OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Office of Inspector General | United States Postal Service

White Paper

Foreign Posts' Retirement Asset Investments

Report Number FT-WP-19-001 | May 21, 2019

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Executive Summary

The U.S. Postal Service participates in two government-wide pension plans that are administered by the U.S. Office of Personnel Management (OPM): the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS). The assets of these plans are held in one trust fund, the Civil Service Retirement and Disability Fund, and are managed by the OPM and U.S. Department of the Treasury. These plans provide defined benefits and the employer is responsible for ensuring enough assets to pay retirees. In contrast to CSRS and FERS, the Thrift Savings Plan is a contribution-based plan, and employees rely on the growth of contributions to their accounts for retirement income. For FERS employees who participate in the Thrift Savings Plan, the Postal Service contributes a percentage of basic pay and matches voluntary employee contributions up to a limit.

In addition to participation in pension programs, eligible retirees may participate in the OPM-administered Federal Employees Health Benefits Program. The Postal Service is responsible for the employer's share of health benefit premium costs for its retirees and had set aside $49.8 billion in a fund at the end of fiscal year 2017.

Investments of Postal Service retirement assets are restricted by law to obligations of the U.S. government. Therefore, the OPM and Treasury are prohibited from diversifying the Postal Service's CSRS and FERS pension assets totaling $278.9 billion among different investment allocations and from otherwise using more sophisticated management practices. Although these assets earn interest and do not change in value, they risk producing low returns at a time when Postal Service retirement assets are insufficient to cover its retirement liabilities.

For this report, we reviewed the investment practices for pension funds of the Postal Service and 11 foreign posts. The 11 foreign posts do not set aside assets to fund retiree health benefits because their governments offer national healthcare services. Therefore, we do not discuss the investment of retiree health benefit assets in this report. However, the information gleaned from our focus on pension assets could be relevant in managing the retiree health benefits fund.

The current pension plans of the foreign posts exhibit very different features, from the number of employees, eligible individuals, and retirees covered to the structures of plans offered. Regardless of these differences, we noted the common element across the 11 foreign posts is diversification of pension investments. As shown in Table 1, eight of the posts invest in three or four asset classes, and the remaining posts invest in two asset classes.

Table 1. Pension Fund Investment Diversification

Post	Bonds	Equities	Real Estate	Other Assets[1]
Postal Service	✓			
An Post	✓	✓	✓	✓
Australia Post	✓	✓	✓	✓
Canada Post	✓	✓	✓	
Deutsche Post	✓	✓	✓	✓
Japan Post	✓			✓
La Poste	✓	✓		
Post Italiane	✓	✓		
PostNL	✓	✓	✓	✓
PostNord Sweden	✓	✓	✓	✓
Royal Mail	✓	✓	✓	✓
Swiss Post	✓	✓	✓	✓

Source: Postal Service Fiscal Year 2018 Form 10-K, WIK-Consult research, and U.S. Postal Service Office of Inspector General analysis.

1 Examples of other assets include bank loans, direct lending, commodities, and derivatives.

Based on available data, we compared the annual and long-term investment returns on Postal Service pension assets with those of four foreign posts,[2] for the years 2004 through 2016 or 2017. During this period, the returns on Postal Service pension assets were substantially less volatile than those for the four foreign posts. For example, CSRS and FERS returns fluctuated between 2.9 percent and 6.1 percent annually while Canada Post's returns fluctuated between -19.3 percent and 16.9 percent annually. Several factors, though, make robust comparisons of posts' long-term investment results challenging. These include the availability of data, returns in capital markets in host countries, investment benchmarks, the importance of returns in funding a plan, and risk acceptance.

The foreign posts demonstrated several common practices in pension asset investment. We found the most common practice to be diversification of pension assets, including domestic and foreign equities and bonds, with some posts investing further in private equities, real estate, or other assets. Other common practices included having defined benefit and defined contribution plans, use of specific benchmarks, and active-management of pension investments.

Broader diversification in Postal Service retirement investments would require legislation that would, in turn, require successful resolution of certain public policy issues. Implementation of asset diversification would also require sound governance, including appropriate focus on benchmark selections and investment management fees.

2 We sought data on annual returns for 20 years or more to cover market fluctuations. Most of the 11 foreign posts made only limited disclosures.

Transmittal Letter

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

May 21, 2019

MEMORANDUM FOR: JOSEPH CORBETT
CHIEF FINANCIAL OFFICER AND
EXECUTIVE VICE PRESIDENT

E-Signed by John Cihota
VERIFY authenticity with eSign Desktop

FROM: John E. Cihota
Deputy Assistant Inspector General
for Finance and Pricing

SUBJECT: White Paper – Foreign Posts' Retirement Asset Investments (Report Number FT-WP-19-001)

This report presents the results of our review of the retirement asset investment practices of eleven foreign posts (Project Number 18BG016FT000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Lorie Nelson, Director, Finance, or me at 703-248-2100.

Thank you in advance for your time and consideration.

Attachment

cc: Postmaster General
Corporate Audit Response Management

Observations

Introduction

This report presents the results of our self-initiated review of Foreign Posts' Retirement Asset Investments (Project Number 18BG016FT000). We identified retirement asset investment options for the U.S. Postal Service for pension and retiree health benefits funds, as demonstrated in the practices of 11 foreign posts.

The Postal Service is required by law to participate in two government-wide defined benefit[3] pension plans that are administered by the U.S. Office of Personnel Management (OPM): the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS). The assets of these plans are held in one trust fund in the U.S. Department of the Treasury (Treasury), the Civil Service Retirement and Disability Fund, and managed by the OPM and Treasury.

In addition to participation in pension programs, eligible retirees may continue participating in the OPM-administered Federal Employees Health Benefits Program. The Postal Service is responsible for the employer's share of health benefit premium costs for its retirees and had set aside $49.8 billion by the end of fiscal year (FY) 2017 to fund these benefits. The funds reside in the Postal Service Retiree Health Benefits Fund, which is also held by Treasury and administered by the OPM. The 11 foreign posts in our analysis do not set aside assets to fund retiree health benefits because the governments of each of the countries have implemented national healthcare services. Therefore, we do not discuss the investment of retiree health benefit assets in this report. However, the information gleaned from our focus on pension assets could be relevant in managing the retiree health benefits fund.

