12-014

BACKGROUND:

Legislation requires the U.S. Postal Service to pre-fund its retiree health care benefits obligation and fund its retiree health care premiums (at about $8 billion annually), and provide employee benefits that are comparable to those paid in the private sector. However, these annual payments, coupled with declining revenue, have challenged the Postal Service's ability to meet all its obligations.

Management proposed to decrease costs by over $63 billion by offering its own health care benefits plan instead of participating in the Office of Personnel Management (OPM) Federal Employees Health Benefits plan. These savings are due primarily to 1) required accounting changes, 2) use of Medicare coverage, 3) impact on employees, future retirees, and retirees, and 4) efficiencies in health care purchasing.

The objective of the review, requested by the postmaster general, was to evaluate the reasonableness of the assumptions in management's proposal and impact on the unfunded health care obligation.

WHAT THE OIG FOUND:

While the $63 billion in proposed savings is reasonable, we found that management used an incorrect funding interest rate assumption to establish its future retiree health care obligation. Thus, management understated the adjusted original liability of $90.2 billion by $14.1 billion, when it should actually have been $104.3 billion. This, however, does not impact the overall $63 billion in cost savings. Subsequent to our review of the proposal, the Postal Service informed us it removed from its proposal the plan to freeze the monthly premium amount it contributes to those retiring after January 1, 2014. Thus, the estimated savings associated with the proposal would be reduced by about 20 percent, or $11 billion due to this change.

Finally, we noted the Postal Service did not have access to its employee and retiree actual claimant data to ensure it has data available to run its plan.

WHAT THE OIG RECOMMENDED:

We recommended revising the alternative health care plan to include rates appropriate for funding assumptions; clearly communicating the impact of transitioning to the proposed plan to all affected employees, future retirees, retirees, and the government; and obtaining historical claims data from OPM to ensure the Postal Service has the best data available when selecting a provider to administer its plan.

Link to review the entire report

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

August 22, 2012

MEMORANDUM FOR: STEPHEN J. MASSE
ACTING CHIEF FINANCIAL OFFICER AND
EXECUTIVE VICE PRESIDENT

ANTHONY VEGLIANTE
CHIEF HUMAN RESOURCES OFFICER AND
EXECUTIVE VICE PRESIDENT

FROM: John E. Cihota
Deputy Assistant Inspector General
for Financial Accountability

SUBJECT: Management Advisory Report – U.S. Postal Service Alternative Health Care Plan Proposal
(Report Number FI-MA-12-014)

This report presents the results of our review of the U.S. Postal Service's Alternative Health Care Plan Proposal (Project Number 11BD014FT000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Denice Millett, director, Policy Formulation and Financial Controls, or me at 703-248-2100.

Attachments

cc: Patrick R. Donahoe
Joseph Corbett
Cynthia Sanchez-Hernandez
Robert A. Dufek
Robert J. Pedersen
Corporate Audit and Response Management

TABLE OF CONTENTS

Introduction

This report presents the results of our review of the U.S. Postal Service's proposal to provide an alternative health care benefits plan[1] to its employees and retirees (Project Number 11BD014FT000). We conducted this review at the request of the postmaster general. The objective of the review was to evaluate the accuracy of the critical assumptions and reasonableness of projected cost savings in its proposal to leave the Federal Employees Health Benefits (FEHB) plan. This review addresses financial and strategic risk. See Appendix A for additional information about this review.

The Postal Service is required to pre-fund its retiree health care benefits obligation[2] and provide employee benefits comparable to those paid in the private sector for comparable levels of work.[3] In addition to paying annual retiree health care premiums of $2.4 billion, the Postal Service pre-funds the Retiree Health Benefits Fund by about $5.6 billion annually to address its future health care benefits obligations.[4] The Office of Personnel Management (OPM) has estimated that the Postal Service's retiree health care obligation will be $102 billion[5] by September 30, 2013.[6] It is projected that in 2013, the fund will have assets of $49 billion, leaving an anticipated unfunded balance of $53 billion.[7] However, these annual payments, coupled with declining revenue, have tested the Postal Service's ability to meet its operational and legislative obligations. In fact, the Postal Service did not make the required pre-funding payment due in August[8] and has indicated it will not be able to make the required pre-funding payment due in September 2012.

During FY 2011, the Postal Service faced challenges that prompted significant changes, including a large reorganization[9] and efforts to reduce expenses.[10] Of the $74.8 billion in annual expenses, $58.8 billion (79 percent) are personnel expenses. Of the $58.8 billion in personnel expenses, $21.5 billion (37.0 percent) are benefits-related. Management requested additional legislative changes in an effort to decrease costs and has proposed to further decrease costs by offering its own health care plan instead of continuing to participate in the FEHB plan. The Postal Service initially provided the U.S.

---

[1] Postal Service employees and retirees currently participate in the Federal Employees Health Benefits (FEHB) plan managed by the Office of Personnel Management. FEHB is a multi-employer plan, which is a bargained health care plan maintained by more than one employer, usually within the same or related industries.
[2] Postal Accountability and Enhancement Act of 2006.
[3] Postal Reorganization Act, 39 U.S.C. §1003(a).
[4] The Postal Service has not yet paid the $5.5 billion for fiscal year (FY) 2011.
[5] This amount and others in this report are derived from unpublished actuarial data and may not match published financial data.
[6] On September 30, 2011, the Postal Service estimated its retiree health benefits obligation was $90.3 billion.
[7] The Postal Service's total health care obligation of $102 billion, less plan assets of $49 billion, equals the unfunded health care obligation of $53 billion.
[8] A $5.5 billion pre-funding payment was originally required in September 2011 but was deferred, ultimately, to August 2012.
[9] The Postal Service announced an organizational redesign in FY 2011 which reduced the number of area and district offices and will decrease the number of authorized administrative, supervisory, and postmaster positions by about 7,500 over the next 3 years.
[10] Expense reductions included reducing workhours by 225 million from the FY 2009 negotiated union labor contract figures; temporarily suspending the Postal Service's contribution into the Federal Employee Retirement System; and planning for optimization of its mail processing, delivery, and retail networks along with revisions to service standards.

Postal Service Office of Inspector General (OIG) with a proposed retiree health care benefits plan on September 23, 2011. We reviewed it and provided informal comments to management for their consideration. The Postal Service provided a revised plan to the OIG for further analysis, based on discussions with stakeholders and considering our initial comments, on February 10, 2012. Management's revised plan included the following seven components that offer cumulative savings:[11]

- A change in accounting for health care costs.
- Required participation in Medicare Parts A and B.[12]
- Implementation of Medicare Part D Employer Group Waiver Plan with wraparound (EGWP/wrap) benefits.[13]
- A shift to a four-tier health care coverage structure.[14]
- Implementation of improved private sector-style health care purchasing initiatives.
- A change in the order of responsibility for paying health care costs (carve-out). Under this process, employees who retire on or after January 1, 2014, will need to meet a standard deductible before the Postal Service pays any costs not covered by Medicare.
- A freeze on the Postal Service's employer dollar contributions for those who retire on or after January 1, 2014. Subsequent to our review of the February 10, 2012, proposal, the Postal Service informed us it removed this provision from its health care proposal. The Postal Service estimated this aspect of the plan would have saved $11.1 billion.

