September 24, 2009

Personal and Confidential

Mr. Eric Hart
Town Accountant
Town of Rockland
242 Union Street
Rockland, MA 02370-1897

Re: Summary of GASB Statement No. 45 & Actuarial Report

Dear Mr. Hart:

The purpose of this letter is to summarize our recently submitted actuarial valuation of the Town of Rockland Other Postemployment Benefits Plan (the "Plan") as of July 1, 2008 in accordance with Statement No. 45 of the Governmental Accounting Standards Board ("GASB 45").

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, 2008, the Plan had accrued benefits (medical & life insurance) of approximately $57.906 million. Additionally, the Plan has a "normal cost" or benefits accruing during the year of approximately $1,941,932. Under GASB 45, we must amortize the accrued benefits in place at adoption of GASB 45 over a period of not more than 30 years resulting in an annual amortization payment of $3,219,895. In combination with the normal cost and interest to the end of the plan year, the OPEB expense is $5,368,302 which exceeds the expected pay-as-you-go cost of $1,926,359 by $3,441,943. 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 $57.906 million 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 affected by many factors including the economy, their health and work satisfaction.

For future medical care costs, we have assumed that such costs will increase at 7.1% per year for FY2009 increasing to 9.0% for FY2010 and grading down to 5.0% per year by FY2014. 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 $57.906 million and this amount is expected to grow over time in the foreseeable future. While some municipal entities across America have chosen 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. Currently, the State of Massachusetts does not allow such a trust although they did consider such legislation.

How do we solve the "problem"? What can be done?

The costs associated with the Plan are based on the likelihood that an employee will meet the eligibility criteria and elect benefits, the cost-sharing arrangement (i.e., participant contributions), the underlying plan design and integration with Medicare. As the State of Massachusetts does not allow you to vary contributions by service, age or some combination, your ability to address the issues through participant contributions is limited. As the Plan is already integrated with Medicare, there is no ability to reduce costs via that route. Therefore, the only viable way to reduce costs and therefore liabilities under the Plan is to modify the underlying plan design (i.e., increase co-pays, reduce covered services, implement deductibles, etc.). However, as you are certainly aware, changing medical plan designs is extremely difficult especially with a collectively bargained population.

What did the automakers do? What is a VEBA?

As you are likely aware, during the last round of negotiations with the UAW, the Big 3 automakers negotiated to transfer their retiree medical and other welfare plan liabilities to a Voluntary Employee Benefit Association ("VEBA") to be administered by the UAW. The VEBA is a trust fund used to hold and invest plan assets and pay claims to beneficiaries (i.e., retirees of the automakers).

Under this arrangement, the automakers transferred funding of approximately 70% of plan liabilities to the VEBA along with the corresponding plan liabilities. If the UAW is able to invest the funds efficiently, they may be able to maintain the existing plan designs. If the investments underperform, the UAW will need to change the plans and/or increase retiree contributions, in order to continue providing benefits.

From the automakers perspective, this approach allows them to gain financial certainly by eliminating these liabilities from their balance sheet and income statement. From the UAW perspective, this approach allows them some control over the future viability of these programs and they determined that taking 70% of plan liabilities provided protection against potential future bankruptcy by the automakers.

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 similar as they will have all adopted GASB 45. Over time, the outliers (those will 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 in still under review and the cost savings promised at implementation have yet to be achieved. As a small plan and population, your ability to greatly impact costs is quite limited.

Summary/Next Steps

Your auditors will use this report to assist you in the implementation of GASB 45 and the preparation of your financial statements.

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