Each October, the OPM provides the Postal Service CSRS and FERS asset[4] balances and actual investment returns.[5] The OPM reported the Postal Service's FY 2017 CSRS and FERS assets at $278.9 billion, which is $41.3 billion below the estimated pension liability.[6] This funding shortfall can be addressed in several ways – lowering the liabilities, increasing the assets, or a combination of both. Prior U.S. Postal Service Office of Inspector General (OIG) reports have addressed lowering liabilities and increasing assets. In this report, the OIG evaluated foreign posts' pension investment practices to identify potential options for increasing the Postal Service's retirement assets.

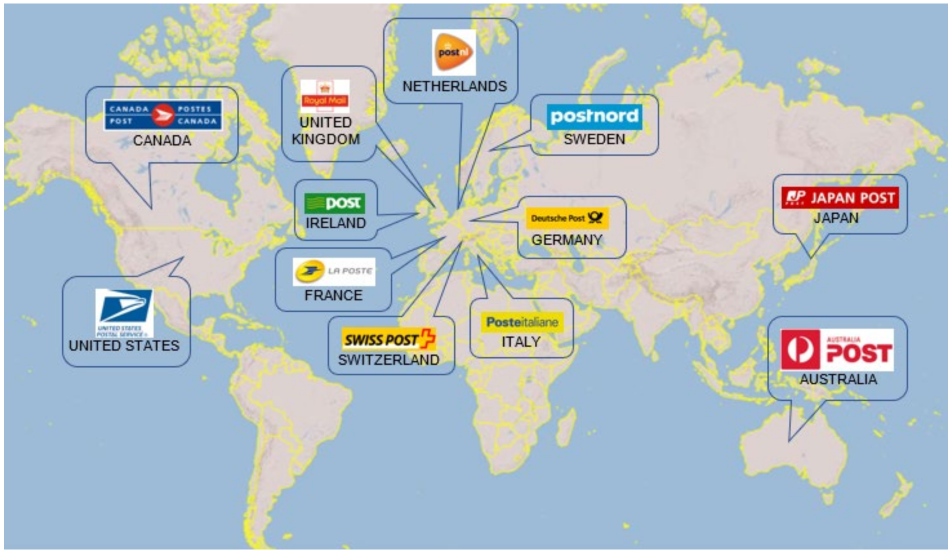
Currently, investments of the Postal Service's CSRS and FERS pension assets are restricted by law to special-issue, fixed-rate Treasury securities (or other interest-bearing obligations of the U.S. government). These securities are always valued at par, meaning there is no risk of losing the investment principal. The Postal Service is prohibited from diversifying its pension investments and from otherwise using more sophisticated management practices. The current investment arrangement does not require investment management services from financial institutions or any other parties outside of the government. However, this investment approach comes at a price – low returns at a time when retirement assets do not fully fund retirement liabilities by billions of dollars. For example, in a previous OIG report on retirement funds investment strategies,[7] we projected the 20-year annual compounded rate of return for special issue Treasury securities at 3.3 percent, while the compounded returns on medium-risk diversified portfolios[8] was 5.4 percent to 6.4 percent.

For this report, we analyzed how 11 foreign posts invest their pension assets and discuss considerations relevant to the Postal Service. The OIG contracted with WIK-Consult[9] to research the retirement assets and investment practices of select foreign posts, as well as each post's ownership structure, financial, and regulatory

3 In a defined benefit plan, the employer guarantees a specific retirement benefit amount for each participant. This amount is usually based on the employee's salary, years of service, or other factors. The employer bears the investment risk of ensuring the defined benefit fund has enough assets to pay retirees.
4 Amounts contributed by the Postal Service and employees to pay future benefits including growth from interest earnings.
5 The OPM provides the balances and returns for its CSRS and FERS assets. In addition, the OPM provides projections for the most recent fiscal year ended September 30th.
6 Actuarially calculated amounts that are expected to be paid to or on behalf of retirees and their survivors in the future.
7 *Postal Service Retiree Funds Investment Strategies* (Report Number FT-WP-17-001, dated September 20, 2017).
8 These portfolios included various allocations to publicly traded stocks and bonds, as well as non-traditional assets, such as high-yield bonds, emerging markets debt, private real estate, private equity, and multi-asset solutions. Some of the foreign posts also invested in non-traditional assets.
9 WIK-Consult GmbH [limited liability company] is a subsidiary of the Scientific Institute for Infrastructure and Communication Services (Wissenschaftliches Institut fűr Infrastruktur und Kommunikationsdienste GmbH) in Bad Honnef, Germany. WIK has more than 35 years of experience in research and consulting in the postal sector.

relationship with its host country's central government. Figure 1 identifies the posts included in our analysis.

Figure 1. Selected Foreign Posts and the Postal Service



Source: OIG research.

By statute, the Postal Service is an independent establishment of the executive branch of the U.S. government. Among the 11 foreign posts:

- Six are fully government-owned either as a government establishment, business enterprise, or through 100 percent ownership of shares (An Post in Ireland, Australia Post, Canada Post, La Poste in France, PostNord Sweden,[10] and Swiss Post).
- Three are listed on a stock exchange with the government as a partial shareholder (Deutsche Post in Germany, Japan Post, and Poste Italiane). For these three, shareholders include government-owned entities guided by public policy goals, such as project financing or economic development.
- Two are also listed on a stock exchange but have no government ownership (PostNL in Netherlands and Royal Mail in United Kingdom).

In each of the countries which host the selected posts, the government provides a mandatory national public pension system. In the U.S., the national public pension system is Social Security. In addition to the national system, eight of the 11 countries mandate that employers offer retirement plans.[11] Only Ireland, Germany, and Netherlands do not require employment-based pension benefits. See Appendix A, Table 6, for further details on the ownership structure of the 11 foreign posts and governmental pension requirements.