For purposes of this report, we have consolidated the seven components above into four categories: required change in accounting; use of Medicare coverage; impact on employees, future retirees, and retirees; and efficiencies achieved from purchasing initiatives.

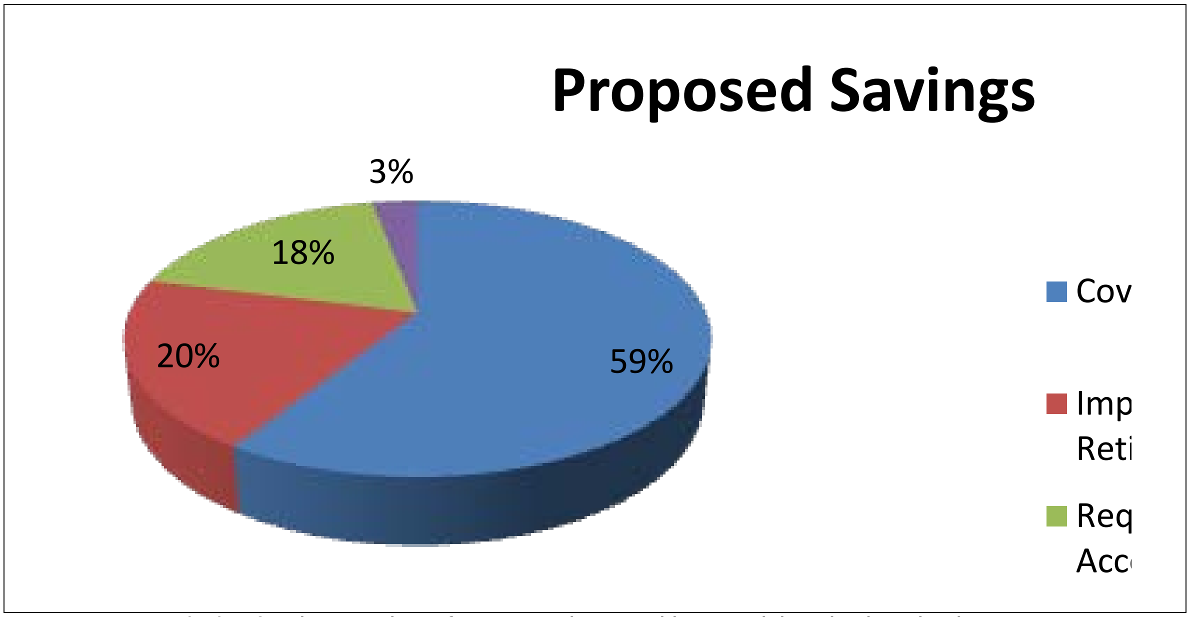
---

[11] See Appendix A for more information regarding the components.
[12] Medicare is a national social insurance program administered by the U.S. Department of Health and Human Services that guarantees access to health insurance for Americans ages 65 and older, among others. Medicare offers all enrollees a defined benefit. Hospital care is covered under Part A and outpatient medical services are covered under Part B. Part D covers outpatient prescription drugs exclusively through private plans — either standalone prescription drug plans or Medicare Advantage plans that offer prescription drugs. See http://www.medicare.gov/Publications/Pubs/pdf/10050.pdf for further information.
[13] EGWP/wrap is an official Medicare Part D program containing a provision that ensures retired employees will receive benefits at least equal to those in their current employer plan. In addition, it allows an employer to achieve significant plan savings above any savings achieved as a result of participating in Medicare's retiree drug subsidy program alone.
[14] The current FEHB two-tier program offers self and family options only. A four-tier program would offer self, self and spouse, self and children, and self and family.

Conclusion

We believe the proposed plan's projected cost savings of $63.1 billion are reasonable and will ensure that future retiree health care costs are sufficiently funded by projected assets. Chart 1 provides an illustrative breakdown of where the savings are derived.

Chart 1: Postal Service Alternative Health Care Plan Savings[15]



Source: OIG analysis of *Nyhart Review of USPS Retiree Health Actuarial Projections by the Hay Group*, dated June 26, 2012. See Appendix C for a copy of the report.

However, we did find that the Postal Service did not always apply the appropriate assumptions in the development of its proposal to leave the FEHB plan and create its own retiree health care benefits plan.

- As a result of using an incorrect funding interest rate assumption to establish its future retiree health care obligation, management understated the adjusted original health care benefit obligation of $90.2 billion by $14.1 billion, when it should actually have been $104.3 billion. As noted previously, this did not impact the reasonableness of the cost savings.

- The original health care proposal did not exclude all populations who were ineligible for Medicare from savings projections. As a result of our analysis, management revised its assumption to exclude those that were ineligible for Medicare, reducing its projected savings by about $307 million.

[15] Subsequent to our review of the February 10, 2012, proposal, the Postal Service informed us it removed from its health care proposal its plan to freeze the dollar amount of the monthly premium it contributes to those retiring after January 1, 2014. The Postal Service estimated this feature would have saved about $11.1 billion.

Further, we identified four additional issues that should be considered should the Postal Service implement its proposed alternative health care plan.

- The Postal Service needs to clearly communicate the impact of its proposed plan on the federal government, current employees, future retirees, and retirees.

- Current legislation requires those eligible for Medicare Part B to enroll by age 65. Many Postal Service retirees[16] are older than 65 years of age and not currently enrolled in Medicare. Therefore, those older than 65 who do not timely enroll would be assessed a late enrollment penalty. We determined that this penalty could cost employees or the Postal Service an additional $53 million per year. Management assumed, in calculating projected cost savings, that the penalty would be waived but did not include how they will address this penalty in their plan. Resolution of this matter and the impact on applicable retirees should be clearly communicated. The Postal Service's proposal includes a congressional waiver of the mandatory late enrollment penalty for enrollees who fail to enroll in Medicare after their initial eligibility period.

- The Postal Service does not have access to its employee and retiree actual claimant data. It is critical that the Postal Service know and understand how its employees' and retirees' claims data performs, particularly as it solicits and selects an organization to implement its health care plan.

- Upon implementation of an alternative health care plan, the Postal Service will need to determine the appropriate discount (interest) rate to report its health care obligations in its financial reports. We believe that accounting standards allow for options in determining which discount rate to use, including the rate used by the Postal Service to compute these costs savings, or a private sector rate. We are not making a recommendation at this time on this issue.

Table 1 summarizes the plan's costs and estimated savings by category.

[16] The estimated Postal Service Medicare-eligible population not enrolled in Part B is 88,000.

