

November 16, 2011

Personal and Confidential

Ms. Linda Cole
Assistant Town Treasurer
Halifax Town Hall
499 Plymouth Street
Halifax, MA 02338

Re: GASB 45 - Summary of Results

Dear Ms. Cole:

The purpose of this letter is to summarize our actuarial valuation of the Town of Halifax Other Postemployment Benefits Plan (the "Plan") for the fiscal year ending June 30, 2012 in accordance with Statement No. 45 of the Governmental Accounting Standards Board ("GASB 45").

What caused plan liabilities to change from FY 09 to FY 12

Plan experience was slightly more favorable than expected. This is due to slightly lower than expected increases in medical costs (premiums went up by approximately 24.6% from FY09 to FY12 versus an expected 29.5% increase), demographics were generally in line with expectation. These net actuarial gains are amortized into the annual OPEB costs over a 15-year period (the segment of the actuarial loss reflecting OPEB costs in excess of employer contributions is offset by the ARC Adjustment). The net impact of the plan experience is a slight increase in the annual OPEB cost.

What is GASB 45 & why does it matter?

GASB 45 was issued to provide a more comprehensive and useful look at the costs and financial obligations that governments incur when they provide postemployment benefits other than pensions ("OPEB"). These benefits often include healthcare, dental insurance and life insurance. Prior to the implementation of GASB 45, most municipal entities accounted for these benefits on a "pay-as-you-go" basis (the actual cash costs of the benefits in a reporting period were charged to the financial statement with no accrual for future costs). It is hoped that GASB 45 will result in more informed policy decisions as all parties will have a better idea as to costs and will further result in a more accurate financial picture of the total costs of services provided by municipal entities by recognizing costs over the working lifetime of employees rather than after their employment has ceased.

Why now & why us? Has Corporate America faced this?

GASB 45 is similar to Statement No. 106 of the Financial Accounting Standards Board ("FASB 106") which was issued in 1989 and was effective in 1992 for private employers. With the issuance of FASB 106, many plan sponsors either curtailed or eliminated their retiree welfare plans. As a municipal entity, you have seen the effects of these corporate decisions as the lack of retiree welfare programs at private employers yields additional spousal and dependent coverage in your plans which ultimately increases your costs. GASB took many years to finally issue GASB 45 and tried to balance the unique nature of municipalities and the desire for more useful financial statements. The final product is far more flexible than FASB 106 to reflect the concerns of municipal entities.

What is the value of benefits accrued to date? How much is accrued each year?

As of July 1, 2011, the Plan had accrued benefits (medical, dental & life insurance) of approximately \$11,244,212. The Plan has a “normal cost” or benefits accruing during the year of approximately \$509,189. Additionally, the Plan must amortize the accrued benefits in place at adoption of GASB 45 over a period of not more than 30 years. Given a 30 year amortization period for the obligation at adoption, the continuing annual amortization payment is \$569,864. In combination with the normal cost and interest to the end of the plan year and required adjustments to the ARC, the OPEB expense is \$1,098,319 which exceeds the expected pay-as-you-go cost of \$336,970 by \$761,349. A key issue to remember is that this is a “non-cash” charge and does not require pre-funding like a pension plan.

What are the key assumptions used to estimate a \$11,244,212 liability?

While there are a number of assumptions used to estimate plan costs and liabilities, the most important are future increases in medical care costs and the likelihood of participants retiring when they are eligible. Unlike a pension plan where a participant receives a reduced benefit for early retirement, a participant in a retiree welfare plan will actually receive a higher benefit by retiring early (more years of benefits to be received plus more years before Medicare). A key issue to keep in mind is that participant behavior (as far as retirement is concerned) is affected by many factors including the economy, personal health and work satisfaction.

For future medical care costs, we have assumed that such costs will increase at 7.0% for FY 2012, increasing by 6.0% for FY 2013, grading down to FY 2014 per year by 5.0%. If costs increase at rates higher than assumed, plan liabilities will escalate while costs less than those assumed will yield lower liabilities in the future.

We have an “unfunded liability”. How do we fund it? Can we fund it?

The Plan currently has an unfunded liability of approximately \$11,214,212 and this amount is expected to grow over time in the foreseeable future. While some municipal entities across America have chose to fund this liability, over 95% are not currently dedicating funding to it. In order for funds to be considered as “plan assets”, they must be placed in an irrevocable trust for this purpose. The State of Massachusetts has recently passed legislation allowing municipal entities to establish a trust for Other Than Postemployment Benefits (“OPEB”) under M.G.L. Chapter 32B, Section 20 for purposes of accumulating assets to pre-fund the liabilities under GASB 45. To the best of our knowledge Town of Halifax has established an irrevocable trust for the purposes of prefunding liabilities under GASB 45.

How do we solve the “problem”? What can be done?

While you are more limited than Corporate America due to various statutory restrictions, you do have some options available to you to manage plan liabilities and “pre-fund” the liability.

Section 18 – as the Plan is already integrated with Medicare, there is no ability to reduce costs via that route.

Pre-Funding – if you were to elect to “pre-fund” the OPEB expenses each year by contributing the entire Annual Required Contribution, you would be allowed to use a long-term interest rate based on your underlying investment policy. Assuming a balanced portfolio (50% equities & 50% fixed-income), you could discount plan liabilities at approximately 7.0% vs. the 4.0% used in our analysis. While this does not impact the ultimate cost of the plan, it would reduce disclosed liabilities and expenses.

Change in cost sharing – You are currently charging retirees 50% of premiums for their contribution. Under Massachusetts law, the maximum allowable contribution rate is 50% so changing the underlying plan design is currently your only alternative.

Blue Cross Blue Shield new design – We worked with Blue Cross Blue Shield of Massachusetts last year to help them design a new product to address the OPEB obligations of municipalities. Basically, under this product the current benefits are slightly reduced for actives & retirees, Medicare benefits are “leveled” to be consistent with those prior to age 65, Flexible Spending Accounts are created for active employees and a VEBA is created to “pre-fund” the retiree liability. This approach creates current cost savings for the Town, long-term accounting benefits due to a higher discount rate, more security for employees/retirees as assets are available to pay future benefits and taxpayers “equity” in that today’s taxpayers pay today’s bills.

How does GASB 45 impact our bond ratings or ability to raise cash?

In the short run, GASB 45 is unlikely to have any material impact on bond ratings. While S&P, Moody’s & Fitch have all stated that they will reflect these figures in their ratings, the comparative financials to other municipal entities will be similar as they will have all adopted GASB 45. Over time, the outliers (those with very modest or very severe GASB 45 liabilities) are likely to see some benefit or harm to their ratings or financing operations.

Healthcare Reform in Massachusetts & Nationally – how does this impact our plan?

As noted earlier, the ultimate cost of the Plan is the premiums and benefits paid from the Plan less the contributions paid by retirees and their dependents. While you can slightly change participant contributions, the true costs of the Plan are the underlying costs of benefits and premiums. As such, if healthcare reform is successful in addressing the underlying cost issue, your Plan will benefit. The experiment in Massachusetts is still under review and the cost savings promised at implementation have yet to be achieved.

If you or your auditors have questions on this, feel free to give us a call.

Sincerely,

Parker E. Elmore, A.S.A., E.A., M.A.A.A.
President & CEO