The current pension plans of the foreign posts exhibit very different features. For example, the number of employees, eligible individuals, and retirees covered by each foreign post ranges from less than 20,000 (An Post) to over 550,000 (Royal Mail). In contrast, Postal Service pension plans serve over 1.1 million individuals. Most of the foreign posts have both defined benefit and defined contribution plans.[12] In addition to its defined benefit plans, the Postal Service contributes a percentage of basic pay and matches voluntary employee contributions up to a limit for FERS employees who participate in the defined contribution Thrift Savings Plan (TSP).[13] Table 2 provides an overview of the pension plans of the Postal Service and the foreign posts we reviewed.

10 PostNord Sweden is owned jointly by the governments of Denmark and Sweden. However, the pension fund information contained in this report represents the postal operations for Sweden only.
11 None of the 11 countries have pension requirements specific to their posts.
12 Defined contribution plans are funded primarily by the employee, with the employer matching contributions to a certain amount. The contributions are invested to grow assets adequate for the employee's retirement. The employee bears the investment risk and the employer has no obligation regarding the value of defined contribution fund assets.
13 The TSP is a retirement savings and investment plan administered by the Federal Thrift Investment Board.

Table 2. Pension Plans Types and Asset Valuations[14]

Post	Plan Type	Employees and Retirees	Asset Valuation (USD Billions)	Funding Status
Postal Service	defined benefit[15] (CSRS)	482,000	$165.3	$24.2 billion (B) underfunded
	defined benefit[15] (FERS)	705,000	$113.6	$17.1 B underfunded
	defined contribution (TSP)	N/A	N/A	N/A
An Post	defined benefit	17,543^	$ 3.3^	$0.1 B overfunded
Australia Post	defined benefit	33,569~	$ 3.0~	114.4% of Vested Benefits Index~
	defined contribution	N/A	N/A	N/A
Canada Post	defined benefit	92,991	$ 19.0	$3.2 B overfunded
	defined contribution	2,212	$ 0.03	N/A
Deutsche Post	active civil servants (special fund)	N/A	N/A	Unfunded
	defined benefit[15]	N/A	$ 6.5	$4.3 B underfunded
Japan Post	defined benefit (Lump sum)	420,000[16]	No specific assets	$20.0 B underfunded
	defined benefit (Former national service)		$ 4.7[17]	$0.3 B overfunded
	defined contribution		N/A	N/A
La Poste	civil servants & public law contracts[15]	N/A	N/A[17]	N/A
	defined contribution	129,096	$ 0.9	N/A
Post Italiane	defined benefit[15]	N/A	No specific assets	$1.4 B underfunded
	defined contribution	98,541	$ 2.4	N/A

14 Valuations and funding status is as of the end of each post's FY 2017 unless otherwise noted. A ^ indicates data from the post's FY 2016 period, and a ~ indicates FY 2018. Foreign currency values were converted to U.S. dollars (USD) using exchange rates as of November 15, 2018. N/A indicates the information was not available.
15 The plan provides a cost of living or inflation adjustment.
16 The Japan Post Group reported 420,000 overall employees in its 2018 annual report, including those of Japan Post and three related companies.
17 The foreign post has established trusts or made contributions to fully discharge the pension obligation.

Post	Plan Type	Employees and Retirees	Asset Valuation (USD Billions)	Funding Status
PostNL	defined benefit	95,434	$ 9.6	113.4% 12-month avg.
PostNord Sweden	defined benefit	31,000[18]	$ 2.1	$0.01 B underfunded
	defined contribution		N/A	N/A
Royal Mail	defined benefit (before April 2012)	388,648~	N/A	Unfunded
	defined benefit (after March 2012)	115,500	$ 12.6	$1.7 B overfunded
	defined benefit (Executives)	N/A	N/A	Deficient
	defined contribution	53,352	$ 0.5	N/A
Swiss Post	defined contribution	71,141	$ 16.8	106.3%

Source: Postal Service Form 10-K (2018), WIK-Consult research, and OIG analysis.

The aspects of the foreign posts, their host countries, or pension plan structures discussed thus far in the report vary greatly. Regardless of these differences, we noted the common element across 10 of the 11 foreign posts is diversification of pension investments. In this report, we also discuss how diversification success is specific to each post and the important considerations that impact investment strategy.

Pension Plan Investment Diversification

Unlike the Postal Service, the 11 foreign posts generally base the financing of their pension plans on sophisticated portfolio and risk optimization, attempting to capture opportunities in capital markets at home and abroad. Appendix A, Table 7 shows 10 posts are investing in bonds and equities, with eight of these investing in real estate or other assets. One exception among the 11 foreign posts is Japan Post, which is heavily invested in bonds, with limited investments in other assets. Because factors such as the availability of data varied widely among the 11 posts, we analyzed returns[19] on pension assets of the Postal Service and four foreign posts: Canada Post, PostNL, PostNord Sweden, and Swiss Post.[20]

The Postal Service's annual returns on CSRS and FERS trend downward since 2003, from about 6.0 percent to about 3.0 percent. Additionally, returns on CSRS and FERS are likely to remain low, based on the investments' current maturity structure and associated yields. In a 2018 report, the OIG found that Postal Service pension assets were at risk of returning less than 3.0 percent in each of the years 2018 through 2032,[21] versus the OPM's projected 4.25 percent long-term rate of return on these assets.

18 The reported number of participants represents all pension plans for the PostNord Group, which includes PostNord Sweden and several other related companies.
19 We did not adjust the returns for inflation.
20 Each of these four posts reported data as of the end of calendar years. Postal Service data are for its fiscal years. Data cover 2004 through 2017 with the exception of PostNord Sweden, whose data series ended in 2016.
21 *Treasury Inflation-Protected Securities* (Report Number FT-AR-19-003, dated November 26, 2018).