Table 1. Comparison Summary of Estimated Cost Savings

Category	Postal Service Proposed Plan (in billions)	OIG Review of Proposed Plan (in billions)	Difference (in billions)
Required Change in Accounting	$11.3	$12.1	+$0.8
Use of Medicare Coverage: ▪ Integration of Medicare Parts A and B	16.2	19.2	+3.0
▪ Implementation of Medicare Part D	21.0	23.7	+2.7
Subtotal	**$37.2**	**$42.9**	**+$5.7**
Impact on Employees, Future Retirees, and Retirees: ▪ Change to Claims Processing for Those who Retire on or After 1/1/2014	$7.1	$5.0	-$2.1
▪ Freeze on Employer Dollar Contributions for Those who Retire on or After 1/1/2014. *(Subsequent to our review, the Postal Service dropped this freeze from its proposal.)*	11.1	15.5	+4.4
▪ Implementation of a Four-Tier Health Care Coverage Structure	(5.5)	(7.2)	-1.7
Subtotal	**$12.7**	**$13.3**	**+$.6**
Efficiencies Achieved from Purchasing Initiatives	$1.9	$2.7	+$0.8
Total	**$63.1**	**$71.0**	**$7.9**

Source: OIG analysis of *Nyhart Review of USPS Retiree Health Actuarial Projections by the Hay Group*, dated June 26, 2012. See Appendix C for a copy of the report.

As noted in Table 1, management's calculations of estimated cost savings are more conservative than ours, by $7.9 billion. Therefore, we consider their estimates reasonable.

Required Change in Accounting

The Postal Service's plan generates savings by changing from a multi-employer health care plan to a single employer plan. The effect of this change is a modification in the accounting for health care costs. As noted in Table 1, nearly 18 percent[17] of the Postal Service's health care plan savings is generated by non-cash changes required by

[17] $11.3 billion (required change in accounting component) divided by $63.1 billion (total estimated cost savings).

generally accepted accounting principles when the Postal Service moves from the current FEHB plan to its own health care plan. Although we generally agreed with the assumptions used for this area, we noted the Postal Service used an incorrect funding discount (interest) rate in the computation of its future retiree health care benefit obligation as of FY 2013, the starting point for determining cost savings associated with the plan. Further, should the Postal Service adopt its own health care plan, management will need to shift from using OPM's proprietary interest rate to one that complies with generally accepted accounting principles for reporting future health care obligations on its financial statements. Neither of these changes impacts the reasonableness of the $63.1 billion in cost savings. The two issues are further described below:

- The Postal Service used a proprietary funding discount rate from the OPM to estimate its retiree health care obligations for purposes of computing cost savings associated with the proposed plan. In determining the amount of savings to be generated from establishing its own plan, a more appropriate rate to use would be the rate currently applicable for reporting obligations for federal employee pension and other retirement benefits.[18] Use of the OPM rate is not suitable for determining cost savings without sufficient plan history (such as demographics and interest rates). If the Postal Service had a plan history or the OPM had provided such information, the OPM rate could be applicable. Since the Postal Service did not have plan history, it needs to use standard, published discount rates. It should be noted the Postal Service used the more appropriate rate (4.9 percent) for reporting its Retiree Health Benefit Fund asset value.[19]

- FEHB is a multi-employer bargained health care plan maintained by more than one employer within the same or related industries, such as the federal government. Should the Postal Service implement its own single employer health care plan and leave FEHB, they would be required to change their accounting for the health care obligation as promulgated under generally accepted accounting principles.[20] As part of implementing an alternative single employer health care plan, the Postal Service will need to use a discount (spot) rate[21] (currently about 4.5 percent[22]) applicable to the private sector when publishing annual financial statements. Use of a spot rate is currently being used by Postal Service for other obligations.[23] Using the spot rate, instead of the rate management used,[24] the future retiree health care obligation would increase by $14.1 billion. Although this is a significant increase, using

[18] The federal rate more accurately reflects the Postal Service's current borrowing and investment activity.
[19] Management's future health care liability of $102.3 billion is based on the 5.75 percent rate used to compute funding for Postal Service pensions. We believe the 4.9 percent rate used in the Postal Service's Financial Report Form 10-K, Fiscal Year 2011, based in underlying U.S. Department of Treasury investments and compliant accounting standards, is more appropriate.
[20] Financial Accounting Standards Board's Accounting Standards Codification 715.
[21] The current interest rate available on the market for a commodity, security, or currency.
[22] Average rate of corporate bonds from January 1 through March 31, 2012, based on a commonly used actuarial bond index. Management should expect fluctuations in the actuarial liability as this market based assumption is periodically adjusted.
[23] *Workers' Compensation Liability Estimate* (Report Number FT-MA-11-002, dated December 23, 2010.)
[24] Management's funding assumption is 5.75 percent.

management's assumptions, we believe the Postal Service should have sufficient projected assets to fully fund its future obligations.[25] Since implementing an alternative health care plan is contingent on many factors, we are not making a recommendation for financial reporting of its health care obligations at this time.

Use of Medicare Coverage

As noted in Table 1, nearly 59 percent[26] of the Postal Service's health care plan savings is generated from requiring applicable employees and retirees to participate in the Medicare program. Currently, up to 24 percent of Postal Service retirees age 65 and older have not enrolled in some or all parts of the Medicare program.[27] However, the Postal Service and its employees have contributed about $25 billion into the Medicare program since 1983. By requiring all retirees to enroll in Medicare, management's alternative health care plan transfers the Postal Service's health care costs to the federal government.

For example, rather than submitting hospital or medical care provider service-related claims under the Postal Service's plan for payment, these claims would be processed by Medicare Part A (hospital costs) or Part B (medical care provider costs), with the Postal Service's health care plan serving as secondary insurance. When the Postal Service becomes the supplemental insurance provider, the primary financial obligation is shifted to Medicare and has the effect of lowering the Postal Service's future health care obligation. The EGWP/wrap (Part D) allows for a prescription subsidy before applying insurance benefits, maintaining the retiree's share of the cost while the employer achieves the cost savings. Therefore, moving to an EGWP/wrap arrangement would allow a reduced employer share of annuitant claim costs for annuitants and survivors over age 65.

While we agree that the overall cost saving initiatives related to the integration of Medicare Parts A, B, and D are reasonable, we identified issues with two assumptions: the Medicare eligibility of prior Post Office Department employees and Medicare Part B enrollment penalties.

Medicare Eligibility of Prior Post Office Department Employees

In the original alternative health care plan provided to the OIG,[28] management included savings related to the enrollment of retired Post Office Department employees[29] into Medicare Parts A and B. However, these retirees did not contribute to Medicare as employees and, therefore, were not eligible for current Medicare benefits. This

[25] We estimate the total future health care obligation to be $104.3 billion using a 4.5 percent discount rate, versus 90.2 billion using the OIG-calculated actuarial rate of 5.75 percent. $104.3 billion less $63.1 billion in proposed savings equals $41.2 billion in future health care obligations after the savings from plan implementation. Plan assets (estimated to be $49 billion) would exceed future health care obligations after plan implementation.
[26] $37.2 billion (use of Medicare coverage component) divided by $63.1 billion (total estimated cost savings).
[27] The Postal Service has employees who may retire as young as age 50. This group is generally not eligible for Medicare until age 65.
[28] Dated September 23, 2011.
[29] Population consists of Post Office Department employees hired before the entity became the U.S. Postal Service.

population included 6,543 employees with an average cost savings of $46,920 per person. During the course of our review, we informed management of this error. They concurred and removed this population from future Medicare savings calculations, resulting in a decrease of about $31 million in estimated annual savings. See Appendix B for our calculation of other impact.