Since 2003, returns on the foreign posts' pension assets exhibited greater annual volatility and wider ranges of annual returns than those of the Postal Service.[22] Returns can vary for numerous reasons, including asset allocation, performance of markets, anticipated pension fund cash flows, perceptions of risk-reward tradeoffs, and other factors.[23] Additionally, the period analyzed (2004-2017 – 14 years) may be insufficient for sound evaluation of long-term returns. In the U.S., for example, the Standard and Poor's 500 stock index's historically worst 15-year return equals just 3.7 percent per year. In contrast, its historically worst 20-year return is higher, at 6.4 percent per year.[24] Also, the 2004-2017 period includes 2008, one of the worst years in history for financial markets, when the Morgan Stanley Capital International World Index and Dow Jones Euro Stoxx Index, as examples, each declined by 44 percent.[25] In the U.S. stock market, 2008 was the worst year since 1931, and the second worst since 1825. In Table 3, we demonstrate long-term growth of pension assets using each post's annual returns, based on the investment of one unit of its home currency at the end of 2003.[26]

Table 3. End of Period Value of Pension Assets Invested at End of 2003

Post	Ending Value in Units of Home Currency	End of Year	Foreign Post Value Minus CSRS Value
Postal Service CSRS	1.94	2017	-
Postal Service FERS	1.85	2017	-
Canada Post	2.79	2017	0.85
PostNL	2.32	2017	0.39
PostNord Sweden	1.75	2016	-0.13[27]
Swiss Post	1.66	2017	-0.28

Source: WIK-Consult research, OPM, and OIG analysis.

Among the four foreign posts, Swiss Post was the only one that provided long-term data on the annual returns of the benchmark[28] it uses to measure fund performance. Had its pension investments annually met the benchmark's returns, one Swiss franc invested at the end of 2003 would have grown to 1.75 at the end of 2017, instead of the 1.66 shown. To Swiss Post, this underperformance versus its chosen benchmark is more informative than are comparisons to the investment performance of other posts' pension funds. Similarly, for the Postal Service, the performance of its investments versus the OPM's projected 4.25 percent long-term rate of return on these assets is critically important.

22 The widest volatility occurred in Canada Post's returns which fluctuated between -19.3 percent and 16.9 percent during this time. See Appendix A, Table 8 for the actual or projected annual returns for the 11 foreign posts and the Postal Service from 2004 through 2017 as available.
23 We did not evaluate these factors as part of this paper.
24 The Balance, "*The Best and Worst Rolling Index Returns 1973-2016*," June 9, 2018.
25 The Boston Consulting Group, "*Collateral Damage, Part 4: Preparing for a Tough Year Ahead: The Outlook, the Crisis in Perspective, and Lessons from the Early Movers*", December 17, 2008.
26 We based our calculations on each post's fiscal year. Consequently, start and end dates varied.
27 This compares to the CSRS value of 1.88 at the end of FY 2016.
28 A benchmark is a standard against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market-segment stock and bond indexes are used for this purpose.

Our research points toward important considerations that may influence investment strategy and performance, such as:

- Fiduciary requirements.
- Governance.
- Investment management style.

Fiduciary Requirements

The 11 foreign posts are not subject to unique laws focused on postal operators; instead, they are subject to the same legal requirements that apply to other employers and pension funds in their respective countries. Fiduciary requirements[29] differ between the various countries, as shown in Table 4.

Table 4. Fiduciary Requirements

Country	Fiduciary Requirements
Australia (applies to Australia Post)	• Trustees must consider diversification in making asset allocations. • Trustees are not permitted to invest more than 5 percent of the pension assets in in-house assets (with some exceptions).
Canada (applies to Canada Post)	• A maximum 10 percent of pension plan assets should be invested in any one person, associated person or affiliated corporations. • Plan administrators are prohibited from investing or lending plan assets directly or indirectly in the securities of a related party. • Funds may own a maximum 30 percent of voting shares of a company.
Germany (applies to Deutsche Post)	• Pension funds must be invested in accordance with the 'prudent person' principle for all their assets. • No limitation as to exposure across asset classes.
France (applies to La Poste)	• No significant general limits for the investment policy of pension funds apart from the "prudent person rule."
Ireland (applies to An Post)	• Trustees must invest the fund assets in a diversified manner to avoid excessive reliance on any particular asset, issuer, or group of undertakings. • Pension assets must be invested 'predominantly' (>50 percent) in regulated markets. • Pension schemes may not borrow except for short-term liquidity reasons. • Investment in derivatives is only permitted to reduce investment risks or to facilitate efficient management of the portfolio. • Investments by schemes in their sponsoring employer in excess of 5 percent of the resources of the scheme are prohibited. Where the sponsoring employer belongs to a group, investment in the employer group must not exceed 10 percent of the scheme's resources.
Italy (applies to Poste Italiane	• Limitations regarding investments in real estate funds, private investment funds, and in securities not traded in regulated markets. • Direct investment in real estate is not allowed. • Loans are not allowed.

29 A legal obligation of one party to act in the best interest of another. The obligated party is typically a fiduciary, that is, someone entrusted with the care of money or property.

Country	Fiduciary Requirements
Japan (applies to Japan Post)	• Limitations for the investments of pension funds/retirement plans only regarding real estate (0 percent) and loans (0 percent).
Netherlands (applies to PostNL)	• No ceilings to pension fund investment for the asset classes are imposed. • Diversification is required, but there are no quantitative rules. There is only a limit for investments in shares of the sponsoring employer of 5 percent.
Sweden (applies to PostNord Sweden)	• No strong restrictions as to types of investments permitted for pension plans and maximum percent in a pension fund portfolio.
Switzerland (applies to Swiss Post)	• For equity, the maximum total exposure is 50 percent. • For real estate, the maximum total exposure is 30 percent. • The limits may be extended under certain, defined conditions.
United Kingdom (applies to Royal Mail)	• Trustee boards are required to invest scheme assets predominantly in instruments admitted to trading on regulated markets. • No limitation as to exposure across asset classes.

Source: WIK-Consult research and OIG analysis.