Medicare Part B Enrollment Penalties

Current legislation requires those who are eligible for Medicare Part B to enroll by age 65. Those who do not enroll within a specified period of time after retiring are assessed a 10 percent, per year, late enrollment penalty.[30] We determined that about 88,000 retirees are over age 65 but have not enrolled in Medicare Part B. Therefore, unless waived, the enrollment penalty would apply to these retirees. This penalty could cost employees or the Postal Service an additional $53 million per year[31] for this retiree population. Management assumed, in calculating cost savings, that the penalty would be waived and did not include how they would address the penalty in their plan or disclose the monetary effect on future retirees. We believe the Postal Service needs to either ensure that it would provide a waiver to the employees age 65 or older, or determine who would bear the responsibility for these costs and inform its employees and retirees of this issue.

Impact on Employees, Future Retirees, and Retirees

The Postal Service's plan, dated February 10, 2012, generated additional savings by shifting costs to Postal Service employees who retire after January 1, 2014. As noted in Table 1, over 20 percent[32] of the Postal Service's health care plan savings was generated from changes made to the claims payment process and the Postal Service's share of (contribution towards) monthly premiums, potentially increasing health care costs to future retirees. Subsequent to our review of the plan, however, the Postal Service informed us it removed from its health care proposal the feature to freeze the dollar amount of the monthly premium it contributes to those employees retiring after January 1, 2014. The plan does provide for current employees to see a reduction in their share of premium contributions with the move to the four-tier coverage structure. These changes in health care costs for employees and future retirees should be clearly communicated to the workforce, as these factors may influence retirement decisions.

[30] Management's white paper *U.S. Postal Service Background and Legislative Proposals,* dated August 31, 2011, detailed their legislative proposal including a waiver to exclude Postal Service plan participants from late enrollment penalties.
[31] Example assumes 5-year average late enrollment. A 10 percent penalty multiplied by 5 years multiplied by the current monthly Part B premium of $99.90 multiplied by 12 months equals $599.40 per year per Medicare recipient. $599.40 multiplied by the estimated Postal Service Medicare-eligible population not enrolled in Part B (88,000) equals $52,747,200.
[32] $12.7 billion (impact on employees, future retirees, and retirees component) divided by $63.1 billion (total estimated cost savings).

Change in the Order of Payment Responsibility for Those Who Retire After January 1, 2014

Employees who retire on or after January 1, 2014, will need to meet a standard deductible[33] before the Postal Service pays any cost not covered by Medicare. Postal Service costs are reduced because the employer has moved itself behind the employee in the payment order. Table 2 shows how the Postal Service's alternative health care plan would shift an additional $1,000 of health care expenses[34] to an employee who retires after January 1, 2014.

Table 2: Effect of Payment Approaches on the Retiree Starting January 1, 2014

Plan Payment with Medicare Reduction Using Standard Coordination (Current Plan)[35]		
a	Medical Expenses For One Person	$ 5,000
b	Medicare-Paid Expenses	$ 3,000
c	Retiree Payments for Deductibles, Co-insurance, and Co-payments (plans pays first and retiree pays balance)	**None needed**
d	Net Plan Paid Expenses: (a–b)	$ 2,000
Plan Payment with Medicare Reduction Using Plan Payment with Medicare Reduction with Proposed Coordination (Proposed Plan)[36]		
e	Medical Expenses For One Person	$ 5,000
f	Medicare-Paid Expenses	$ 3,000
g	Retiree Payments for Deductibles, Co-insurance, and Co-Payments (retiree pays first and plan pays balance)	**$ 1,000**
h	Net Plan Paid Expenses : (e–g)	$ 1,000

Source: OIG analysis of *Nyhart Review of USPS Retiree Health Actuarial Projections by the Hay Group*, dated June 26, 2012. See Appendix C for a copy of the report.

Postal Service Share of Monthly Premiums

The Postal Service's February 10, 2012, plan called for freezing the dollar amount of the monthly premium it contributes to those employees retiring after January 1, 2014. Under the current OPM plan, the Postal Service's percentage of the monthly premium stays constant as an employee ages. However, under management's alternative health care proposal provided to us in February 2012, the Postal Service's dollar amount contribution remains constant. Thus, as health care costs increase, the percentage contributed by the Postal Service declines, leaving the future retiree to bear the burden of the increase in monthly premiums. The long-term impact of this change to future

[33] Standard deductible is the out-of-pocket expenses paid by the employee, consisting of deductibles, co-insurance, and co-payments.
[34] Compare lines d and g.
[35] Postal Service program with current standard coordination (payment made in order of Medicare, employer, employee).
[36] Postal Service program with carve-out coordination (payment made in employee, Medicare, employer order).

retirees could be significant. Subsequent to our review of the plan, the Postal Service informed us it removed this feature from its health care proposal.

Table 3 illustrates the reduction in the Postal Service's percentage subsidy as health care premiums costs increase by an average of 5.8 percent[37] annually.

Table 3: Employees Age 65 Retiring after January 1, 2014

			Employee Premium Payment Responsibility (Percentage)		Employee Premium Payment Responsibility (Dollar Amount)	
Year	**Age**	**Monthly Premium**	**Current Policy[38]**	**Alternative Plan Policy**	**Current Policy**	**Alternative Plan Policy[39]**
2014	65	$683	32.0%	32.0%	$218.56	$218.56
2015	66	$733	32.0%	36.7%	$234.56	$269.01
2016	67	$777	32.0%	40.2%	$248.64	$312.35
2017	68	$823	32.0%	43.5%	$263.36	$358.01
2018	69	$868	32.0%	46.5%	$277.76	$403.62
2019	70	$911	32.0%	49.0%	$291.52	$446.39
2020	71	$943	32.0%	50.7%	$301.76	$478.10
2021	72	$1,009	32.0%	54.0%	$322.88	$544.86
2022	73	$1,080	32.0%	57.0%	$345.60	$615.60
2023	74	$1,139	32.0%	59.2%	$364.48	$674.29

Source: OIG analysis of *Nyhart Review of USPS Retiree Health Actuarial Projections by the Hay Group*, dated June 26, 2012. See Appendix C for a copy of the report.