Legally established fiduciary obligations are generally supplemented by internal policies. Often, contractual trust arrangements and trustees play a vital role, and the trust and the post may overlap even though the trust is a distinct legal entity. For example, at Deutsche Post, the managers of the trust and the pension fund owned by the trust are post employees. There are also cases in which management of assets is the responsibility of external parties. In Switzerland, for example, most mandates for asset managers are assigned to external parties, with general investment policies developed for the respective funds. Within these requirements, fund managers usually have substantial flexibility for their investment decisions, which are subject to oversight of performance versus established targets or benchmarks. For many of the posts, oversight bodies include representatives of post management and employees.

Governance

In the U.S., the Employee Retirement Income Security Act of 1974 provides the legal framework for the governance of private sector pension plans, but public entities like the Postal Service are exempt from this law. The investment of Postal Service retirement funds in diversified assets would, therefore, require sound governance to provide adequate protections for retirees. In a prior report, we discussed three defining principles of governance: involving a governing board to establish long-term strategic goals, maintaining committees of the board to focus on policy implementation and other details, and identifying individuals to manage the funds daily.[30]

30 *Postal Service Retiree Funds Investment Strategies* (Report Number FT-WP-17-001, dated September 20, 2017).

A key component in governance is determination of long-term strategic goals including selected benchmarks. For pension funds, lower returns than those targeted can lead to the need for increased employer or employee contributions.

Nine of the 11 foreign posts provided specific details regarding benchmarks, as shown in Table 5.

Table 5. Investment Benchmarks

Post	Specific or General	Benchmark
An Post	General	"...Trustees are seeking to reduce exposure to volatile equity returns."
Australia Post	Specific	"5.0 percent per year (after taxes and costs), measured over rolling 5-year periods."
Canada Post	Specific	4.5 percent above inflation.
Deutsche Post	Specific	3 percent "order of magnitude of the expected return for the portfolio at large."
Japan Post	Specific	Expected long-term returns: 2 percent in 2014, 0.1 to 2.0 percent in 2015-2018.
La Poste	Specific	Benchmarks for five specific funds: • For three funds -- money market, bond, and equity – management seeks to exceed returns on specified indexes. • For stock and bond funds, management seeks to exceed combined (weighted) returns of stock and bond indexes.
Poste Italiane	Specific	For each of two funds, management seeks to exceed combined (weighted) returns of specified indexes annually.
PostNL	Specific	Actively managed funds are expected to exceed an undisclosed benchmark, and passively managed funds are expected to track an undisclosed benchmark.
PostNord Sweden	General	Unspecified target to be achieved long-term.
Royal Mail	Specific	Targeted return of 0.4 percent in year ended March 2018, 0.5 percent for three-year period ended March 2018.
Swiss Post	Specific	Developed targeted (benchmarked) returns from 2004 through 2017.

Source: WIK-Consult research and OIG analysis.

Instead of benchmarks, the OPM assumes long-term returns in its pension calculations. From the end of FY 2012 to the end of FY 2017, the funding level of Postal Service FERS pension plan changed from almost $1 billion overfunded to $17.1 billion underfunded. This underfunding generated a required supplemental contribution of $958.0 million in FY 2018.[31] In the same 5-year period ended FY 2017, Postal Service returns on FERS assets averaged 3.3 percent while the OPM's projected long-term rates of return averaged 4.9 percent. CSRS's funding level declined $5.4 billion, and its returns averaged 3.8 percent in the same 5-year period.

The OPM also factors in assumptions regarding demographics, long-term wage growth, and long-term inflation.[32] The OPM's inclusion of a long-term inflation assumption reflects that Postal Service retirees generally receive an inflation-based cost-of-living adjustment.

Investment Management Style

Investment management is considered "active" when managers rely on research, analytics, and their own judgment and experience regarding the purchase and sale of assets. "Passive" management involves efforts to mirror a market index (for example, a recognized stock fund such as the Standard & Poor's 500, or a bond fund such as the Barclays Capital U.S. Aggregate Bond Index). Passive management is also referred to as passive strategy, passive investing, or index investing.

Pension fund managers may use a combination of active and passive strategies. Ten of the 11 foreign posts reported using either active or a combination of active and passive strategies.[33] Most of the posts expect active fund managers to exceed returns on market indexes or benchmarks. See Appendix A, Table 9 for information on the posts' investment management styles.

The OPM and Treasury generally follow a mechanical style by ensuring that similar amounts of assets mature in each of the next 15 years (known as laddering). This can mitigate volatility in annual returns but is detrimental when portfolio returns are low. The legal limitation on asset investment and the laddering of its investments offer a unique investment management style among the 12 posts and preclude more sophisticated approaches to asset management. However, the OPM and Treasury ensure that Postal Service retirement assets earn interest and do not lose value.[34]

While the investment of Postal Service pension assets is limited to special-issue, fixed rate Treasury securities, in the U.S., there has been a shift in investment strategies among state pension plans. In 2018, Pew Charitable Trusts (Pew) reported:

> *In a bid to boost investment returns and diversify portfolios, plans in recent decades have shifted away from low-risk, fixed-income vehicles in favor of stocks and alternatives such as private equity, hedge funds, real estate, and commodities.*[35]

Pew noted that in 2006, for example, state pension funds invested 11 percent of plan portfolios in alternative investments. By 2016, this allocation had increased to 26 percent of the average plan portfolio. Pew concluded the move from lower-risk to higher-risk investments resulted in greater vulnerability to market volatility. Despite the greater risk, the plans' returns underperformed against expected long-term returns. As a cautionary note regarding Pew's analysis, a 10-year period may be insufficient for a robust evaluation of long-term returns.

Managing Investment Expenses

In the U.S., investment expense management is an important component of sound governance, since investment fees paid to professional investment managers can range widely, in part depending on asset allocations. Fees for active-management are generally much higher than fees for passive-management.

We independently researched selected investment expenses in the U.S. to determine considerations that would be relevant to Postal Service investments in markets.[36] In the period 2006 to 2016, Pew reported a 30 percent increase in

31 The $958.0 million was a component of the $6.9 billion of fiscal year end retirement payments the Postal Service did not make in 2018.
32 We did not analyze the net impact attributable to each of the OPM's factors.
33 Information was not available for Japan Post.
34 OIG report, *Postal Service Retiree Funds Investment Strategies* (Report Number FT-WP-17-001, dated September 20, 2017), found that the current investment strategy could well be the riskiest of all.
35 The Pew Charitable Trusts, *State Public Pension Funds' Investment Practices and Performance: 2016 Data Update*, September 2018.
36 We did not obtain data on the investment management expenses of the 11 foreign posts.

state pension funds' reported fees. In FY 2018, the OPM investment expense totaled less than 1 cent per $1,000 invested. The Federal Retirement Thrift Investment Board reported that its average net expense was 40 cents per $1,000 invested in calendar year 2018. These compare very favorably to external management fees paid by state public pension funds. Using 2016 annual financial reports in the U.S., Pew reported investment management fees at $3.30 per $1,000 invested, ranging from 40 cents to $22.30 per $1,000 invested. This demonstrates that external management fees can significantly impact investment returns.

Public Policy Issues

In the U.S., if funds in the Postal Service pension accounts were invested in equities, bonds, real estate, or other assets, the Treasury would have to replace the funds it has removed from Postal Service retirement accounts by borrowing a corresponding amount from the public. Further, were the Postal Service's investments transitioned from Treasury investments to investments in markets, important considerations would include federal ownership of shares in private sector companies, decisions regarding which companies' securities to own, and the risk of investment losses or poor long-term performance.[37] These issues are solvable, however. Nine of the 11 the foreign governments maintain at least some ownership of their posts, and these posts' pension funds own equities, bonds, or other assets.

In Europe, the status and pension obligations of (former) civil servants posed unique challenges to postal reform. In Germany, for example, Deutsche Post (when partially privatized) was able to eliminate its civil service pension obligation by paying a set amount into a public fund, while the remainder of the obligation is financed by the government. In addition, Deutsche Post created different defined benefit plans for new employees which reflected changes in benefits and required contributions. In France, legislation replaced a system of comprehensive defined benefit obligations for civil servants with a defined contribution system for La Poste. In the process, La Poste was relieved of its civil servant pension liabilities. The task of distributing retirement benefits to La Poste's civil servants was transferred to a government agency created for that purpose, and La Poste made a one-time contribution to the agency.

Five of the 11 countries in which the posts operate have mechanisms that guarantee pension benefits in case of insolvency of the post (Australia, Germany, Italy, Switzerland, and United Kingdom). These are often national systems set up for the insurance industry generally and are not specific to the posts. Government requirements in the Netherlands and in the Ontario province of Canada provide limited protections to retirees.[38] Employees and retirees covered by the posts in the remaining countries (France, Ireland, Japan, Sweden, and most of Canada) have no established guarantors in the event of fund insolvency. In the U.S., the federal government is obligated to provide pension benefits to eligible Postal Service retirees.

Conclusion

Our analysis of foreign posts revealed several common practices in pension asset investment. We found the most common practice among eight of the 11 posts was diversification of pension assets, including domestic and foreign equities and bonds, with some posts investing in private equities, real estate, or other assets. Other common practices included having defined benefit and defined contribution plans, use of specific benchmarks, and active-management of pension investments.

Our comparison of returns data over 14 years showed the Postal Service pension assets returns were substantially less volatile, fluctuating between 2.9 percent and 6.1 percent annually. In contrast, the widest volatility occurred in Canada Post's returns which fluctuated between -19.3 percent and 16.9 percent annually. Canada Post also had the largest cumulative return (2.79 CAD) on one unit of their currency invested at the beginning of 2004. Certain factors, including the availability of data, returns in capital markets in host countries, benchmarks, and the importance of returns in funding a plan, make robust comparisons of posts' long-term investment challenging.

37 These issues were raised by Katelin Isaacs in Congressional Research Service, *Federal Employees' Retirement System: Benefits and Financing,* (Report Number 98-810, dated July 15, 2015).
38 If PostNL does not maintain a 105 percent ratio of fund assets over pension liabilities, they can be required to make additional payments of up to 1.25 percent of the obligations per year for up to five years. In Ontario, the provincial government may step in and provide up to the first 1,000 Canadian dollars per month of the retiree's pension.

Broader diversification in Postal Service retirement investments would require legislation that would, in turn, require successful resolution of certain public policy issues. Implementation of asset diversification would also require sound governance, including appropriate focus on benchmark selections and investment management fees. Broader diversification would likely result in additional volatility but could allow the Postal Service to improve returns on their pension assets.

Management's Comments

Management agreed with the OIG's observation that many foreign posts have less restrictive investment policies than those imposed on the Postal Service, and that revision to these policies would require legislative action. Management noted that the foreign posts had broader authority to invest in a variety of asset classes, and as a result, their annual returns on investments were more volatile than those of the Postal Service.

See Appendix B for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considered management's comments responsive to the issues offered in this white paper.

Appendices

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Appendix A: Postal Service and Foreign Post Pension Plan Information

Table 6 provides information on the legal status, ownership structure, and governmental pension requirements of the Postal Service and the 11 foreign posts in this review.