Overall, the impact of implementing a new claims payment process and freezing the Postal Service's premium dollar contribution would add costs to future retiree and annuitant health care premiums. All risks of additional cost associated with the final proposal that moves forward should be clearly disclosed to future retirees along with the potential monetary impact associated with these risks. This information could be considered critical to employees planning retirement and might otherwise cause an employee near retirement to adjust their plans. Moreover, updates to management's plan should include costs associated with the risks of accelerated retirement, as any savings calculated as a result of freezing employer contributions would decrease as more employees retire before January 1, 2014.

Four-Tier Coverage Structure

Under the proposed alternative health care plan, the Postal Service would offer four coverage options instead of the two the current FEHB plan offers.[40] Under the four-tier

[37] Percentage used for illustrative purposes and deemed a reasonable estimate over the 10-year period based on actuarial assumptions (Getzen model) from The Nyhart Company.
[38] Based on assumptions used by the Postal Service to compute cost savings, the Postal Service currently provides a 68 percent subsidy to its employees.
[39] Assumes the Postal Service freezes its monthly health care premium contribution to employees at $464.44.

structure, we estimate the Postal Service's monthly composite employer share of the health care premiums would increase from $403 to $463[41] and result in a $7.2 billion cost to the Postal Service.

Management intended its proposed plan to mirror the current FEHB plan's employee distribution between tiers and maintain the same level of coverage. Our estimate shows a reduction in employee contribution as the structure expands to four tiers. Since the premium contribution required of employee participants would be reduced, the employer share of the premium contribution would increase to offset the reduction of employee's share of cost, thereby increasing the overall health care fund obligation by $5.5 billion (as determined by the Postal Service). However, our analysis indicates that costs would increase by $7.2 billion, which is slightly more than the Postal Service's estimate but considered reasonably consistent. See Table 4 for an illustrative comparison of current versus proposed tiers.

Table 4: Current Two-Tier Structure and Current Retiree Contributions

Current 2011 Two-Tier Structure Expressed in a Four-Tier Format[42]					
	Self Only	**Self and Spouse**	**Self and Children**	**Self and Family**	**Composite of Family Levels**
Bi-weekly Premium	$267	$603	$603	$603	$603
Retiree Contribution	($86)	($199)	($199)	($199)	($199)
Postal Service Subsidy	$180	$403	$403	$403	$403
Proposed Four-Tier Structure and New Contributions					
Bi-weekly Premium	$275	$577	$466	$760	$621
Retiree Contribution	($70)	($146)	($118)	($192)	($157)
Postal Service Subsidy	$204	$430	$347	$567	$463
Decrease in Monetary Retiree Contribution	($16)	($53)	($81)	($7)	($42)
Decrease as Percentage of Current Contribution	18.60%	NA	NA	NA	21.1%
Assumed Family Composition		60%	10%	30%	100.00%

Source: OIG analysis of *Nyhart Review of USPS Retiree Health Actuarial Projections by the Hay Group*, dated June 26, 2012. See Appendix C for a copy of the report.

---

[40] The OPM plan provides for self only and family only coverage. The Postal Service's alternate health care plan would provide self only, self and spouse, self and children, and self and family options.
[41] Using the current Blue Cross Blue Shield standard plan (due to its popularity) as an example.
[42] Using the current Blue Cross Blue Shield standard plan as an example.

Efficiencies from Purchasing Initiatives

The Postal Service's plan generates comparatively minor savings by implementing efficiencies from purchasing initiatives. As noted in Table 1, just 3 percent[43] of the Postal Service's health care plan savings is generated from initiatives related to lower administrative costs, increased prescription drug procurement leveraging, more competitive bidding, and a more comprehensive disease management program.[44] For example, the Postal Service's plan notes that lower administrative costs, increased prescription drug procurement leveraging, and increased competitive bidding could be attained through direct negotiation with an insurance provider. The Postal Service currently does not have this capability under an OPM-governed plan. It is reasonable to assume management could negotiate a more robust disease management program directly with a health care provider that could result in additional savings. While overall projected savings related to this initiative are difficult to estimate due to the human factors associated with chronic disease education and management, our review of the assumptions associated with efficiencies in purchasing initiatives resulted in similar savings as those projected by management.

Availability of Office of Personnel Management Claims Data

Management did not have access to the OPM claimant data used to compute future health care obligations and cost savings. The Postal Service contractor (Hay Group) had access to more detailed data but OPM did not allow the contractor to provide this information to the Postal Service or the OIG. This data included FEHB plan demographics, including Postal Service population demographics, assumptions regarding retirement age, turnover rates, and estimated health care premiums. The Postal Service's contractor used OPM data to determine cost savings associated with the different areas. For the OIG analysis, we used independent data to evaluate the Postal Service's estimates. We believe the differences in cost savings resulted from the Postal Service's contract actuary using proprietary OPM data not available to us. Based on the independent claims data available to us, we computed a greater overall cost savings of an additional $7.9 billion. Therefore, since the Postal Service's projected savings are more conservative, we conclude the Postal Service's cost savings overall are reasonable.

However, the availability of specific claims data is critical. The Postal Service should understand how employee and retiree claims data performs, particularly as it solicits and selects an organization to implement its health care program. We believe the Postal Service should obtain from OPM the important health insurance data of its employees. Without that data, the Postal Service may not be able to get the best value for administering its own health care program. Also, insurance companies bidding on administering the Postal Service plan may have access to some or all Postal Service

[43] $1.9 billion (impact from purchasing efficiencies component) divided by $63.1 billion (total estimated cost savings).
[44] Disease management is the concept of reducing health care costs and/or improving the quality of life for individuals with chronic disease conditions by preventing or minimizing the effects of a disease.

employee claim data due to prior participation in the FEHB. This could put the Postal Service at a disadvantage in the bidding process.

Recommendations

We recommend the acting chief financial officer and executive vice president, in consultation with the chief Human Resources officer and executive vice president; direct the acting vice president, Finance and Planning, to:

1. Revise the Postal Service's alternative health care plan projected savings to include the additional cost of shifting to the appropriate discount rate used for funding obligations for federal employee pension and other retirement benefits.

We recommend the acting chief financial officer and executive vice president, in consultation with the chief Human Resources officer and executive vice president:

2. Disclose to affected employees, future retirees, retirees, and the federal government all potential cost increases, cost savings, and cost shifts that would result from a transition to a Postal Service-proposed alternative health care plan. This disclosure should describe detailed expected costs and savings to individuals based on choices available and timing of retirement.

3. Obtain historical claims data from the Office of Personnel Management to ensure the Postal Service has the information needed to obtain the best value when soliciting and selecting a health care provider to administer and implement its alternative health care plan.

Management's Comments

Management provided a letter of response to the discussion draft report. Although management did not specifically address the recommendations made in the report, management agreed with our overall finding regarding the $63 billion in savings to be reasonable. However, management disagreed with three broad areas: required changes in accounting; use of Medicare; and impact on employees, future retirees, and retirees.