Table 6. Overview of the Postal Service and Selected Foreign Posts

Post	Country	Legal Status	Ownership Structure	Country Mandates Employers Offer Pension
Postal Service	U.S.	Independent establishment of the government	100% government owned.	No
An Post	Ireland	Government business enterprise	100% government owned.	No
Australia Post	Australia	Government business enterprise	100% government owned.	Yes
Canada Post	Canada	Crown Corporation	100% government owned.	Yes
Deutsche Post	Germany	Joint stock company, listed at stock exchange since 2000	20.6% of shares owned by a government owned investment and financing vehicle.	No
Japan Post	Japan	Joint stock company, listed at stock exchange since 2015	63.3% government owned.	Yes
La Poste	France	Joint stock company, not quoted at stock exchange	73.7% government owned, 26.3% government owned by a public group serving the public interest and the country's economic development.	Yes
Poste Italiane	Italy	Joint stock company, listed at stock exchange since 2015	29.3% directly controlled by government, 35% indirectly via a government owned financial institution which focuses mainly on financing of public projects, 35.7% is represented by free float.	Yes

Post	Country	Legal Status	Ownership Structure	Country Mandates Employers Offer Pension
PostNL	Netherlands	Joint stock company, listed at stock exchange since 1998	0% government ownership.	No
PostNord Sweden	Sweden	Joint stock company, not quoted at a stock exchange	40% Danish State, 60% Swedish State (with voting rights shared 50/50 between the two governments).	Yes
Royal Mail	United Kingdom	Joint stock company, listed at stock exchange since 2013	0% government ownership.	Yes
Swiss Post	Switzerland	Joint stock company under special legislation, not quoted at stock exchange	100% government owned.	Yes

Source: WIK-Consult research and OIG analysis.

Table 7 shows 10 posts are investing in bonds and equities, with eight of these investing in real estate or other assets. One exception among the 11 foreign posts is Japan Post, which is heavily invested in bonds, with limited investments in other assets.

Table 7. Pension Fund Investment Diversity[39]

<table>
<tr><th>Post and Type of Plan</th><th>Bonds</th><th>Domestic Equities</th><th>Foreign Equities</th><th>Private Equities</th><th>Real Estate</th><th>Other Assets[40]</th><th>Cash</th></tr>
<tr><td>Postal Service defined benefit</td><td>100.0%</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>An Post defined benefit^</td><td>30.3%</td><td colspan="3">48.9%</td><td>5.2%</td><td>10.4%</td><td>5.2%</td></tr>
<tr><td>Australia Post defined benefit~</td><td>20.6%</td><td>8.6%</td><td>34.2%</td><td>19.7%</td><td>3.5%</td><td>3.3%</td><td>10.6%</td></tr>
<tr><td>Canada Post defined benefit~</td><td>38.6%</td><td>14.8%</td><td>29.0%</td><td>3.7%</td><td>13.4%</td><td></td><td>0.5%</td></tr>
<tr><td>Deutsche Post defined benefit</td><td>34.0%</td><td colspan="3">27.8%</td><td>28.0%</td><td>7.3%</td><td>2.8%</td></tr>
<tr><td>Japan Post defined benefit</td><td>89.0%</td><td></td><td></td><td></td><td></td><td>11.0%</td><td></td></tr>
<tr><td>La Poste defined contribution</td><td>63.0%</td><td>14.7%</td><td>19.8%</td><td></td><td></td><td></td><td>2.4%</td></tr>
<tr><td rowspan="2">Poste Italiane defined contribution[41]</td><td>88.7%</td><td>0.1%</td><td>6.9%</td><td rowspan="2"></td><td rowspan="2"></td><td rowspan="2"></td><td>4.7%</td></tr>
<tr><td>69.0%</td><td>1.0%</td><td>24.4%</td><td>6.1%</td></tr>
<tr><td>PostNL defined benefit</td><td>61.0%</td><td colspan="3">32.0%</td><td colspan="2">7.0%</td><td></td></tr>
<tr><td>PostNord Sweden defined benefit^</td><td>15.3%</td><td></td><td>23.3%</td><td>6.7%</td><td>16.1%</td><td>31.3%</td><td>7.4%</td></tr>
<tr><td>Royal Mail defined benefit~</td><td>15.4%</td><td></td><td colspan="2">5.5%</td><td>3.0%</td><td>74.4%</td><td>1.7%</td></tr>
<tr><td>Swiss Post defined contribution</td><td>42.7%</td><td>7.7%</td><td>21.6%</td><td></td><td>10.9%</td><td>10.9%</td><td>6.2%</td></tr>
</table>

Source: Postal Service FY 2017 Form 10-K, WIK-Consult research, and OIG analysis.

39 Investment diversity is as of the end of each post's FY 2017 period unless otherwise indicated. A ^ indicates the data is for the post's FY 2016 period, and a ~ indicates the FY 2018 period.
40 Examples of other assets include bank loans, direct lending, commodities, and derivatives.
41 Poste Italiane reports separately for their 'Guaranteed' fund (top entry) and their 'Balanced fund' (bottom entry).

Table 8 provides the actual or projected pension asset investment returns data, as available, for the Postal Service and 11 foreign posts.

Table 8. Performance of the Postal Service and Foreign Post Pension Plans

<table>
<tr><th colspan="2">Post</th><th>2004</th><th>2005</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th><th>2011</th><th>2012</th><th>2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td rowspan="2">Postal Service</td><td>CSRS</td><td>6.1%</td><td>5.9%</td><td>5.7%</td><td>5.6%</td><td>5.5%</td><td>5.2%</td><td>5.1%</td><td>4.7%</td><td>4.7%</td><td>4.0%</td><td>4.1%</td><td>4.0%</td><td>4.1%</td><td>2.9%</td><td></td></tr>
<tr><td>FERS</td><td>6.0%</td><td>5.8%</td><td>5.5%</td><td>5.4%</td><td>5.4%</td><td>5.2%</td><td>4.8%</td><td>4.6%</td><td>4.0%</td><td>3.8%</td><td>3.5%</td><td>3.0%</td><td>3.0%</td><td>3.0%</td><td></td></tr>
<tr><td colspan="2">An Post</td><td colspan="7"></td><td>- 3.7%</td><td colspan="2"></td><td>18.7%</td><td></td><td>8.0%</td><td colspan="2"></td></tr>
<tr><td colspan="2" rowspan="2">Australia Post</td><td colspan="13"></td><td colspan="2">6.7%</td></tr>
<tr><td colspan="15">For July 2017 – June 2018. Australia Post's FY is from July to June.</td></tr>
<tr><td colspan="2" rowspan="2">Canada Post</td><td>11.1%</td><td>13.7%</td><td>14.3%</td><td>2.1%</td><td>- 19.3%</td><td>16.2%</td><td>10.4%</td><td>0.2%</td><td>10.1%</td><td>16.9%</td><td>10.9%</td><td>7.3%</td><td>7.9%</td><td>10.4%</td><td></td></tr>
<tr><td colspan="15">Data for defined benefit. Defined contribution return (9.5%) only available for 2017</td></tr>
<tr><td colspan="2" rowspan="2">Deutsche Post</td><td colspan="4"></td><td colspan="11">4%</td></tr>
<tr><td colspan="15">Interviewee pointed out that the average annual performance between 2008 and October 2018 is equal to about 4%.</td></tr>
<tr><td colspan="2" rowspan="2">Japan Post</td><td colspan="10"></td><td>2%</td><td>0.1% to 2 %</td><td>0.1% to 2%</td><td>0.1% to 2%</td><td>0.1% to 2%</td></tr>
<tr><td colspan="15">Percentage figures denote the expected long-term return on plan assets of the Japan Post Group.</td></tr>
<tr><td colspan="2">La Poste</td><td colspan="9"></td><td colspan="5">Average annual performance 2013 thru 2017
• Money market fund: - 0.07%
• Bond fund: 3.5%
• Diversified fund: 5.07%
• Social/solidarity fund: 6.62%
• Equity fund: 8.12%</td><td></td></tr>
</table>