Management disagreed with the term "accounting changes" as it suggests an adoption of accounting procedures that are not consistent with generally accepted accounting principles. The Postal Service intended to present its plan to show its future health care liability, offset by assets, and noted it is the only approach suitable to illustrate how key objectives of reducing or eliminating the unfunded heath care liability are met. They acknowledged generally accepted accounting principles require the change to single-employer reporting for financial statement purposes. Management maintains the intended presentation of the plan would not be affected by this change.

Regarding the use of Medicare, management responded that its plan would reverse the cost shifting that has been in place for years because the FEHB plan does not integrate with Medicare, as is done in the private sector and state and local governments. Under FEHB, if a retiree eligible for Medicare elects not to participate, the only consequence is that he or she has the same level of medical benefits provided under FEHB before retirement or Medicare eligibility. The only incentive to enroll in Medicare currently for the retiree would generally be to avoid out-of-pocket costs such as deductibles, co-pays, and co-insurance. The failure to integrate FEHB plans with Medicare is detrimental to active employees and retirees because the current approach shifts costs that would normally be borne by Medicare to FEHB. Finally, they noted our report did not include Postal Service and employee contributions to Medicare of over $25 billion.

Regarding the impact on employees, future retirees and retirees, management stated while the proportion of the total costs paid by the Postal Service, its employees, and its retirees will change as described in the OIG report, out-of-pocket costs for most employees and retirees will not increase. Specifically, the Postal Service has indicated its intention to share a substantial portion of the cost savings with its employees and retirees through lower contributions and no reduction in benefits. In addition, management responded the OIG report did not adequately emphasize changes to the plan since the plan date, such as Postal Service removal of the proposal to limit future employer contributions for retiree premiums or the inclusion of a late enrollment penalty waiver in the proposed legislation. See Appendix D for management's comments in their entirety.

Evaluation of Management Comments

The OIG considers management's comments responsive to the findings in the report. We disagreed with the discount rate the Postal Service used for the critical funding assumption for its future health care obligation (liability). Critical management assumptions used to estimate future liabilities are part of the accounting process. Also, the OIG noted in the discussion draft report that the change to single-employer reporting would differ from the liability stated in the Postal Service plan and is required under generally accepted accounting principles. We acknowledge that single-employer reporting liability is not a necessary part of the Postal Service plan for funding purposes, but we provided this information for stakeholder transparency should management implement the plan. Subsequently, we brought references out of the footnotes into the body of the report to ensure clarity to both issues.

We acknowledge that the FEHB is not integrated with the Medicare program. Additionally, OIG noted in the discussion draft report that the Postal Service and its employees have paid into the Medicare program since 1983 (in footnotes). For purposes of the final report, we brought the reference to Postal Service's participation out of the footnote and added the amount contributed into the body of the report.

The OIG also noted in the details of the discussion draft that the employee contribution required under the four-tier coverage structure would decrease. For purposes of this report, we added a sentence in the section's opening paragraph to emphasize that point. We also acknowledge that those retired before January 2014 will not be adversely impacted, and we did not address in our report because they were not part of the cost savings.

Finally, we agreed with Postal Service management that the review would be limited to the subject document, dated February 10, 2012. Changes to the plan based on ongoing negotiations with the various stakeholder groups would not be reassessed. However, we did include in our report that the Postal Service subsequently removed its proposal to limit future employer contributions for retiree premiums.

The OIG considers recommendation 1 significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action is completed. This recommendation should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendation can be closed.

Appendix A: Additional Information

Background

The Postal Service has experienced volume declines as a result of the recent recession and the shifting of hard copy communications to digital alternatives. In the 5-year period from FYs 2007 through 2011, mail volume declined from 213 billion pieces to 168 billion pieces, or about 21 percent, while postal rate price increases were held at inflationary rates. The Postal Service experienced a loss of over $25 billion over this period, including the loss of $5.1 billion in FY 2011. First-Class Mail has a significant impact on revenue as it generates about two-thirds of Postal Service's income. In addition, the Postal Service has significant personnel expenses. The OPM has estimated the Postal Service's future retiree health care obligation will be $102 billion by 2013. To date, the fund has assets of $49 billion, leaving an anticipated unfunded balance of $53 billion.[45] To address the unfunded portion, the law requires the Postal Service to provide an annual payment of about $5.6 billion to fund future retiree health benefits.[46] Decreasing revenue and significant expense conditions have resulted in a significant cash shortfall. The Postal Service was unable to make the required pre-funding payment due in August, and its current financial projections indicate that it will not be able to make the required pre-funding payments due in September 2012.

To partially address its cash flow problems and eliminate its retiree health care unfunded obligation, the Postal Service proposed an alternative health care plan. The proposal includes the following seven components. All components are cumulative in nature and cannot be taken in isolation. Each component, taken by itself outside of the plan as presented, could result in a difference in calculated savings.

1. Modify its accounting for health care costs to match a private sector model.

2. Require Medicare-eligible annuitants and survivors who are not currently fully participating to enroll in Medicare A and B with no late enrollment penalty.[47] Part A would be free to qualified annuitants who timely enroll in Medicare, and Part B would require voluntary election and payment of a monthly premium. Medicare-age annuitants not already enrolled in Part B would be responsible for the monthly Part B premium (currently $99.90/month).

3. Coordinate prescription drug benefits with Medicare Part D using an EGWP/wrap approach for enrollees over 65. The EGWP/wrap allows for a prescription drug

[45] The Postal Service's total health care obligation of $102 billion, less plan assets of $49 billion, equals the unfunded healthcare obligation of $53 billion.
[46] The 2012 Consolidated Appropriations Act, the most recent law affecting the Postal Service Retiree Health Benefits Fund payment, changed the due date of the $5.5 billion pre-funding payment originally due September 30, 2011, to August 1, 2012. As a result, the total required pre-funding payment in 2012 is $11.1 billion: $5.5 billion due by August 1, 2012, and $5.6 billion due by September 30, 2012.
[47] Currently, the late enrollment penalty is 10 percent for Part A and 10 percent for each 12-month period one could have had Part B but did not sign up. The Postal Service's proposal includes a congressional waiver of the mandatory late enrollment penalty for enrollees who fail to enroll in Medicare after their initial eligibility period.

subsidy before applying insurance benefits, maintaining the retiree share of the cost while the employer achieves the cost savings. Specifically, EGWP/wrap is an official Medicare Part D program with a provision that ensures retired employees will receive the same benefits as those currently offered. In addition, it allows an employer to achieve significant plan savings above those achieved from participating in Medicare's retiree drug subsidy program alone. Generally, savings occur later in the year when a retiree accumulates more and more prescription drug costs. Once cumulative drug costs reach a certain level (roughly $3,000 to $6,400 dollars – called the "donut hole"), the employer directly benefits from price concessions funded by the pharmaceutical industry. The wrap feature is a necessary design that provides continuity of coverage for brand name drugs during the donut hole period and keeps retirees' out-of-pocket costs from increasing. Therefore, moving to an EGWP/wrap arrangement would result in a reduced employer share of retiree claim costs for retirees and survivors over age 65.