Post		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
La Poste (continued)													Average annual performance 2015 thru 2017 • Money market fund: - 0.24% • Bond fund: 1.61% • Diversified fund: 3.24% • Social/solidarity fund: 5.57% • Equity fund: 6.04%			
															2017 annual performance • Money market fund: - 0.46% • Bond fund: 1.25% • Diversified fund: 3.88% • Social/solidarity fund: 7.97% • Equity fund: 8.34%	
Poste Italiane	Guaranteed Fund					3.1%	6.2%	1.2%	0.7%	2.8%	3.4%	1.8%	1.8%	0.8%	0.8%	
	Balanced Fund					- 2.3%	8.5%	2.9%	0.8%	6.2%	1.3%	10.9%	3.7%	3.1%	2.6%	
PostNL		8.8%	12.7%	8.5%	2.4%	- 14.2%	16.8%	12.7%	6.6%	10.9%	0.9%	16.6%	1.4%	1.5%	5.5%	
PostNord Sweden		7.0%	9.4%	5.9%	3.2%	- 12.3%	4.9%	7.8%	0.5%	2.4%	7.3%	13.0%	3.2%	7.0%		
Royal Mail													7.3%			
	Compound annual growth rate (CAGR) (April 2015 – March 2018). Royal Mail's FY is from April to March.															
																4.8%
	CAGR (April 2017 – March 2018).															
Swiss Post		5.0%	10.7%	7.5%	0.9%	- 13.6%	9.4%	3.9%	1.9%	6.5%	5.4%	6.8%	0.2%	3.2%	6.1%	

Source: WIK-Consult research.

Table 9 provides information on the investment managers and management style for each foreign post.

Table 9. Management of Pension Plan Assets

Post	Investment Manager	Investment Management Style
An Post	Trustee: An Post Superannuation Schemes (APSS-Ireland). The Trustees employ various investment management firms to manage the investments of the Fund.	APSS-Ireland offers both, actively and passively managed defined benefit investment options.
Australia Post	Trustee: Australia Post Superannuation Scheme (APSS). The Trustees have appointed investment managers for recommendations.	APSS offers both, actively and passively managed defined benefit investment options.
Canada Post	Trustee: Canada Post Corporation Pension (CPC Pension). Investments of the defined contribution component are managed by an investment company (Sun Life Financial).	CPC Pension offers actively and passively managed investment options (~50/50).
Deutsche Post	Contractual trust arrangement and pension fund owned by the trust. Managers of the trust and the pension fund are employees of Deutsche Post.	An active asset management style is used. The management of assets considers both the development of liabilities and of the assets.
Japan Post	Information not available.	Information not available.
La Poste	La Banque Postale Asset Management (LBPAM).	An active asset management style is used.
Poste Italiane	Assets are managed by the Fondoposte Pension Fund. The fund is registered with the commission for the supervision of pension funds and has the legal status of a "recognized association".	Mainly active asset management.
PostNL	Trustee: Stichting Pensioenfonds PostNL (main pension plan). Investments are managed by TKP Investments.	Both active and passive asset management style is used.
PostNord Sweden	Board of Directors defines investment guidelines, approves investment policy, and reviews it continuously.	An active asset management style is used.

Post	Investment Manager	Investment Management Style
Royal Mail	Trustee: Royal Mail Pensions Trustees Ltd. for the Royal Mail defined benefit plan. Investment managers are appointed for recommendations. For the Royal Mail defined contribution plan, there is a contractual trust arrangement and pension fund owned by the trust. Investments are managed by Zurich Corporate Savings.	Both active and passive asset management style is used.
Swiss Post	A foundation board (Stiftungsrat) determines investment strategy. An investment committee (Anlageausschuss) focuses on controls implementation and consists of employer/ employee representatives (three each). Asset management mandates are assigned to 37 external parties and 5 internal asset managers.	Both active and passive asset management style is used across all the mandates.

Source: WIK-Consult research.

Appendix B: Management's Comments

LUKE T. GROSSMANN
VICE PRESIDENT, FINANCE AND PLANNING

UNITED STATES POSTAL SERVICE

May 15, 2019

LAZERICK POLAND
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Draft White Paper – Foreign Posts' Retirement Asset Investments
(Report Number FT-WP-19-DRAFT)

Thank you for the opportunity to review and comment on the draft white paper "Foreign Posts' Retirement Asset Investments."

The study found that many foreign postal organizations have less restrictive investment polices than those imposed upon the U.S. Postal Service and broader authority to invest in a variety of asset classes. As a result, the annual returns on investments of the foreign posts were much more volatile than those of the Postal Service.

We concur with the observation that many foreign postal organizations have less restrictive investment polices than those imposed upon the U.S. Postal Service and note that a revision to such policies would require legislative action.

Luke T. Grossmann

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