4. Shift from the current (single and family) two-tier health care structure to a four-tier coverage structure: employee only, employee and spouse, employee and children, and employee and family.

5. Implement improved private sector-style health care purchasing arrangements to include competitive bidding, administrative cost improvements, and implementation of wellness and disease management programs.

6. Change the order of responsibility for payment of health care costs. Under this process, the current standard coordination[48] of benefits claims payment process used in the FEHB plan would be relinquished in favor of using a "carve-out" coordination[49] methodology. Specifically, employees who retire on or after January 1, 2014, would need to meet a standard deductible, co-payment, or co-insurance payment before the Postal Service would pay any cost not covered by Medicare.

7. Freeze the Postal Service's retiree health care premium subsidy at 2013 dollar levels for employees who retire after January 1, 2014. As the Postal Service's dollar subsidy remains constant as a dollar amount, future retiree monthly contributions would increase $1 for $1, as the premiums increase. Subsequent to our review of the February 10, 2012, plan, the Postal Service informed us it removed this feature from its health care proposal.

By implementing all these items, management estimates its unfunded liability would be eliminated and its future retiree health care obligation would be reduced to $39.3 billion, based on projected cost savings, by January 2014.[50]

[48] Standard coordination requires that payment for health care services be made in Medicare, private insurance, the employer, employee order.
[49] Carve-out coordination requires that payment for health care services be made in employee, Medicare, private insurance, employer order.
[50] Plan assets are $48.9 billion. If the health care obligation is reduced to $39.3 billion by implementing this alternative health care program, the Postal Service would fully fund its future health care obligations.

Objective, Scope, and Methodology

Our objective was to evaluate the reasonableness of the critical assumptions and the impact on the unfunded health care obligation in management's proposal to offer its own health care benefits plan in lieu of remaining in the OPM's FEHB plan. To address our objective, we:

- Reviewed supporting health care proposal documentation, applicable accounting standards guidance, previous Government Accountability Office and Postal Regulatory Commission reports, and testimonies related to Postal Service health care.

- Evaluated the accuracy of actuarial model computations.

- Performed benchmarking procedures to determine best practices.

- Interviewed Postal Service subject matter experts, including contractors, regarding health care proposals.

- Interviewed Postal Service union representatives regarding proposed health care changes.

- Engaged an independent actuary firm, The Nyhart Company, to opine on the critical assumptions used to prepare health care cost actuarial projections. See Appendix C for the *Nyhart Review of USPS Retiree Health Actuarial Projects by the Hay Group*, dated June 26, 2012.

We conducted this review from September 2011 through August 2012 in accordance with the Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Inspection and Evaluation.* We discussed our observations and conclusions with management on August 1, 2012, and included their comments where appropriate. We did not rely on computer-generated data. Rather, we used data independent of the Postal Service to evaluate the assumptions and cost savings.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to this objective.

Appendix B: Other Impacts

Recommendation	Impact Category	Amount (in millions)
2	Predicted Savings Shortfall[51]	$307

Management's calculation[52] for the integration of Medicare Parts A and B included employees who were not eligible for Medicare (6,543 employees), with an average cost of $46,920 per person. The $307 million in savings is cumulative over a 10-year period, with annual savings of $30.7 million. This was included in management's proposed plan dated September 23, 2011, but was subsequently removed in their February 10, 2012, updated plan after we brought it to management's attention.

[51] The difference between the savings the Postal Service predicts for its alternate health care plan and the OIG's estimate of savings which will be realized.
[52] Included in report titled *United States Postal Service Retiree Health Benefits* (dated September 23, 2011).

Appendix C: Actuary Report

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Appendix D: Management's Comments

August 10, 2012

TAMMY WHITCOMB
DEPUTY INSPECTOR GENERAL

SUBJECT: Draft Management Advisory Report – United States Postal Service Alternate Healthcare Plan Proposal (Report Number FI-MA-12-DRAFT)

We have reviewed the discussion draft of the Office of Inspector General's (OIG's) report on the United States Postal Service Healthcare Plan proposal, and while we appreciate the OIG's finding that the projected $63 billion in savings are reasonable, we are concerned that the report's negative tone and misstatements of several key facts would have the unintended effect of damaging the possibility of meaningful healthcare reforms being enacted. In addition, we are concerned that important features of management's proposal are given scarce mention, despite validation by OIG staff. We hope that you and your staff will reconsider the tone and content of the draft report.

As stated on the Highlights page of the draft report, "The objective of the review was to evaluate the reasonableness of the assumptions in management's proposal and impact on the unfunded healthcare obligation." The conclusion that management's $63 billion savings estimate is reasonable and based on sound assumptions is lost because the vast majority of the report describes other findings, many of which are based on flawed analyses. In fact, Nyhart's estimation of the potential savings from the Postal Service's plan is greater than management's own estimate. Only an extremely perceptive reader would be able to identify this important fact because it is obscured by unrelated detail, and by the fact that some of the detail in the draft report is inaccurate or otherwise misleading.

Our concerns with the draft report fall into three broad areas: accounting and discount rates, integration with Medicare, and costs to employees and retirees, each of which is discussed below.

<u>Accounting and Discount Rates</u>

The report erroneously states that a substantial portion of the savings from adopting a Postal Service-sponsored health plan would come from an "accounting change." This statement is misleading and would certainly result in the reader assuming that the savings are fictional, or the result of an "accounting gimmick".

In fact, the $63 billion savings result from the development of a plan tailored to the needs of the Postal Service, its employees and its retirees, taking full advantage of integration with Medicare and the most modern healthcare cost management tools available. The line in the HayGroup actuarial report that the OIG refers to as an "accounting change" is, in fact, the product of converting the liability from the federal financial accounting basis (SFFAS No. 33) to the funding basis used by OPM's actuaries to evaluate the financial soundness of the federal retirement and health benefits programs. As the HayGroup report is intended to present the prospective funded status of the postal health plan, this conversion is entirely appropriate and necessary. Moreover, conversion to the funding basis is the only approach that permits determination of the extent to which our proposals address the key objective of reducing or eliminating the unfunded healthcare liability.

The only accounting change that would be required when the Postal Service sponsors its own plan is the adoption of private-sector GAAP applicable to single-employer sponsored healthcare plans for the purposes of reporting in the Postal Service's 10-K. This would simply be a by-product of the change in plan sponsorship and although the 10-K reporting would be different, the underlying funded status of the plan would not be affected. This point must be clearly and prominently articulated in your report.

The conclusion that the Postal Service applied an incorrect discount rate in valuing its retiree healthcare liability is wrong. The report fails to distinguish between the differing discount rate assumptions required for specific uses. The HayGroup analysis that the OIG and their contractor, Nyhart, evaluated was prepared for the purpose of analyzing funding requirements, yet the OIG chose to present the use of the exact same discount rate that OPM uses for determining funding levels as an "error." The report erroneously conflates financial reporting requirements and funding analyses which can only lead to an incorrect conclusion. Nyhart even states in Appendix C of the OIG report that, "Each of the three interest rate assumptions is reasonable when used in the appropriate setting." The OIG audit team failed to consider the interest rate assumptions used within the appropriate setting and therefore presented an erroneous conclusion in the draft report.

Medicare Integration

The draft report discusses the proposed integration of retiree health benefits with Medicare in terms of a transfer of costs from the Postal Service to the federal government. In fact, our proposal would reverse the cost shifting that has been in place for years because of the failure of the Federal Employees Health Benefits (FEHB) plan to integrate with Medicare on the basis that is essentially universal in the private sector, and for state and local government plans that provide retiree health benefits.

In standard integration with Medicare, the plan sponsor assures that most participants will enroll in Medicare by offsetting benefits from the employer plan by the amount that Medicare would have paid, even if an eligible retiree decides not to participate in Medicare. Whether the retiree participates or not, the cost to the employer plan sponsor is the same.

In FEHB, the medical plans have never been required to adopt this approach, and payments are made under the standard Coordination of Benefits (COB) rules that were designed to cover situations in which a plan participant is covered by more than one employer plan. In the context of FEHB, this means that if a retiree eligible for Medicare doesn't elect to participate, the only consequence is that he or she has the same level of medical benefits that were provided under the FEHB plan before retirement or Medicare eligibility. The net effect is that the only incentive to enroll in Medicare is that under COB the retiree would generally avoid the out-of-pocket costs that would otherwise be incurred through the deductibles, co-pays, and coinsurance features of the FEHB plan. That is sufficient incentive for 75% of Federal retirees to purchase part B of Medicare, and more to join part A. Eliminating this nonparticipation creates a significant portion of the cost savings the Postal Service proposal contemplates, as the materials the OIG has reviewed fully document.

A second feature of proper integration is the proposed adoption of an Employer Group Waiver Plan (EGWP) with wrap-around features, to take advantage of Part D of Medicare. Part D is not in the picture at all within FEHB, thus drug costs for retirees are fully borne by the FEHB plans.

The EGWP will save approximately the same amount of money in the first year of a new Postal Service plan as would be created by 100% participation in Parts A and B of Medicare, but the savings will grow more rapidly because of the increasing discounts and the closing of the so-called "donut hole" in the current law over time. This has a larger impact on the liability than the increased participation in Parts A and B because of that more rapid growth in savings in the future. Much of these savings would come from standard contributions by the pharmaceutical manufacturers pursuant to the Patient Protection and Affordable Care Act, so they are not at taxpayer expense. Additionally, the drug plan benefits will remain as generous as before, and in some cases will be more generous, especially for catastrophic drug expenses.

The failure to integrate the FEHB plans properly with Medicare is detrimental to both active employees and retirees, because the current approach shifts costs that ordinarily would be borne by Medicare to the FEHB plans. Since participants in Medicare contribute nothing for Part A and about 25% of the cost of part B (unless their income exceeds $85,000 annually), taken together their cost for participation in both A and B is about 12% of the cost of Medicare benefits. Nonparticipation shifts those costs from Medicare to the FEHB plans, for which participants pay on average about 30% of the cost. That cost shifting is spread among both active employees and retirees in the blended rate structure used in FEHB, in which premiums are the same for actives, pre-Medicare retirees, and Medicare-eligible retirees, whether they participate in Medicare or not. This cost shifting would be reversed under Postal Service's health plan proposal.

It is thus accurate and essential to note that the Postal Service plan would be integrated with Medicare in the same manner as private sector plans and state and local government plans, and to point out the beneficial effects over and above the savings that would be created for Postal Service and for participants through lower rates and thus lower contributions.

Finally, the draft report fails to mention that the Postal Service and its employees have contributed over $25 billion to Medicare through payroll taxes, beginning in 1983, even though many retirees never enroll in Medicare. In effect, the Postal Service and its employees have been subsidizing Medicare for years. This context is vital to a fair representation of management's proposal.

Costs to Employees and Retirees

The draft report also repeatedly states that savings to the Postal Service are derived from cost-shifting to employees and retirees. This is fundamentally incorrect and misleading. Although it is accurate to note that the proportion of the total costs paid by the Postal Service, its employees, and its retirees will change under the Postal Service-sponsored health plan, the draft report totally ignores the fact that total costs will decrease substantially and that out-of-pocket costs for most employees and retirees will decrease. The examples provided in the report, while mathematically correct, do not properly reflect the lower overall costs of the program and therefore mislead the reader into the conclusion that the Postal Service plan is merely a cost-shifting device, rather than a cost-saving approach.

The Postal Service has consistently indicated its intention to share a substantial portion of the cash savings that will be generated from the postal health plan with its employees and retirees through the lower contributions that they will be required to make, with no reductions in the overall value of the medical and prescription drug benefits provided. The anticipated first-year cash savings (ignoring the effect on liability and PAEA payments) are projected to be $1.76 billion. Of that amount, $653 million would be returned to participants, largely through significantly reduced employee and retiree contributions. That represents about $725 annually per participant, spread among the roughly 500,000 employees and 400,000 Postal Service retirees who participate in the FEHB plans and would be covered by the new plan, if our proposal is adopted by Congress.

Far from shifting costs to employees and retirees, the postal health plan would create significant savings for employees and retirees. We acknowledge, however, that future retirees after January 1, 2014, will see a slight reduction in benefits through the adoption of carve-out rather than COB for determining payments under the plan. Under carve-out, future retirees will retain the same level of benefits from the plan plus Medicare combined that they had prior to retirement and after retirement before they become eligible for Medicare at age 65.

The draft report also must acknowledge changes that management has made to their healthcare plan proposal in response to concerns from stakeholders. This is particularly true with respect to the freeze in Postal Service contributions for retiree premiums that was proposed as part of the original plan and subsequently withdrawn (Element 6 in the HayGroup analysis).

Likewise, the report needs to acknowledge that management's proposal provides legislative language to relieve current retirees from penalties due to late enrollment. This relief has been included in all documents and legislative proposals from the beginning, and it is embedded in the HayGroup analysis as well: "Annuitants and survivors over age 65 are assumed to enroll in Medicare Parts A and B with no penalty." There is no valid reason for including in the OIG draft report, language suggesting that these late-enrollment penalties will be of the magnitude described. While it is possible that Congress might not approve the waiver of the penalties, that possibility necessarily applies to all elements of our proposal and is thus irrelevant, since it is the proposal itself that is being analyzed by OIG, and not possible legislative outcomes.

As discussed with OIG staff on August 1, more care must be taken in the draft report regarding subtle but critically important distinctions between employees and retirees, to avoid inaccurate descriptions of management's proposal. The section of the draft report pertaining to the potential effects on employees and retirees needs to be rewritten to accurately reflect the nature of the cost-sharing that would occur between the Postal Service, its employees, and its retirees.

I appreciate your consideration of my concerns.